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# Viewpoint: We cannot let the fear of greenwashing impede real change

BY HANS STOTER, AXA IM | 10 SEPTEMBER 2021

***You could be forgiven for thinking greenwashing is everywhere***

A recent survey by Quilter found that greenwashing topped a list of investor anxieties about ESG, with 44% concerned that ESG investments fail to match their claims. Meanwhile allegations of corporate greenwashing continue to make headlines, with dubious efforts to showcase green credentials withering under closer scrutiny.

There is no doubt that greenwashing is a genuine issue. Nor is there any question that, when asset managers or companies make claims they cannot support, they should be called out.

But we risk finding ourselves in a situation where the fear of greenwashing – the suspicion that it is so prevalent that it is largely pointless to invest through a sustainable lens – leads to a worse outcome than greenwashing itself.

If investors begin to lose faith and turn against sustainable investing in sufficient numbers – and flows, while overwhelmingly positive now, could conceivably reverse over time – it could have serious ramifications for the future, and potentially undermine efforts to reach carbon neutrality by 2050.

Part of the problem is that there is little consensus on ESG and a lack of consistent standards. That means a company like Tesla scores highly with some ESG rating providers and badly with others. But it also extends to the composition of ESG indices, which can often include companies in industries that are not, on the face of it, at all green.

Opinions vary as to whether holding an oil major in an ESG index, for example, is consistent with a sustainable mandate. Some, like fund managers with specific exclusion screens, would argue it is not; others would maintain that the big oil companies are critical to delivering the transition to a greener, clean energy world.

Ultimately, it is up to asset owners and asset managers to express their view through mandates and mutual funds. But these are not straightforward decisions to make. It is easy to exclude

nuclear weapons from a portfolio, but what about aerospace manufacturers with subsidiaries which make the rockets that deliver those weapons? They manufacture conventional jetliners too. Do you exclude these companies? What about the carriers flying their planes?

Wherever they choose to draw the line in this spectrum – one that is not black-and-white but rather various shades of grey – it is imperative that asset managers are clear about their approach. They must invest in a way that is consistent with their prospectus and marketing documentation – and even their public pronouncements – or risk being accused of greenwashing.

The same is true of corporates. We have all seen examples of companies trumpeting their green credentials while disregarding the inconvenient truths that undermine their claims. But we are aware of these cases because companies are increasingly finding their hypocrisy exposed by the media.

When these instances occur, the offending company will often attempt to repair its reputation by putting in place better and more sustainable practices, policies and oversight. That means a key part of the policing system that holds companies to account – media scrutiny – is working. Specific instances of poor or hypocritical practice, no matter how high profile, should not be interpreted to mean that efforts to make the world a greener place are doomed to fail.

Of course, regulation is also pushing companies and fund managers in a better, more sustainable direction. We all realise that the longstanding lack of standardisation around definitions has been unhelpful, but steps are being taken here.

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There is now a clear EU definition of greenwashing, "companies giving a false impression of their environmental impact or benefits", and legislation designed to help tackle it, the sustainable finance disclosure regulation (SFDR), which came into force in March 2021.

This sets tough – and standardised – disclosure requirements for any firm that wishes to market its investment products as sustainable. In essence, those that do not meet such requirements will be labelled 'non sustainable'.

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This is hugely welcome. Morningstar analysis shows that the number of European funds rebranding to ESG has jumped from just over 2,000 in 2017 to around 3,500 in 2020, excluding new products launched with a sustainable label. Henceforth, the SFDR, which the European Commission is seeking to strengthen further to improve the disclosure and effectiveness of decarbonisation action by financial market participants for all investment products, will help fund buyers make more informed decisions.

Asset managers themselves, however, must also take more responsibility. As an industry, we should encourage more issuers of securities to make their best possible efforts to green their businesses and assets. If they do not – or cannot demonstrate the extent to which they are doing so – we should be firmer with our engagement and voting and, where required, deny them capital.

Green bonds are one asset class where we want to see a clear improvement. While they have become a major part of green portfolios in recent years, green bonds can lack clear definitions and consistent standards.

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We recently declined to invest in two issues because they failed to commit to reporting on the impact delivered by the projects financed by the debt. It is in these areas, as with impact investing more broadly, we expect to see progress in terms of standards and measurability.

Today, assessment of how well a strategy has contributed towards a Sustainable Development Goal, for instance, is entirely subjective and judgemental – there is no hard data to measure the impact. In future, as this situation improves, data analysis will demonstrate objectively whether a strategy was optimally aligned with, or contributed to, its goal. Any greenwashing, or impact washing, will be easily identified and tackled.

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# Greenwashing is an issue that will eventually become regulated and scrutinised to the point where its risk is marginal

Similar advancements will be made in the realm of ESG ratings, which could eventually become as standardised as credit ratings. In the credit world, no-one disputes what constitutes a high yield or investment grade bond: there is an established framework to assess credit risk that market participants abide by.

Over time, this could be mirrored in the ESG space, as data sets improve, and as investors coalesce around a select few providers. But progress could be slow as data, and what providers attempt to score – from carbon footprint to biodiversity to temperature alignment with the Paris agreement – continues to evolve. Clearly, however, better data will improve scoring, help investors make more informed decisions, and mitigate against greenwashing.

All this will take time – but the industry is heading in the right direction. Greenwashing is an issue that will eventually become regulated and scrutinised to the point where its risk is marginal.

Given the scale of the problems genuine ESG and impact strategies are trying to solve, we cannot allow the fear of greenwashing to impede the progress we urgently need to make. The 'race' to net zero is a real one, and we can't afford to arrive there too late.

*Hans Stoter, global head of AXA IM Core, AXA Investment Managers*