

## Will new EU regulations stop greenwashing?

### » In brief

- On 10 March the EU issued new regulation called Sustainable Finance Disclosure Regulation (SFDR) which sets minimum requirements for funds that wish to market themselves as sustainable
- This regulation does not apply to UK investment funds, but it is believed that a similar approach will follow in due course although no formal commitment has been made at this point
- The knock-on benefits to the UK industry are significant, moving it forwards by materially improving the consistency of terminology in relation to ESG and sustainable investment

Sarita Gosrani explores how new EU regulation is tackling 'greenwashing' head on, in a way that will benefit UK pension schemes despite the UK not being subject to the regulation.

Investing sustainably, with attention to the changing needs and risks of the world around us is now taking centre stage. Morningstar's data from 2020 highlights global assets invested in sustainable funds hit a record high of \$1.7trn.

The increased demand presents a massive commercial opportunity for investment managers and has led to a proliferation in products that claim to integrate Environment, Social and Governance (ESG) and sustainability into the strategy. The benefit to asset owners is a wider choice of products that are innovative and have sustainability at their core. However, it is providing a breeding ground for 'greenwashing', the term used to describe the process of portraying a fund as incorporating ESG or sustainability when in practice it does not.

With this in mind, the EU is tightening its grip on investment managers. Sustainable Finance Disclosure Regulation (SFDR) which took effect on 10 March 2021, bringing much needed transparency by imposing ESG specific disclosure requirements for investment managers both at firm and product level, within fund documentation and on their websites.

**It will require managers who market their funds to EU investors to carefully consider and classify their products into three categories as below:**

#### Article 6:

Designation for products that do not integrate any kind of sustainability into the investment process.

#### Article 8:

Light Green designation for products that promote environment and/or social characteristics provided the companies in which the investments are made follow good governance practices.

#### Article 9:

Dark Green designation for products that have a specific sustainable objective alongside generating financial returns.



*For the first time we have a set of measures that define objectively what sustainability means. This is huge step forwards, and will have benefit beyond the EU."*

**Sarita Gosrani**  
Investment Consultant & Head of ESG Research



## Investors can expect detailed disclosures from fund managers on:

- i) how sustainability related risks are integrated into investment processes;
- ii) how adverse sustainability related impacts of investments are considered in the product; and
- iii) the ESG approach undertaken e.g. screening or tilting, ESG integration, thematic or impact investing.

Whilst, the UK will not be implementing the regulation, UK investment managers that market products in the EU will fall into scope of SFDR. Given the overlap in products used by UK pension schemes, we expect trustees will benefit from this regulation. Further it is believed to be likely that the UK will follow suit with similar requirements in due course, although no commitment has been made at this point.

Within our research at XPS we assess all funds on a full range of ESG and sustainability metrics and provide our clients with scores broken down across the underlying components. Since 2019 we have supplemented this by designating funds that meet a set of stringent criteria to be 'Sustainable' funds when discussing with our clients. The SFDR regulation is a significant step forwards as it sets out minimum requirements across the industry and provides a standard threshold that all funds need to meet. This does not replace the detailed research that XPS does for our clients, but is an important step for the wider industry using a common language and routinely disclosing key information that facilitates good decision making by investors.

**So is SFDR the answer to greenwashing? At XPS we think it is a very promising start.**

*Investing sustainably needs to become the norm but for this to happen investors need to feel comfortable with how it is done in practice, and SFDR along with other regulations in the pipeline help address this issue."*

**To discuss any of the issues covered in this edition, please get in touch with Sarita Gosrani.**



**Sarita Gosrani**

**Investment Consultant & Head of ESG Research**

**t** 0113 284 8147

**e** sarita.gosrani@xpsgroup.com

**Alternatively, please speak to your usual XPS Investment contact.**

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