

# Greenwashing and Other ESG Issues

Theo Marinis delves into the investment quandaries around ESG criteria and why it's important to sort the wheat from the chaff.



By **Theo Marinis**

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The whole ethical investing debate or incorporating ESG (Environmental, Social and Governance criteria) has become a regular topic for discussion within investing circles. It is being driven largely by enquiries from clients and potential clients.

It's a focus of spirited debate with one of my clients, fellow economist, and old friend, Sam. Our most recent discussions – prompted by American historian and academic Stephen Kotkin's comments on 'greenwashing' – found us both singing (in principle) from the same song sheet.

Greenwashing is making misleading or unsubstantiated claims about how environmentally sound one's products or services are. According to Kotkin, greenwashing is pervasive because governments continue to sign on to mandates they cannot meet and investors pledge commitments they cannot redeem.

"If governments in the largest economies focused on just two areas – carbon pricing and reinventing the (electricity) grid – the greenwashing sector might crater as fast as it arose," Kotkin contends.

My friend Sam thinks this is a sound observation, at least from an economic perspective. Governments should be focused on putting a price (and cap) on carbon emissions and getting out of the way so that the market can then do the heavy lifting. He believes that building an electricity grid that can support de-carbonisation is one obvious area where government intervention is likely to be needed, although there may be others.

With the right regulatory framework in place, the markets would be, as described by Sam, “brutal on carbon misinformation.” As it stands, they are not.

Client appetites are changing, and of course, markets will respond. Sam wants to use every lever he can reach to push change forward. He wants ESG options, and he particularly wants low carbon investment options. I think he is in the vanguard, but I also believe eventually, there will be plenty of people who follow.

How do I see this change in the investment markets occurring? Like anything new, there will be (as Sam puts it) the ‘Three Is’ of Innovation – the ‘Innovators’, the ‘Imitators’ and the ‘Idiots’.

I think that the industry in general, regulators in particular, together with individual Australian Financial Services licensees, can all help sort the wheat from the chaff here. Market forces will always prevail but there will be casualties among those who fall for the snake oil salesmen. This is why it is important to proceed with caution.

When we are not arguing, Sam nags me to use my conviction as a professional sceptic to cut through the greenwashing and find options that deliver clients with the maximum ESG bang for their buck.

He sees my role on ESG as no different to any investment opportunity: understanding the needs of clients, using industry knowledge to avoid bad choices, and to help clients get the outcomes they want, with efficiency.

I remain more than a little sceptical for now. Based on the three ‘I’s index, I think we are still at the ‘Innovation’ stage, and market forces have not yet squeezed out the ‘Idiots’ and the ‘Imitators’.

My experience over the last 24 months with investment funds that market themselves as ethical investments (or ESGs) is that they are expensive, and they underperform relative to the broader market indices. As we have learned, however, some investors are prepared to pay this premium in exchange for salving their conscience.

Of course, ESG isn't just about the environment – there's the social and governance aspects as well. But right now, the debate is focused on the E. I endorse Sam's view that our leaders need to make carbon reduction a national priority and depoliticise this, as well as so many other aspects of climate sustainability solutions.

Our investment committee has researched and approved an 'ESG aware' index offering which is available at minimal extra cost to our 'Non ESG' Index solution (which due to its transparent nature does score very highly, at 64 per cent against the ESG filter) for those clients who wish to act now, rather than wait for market forces to do their job on our preferred, Non ESG Index solution.

While I support the ESG concept in theory, until the market forces described by Sam are brought to bear, I won't be committed. I am very happy to help those who are resolute about investing in products branded ethical (or ESG) to buy what I consider the best available on the market – however I will also always explain the performance limitations, so they fully understand their decisions.

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