Cleaning greenwash out of pensions

With an increased focus on ESG in both pensions investment strategies and the activities of underlying businesses in which funds are invested, greenwashing is not just an irritant but a real danger to schemes, members and trustees. David Adams reports on attempts to tackle the problem

Greenwashing is a dirty business. It could undermine efforts to combat climate change while also threatening the financial futures of pension schemes, members and savers. With more pressure from members, savers and regulators for pension pots to be invested in ways that help drive positive outcomes around environmental, social and governance (ESG) factors, these considerations are being integrated into pension scheme investment strategies. But if those strategies turn out to be based in part on exaggerated or false claims about investment funds or underlying assets, that creates financial, reputational, regulatory and possibly legal risks for schemes and trustees.

"Trustees for the most part have defined ESG factors as material and they're looking to manage them through investments," says PwC manager for the ESG pensions advisory team, Alexandra Westley. "If trustees fall victim to greenwashing it can mean risks are not managed as well as they should be."

"It damages trust; and our industry is built around trust," says WTW senior director and head of sustainability solutions, Monique Mathys-Graaff. "The more that *[schemes, funds or businesses]* set targets like net zero but don't deliver, the more we lose that trust."

Policymakers, regulators, businesses and the pensions and investment industries have all responded to the rise of greenwashing in different ways. Those responses are beginning to cohere, but only very slowly.

An evolving space

One problem is that there is some disagreement as to exactly what constitutes greenwashing. It certainly includes deliberate fraud, as when Global Forestry International marketed a fake green pension scheme invested in a Brazilian teak forestry fund. But it might also include cases where a lack of transparency has led to misunderstanding or miscommunication about the underlying assets in which funds are invested.

"It's very difficult to quantify the scale *[of greenwashing in the UK pensions landscape]*, because there hasn't been a common way of measuring the impact and reporting of green issues to a straightforward compliance regime and taxonomy," says Pensions and Lifetime Savings Association (PLSA) deputy director, Joe Dabrowski. "Different companies might assess how green a product is, or how green a company is, using different lenses. *[The underlying companies are not]* subject to consistent regulatory or reporting requirements.

"So if you're investing in multiple portfolios, invested in multiple underlying companies, dragging this information into view is really difficult. You're having to live with uncertainty as to whether a fund or an underlying company is matching up to their stated aims. But it's an evolving space – everybody's trying to improve things."

That includes The Pensions Regulator (TPR), which introduced updated guidance for trustees on managing and reporting on climate-related risks and

Summary

- Greenwashing has the potential to create financial, reputational, regulatory and legal risks for pension savers, schemes and trustees.
- It is difficult to quantify the extent to which greenwash is prevalent in the pensions system because of a lack of consistent, international, interoperable measures for carbon emissions and other environmental impacts. Such a system is developing, but only slowly.
- A focus on stewardship will also help to identify and mitigate greenwash risks.
- At present, trustees would be best-advised to continue to monitor strategies and work with advisers and service providers to identify and manage ESG and greenwash-related risks. Improving member communications will also help.

opportunities in October 2022. Trustees must calculate and report these risks using a portfolio alignment metric linked to the Paris Agreement goals for restricting global warming to no more than 1.5 degrees centigrade above pre-industrial levels. These rules were rolled out in 2021 for authorised master trusts and schemes with net relevant assets of £5 billion or more; since October 2022 they have applied to those with assets of more than £1 billion.

Those regulations are guided by the recommendations of the Taskforce on Climate-related Financial Disclosure (TCFD). But pension schemes and investment managers may also be signatories to, or be working with, the Principles for Responsible Investment (PRI), an independent, international organisation which works to help create and support sustainable markets and businesses; and has coordinated development of actions for integrating ESG issues into investment practice.

Schemes and their service providers may also be signatories of the Financial Reporting Council (FRC) UK Stewardship Code, which sets standards for investors on behalf of UK savers and pensioners to allocate, manage and oversee assets that will create long-term value and "sustainable benefits for the economy, the environment and society".

All these initiatives and tools may help to reduce the extent to which schemes and savers are exposed to greenwash-related risks. But Westley says this plethora of ways in which scheme trustees can seek to combat greenwashing can actually be split into two areas: Strategy and stewardship.

She points out that some trustees are wary of using investment strategies based in large part on exclusions, because of a perceived or real clash with their fiduciary duties. Instead, "a lot of trustees are deciding to focus on engagement".

One way to do this is to use tools such as those developed by fintech Tumelo, which helps scheme members engage with the businesses in which their money is invested. Tumelo CEO, Georgia Stewart, argues that this sort of engagement, aiming to drive change from within a business, can have hugely positive impacts, including a reduction in greenwashing. "I think the modern perception of ESG is more than just what you do or don't invest in," she says.

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Regulatory scrutiny

Meanwhile, we are also likely to see more regulatory efforts to reduce greenwashing. In October 2022 the Financial Conduct Authority (FCA) proposed anti-greenwash measures based around how terms such as ESG, green or sustainable can be used to label investment products. It suggests using three categories for labelling, including one for products that should become more sustainable over time. The proposals do not currently cover pension products, but the FCA says it is "considering how we might bring these products into scope".

However ,the current proposals, due to be finalised during 2023, may be helpful to the pensions industry anyway. "I think the FCA proposals … could be quite a leap forward for everyone using these products," says Westley.

"It is exciting to see regulators stepping into this space," says Mathys-Graaff. "It is a positive development that will prevent greenwashing, but it is also an exciting opportunity to ensure that consumers make better informed decisions about how their money is invested."

But she also highlights the need for a more integrated international approach to help reduce the potential risks of greenwashing. "It's a systemic challenge, so interoperability is key," she says. "You can only measure performance if you can trust the interoperability of the data."

Maintaining momentum

While we wait for truly interoperable standards for risk identification and climate disclosures, the best thing trustees can do, Westley suggests, is review the extent to which ESG considerations and metrics are built into their strategies. "Trustees can look at their whole strategy, at funding, at the sponsor and investment, to ask: 'How do we think ESG impacts this and what choices to we want to make?'" she says.

She also thinks communication with scheme members around ESG – and by extension, greenwashing – needs to improve. "We need to make *[reporting]* more understandable for members," she says. "We need to make sure that claims around how trustees are managing ESG risks and opportunities can be demonstrated, to ensure members can also be part of the accountability process."

The optimistic view of where all of this activity will lead is that a proactive approach, among schemes, their advisers, the investment industry and businesses in general will accelerate meaningful progress: reducing the risk of and the risks related to greenwashing, while using pension savings to help reduce carbon emissions and pollution. The alternative scenario, where businesses and consumers become more cynical about ESG credentials, isn't pleasant, at a time where we need to take every step we can to mitigate the effects of climate change.

"The direction of travel is really positive," says Dabrowski. "But it's important that we keep up that momentum."

Written by by Dave Adams, a freelance journalist