

ESG: how can clients avoid 'greenwashing'?

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As environmental, social and governance (ESG) principles become increasingly mainstream and with asset managers under increasing pressure to embrace the trend, the number of fund launches featuring ethical and sustainable credentials has grown significantly in the past few years. However, the ESG term itself may still be somewhat perplexing for investors, especially given the proliferation of ESG definitions.

Although there is no single, widely accepted definition of what ESG principles represent or encompass, a number of international initiatives have been undertaken in the past 15 years in order to clarify the practical meaning and implications of sustainability for investors.

A number of governments, through their relevant regulators, have put in place different programmes and initiatives encouraging and even subsidising the activity of various stakeholders to ESG and other sustainability issues in the context of their business activities by either introducing new, or strengthening/expanding existing, initiatives and/or regulatory frameworks.

Transnational initiatives have also been put forward recently in an effort to both harmonise and clarify the nature, breadth and scope of ESG principles and assist multi-governmental efforts aiming to apply them domestically in a coherent manner. The United Nations' Principles for Responsible Investment (PRI) is an established body, comprising more than 2,500 members from over 50 countries and representing over USD 70tn assets under management, which established six principles for responsible investment (Principles for Responsible Investment). Although the Principles for Responsible Investment are "voluntary and aspirational" in nature and do not provide any enforcement and/or sanction mechanism per se, signatories are still expected to report on the extent of their compliance with such principles by way of annual reporting and continuing self-assessment processes. Investors, especially institutional investors, are thus now in a position to require investment managers and advisors to disclose and evidence their membership to the PRI and compliance with the Principles for Responsible Investment.

The growing awareness of, and interest in, environmental, social and governance principles has also led to the development of the United Nations Sustainable Development Goals (UN SDGs) in 2015. The UN SDGs provide a much-needed and detailed uniform framework within which all relevant actors may report efforts, measure improvement and ultimately aim for more. Authors of the Principles for Responsible Investment have stated that achieving the UN SDGs "will be a key driver of global economic growth, which any long-term investor will acknowledge as the main ultimate structural source of financial return: over the long term, economic growth is the fundamental driver of the growth in corporate revenues and earnings, which in turn drive returns from equities and other assets".

One incidental effect of entities claiming early compliance with the Principles for Responsible Investment and/or the UN SDGs is that they may attract additional scrutiny from discerning investors, which in turn could encourage such entities to demonstrate further transparency with respect to their investment strategies as well as strengthen their commitment to sustainability efforts.

As compliance with ESG principles has moved from an aspirational goal to a sine qua non

condition, a growing number of investors (mainly institutional, so far), have been part of the effort to create a more standardised set of objectives and uniform disclosure standards, perhaps in response to the marketplace's legitimate apprehension to potential 'greenwashing'. Despite such timely and well-meaning initiatives, progress remains slow and concerns that sustainability reporting lacks accuracy and accountability remain well-founded. In this context, some have argued that until such standardised objectives and uniform disclosure standards are sanctioned by actual mandatory (rather than voluntary) legislation, the risk of 'greenwashing' at any level of the investment chain will remain. In the context of ever-expanding regulatory reach in the investment funds industry, perhaps the biggest test to the various stakeholders' genuine commitment to ESG principles will be how they welcome and respond to such regulations.

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