

Category [Thought Leadership](#)

'Competence greenwashing' could be the next risk for the ESG industry

In a world of growing short-courses and modules in sustainability, awareness does not equate to expertise, warns Kim Schumacher



by [Kim Schumacher](#) Feb 5, 2020

The 2020 edition of the World Economic Forum displayed an intriguing turning point in the way the business community views climate and environmental issues. For the first time in its history, the participants considered issues related to the climate crisis or natural resource depletion as top global economic risks in terms of likeliness and impact.

The financial sector is responding to increasing pressure from a range of developments, including more extreme weather events, notably wildfires, as well as the ongoing Fridays for Future youth protests. Asset owners such as [REDACTED] have all announced more stringent internal policies to foster ESG-alignment across their portfolios. Albeit ESG integration and sustainable finance not being new concepts in the world of finance, many institutions and organisations are still caught off-guard by the pace and intensity with which this trend is materialising across the industry. Many organisations that only had small sustainability or ESG teams prior, and those often integrated into the CSR activities, struggle to adapt to these systemic paradigm shifts.

The race for the best talent has started as expectations and regulatory requirements have been increasing manifold in recent years, notably in the areas of non-financial and climate-related risk disclosures, integrated reporting, carbon accounting, impact measurement, ESG data management, corporate engagement, or supply chain monitoring. This search for ESG experts has been posing quite unique challenges given the wide spectrum of required skillsets for ESG investment and sustainable finance positions. Numerous organisations chose to simply expand the scope of their existing CSR and sustainability operations by integrating ESG activities. Others had to build new departments from the ground up and promoted senior non-ESG personnel to newly created ESG posts, either by recruiting internally or targeting outside talent.

The financial crisis was in part facilitated by a majority of managers and analysts not fully grasping the complexities of certain financial products created by a small group of financial engineers... We need to be cautious not to repeat the mistakes of the past in the areas of ESG and sustainable finance.

Looking at the profiles of many senior ESG staff that were appointed over the last few years, one can observe a trend insofar that most ESG posts have often been filled with people with non-traditional ESG backgrounds. This is, on the one hand, laudable as it enables cross-entrants into the areas of ESG and sustainable finance. On the other hand, it raises the question about what skills are actually needed in order to manage further sectoral ESG integration. A look at profiles of ESG professionals reveals few people with natural science backgrounds, with people mostly trained in traditional financial sector disciplines such as management, business, accounting, finance, economics, or politics and law. And while these skills, in combination with traditional professional certifications, especially the ones conferred by the Chartered Finance Analyst Institute, constitute essential skills if operating with purely financial metrics and indicators, they represent only one side of the ESG coin.

Non-financial and extra-financial data are inherently different from the data that financial sector experts have dealt with before. Practitioners need to understand the complex and granular aspects of science-based measurement and verification processes beyond scope 1 and 2 emissions. However, the breadth of ESG data points is seldom fully understood, as ESG in itself is already a composite of environmental, social and governance issues that are sub-divided in multiple categories. E, for example, contains highly technical fields including climate change, biodiversity, natural capital, ecosystems, and pollution, to name a few. Scientists are often specialised in one particular area as it is virtually impossible to cover every aspect of a discipline.

Across the financial sector, ESG-related skills are now being considered essential in terms of securing a growing number of newly-created positions in the industry. Professionals see the writings on the wall now that even some of the most conservative investors have shifted their positions on ESG and consider sustainable finance and responsible investment material to their core business strategies. This has generated a high demand for qualified financial practitioners that possess solid knowledge of ESG issues and know how to take account of those in the execution of their tasks. Some recruiters specialising in ESG state that [REDACTED] or provide advice on [REDACTED]. Several recruiters and organisations state that despite the large interest, they often find it difficult to fill these specialised positions.

With the emergence of ESG investing and sustainable finance, as well as the scarcity of high-calibre talent, we see numerous financial practitioners and professionals, from entry-level applicants to C-suite veterans are now considering ESG careers or representing themselves as ESG experts. However, the absence of common minimum ESG and sustainable finance standards does not only affect frameworks; it also pertains to the rapidly increasing number of professional ESG certifications, short-term sustainable finance courses, and sustainability-related leadership programmes. It is important to bear in mind that many certificate programmes are being developed by financial sector practitioners and their emphasis is more on generating awareness and providing foundational knowledge about ESG issues among financial sector professionals without scientific backgrounds. Furthermore, the content and class materials often being proprietary, it is difficult to compare the level of granularity of the different elements being taught.

The financial sector is now tasked with integrating the highly complex realities of multiplying disasters, global warming, natural resource depletion, socio-economic inequalities and their interplays with geopolitical events into their portfolio strategies. With few scientifically trained experts at the managerial levels of large investors, how will these challenges be adequately managed? A lot of them are now relying increasingly on external ESG services and data providers. Yet, one of the main recurring criticisms about said data is that it is still not granular or consistent enough to allow reliable ESG factor consideration in portfolio management. As the primary data is mostly originating from self-assessed corporate and investor sources, such as annual reports and stakeholder surveys, portfolio and corporate ESG ratings and scores vary largely. This requires profound levels of expertise about ESG data and ESG issues in general in order to independently identify and analyse potential rating or scoring inconsistencies. This brings the question of greenwashing to the forefront,

which some ESG-aligned financial products like green bonds or climate funds have been accused of given vague definitions or misaligned use of proceeds. At times little-transparent assessment methodologies by issuers or auditors made it hard to evaluate the actual ESG impacts or risk mitigation generated through ESG factor integration.

A similar and growing risk is competence greenwashing, which pertains to ESG credentials and expertise among sustainable finance professionals. Investors need to further acknowledge the complexity of ESG issues, and the fundamental variances between numerous environmental, social, and governance factors.



K m Schumacher

History of the 2008 financial crisis and the subsequent great recession have shown that competence is key in terms of spotting and managing credit and portfolio risks. The financial crisis was in part facilitated by a majority of managers and analysts inside financial institutions, auditors, and credit rating agencies, as well as regulators, not fully grasping the complexities of certain financial products created by a small group of financial engineers. With no one wanting to spoil the party, and few admitting that they did not fully comprehend the very underlying principles of these products in question, we need to be cautious not to repeat the mistakes of the past in the areas of ESG and sustainable finance.

Currently, the complexity of ESG topics is often not represented in the ESG, sustainability, climate change, or sustainable finance teams. A large number of investors and auditors do emphasise diversity, yet their teams often count very few people with truly technical knowledge about E, S, or G issues. Many practitioners performing ESG-related activities inside financial institutions, consulting agencies, or auditors like to highlight their recently acquired credentials, such as certificates in sustainable finance or ESG from online courses or short-term training courses. While these courses do serve an important purpose and play a crucial role in generating awareness for climate and ESG issues across the financial sector, it is crucial to note that awareness does not necessarily equate expertise. Otherwise, the risks stemming from climate change and other ESG issues will be difficult to manage in a competent manner.

To address human resource imbalances, I propose five concrete solutions:

1. First, do an internal assessment of your human resources capacities and define to what extent ESG capacities are covered throughout the organisation. It entails going beyond existing CSR or sustainability capacities and identifying how dependent the organisation is on external ESG services. The complex nature of ESG and the persistent unreliability of corporate data require experts who have knowledge about financial materiality just as much as about non-financial ESG-related aspects. Given these data risks, consider to what extent these can be identified and dealt with internally, should there be inconsistencies with the data. Large asset owners such as the GPIF have described the significant variances between corporate ESG ratings from service providers. Therefore asset managers, as well as asset owners, require competent staff that are able to evaluate financial products and corporates independently based on raw data. Using a terminal or consulting ESG scores and ratings is not enough, in both active and passive management strategies. Furthermore, ESG covers a vast area of different disciplines and topics, for which sectoral experts are indispensable. An expert in biodiversity is not necessarily an expert in energy-related carbon emission reduction technologies. A development expert might have some knowledge about water issues, but that does not amount to profound expertise in hydrology. Natural scientists are not experts in human rights law.
2. Second, expand ESG training of current staff by evaluating the quality of ESG training programmes on the market, because not all programs are created equal. The content and institutional relevance of programmes vary largely, with some focusing primarily on corporate governance or disclosure, with others looking more at the financial aspects of ESG integration. The main element of any solid introductory ESG or sustainable finance certificate programme should be the science behind ESG integration, as it represents the key rationale for considering ESG factors in financial decision-making and risk management.
3. Third, certificates or short leadership programmes are not an adequate substitute for expert-level technical knowledge level that years of scientific research about ESG issues can provide. The next steps for organisations and institutions are to create diverse teams that cover that complexity of ESG factors. As non-financial data becomes more science-driven, and the topic broadens from purely financial considerations, investors and companies that are serious about ESG need to hire more people with scientific backgrounds, be it from the E, S, or G areas. The presence of these people within the ESG, sustainable, or climate change divisions will lead to 'cross-pollination' effects, wherein practitioners with financial, business, and management backgrounds will learn from their scientist counterparts, and vice-versa.
4. Fourth, not all organisations have the material or financial resources to build up or maintain large ESG or sustainable finance divisions. Collaborations with academic and professional research organisations offer a way of supplementing internal capacities with existing scientific know-how. Scientific reports like the IPCC assessment reports on climate change, which form the basis of climate action, cite scientific publications produced by academic and other public or private research organisations. These organisations produce most of the world's raw peer-reviewed and non-self-

assessed ESG-related data. Therefore, establishing collaborations and partnerships between the financial sector and the research community can be mutually beneficial. They can provide technical and scientific expertise to the financial sector while providing additional funding and internship pipelines to research organisations.

5. Fifth, in line with the plans for uniform sustainable finance taxonomies and standards, ultimately there could be some form of objective standards for ESG practitioners, similar to the bar exam for legal practitioners. This would guarantee a minimum of foundational knowledge for people in the ESG and sustainable finance sectors. The learning requirements and assessment criteria need to be transparent and could comprise a general portion, and a speciality portions respectively for E, S, and G, depending on individual skills and preferences. Organisations such as the International Standards Organisation could initiate a globally standardised test based on science and international policy principles. This does not preclude national test variations, which could take account of specific jurisdictional circumstances.

This article is not meant to be a criticism of people with financial or non-scientific backgrounds taking certificate courses in sustainable finance or pursuing careers in ESG. It is rather a call for more natural scientists being systematically integrated into financial institutions, as it would benefit the entire sector. For climate change, we listen to scientists; for ESG, we should do the same.

ESG staff diversity will help being in line with upcoming non-financial disclosure rules and materiality assessments investors and auditors need ESG specialists. For example, under the revised EU non-financial disclosure directive, the concept of double materiality in the context of reporting climate-related information, meaning the disclosure of both financial as well as environmental and social materialities, [REDACTED] will require people with particular skillsets, and having a one-size-fits-all ESG employee will not suffice.

Dr Kim Schumacher is a Lecturer in Sustainable Finance and ESG at the Tokyo Institute of Technology and a Chartered Environmentalist. He is an ESG consultant for Luxembourg's Ministry of the Environment, Climate and Sustainable Development, an Honorary Research Associate at the University of Oxford, and a committee member for ISO's sustainable finance and environmental management standards.

agged w SO ESG T a g Peo e

Copyright © 2020 RGM.