

# Renaming with purpose: Do investment funds' ESG names match their actions?

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## Motivation

Around 250 European funds changed their name and investment policies to include sustainability related terms in 2020, while the number doubled to 536 in 2021 according to Morningstar classifications (Morningstar, 2022).

Whether funds' actions mirror their new names or labels is subject to debate. The perceived risk of "ESG-washing" has been significant enough to attract the attention of regulators in the U.S. and Europe.<sup>a</sup>

- Investors may be unable to distinguish between superficial and non-superficial fund name changes.
- Fund managers collect fees based on assets under management.
- Fund managers could be using repurposing as a signal of legitimate change, or only cosmetically to attract capital from investors sensitive to trendy names and/or charge higher fees.

We investigate how investors respond to first-time ESG-renaming by mutual funds around the world, and whether fund managers' subsequent investments align with ESG repurposing.

- We look at how fund repurposing affects flows into funds, their ESG performance, as well as turnover and fees.

## Data

We identify a preliminary sample of over 750 funds that change their name to include an ESG term (i.e. 'Sustainable', 'Responsible', 'Social'), using a customised keyword search algorithm similar to previous literature.

- MSCI ESG Fund Metrics module from FactSet provides the universe of open-ended equity funds. Time frame: July 2016 → Oct 2022.
- CRSP Mutual Funds, Factset, Eikon and Morningstar databases provide fund characteristics such as legal structure, domicile, and time varying variables such as returns, TNA and ESG score.
- Flows calculated using total net assets (TNA) and returns.
- ESG score: based on aggregation of firm-level MSCI ESG ratings of the fund's holdings.
- Robustness checks using carbon intensity measures and Morningstar sustainability scores.

All mutual funds Active Passive			
Repurposed date			
2016	10	8	2
2017	17	15	2
2018	40	36	4
2019	73	70	3
2020	151	141	10
2021	218	170	48
2022	250	208	42
Total	759	648	111

Table 1. Fund name changes Jul 2016 - Oct 2022

## Methodology

Model specification:

$$y_{i,t} = \alpha_i + \alpha_t + \beta.Repurposed_{i,t} + Controls_{i,t} + \epsilon_{i,t}$$

- Outcome variables are flows when examining investor behaviour, and ESG scores, turnover or fees when examining fund manager behaviour.
- Variable of interest, repurposed → dummy which takes value of 1 after repurposing.
- Controls within flows regressions include: lagged log TNA (size of fund), lagged fees, past performance and ex ante ESG score. For the ESG score regressions controls include lagged log TNA and past performance.
- We additionally run regressions with an estimator created by Callaway and Sant'anna (2021) to address recent advances in econometric theory that show two way fixed effect estimators (TWFE) can be biased when treatment is staggered.
- The Callaway and Sant'anna estimator calculates treatment effects for each group in each time period of the panel separately and enables aggregation in three ways: simple, group and dynamic. Of these, the simple and group methods are most relevant to our data structure.

<sup>a</sup>The European Securities and Markets Authority (ESMA) launched a consultation on guidelines for funds using ESG or sustainability related terms in their names (ESMA, 2022). The US Securities and Exchange Commission (SEC) proposed last year to amend the Investment Company Act "Names Rule", which outlines an 80% investment policy, to include ESG terms (SEC, 2022).

## Results - Fund flows

First, we examine to what extent investors respond to ESG repurposing through an analysis of fund flows.

	Model 1	Model 2	Model 3
Repurposed	1.7948*** (10.660)	0.9402*** (4.4995)	0.9947*** (4.4521)
Institutional x Repurposed	-0.2744 (-0.9318)	0.3842 (0.9910)	-0.0196 (-0.0501)
Lagged_fees		-0.1798* (-1.7635)	-0.0945 (-0.8920)
Month_lagged_return		0.1626*** (39.602)	0.1712*** (38.272)
log_month_lag_TNA		-2.5090*** (-62.698)	-2.5084*** (-53.390)
Lagged_ESG score			0.1675*** (7.7979)
Effects: Time & entity	✓	✓	✓
No. Observations	2591549	1988052	1501160
R-squared	0.0001	0.0338	0.0302

T-stats reported in parentheses. p<0.01\*\*\* p<0.05 \*\* p<0.1 \*

- Monthly percentage flows increase by about 0.9 percentage points, this effect is sizeable given a sample-average monthly flow of 1.1%.
- No significant difference between retail and institutional investor types.
- The positive effect of repurposing on flows remains even after controlling for ESG scores.

Callaway and Sant'anna (2021) estimator results:

Sample	Method of aggregation	ATT	SE
All	Simple	0.7095	0.6206
US		-2.0111	3.1385
EU		1.0186	0.6915
All	Group	0.8753**	0.3844
US		-1.3599	0.91
EU		1.1448**	0.4036
All	Dynamic	0.571	0.9913
US		-1.1913	2.5646
EU		0.6221	1.8116

- Accounting for staggered treatment, we find a smaller positive effect which remains significant for EU funds in sample splits.

## Results - Fund ESG scores

Do fund managers change behaviour after repurposing → evidence from fund ESG scores.

	Model 1	Model 2	Model 3
Repurposed	0.3427*** (11.576)	0.6523*** (6.0269)	0.6499*** (6.0006)
France x Repurposed		-0.6175*** (-5.0015)	-0.6143*** (-4.9665)
Luxembourg x Repurposed		-0.2557** (-2.1764)	-0.2572** (-2.1676)
Switzerland x Repurposed		-0.2955** (-2.2155)	-0.2999** (-2.2250)
UK x Repurposed		-0.2890* (-1.8823)	-0.3133** (-1.9939)
Effects, controls	✓	✓	✓✓
No. Observations	1344405	1344405	1314061
R-squared	0.0019	0.0029	0.0031

T-stats reported in parentheses. p<0.01\*\*\* p<0.05 \*\* p<0.1 \*

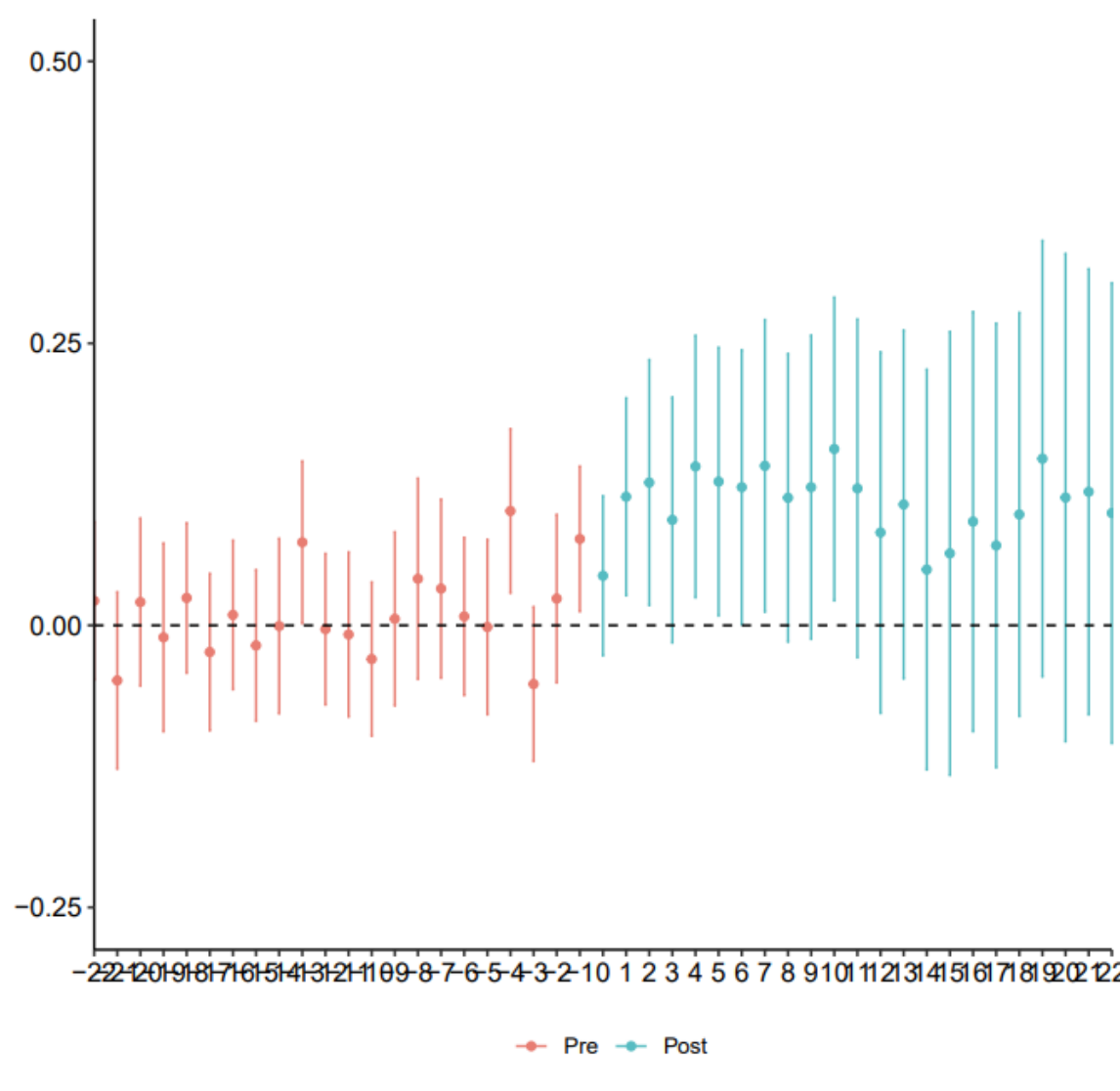
- The average mutual fund experiences an increase in fund-level ESG score, by 3.5% i.e. 6.2 to 6.4, even after accounting for staggered treatment.
- The US is the reference category and we see as much as a 6.5% improvement in ESG score for funds domiciled there, whereas much more variation in EU funds.

Callaway and Sant'anna (2021) estimator results:

Sample	Method of aggregation	ATT	SE
All	Simple	0.1247**	0.0372
US		0.5473**	0.0957
EU		0.0936**	0.0325
All	Group	0.088**	0.0319
US		0.4313**	0.0882
EU		0.0866**	0.0337
All	Dynamic	0.2401**	0.086
US		0.631**	0.1085
EU		0.1366	0.0955

- Again looking at the results which are robust to staggered treatment timing, we see the positive effect of repurposing on ESG scores is driven largely by US funds.

## Parallel trends - Fund ESG score



## Results - Fund turnover & fees

Finally, we ask whether ESG repurposing by mutual funds is accompanied by changes in funds' turnover rates and expenses.

Turnover:

	Model 1	Model 2
Repurposed	92.690 (1.2256)	91.343 (1.2115)
Month_lagged_return		2.0478 (1.0424)
log_month_lag_TNA		10.372 (0.9231)
Effects	Entity Time	Entity Time
No. Observations	662448	635070
Cov. Est.	Clustered	Clustered
R-squared	6.676e-07	2.717e-06

T-stats reported in parentheses.

- Turnover increases after ESG repurposing but not significantly so. Note: small sample coverage (100 funds).

Fees:

	Model 1	Model 2	Model 3
Repurposed	-0.0223*** (-2.8355)	-0.0222*** (-2.8615)	-0.0179*** (-2.5905)
Month_lagged_return		0.0002*** (3.0775)	8.739e-05* (1.8378)
log_month_lag_TNA		-0.0100*** (-11.748)	-0.0090*** (-10.931)
Lagged_ESG score			0.0026*** (3.6315)
Effects	Entity Time	Entity Time	Entity Time
No. Observations	1564632	1513972	1141317
Cov. Est.	Clustered	Clustered	Clustered
R-squared	0.0001	0.0028	0.0028

T-stats reported in parentheses. p<0.01\*\*\* p<0.05 \*\* p<0.1 \*

- We see a positive effect of ESG score on fund fees, repurposing itself does not however appear to be a driver of fee increases. Regardless the economic significance of the effect is small.

## Conclusions

- We study the widespread phenomenon that mutual funds change their name to ESG-related appellations, i.e., ESG repurposing.
- We provide mixed evidence on the response of mutual fund flows.
- We provide consistent evidence that mutual funds improve the ESG performance after ESG name changes.

## References

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## Acknowledgements

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