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Unintentional Greenwashing – Product Classification Challenges for Asset Managers

As mentioned in our previous post on ESG investing, unintentional greenwashing is something that every asset manager needs to avoid. In this post we explore the issues faced when categorising products for which ESG characteristics are claimed. Here we offer some suggestions for the key activities that managers can take to minimise the risk of unintentionally categorising products (e.g., claiming article 8 or 9 status when the product in question does not meet the appropriate criteria under regulatory scrutiny), particularly given the reputational damage that could be suffered having promoted an inappropriately categorised product to the market:-

- **Understand the Regulatory Frameworks:** An obvious place to start, but a deep understanding of exactly how the various regulatory jurisdictions operate in terms of product categorisation is imperative. Furthermore, firms should be aware that as ESG develops within the industry, the regulation around it is liable to change. (The ESG framework that exists in 5 years-time may be more sophisticated than the way it is now). Accept that it will evolve over time and keep abreast of changes. Perhaps more than anything else, bear in mind the intended spirit behind the regulation rather than look for gaps within it.
- **Develop a Robust ESG Product Policy:** Create a comprehensive ESG policy that outlines your various product's investment objectives, criteria, and methodology for selecting and evaluating ESG investments. Clearly define your product's ESG goals and the specific metrics used to assess environmental, social, and governance factors. Ensure that the Product Strategy is consistent with the Corporate ESG policy.
- **Maintaining the Appropriate Categorisation:** Bear in mind that over the life-cycle of the product, the ESG focus could change due to factors such as changes in the ESG worthiness of some of the underlying investments either as those assets diversify or are found to be less (or more) ESG friendly than first thought. Ensure your ESG product policy accounts for the effects of time on your product. Regularly assess and report on the product's ESG metrics, progress towards sustainability goals, and any changes in ESG classification. Provide transparent and accessible reporting to investors.
- **Select Suitable External ESG Data Providers:** Collaborate with reputable ESG data providers to access reliable and standardised ESG data that meets the needs of your products. The right providers can offer valuable insights, ratings, and benchmarks that aid in consistent classification and evaluation of ESG products. Verify the credibility and methodology of the data provider before making any decisions. Bear in mind that you must exert sufficient due diligence before using such providers and be able to justify their use in the face of any regulatory scrutiny.
- **Encourage Independent Verification:** Consider engaging independent third-party auditors or verifiers to assess and validate your ESG product classification processes. Independent verification adds credibility and demonstrates a commitment to accuracy and transparency.

- **Train and Educate Staff:** Ensure that your team members are well-informed about ESG concepts, methodologies, and the specific classification criteria for your fund. Conduct regular training sessions to enhance their understanding of ESG factors and their impact on investment decisions.
- **Seek Legal and Compliance Expertise:** Consult legal and compliance professionals with expertise in ESG regulations and reporting requirements. They can provide guidance on compliance, help interpret regulations, and ensure your product's ESG activities align with applicable laws.
- **Keep Detailed Accessible Records:** Transparency is key in proving that not only did you follow due process to ensure that your products were categorised correctly, but that any opinions, assumptions approvals, and decisions are fully documented and can be easily retrieved. You should be able to fully explain why a fund was categorised a particular way, and a comprehensive/easily accessible audit trail is the best way to do this. Those who can't, may find themselves struggling in the face of any regulatory scrutiny.

By following these suggestions, asset managers can strengthen their ability to classify ESG products correctly and consistently, enabling them to meet investor expectations and satisfying regulators that they have acted appropriately.

Please get in touch with us should you wish to discuss how ISC Ltd can help you.

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