Discussion of Gantchev-Giannetti-Li: Sustainability or performance? Ratings and fund managers‘ incentives

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How much do Green investors care about performance?

- Recent work on ESG in Asset Pricing derives equilibrium outcomes assuming that some investors care more about ESG (“Green investors”)
- Other literature has linked ESG preferences of individuals to their pension allocation decisions
- But these individuals do not invest directly, they use intermediaries
- How do intermediaries behave in terms of the performance-ESG trade-off?
- Here: evidence from the introduction of a sustainability fund rating
    - No changes in underlying preferences or firm performance or ESG
    - New rating allows investors to sort themselves into funds by sustainability

This paper

- Morningstar's "globe ratings" introduced in 2016
  - Entirely based on portfolio stocks' Sustainalytics rating
  - Discontinuities that investors care about but are not related to underlying fundamentals
- Funds reacted during transition period (~9 months)
  - Some funds tried to increase their globe rating by buying highly rated stocks
  - Other funds took advantage of buying pressure, increasing their "star" ratings
- Fund flows more sensitive to star rating than globe rating
  - Both in transition period and later
  - Initial flows to high-globe funds, not any more after 9 months
- After 9 months, funds stop trying to improve their globe ratings
  - Conclusion: funds care more about flows than sustainability
- Extremely well executed
  - All my questions were answered on the next page
  - Here are some remaining thoughts

A stark conclusion – some caveats

"…suggesting that ultimately investors care predominantly about performance. Our findings indicate that regulation may be necessary to direct capital to more sustainable investments"

- Why was there a trade-off in the sample period?
- Do green investors pay less attention?
- Does that apply to both SRI and Non-SRI funds?
- How does this square with the previous literature?

A persistent performance/ESG trade-off?

- Pastor, Stambaugh, Taylor: Dissecting Green Returns

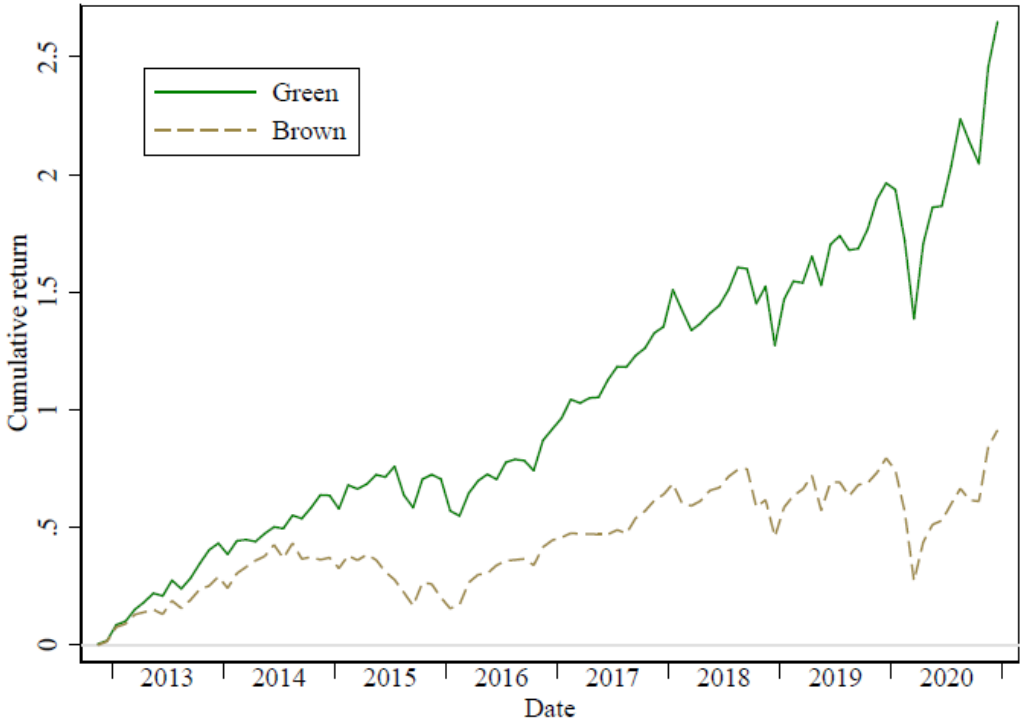

Figure 3. Returns on value-weighted green and brown portfolios. This figure plots the green and brown portfolios' cumulative returns. The values of the green and brown lines at the end of 2020 are 2.649 and 0.913, implying green stocks outperformed brown by $(2.649 - 0.913) \times 100 = 174$ percentage points over this period.

Do green investors pay less attention?

- Anderson and Robinson: Financial Literacy in the Age of Green Investment

Table V: Green Beliefs and Green Pension Choices

This table presents the results of Probit and OLS regressions where the dependent variable equals one for respondents that at some point made an active choice to opt out of the default fund (Active choice) in Columns (1) through (3), and zero otherwise. The dependent variable in Columns (4) through (7) is weight in ESG-labeled funds (ESG-Labeled), and in Columns (8) through (10) the weight in funds with names suggesting that the fund is devoted to sustainable investments (ESG-Named). Column (7) displays the results for the 1,738 respondents of active choice investors that answered the "Big 3" financial literacy questions correctly. Independent variables and characteristics follow those in Table IV. Fund controls include fund categories and fees. The survey data is matched to 3,667 accounts obtained from the Premium Pension Agency (PPA). The table reports marginal probabilities. Robust standard errors within parenthesis where *, ** and *** denote significance at the 10%, 5% and 1% level.

	Active Choice			ESG-Labeled				ESG-Named		
VARIABLES	(1)	(2)	(3)	(4)	(5)	(6)	(7)	(8)	(9)	(10)
Clean planet	-0.066***	-0.050**		-0.000	-0.015			0.012**	0.010	
	(0.020)	(0.021)		(0.017)	(0.019)			(0.006)	(0.006)	
Higher cost		-0.048			0.031				0.017	
		(0.031)			(0.031)				(0.011)	
Higher return		-0.022			0.036				-0.001	
		(0.026)			(0.024)				(0.008)	
Green preferences			-0.022*			0.015	0.024**			0.009***
			(0.011)			(0.010)	(0.012)			(0.003)
Env. Lit.	-0.002	-0.002	-0.003	-0.005	-0.005	-0.005	-0.007	0.001	0.001	0.001
	(0.008)	(0.008)	(0.008)	(0.008)	(0.008)	(0.008)	(0.009)	(0.002)	(0.002)	(0.002)
Fin. Lit.	0.033***	0.033***	0.033***	-0.006	-0.006	-0.007	0.001	0.003*	0.003*	0.003*
	(0.008)	(0.008)	(0.008)	(0.007)	(0.007)	(0.007)	(0.013)	(0.002)	(0.002)	(0.002)
Characteristics	Yes	Yes	Yes	Yes	Yes	Yes	Yes	Yes	Yes	Yes
Fund controls	No	No	No	Yes	Yes	Yes	Yes	Yes	Yes	Yes
Sample	PPA	PPA	PPA	Active	Active	Active	High Lit.	Active	Active	Active
Observations	3,667	3,667	3,667	2,474	2,474	2,474	1,738	2,474	2,474	2,474
Pseudo-R^2	0.236	0.237	0.235	0.219	0.220	0.220	0.228	0.029	0.030	0.030

Specialization

- Literature shows that dedicated sustainability funds are different
  - Bialkowski & Starks: SRI fund flows are different
  - Barber, Morse, & Yasuda 2021: investors are willing to accept lower returns for high SRI VCs
  - Benson & Humphrey 2008: SRI fund flows are less sensitive to performance
- What happens to dedicated SRI funds?
  - Do their investors care less about performance? More about globes?
  - Do they react more to “true”/forward-looking ESG performance than the rating?
  - Are they more stable in their globe rating after the transition period?
- What happens to funds that took advantage of the transitory price pressure?
  - Did their globe rating suffer?
  - Did they remain “less green” going forward or did they reverse their portfolios?

Conclusion vs. previous literature

- Sustainability vs. performance relationship
  - Conclusions vary by time (see previous slides), but jist is that investors are more and more willing to pay for Green
  - Here: trade-off from perspective of fund leads to the opposite conclusion
  - Is this because all the WTP for Green does not aggregate to be significant for funds?
  - Paper quantifies flow-effects of one globe vs. one star (very clean: focus on those that are able to manipulate ratings)
  - How does that translate to actual decisions? For a fund that is close to improving both its globe and star rating, which one is more expensive, and how does that compare to the benefits?
- Morningstar globe ratings
  - Hartzmark and Sussmann 2019: flows to funds with most globes, away from those with least globes (11 months)
  - Here: in-depth analysis of the transition period and contrast to steady state
  - Important in a changing market and worth emphasizing more

Transition period

- Rare setting without underlying changes in preferences or firm performance
- How quickly do funds learn about flow-ranking sensitivities?
- Which funds learn the quickest? Are they awarded with more flows?
- How quickly do counterparties learn about buying pressure?
- Does competition (within grid) matter?

Herding

- The only rating that matters is Sustainalytics
- Does the rating lead to more herding towards Sustainalytics?
  - How much herding do we get, and how does that compare to herding towards other benchmarks?
  - Do changes in other ratings trigger less buying pressure after the introduction of globes?
  - What does herding imply for information acquisition?
- Is herding why flows don't change any more after the transition period?
  - Do investors learn about which funds deviate from Sustainalytics (and therefore Globes) and how that affects performance?
- Does the focus on Sustainalytics lead to less "ESG rating uncertainty" as in Avramov, Cheng, Lioui, & Tarelli?
  - Do we observe their predictions? (Lower market premium, higher demand for stocks, lower CAPM alpha and effective beta)

Thank you for giving me this paper to discuss

- Great setting to isolate flow incentives from changes in underlying preferences and fundamentals
- Rich set of results, especially on the transition to steady state
- Could benefit from more guidance and packaging of the results
- Best of luck!