Fifty shades of green

As ethical investing becomes truly mainstream, investors are faced with the challenging task of telling the green from the green-washed. A complex web of labelling efforts have sprung up around the world, attempting to identify what is and isn’t ethical – but it isn’t so simple. Elizabeth McArthur writes.

European level is that, in order to be strong and widely accepted and recognised, a system of labelling needs to get the endorsement of a broad basis of stakeholders: civil society, state bodies, and the investment industry,” Gond says.

“What remains a challenge, both in France and in Europe, is to make sure that the actual content and functioning of stringent ESG labels is well understood downstream, notable by the ultimate retail clients or beneficiary of pensions funds.”

Closer to home, RIAA is responsible for Australia’s best known ethical label for investment products and advisory services.

RIAA’s labelling system is actually the world’s longest running responsible investment certification scheme, having been around since 2005.

RIAA chief executive Simon O’Connor is interested in some of the European labelling systems. He says the French label for investment products claiming to be “sustainable” was a development RIAA watched closely.

“The advantages of the French system is the codification of what is environmentally sustainable in the standard – so an in-built taxonomy of what constitutes green investment – energy, transport, built environment, waste, industry, agriculture and climate change adaptation – but a notable shortcoming is that the standard doesn’t extend to the social outcomes responsible investing can drive,” O’Connor says.

“We know retail investors in Australia and New Zealand are increasingly interested in this.”
He says, in his opinion, the French system labels environmentally themed funds well but fails to cover other ethical and impact funds. RIAA is rolling out new minimum standards in its certification program that mean the most controversial industries (tobacco, weapons) will be automatically excluded.

RIA’s current certification system is currently more about making sure that fund managers are doing what they claim to and meeting their own ESG standards, rather than enforcing an external standard or assuming community expectations.

For O'Connor, providing clear guidance to consumers is part of RIAA’s core mission especially as their own research indicates that 92% of Australians expect their super or other investments to be invested responsibly and ethically.

“Achieving RIAA Certification is hard and as demand from consumers grows, we see an ongoing and growing level of interest by fund managers in gaining Certification,” O’Connor says.

“On occasion, we reject funds that apply, but in addition, we recommend others not to apply where we see early on that the product won’t meet requirements, and for others we work with them closely for up to 12 months to get their products strengthened to a point that they’ll meet the required standards.”

The Ethical Advisers Co-Op recently launched its own labelling system, offering investment options a rating out of five green leaves.

Chair of the Ethical Advisers Co-Op Terry Pinnell says: “As advisers, we are constantly being bombarded by companies that say they are ethically minded and environmentally friendly, but when we look at what their investments are it’s a completely different story.”

The Ethical Advisers Co-Op rating system works by all of the advisers who make up the co-op rating investment options to create an aggregate score which aims to act as an indication of how likely the advisers would be to recommend their own clients put their money in those options.

“We’re trying to help the public who may be thinking they’re in an ESG fund or an ethical fund without really knowing what’s underlying. The leaf system is a way of helping the general public to work out how ethical those funds really are and how true to label they are,” Pinnell explains.

He has seen companies including Oil Search, BHP and Rio Tinto in investment options labelled as ethical.

“They’d be justifying that by saying their best of sector or only a small percentage of the companies’ profits could be deemed to be from environmentally damaging behaviour,” Pinnell says.

BetaShares was one of the companies to enjoy a high rating from the Ethical Advisers Co-Op for its Global ETHI ETF.

Chief economist for BetaShares David Bassanese explains that the interest in ethical options from BetaShares has been strong.

“What we’ve tried to do with these funds is become the most true to label ethical product.

So what separates us from some other groups out there is that we probably have the broadest screens. Everybody has a different idea of what ethical means – some people care about fossil fuels, some people care about the sin activities like alcohol, tobacco, gambling,” Bassanese says.

“What we’ve done is screen out all of the things people might be concerned about, so that one product can tailor for as many ethical investors as possible.”

While he acknowledges that there is no simple definition of what makes an investment an ethical investment, Bassanese also thinks it is important to offer a rules-based and transparent ethical screen.

He says that if an ethical label could be achieved it would make sense and suggests that perhaps the ASX could be well placed to offer such a scheme.

Elsewhere, Future Super is attracting members by offering an environmentally friendly and ethical super option.

One of its investment options, the Renewables Plus option, is essentially an impact fund – with a high exposure to renewables and the stated aim of supporting a transition away from fossil fuels and to clean energy.

Future Super founder and director Adam Verwey acknowledges that rolling out a labelling system to identify ethical or environmentally friendly investment options and fight greenwashing is no easy task.

He says that RAA is the natural place to start setting a benchmark for what it means to meet ESG standards.

“I think when funds are creating options they’re choosing the most marketable labels to attach to those funds – whether it’s ethical or impact or responsible. It’s not really a label that is that relevant to how they’re investing your money,” Verwey says.

Like Pinnell, Verwey has witnessed greenwashing in funds management.

“It seems strange that you can put an ethical label on something that still has exposure to fossil fuels or gambling or live animal exports,” he says.

Verwey warns that greenwashing and mislabelling are a risk for the industry. He feels that it could turn consumers away and make them unduly sceptical of everything claiming to be green.

“The frustrating thing is that the confusion around labelling makes people suspicious of ethical investments. Every time someone looks into something with an ethical label and sees something they don’t expect in it, it makes them distrust the whole industry not just that fund,” he says.

Looking to scale, Australian Ethical is perhaps the biggest name in ethical or environmentally friendly funds management in Australia.

Australian Ethical head of ethics Stuart Palmer says that part of the challenge is that terminologies in the ethical investing space are not set in stone.

“It’s really hard for consumers and retail investors at the moment because there’s a limited amount of transparency about those characteristics of funds,” Palmer says.

“While there are relatively standard requirements around the risk return characteristic of funds, the financial characteristics of funds – those don’t exist for the ESG characteristics of funds and investments.”

He says that efforts like RIAA’s certification scheme are great because they bring together complex information in a way that consumers can make sense of.

However, while he agrees with a labelling system for investment options using ESG principles he sees many practical issues with the roll-out of such a thing.

Palmer says: “The ethical characteristics, the ESG characteristics are multi-dimensional – it’s not just returns and volatility measures; it is impact on people, animals and the environment. What people? What animals? Where? Over what time period? How deep is the impact?”

He cautions that it’s not a good idea to think that problems like greenwashing and mismarketing can be solved by one simple green label.

This is particularly true when it comes to impact funds as it is important to allow room to be critical but open minded about the way positive impact might be achieved, he says.

While labels could be a valuable resource for the general public, Robeco head of sustainability integration Masja Zandbergen warns against being too prescriptive about the way ethics like sustainability are implemented in funds.

“The risk is that it can become a box ticking exercise. If you do exactly what is needed and gain the label, you have no incentive to do your own research, to really think about sustainability at a deeper level, or to innovate,” Zandbergen said.

She also points out that when it comes to label development, credibility is important. If a label were to be broadly accepted it may require fund managers to spend time and money to meet the requirements of the label – so it would have to be worth their while.

The other issue Zandbergen raises is that there would have to be some enforcement of such a label.

“I believe no asset manager would try to get the label only to lose it the next year. In most cases you need to prove on an annual basis that you still fulfil the requirements. I think that should be enough.”

Zandbergen sees the ESG labelling situation in Europe as being a reflection of the fact that institutional investors there have had very general policies and have left implementation to the asset managers but they are now starting to create more specific policies which can be implemented across entire portfolios.

She points out that there has also been a shift in Europe towards investing that is aligned with achieving the sustainable development goals as outlined by the United Nations and that has led to investors looking for a way to measure the impact funds are having.

“Unfortunately there is no one size fits all; there are many shades of green,” Zandbergen warns.

“We should give the investor choice and clarity.”