Beware of Greenwashing as Global ESG Investing Momentum Builds

Delegates at the Hubbis Investment Solutions Forum in June were treated to a tale of both great growth potential and also of caution from Shihan Abeyguna, Head of Business Development for Asia at global investment research and management group Morningstar. He told the audience of the growth in sustainable investment activity globally, but also addressed the concerns of 'Greenwashing' as demand for ESG funds grows around the globe. In short, Greenwashing is the optical illusion of making ordinary funds appear as having ESG attributes. ESG investing is a complex space, he explained, and investors who truly want to participate must evaluate if the fund's holdings align with its stated objective.

HE BEGAN BY EXPLAINING THAT he wanted to highlight three key 'takeaways' in his brief presentation. Number one, is the growth of ESG - environmental, social, and governance - investing is actually a genuine global trend that is growing rapidly. Secondly, he wanted the audience to beware of 'Greenwashing' which is the practice of product issuers falsely marketing products as having ESG attributes. And thirdly, he highlighted what the funds and investment industry can do to address this.

Phenomenal growth, but Asia lags

Armed with some detailed and easily understandable slides, he then showed the audience the remarkable growth path of what Morningstar terms Sustainable Investment Assets, showing that these have grown from under USD4 trillion in 2006 to almost USD31 trillion today. "ESG has entered the mainstream," he reported, "and about 25% of the USD31 trillion figure today are professionally managed assets."

He explained that in Asia, the numbers are quite modest but rapid growth is expected. He said the universe of roughly 3000 ESG mutual funds and ESG-related ETFs globally total about

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USD762 billion and USD441 billion in assets in Europe and the US, respectively. But in Asia it is just USD12 billion, underlining just how much room for expansion there is in the region.

The growth drivers

He then explained what drives the growth around these assets. "Number one is the climate risk," he reported, "as this moves up the political and economic agenda. "The world has moved on to focus on the economic implications of natural disasters, extreme weather events, the impact on water and water crises, as well as on potential food shortages."

He noted that more governments as well as regulators are playing an increasingly active role to ensure that companies are adopting sustainable practices, as well as encouraging asset owners to make sure that they adopt ESG factors in their investment decision making.

And he highlighted the growing body research that shows that there is a positive linkage between ESG factors and financial performance.

"Finally, but not least," he reported, "there is the rapidly growing demand amongst the managers of institutional, pension and governmental asset, as well as from retail and HNWI investors."

Demystifying the process

Abeyguna then covered what sustainable investing is. "It is a complex area," he observed, "and can actually mean different things to different people. There are many terminologies that are being used from SRI to ethical and green investing, but from Morningstar's perspective we see this in three segments."

The first, he explained, is investors that consider sustainable investing to be exclusionary based on their values, such as avoiding tobacco, gambling, alcohol, weapons and so forth.

The second is ESG integration where industries are not excluded and instead better performing companies are selected. So the decision is financial rather than ethical, and this is the area which Morningstar is seeing increasingly adopted by asset managers globally.

And the third type is what is called 'impact investing', where the capital is allocated based on financial returns, but also based on impact measurement on certain causes, for example clean water, women's empowerment, education, public health and so forth.

Beware of greenwashing

All of this complexity on the nomenclature applied to this type of investing has allowed some product issuers disguising their

products in the market by using loosely defined attributes and overstating their commitments around ESG to potentially garner assets from the marketplace.

"And that is what we call greenwashing," he explained. "Although there is no standard definition of greenwashing, the European Commission terms this as unsubstantiated or misleading claims about sustainability characteristics and the benefits of an investment product."

He highlighted the many funds in 2018 have launched with purportedly sustainable characteristics. "Actually," he reported, "while many are actually truly repurposed towards ESG, some of them are merely renamed. It was just a relabelling exercise, nothing really changed."

And, without naming the managers directly, he showed the audience some major funds that had been market as ESG integrated or impact funds, but its holdings conveyed a different story.

You can do more

That brought Abeyguna to his final point, his assessment on how the industry should respond. He said fund managers should be more transparent on how they incorporate ESG into their investment processes as well as their engagement through shareholder resolutions. There are regulators such as the Hong Kong SFC that have issued guidelines for investment management companies.

Most importantly the investor should conduct their homework, look under the hood, drill down funds at the holdings level rather than simply relying on labels.

"This is an exciting and dynamic area for the world of investment," he concluded, "and although in its nascent stages of development, the industry is certainly heading in a positive direction where capital is allocated to issues that were previous not getting much attention. So the more assets invested in this space, the better, even if these assets reflect a different degree of commitment.■