Special Report German Asset Management: A larger appetite

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How German asset managers are taking up the cudgels as demand for ESG approaches continues to grow

Key points

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• ESG integration is being practised
• There is diversity in ESG demands among German investors
• ESG is now a must-have in general tenders

Germany's diverse institutional investment sector includes first and second pillar retirement funds, as well as foundations, endowments, church funds and insurers.

Traditionally, many of these groups have showed little interest in environment, social and governance (ESG) compared with their counterparts elsewhere. Correspondingly, many asset managers also lag in their expertise and offerings.

This has definitely started to change. Ingo Speich, head of sustainability at Union Investment, started to oversee ESG mandates in 2004. Although church-based institutions were relatively early adopters of ESG exclusion approaches from the 1990s, Speich says Union Investment saw little interest from other investors until after the financial crisis.

Nevertheless, in 2009, the firm “actively decided to create a team and invest resources” into building a responsible investment department. This year the team numbers 12.

At DWS, the recently spun-off Deutsche Asset Management, the idea of responsible investing surfaced in the early 1990s. Petra Pflaum, the firm’s CIO for responsible investments, joined in that decade.

“In 1994 DWS first spoke at a company’s annual general meeting about topics related to ESG, and in 1997 collaborated to launch Deutsche Bank’s first micro-finance fund,” Pflaum says. Today, she heads an expanding team of specialists.

None of the asset managers interviewed would comment on specific budget numbers for building and maintaining a responsible investment strategy. “The financial expense is substantial,” says Speich, taking into account data as well as additional IT and staffing costs. “It should not be underestimated how the price for ESG data is appreciating as the providers are becoming more professional,” he adds.

Another German problem is the lack of expertise. “Those that have ESG experience have already been scooped up,” says Speich. Not only asset managers but consultancies and ESG research houses have been hiring experienced employees.

A solution is in-house training. In 2016, Union Investment created an internal ESG Academy where all portfolio managers and analysts must attend various modules. The training is regularly adapted.

Speich explains: “Sector specialists receive additional training. We compiled the curricula ourselves as they had to fit our asset management approaches and philosophy. Eventually ESG should become second nature.”

DWS initiated mandatory training for its research team in 2011, and this was expanded in 2016 to include all active investment portfolio managers and analysts, although people from other departments attend on a voluntary basis. Pflaum says: “All investment professionals should be able to understand the ESG data. The next step has already started with the growing participation in the financial analysts association EFFAS ESG certification exam.”

Integration approaches

Not only has demand for ESG increased exponentially but there has also been a rapid increase in data available for research and investment. Pflaum notes: “Today we are using seven different data providers and since 2016 our in-house database has been fully integrated into the portfolio management system.”

And then there are clients who want to use their own data provider. “Not a problem,” says Pflaum, “we can adapt our data flows flexibly.”

“All investment professions should be able to understand the ESG data”

Petra Pflaum

Complete integration of ESG data into portfolio management is also Union Investment’s approach: “The ESG team gets raw data from providers and feeds them in our internal sustainability database, which is accessible to all analysts and managers,” says Speich.

Data has become more useful as it has become more numerous. For Speich, this is because companies are reporting on a more granular basis. Additionally, consolidation among ESG data providers is leading to professionalisation and standardisation, he believes.

As for demands on investee firms, Pflaum notes: “Small cap companies are still struggling somewhat with the current ESG reporting requirements. This is one of our most important engagement topics.” Speich is less concerned about the increased data demand, however: “Large groups in particular have all this data available somewhere.”

Integration and what it means

For Germany, it is clear that offering ESG products and strategies is a must-have for asset managers – albeit not across the board.

“There is hardly an asset manager, apart from some specialised in alternatives, for example, that is not considering offering responsible investment strategies,” says Peter König, managing director of Delta Management Consulting.

König adds: “There is anything but a clear definition of ESG in the market. Asset managers but also institutional investors have a huge variety of concepts with respect to filters, screenings and even goals they want to achieve with ESG investing.”

Pflaum notes: “In Germany there are still many institutional investors carrying out exclusion only, but we are already noticing a shift towards adding other strategies such as best-in-class.”

Investors like churches, foundations or corporate pension plans – which are already invested according to certain criteria – have developed unique demands, she says, which asset managers cater for.

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König explains that due to the lack of standardisation, adding ESG criteria to investment approaches complicates the benchmarking of mandates. He says: “When implementing ESG it is desirable to benchmark against markets and mandates without ESG filters, that is, identify the ESG impact. After all, ESG is a goal or a restriction beyond financial goals and imposed by the investor.”

According to Speich at Union, it only makes sense to offer ESG when it is integrated into all asset classes, as there are many multi-asset institutional mandates in Germany due to the prevalence of master-KVGs, master-feeder institutional fund structures.

“This is what some asset managers underestimated when they only offered specialised ESG products, thinking it is a niche market,” Speich says.

In domestic beauty contests for institutional mandates ESG may not the first thing that is being looked at, Speich explains: “But if you cannot convince investors that you are considering it in your classic investment analysis you will quickly fall out of the shortlist.”

For the near future he sees a “differentiation of managers by ESG content” – other words, whether they can offer portfolios structured according to certain criteria like the UN Sustainable Development Goals, governance or the Paris climate accords.

Pflaum is convinced that ESG is standard in asset management as it “both helps to identify risks but also opportunities” and says the additional inputs helps compile a holistic perspective on a company. “Weaknesses have a financial impact, which many investors were not as aware of before when markets did not react as extremely to it as they do now,” Pflaum explains.

For König, governance is already part of the financial analysis. As for factors, including environmental and social, he calls on investors and asset managers to review different approaches carefully to see how the application of ESG affects a portfolio.

“ESG works like a style bias, even with best-in-class,” he concludes. “But given that its definition is soft, there is room for different implementations, in particular when financial performance goes the other way.”

Presentation is more important than location

It may be a fairly recent development, but most German institutional investors make little distinction between domestic asset managers and international houses with established offices in

Germany – as long as they offer presentations and client representation in German. The same goes for ESG. The differentiation is along the lines of transparency and openness.

"There is no right or wrong ESG approach when you are talking to German institutions," confirms Stefan Bauer, head of institutional business Germany for Franklin Templeton, which managed €3.6bn of assets for German institutional clients as of end-2017, according to IPE's 2018 German institutional asset management survey.

"Each investor has individual demands and there is a lot of room for innovation. The investor has to be convinced that the asset manager is truly integrating the ESG approach into its investment strategy, that it is transparent and not purely a label."

This is confirmed by Anthony Eames, director of responsible investment strategy for Eaton Vance Management, which acquired a five-strong fixed income team in Germany earlier this year: "Talking to German investors we found they really want to understand an approach before investing in it."

With a deeper understanding comes demand for an approach that makes portfolio sense. "For many, pure exclusion no longer makes sense as it is a blunt instrument. Highlighting the best will also lead to the worse ones falling out of the grid," explains Eames. Another important factor which many investors want included is "materiality" – rating ESG factors according to their significance for certain sectors, he adds.

But, overall what is still considered first of all is the return. Franklin Templeton's Bauer thinks this is the case among the majority of institutional investors globally. "But, in some countries like the Nordics, investors have already had more time to integrate ESG into their processes and there is a different social pressure to apply it."

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