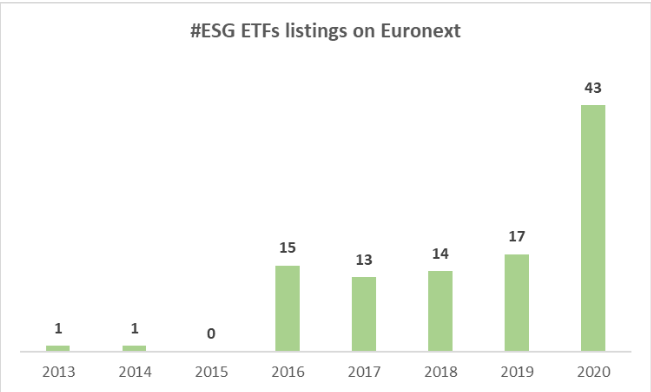
ESG ETFs: the ideal vehicle for sustainable investing

Today's investors are interested in more than a company's size or market worth. Particularly in the younger generation, they expect companies to operate according to environmental, social and governance (ESG) principles. It's no longer about "do no harm"; rather it's about finding companies that are actively contributing to a sustainable future. For these socially conscious investors, ETFs play an important role in an ESG-based investment strategy.

ESG ETFs are on the rise

ESG ETFs are not exactly new; the first ESG-related ETF listing on Euronext took place in 2013, but the growth in this area is impressive, with more than 100 ESG-related ETFs now listed on Euronext markets, representing more than €40 billion in assets under management (AuM) as of January2021.



Some may have thought the Covid-19 crisis would have relegated ESG interest to a second priority, but both product launches and asset growth over this period demonstrate the opposite. During February 2021, new ESG ETF assets saw a monthly record of €19 billion worldwide compared to the previous record of €17 billion in January 2021. This has led to a total of €193 billion in AuM on ESG ETFs worldwide.[1] This trend seems to be here to stay, as highlighted in an analysis by PricewaterhouseCoopers (PwC) indicating that ESG assets will make up between 41% - 57% of total mutual fund assets by 2025. Moreover, more than 75% of European institutional investors surveyed this year by PwC said they plan to stop buying non-ESG European products within the next two years[2].

The new era of ESG investments is rapidly evolving in terms of product innovation, launch frequency, and asset gathering. This brings with it a natural need for more classification, and label certification is growing. This had begun with the French SRI and GreenFin labels in 2015 and 2016, the Paris Aligned Benchmark (PAB), the Climate Transitional Benchmark (CTB) last year and even more recently, the ongoing EU Taxonomy classification. These examples illustrate the industry's commitment to adhere to sustainable impact guidelines. There is still progress to be made and a need for a more international approach to complement local initiatives, but ETF transparency is very powerful. Indeed, ETFs are mainly focused on index tracking products for the moment (c. 96% of total AuM as of February 2021), which broadcast their total holdings on a daily basis. This gives investors a strong positive insight, allowing them to control the details of their investments and in the relatively new world of ESG, this is a strong argument in favour of the ETF structure.

[1] https://etfgi.com/news/press-releases/2021/03/etfgi-reports-assets-invested-esg-etfs-and-etps-listed-globally-reached

[2] https://www.pwc.com/gx/en/industries/financial-services/assets/wealth-management-2-0-data-tool/pwc_awm_revolution_2020.pdf

ETFs support many ESG-focused investment strategies
ESG ETFs offer a wide range of different investment strategies and themes. An ETF may offer a complete ESG strategy or focus on only one aspect – the environment (E), society (S) or governance (G).
To simplify, these strategies can be placed into three categories:

- Exclusion
- Best in class
- Thematic

The Exclusion strategy: the ETF issuer will select an index or create a new one that does not contain any companies (equities and/or bonds) that belong to specific sectors (typically tobacco, coal, or weapons, for example).

The Best in Class strategy: the ETF issuer will decide to create a custom index (through an index provider) with specific ESG criteria that will determine the best companies in each sector. The criteria and rates will be linked to the ETF focus (can be carbon emission or gender equality or a combination).

The Thematic strategy: the ETF issuer will decide to create a custom index (through an index provider) with a specific theme that is part of the ESG scope such as gender equality, blue economy, or circular economy.

All these different strategies can be found on Euronext listed ETFs. As an example, Euronext was the very first exchange in the world to offer access to an ETF themed on the Blue Economy, which promotes responsible economic growth that preserves the marine ecosystem.

ETFs appeal to the trend we see in today's investors, who are less likely to be influenced by a company's size or market worth, and are more interested in the company's business practices, and the extent to which they are "walking the talk" when it comes to diversity, environmental impact and other ESG topics.

ESG ETFS: part of the new reality
While no one can predict the future with 100% certainty, we do know that ESG is here to stay. It represents not only a new reality for investors; it is a new prerequisite for companies. Sustainability will be a fundamental part of all activity, whether on a company level or for individual ETFs or Funds.

Thanks to the product's flexible nature, the ETF product range will continue to reflect changing investor preferences, which will lead to an increase in thematic products. Investors want to invest in companies they understand and want to be familiar with the "topic" on which they are investing in. They take a more in-depth approach to their investment strategy and are influenced by practical trends. ETF issuers will be able to meet these demands by offering products that enable investors to capitalise on emerging developments. The thematic strategy particularly offers efficient time-to-market in order to provide exposure on short-lifecycle economic trends that can arise from ESG findings.

The importance of the Index
The ETF issuer will choose its investment strategies wisely for the products it offers to its clients and will rely heavily on the index provider to do this. All the criteria linked to ESG require a massive amount of extra financial data to be collected and analysed. Index providers have the capability to

offer this and can easily work alongside experts on specific areas to build a specific index. This can be seen through the launch of three significant ESG indices at Euronext. In 2008, Euronext launched the Low Carbon 100 Europe index, the first ever pan-European index focusing on companies reducing their CO^2 emissions. In June 2020 we launched the Euronext® Eurozone ESG Large 80 Index which allows investors to invest in the 80 best-performing ESG and energy-transition-scoring listed companies in the euro zone. Even more recently, building on our historical blue-chip indices, a new ESG version of the well-known CAC 40® index was launched on 22 March this year, the CAC 40 ESG®. This index is the first national ESG index derived from the CAC 40 family and is designed to identify the 40 companies within the CAC® Large 60 index that demonstrate the best ESG practices. It is our goal to offer products that reflect market interest and cater to new investment strategies, and we look forward to welcoming more ESG indices to be launched this year.

Next steps

The need for more international labels and classification is essential in order to make this new generation of products more understandable for investors and easier to choose. Lastly, it is worth highlighting that ETF issuers are mainly focused on passive investments, as explained above, but are active on their voting rights. A passive investor tends to be a long-term investor (i.e. the ETF issuer will remain a shareholder until the company is excluded from the index) who can provide strong input with their voting rights in the General Assembly in order to reflect their ESG objectives.

The new world moving towards ESG investment is here to stay and ETFs will continue to grow alongside of it, offering one of the most comprehensive, transparent, and low-cost tools for all types of investors.