

ESG Reporting and Greenwashing: A Q&A with David W. Richardson

David W. Richardson, **Lauren Hunt**, and **Evan Carter** — 4 MIN READ

Investors are looking to be environmentally and socially responsible. But are they getting accurate information?

As interest in environmental, social, and governance (ESG) investing has grown in recent years, so too have questions about companies' ESG-related disclosures and about investment managers' responsibilities to accurately convey this information to investors. Disagreements about the extent and accuracy of this information can lead to charges of "greenwashing" – a situation where claims of environmental benefits do not match a company's sustainability commitments.

To explore how greenwashing happens, and the related issues of ESG reporting and disclosures, Analysis Group Vice President **Lauren Hunt** and Manager **Evan Carter** spoke with affiliate **David W. Richardson**. Mr. Richardson is an expert in asset management and institutional investments, and his experience includes managing portfolios with particular attention to the role of ESG factors in investment decision making.

Why is ESG reporting important?

ESG is a fast-growing investment trend: According to some estimates, ESG assets will exceed $50 trillion by 2025. This growth is driven by demand for financial products that enable an alignment of investor interests regarding ESG topics with the pursuit of strong financial returns. As a result of this demand, many investment managers have created ESG-driven products and made a number of related environmental commitments. The disclosures regarding these commitments are important because managers' performance will be measured by whether they adhere to these ESG-related statements (alongside their investment returns).

Perhaps not surprisingly, such statements have attracted the attention of regulators, the media, and the plaintiffs' bar, with a focus on investment managers' ESG reporting and disclosures, and whether they and their funds are meeting their stated ESG objectives and commitments. When litigation arises over whether ESG commitments have been fulfilled, appropriate and accurate ESG reporting and disclosures will likely play a critical role in investment managers' defenses.

Do the expectations and requirements for ESG disclosures vary among stakeholders, such as investment managers, policymakers, and investors?

ESG investing is somewhat unusual in that it is often driven by aspirational investor goals, and thus subject to different expectations among market participants. While there are a number of proposed standards for measuring or reporting on ESG-related criteria, virtually all ESG reporting in the US is currently voluntary, not mandatory. Because there is no current set of broadly accepted ESG reporting standards for investment managers, the content and quality of their ESG reporting differ. Policymakers, increasingly focused on climate-related disclosures such as carbon emissions, have yet to define how to appropriately measure and report on carbon emissions, leaving market participants to struggle to provide and/or evaluate emissions data disclosures.

As for investors seeking to align their ESG and financial goals, they may be disappointed with how an investment aligns (or fails to align) with ESG objectives, or with their investment returns. Such disappointment may lead to claims that the investment managers failed to provide proper ESG reporting and disclosures, or failed to invest the underlying assets in accordance with the stated ESG objectives, which may in turn lead to litigation.



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> DAVID W. RICHARDSON

In this context, what is greenwashing?

Greenwashing occurs when an investment manager attempts to persuade an investor that a particular financial product is environmentally sound by conveying false or misleading information. This can occur either by omitting information or by making misleading statements about a business's or an investment's positive impact on the environment.

While the significant growth in this area of investing perhaps makes instances of greenwashing inevitable, investment managers who are not rigorous in their ESG promotional materials, reporting, and disclosures will almost certainly face scrutiny from investors, and possibly from regulators as well.

What are some factors to consider when assessing claims that an investment manager has engaged in greenwashing in its ESG reports?

Assessing greenwashing claims is challenging because of the lack of widely adopted industry standards and clear governmental regulations around ESG reporting. Investment managers should recognize the difference between announcing well-intentioned future objectives and making misleading statements that may be interpreted as concrete, measurable, and transparent near-term commitments that the investment manager may struggle to achieve. Put simply, an investment manager claiming that they will seek to eliminate fossil fuel companies from a platform over an indefinite period is a very different situation from an investment manager claiming to have invested in a "fossil fuel-free fund," which is a fund that must be completely fossil fuel-free at the time that the client invests.

A major factor in this assessment is understanding the true intentions of an investment manager or company to live up to their near- and long-term ESG goals, which in turn requires an assessment of whether the statements are aligned with their actual policies and practices, from the management team on down. Understanding this intentionality will likely play a critical role in assessing whether greenwashing has occurred. ▪