The industry's greenwashing problem – and how it must adapt

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Summary

- Sustainable investment strategies saw significant inflows and fund launches in 2020
- Growing investor scepticism of manager claims, and accusations of "greenwashing"
- Data and reporting from by fund managers on impact portfolio companies have on all stakeholders is only way to win investor trust
- Managers also need to be rigorously transparent around their sustainability approach and engagement activities to improve outcomes for investors and other stakeholders

2020 was a blockbuster year for 'sustainable' investment strategies. Morningstar data suggests strategies with this label attracted more than US$190bn of net inflows to Q3 2020[1]. This surge even remained positive through the peak of the pandemic-driven market selloff. The number of sustainable fund launches was also high – Morningstar puts the number at over 450 to Q3 2020[2] – accompanied by the rebranding of established strategies to reflect a new, more 'sustainable' approach.

While it is difficult to disentangle exactly how much of this has been accelerated by the pandemic, it is clear 2020 was a turning point for the industry. It is also a reassuring and encouraging moment for those who have been calling for greater responsibility to be taken by investment managers.

However, alongside this increase in visibility and acceptance of sustainability, we have seen a rise in investor concerns around 'greenwashing'. This is the phenomenon of labelling a strategy as being highly sustainable or green when it is often only marginally different to traditional portfolios, if at all.

Across the industry, we have seen too many disappointing examples of investors finding out their 'sustainable' or 'ethical' funds have exposure to tobacco or controversial weapons. It is therefore no surprise

[1] Source: Morningstar Manager Research, October 2020:
Global Sustainable Fund Flows: Q3 2020 in Review ESG fund assets reach USD 1.2 trillion, boosted by product development

[2] Source: Morningstar Manager Research, October 2020:
Global Sustainable Fund Flows: Q3 2020 in Review ESG fund assets reach USD 1.2 trillion, boosted by product development

the public are often sceptical of claims that the industry has grown a greater conscience.

Yet, despite some discouraging discoveries, we believe there is a great deal of positive momentum driving investors towards more sustainable portfolios. Across the investment sector, we also see an overall willingness and aspiration to work together to achieve better social and environmental outcomes.

Perhaps this is a function of new blood within our industry and the start of a generation taking the lead in investment decision making roles. Maybe it is a growing understanding that making the "right" decision may also be the best one to generate better investment returns.

Whatever it is, more investors and companies than ever are becoming highly receptive to collaborations and allocating more resources to achieve better outcomes.

It would be a shame, therefore, for all this to be dismissed as merely 'greenwashing', so we, as an industry, must do more to be better and prevent this dangerous perception gaining unwarranted ground.

We believe the bedrock of credibility is created first and foremost by impact awareness and reporting. We need to be accountable, transparent and allow our methodology and activities to be rigorously tested.

It is vital that we carefully analyse a company's total impact on all stakeholders to assess whether to hold it in a portfolio that aims to promote sustainable outcomes. It is also important to note that the greenwashing phenomenon is not unique to the asset management industry. Companies themselves may 'greenwash' their reporting to promote a more sustainable appearance. This means the onus is on us, as responsible investors, to carefully assess and cut through the rhetoric to the correct and detailed information.

Data that truly gets to the heart of the impact can be idiosyncratic and hard to find, but it is possible to work with a company to disclose it. For example, if a company develops emission reduction technology, a responsible investor will need to analyse data related to the amount of emissions it actually avoided making by using it. For a mobile payments business in an emerging economy, we might need to look at the number of people using the service and volumes on its platform, to assess how well it supports access to otherwise scarce basic financial services.

As fund managers, it is vital we are fully transparent over what data we use to assess a company's impact. This openness will go a long way to ensuring clients understand both what we aim to do and actually achieve with their capital. It also helps to keep investee companies and asset managers fully accountable.

As a starting point, we advise investors analysing sustainable strategies to ask what 'sustainability' really means to the fund manager – and what exactly they are trying to achieve. We would also advise probing a manager's stewardship and engagement activity to examine how this supported positive outcomes.

The manager should be transparent not only over their entire portfolio, but explain each holding's contribution to an overall positive impact and offer the data to support the claim. While we recognise that most of the impact data currently offered by companies needs upgrading and improvement, we believe there is enough to start to build a clear picture for clients.

As we progress on this sustainability journey, it is becoming clear that investors' approaches are wide-ranging and subjective. Sustainability as a notion is bound to keep evolving, as it is a reflection of societal thinking and expectations.

As stewards of investor capital, we believe asset managers should embrace being as open as possible to understanding this growing range of different perspectives. We should also relish being challenged as it will help us ultimately work together to achieve the outcomes needed for a sustainable world – and our clients' portfolios.

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