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GROUP

ESG CERTIFICATION: ASSISTING IN  
MITIGATING GREENWASHING FOR  
INVESTORS, MANAGERS, FUNDS  
AND REGULATORS



# ESG Certification: Assisting in Mitigating Greenwashing for Investors, Managers, Funds and Regulators

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Assume the following scenario: You are a fund manager that wants to make a real difference as you generate returns. You have answered the call of your investors. You have in place the due diligence, research and investment process for environmental, social, governance ("ESG") or impact investing. Yet you encounter skepticism and increasing requirements to demonstrate that you are contributing to societal good.

Your fund's ESG rubric is proven. Yet misgivings remain after other actors in the space have fallen short from the standards set in the asset management industry. For example, a university endowment with which your firm has a new possible mandate is still reeling after the board uncovered greenwashing in another set of its investments—or a pension fund your firm has been courting which has had to confront media coverage showing its recent allocations have connections to corrupt national governments. To demonstrate your ESG rubric, you need to satisfy investors and regulators that you are doing what you say you are doing. If your fund has done its side of the deal, how can the fund quantify all of this work to potential allocators and regulators?

When it comes to ESG, funds and managers are struggling to showcase and validate their initiatives. A clear framework and methodology for independent ESG reporting and certification could help overcome this issue and can increase credibility with respect to their

ESG strategies. Through collaboration among key stakeholders such as asset managers, service providers, consultants and academic researchers, the industry can strive to set the standard for what constitutes true ESG investing certification.

## The ESG Evolution

The concept of institutional investment is rooted in managing money dedicated to a community's general good and emerged alongside the rise of ancient civilisations. Examples include the Greco-Roman campaigns for the wealthy to donate a portion of their funds to public coffers or, in the medieval Islamic world, the waqf, a funding pool that would go toward developing education and public infrastructure. The earliest forms of ESG investing developed along similar lines. Those with oversight of these early institutions developed guidelines for investing in what was considered permissible according to their religious, moral or societal standards.

Socially responsible investing in the popular sense as we know it today, gained ground in the 1970s amid a societal awakening to environmental issues and outcry against the Vietnam War. Later in the decade and into the 1980s, outcry against the apartheid movement and environmental concerns such as global warming entered the conversation.

ESG awareness and investing continued to gain traction through the 1990s and 2000s, with the institution of the UN Principles for Responsible Investment ("PRI") in 2006 making the biggest waves in the asset management industry.

The PRI was the brainchild of then-UN Secretary General Kofi Annan, who had some 20 of the world's leading investment minds as well as 70 experts from across government, business, and society convene to discuss how environmentally and socially conscious investing is part and parcel of fiduciary duty to shareholders. The risks inherent in climate change, endemic corruption, and civil liberties should be considered alongside other investment decisions, as they pose as much concern to a fund's returns as do factors traditionally taken under advisement when making portfolio allocations. Essentially, as elaborated in the six principles, the investment community cannot afford to overlook ESG concerns—and it is to its benefit to embrace them when building out strategies.

As of May 2022, the PRI has 4,902 signatories, accounting for a total US\$121 trillion in assets under management. The UN encourages asset managers and service providers that have joined on to the PRI to "publicly demonstrate [a] commitment to responsible investment and [place] it at the heart of a global community seeking to build a more sustainable financial system".

These principles have spurred the evolution of sustainable, responsible and ethical investing into what it is today. Topics that were previously the focus of policy roundtable discourse have become headline news across financial forums and business media. Most importantly, these ideas have become an inextricable part of investors' evaluation process when selecting fund managers. It is no coincidence that the

board of the UNPRI includes representatives from some of the world's largest and best-performing pension funds, such as California's CalSTRS, Norway's NBIM, and Sweden's AP2.

## ESG in the Asset Management Industry Today

Those pension funds on the UNPRI were among the early adopters of ESG investment philosophies but today it is the standard for many large institutional investors to require a certain threshold of ESG-related funds in their portfolio. With allocators of such caliber driving demand, the majority of asset management firms have now, by and large, embraced such strategies.

According to K2 Integrity, a New York-headquartered consultancy, 78 percent of asset managers now incorporate ESG into their investment allocations. According to Morningstar, as of the first quarter of 2022, more than 2,000 asset managers globally handle some US\$343 billion in sustainable funds, with such strategies taking in more than US\$96.6 billion in net new deposits over the period. ESG options continue to evolve to meet the demand. Over the course of 2021, US investors launched 121 new sustainable funds, bringing the total available to US investors to 534, marking year-on-year growth of 36 percent.

European asset managers, in particular, have been at the forefront of the ESG investing wave, with regulations and disclosure requirements further ensconcing these principles into portfolio construction. The EU's Sustainable Finance Disclosure Regulation ("SFDR"), which first entered into force in December 2019 and began to apply across the 27-nation bloc since March 2021. The EU's Taxonomy Regulation, which has been phased in since the start of 2022, builds upon the SFDR to stipulate that "financial market participants," which includes alternative investment fund managers, portfolio managers, and UCITS, to disclose the proportion of environmentally sustainable business allocated in the portfolio compared to other investments. Within the UK, the country's Financial Conduct Authority rolled out its own set of rules late last year alongside the Recommendations of the Task

Force on Climate-Related Financial Disclosures. Also in the works is a proposed sustainability disclosure regulatory with products and firms to be labelled according to how climate risk gets factored into investment and corporate decisions along a five-level system ranging from "not sustainable" to "impact." These advancements across Europe are expected to influence US regulation as well. Stateside, the SEC's push in March for ESG disclosure in portfolios has put managers on alert.

While these developments have been positive for both managers and investors, the research needed to assess which investments are truly ESG-compliant and which are tantamount to greenwashing is burdensome. It is estimated that US asset managers spend over US\$200 million on ESG research each year. For the boutique manager and the major market maker alike, the time and cost associated with discerning if a fund is meeting its ESG mandates can be prohibitive. While regulators have drafted outlines to set some ground rules on ESG, there remains no clear consensus in many cases on what constitutes ESG investing and what is merely portfolio lip service. In some cases, overselling a financial product could be intentional, but more often, a misalignment on ESG could be a matter of differing perspectives between the buy-side and sell-side on what constitutes compliance.

## The Independent ESG Certification Solution

An independent ESG evaluation and certification could address this problem and can support better alignment between managers and investors – and regulators – when making allocation decisions. Instead of managers self-reporting, independent certification would provide a thorough review of their approach and processes to help validate and quantify ESG initiatives and ensure they are following through on their commitments.

Tools that employ industry best practice, take the highest industry standards and global regulations into consideration, and harness the perspectives of the leading ESG legal, investment, operational, compliance and technological minds can help pave the way for a

beneficial shift in the industry. At the moment, however, the industry remains reliant on self-certification by funds and managers. How could such a shift come about?

K2 Integrity, in partnership with the Maples Group, has collaborated with leading investment managers and academics from such renowned institutions as Cornell, Carnegie Mellon, Columbia, and University College-London to develop a robust, thorough, meaningful and independent ESG assessment certification for fund managers and funds.

The result is a unique, first-of-its-kind product for independent ESG certification for alternative investments that is forward-thinking, innovative and inherently designed to evolve with the industry. Fund managers can look to this tool for guidance on allocations that meet ESG credibility standards and are aligned with industry best practices and jurisdictional regulations. This approach allows fund managers to feel confident that their investments are contributing to the common good. In other words, institutional investment as it was originally intended.

## About the Authors

### Mark Weir

Mark Weir is the Deputy Global Head of Fund Services at the Maples Group and a member of firm's Executive Management Team. Mark has specialist experience in providing operational, compliance and technology solutions to institutional investors, hedge funds and private asset funds across the US, Europe, Asia and the Middle East. He is the chairperson of the Group's European (AIFMD and UCITS) management company business and also has oversight of the Group's middle office services offering, fund administration teams and anti-money laundering centre of excellence. In addition, Mark has responsibility for the global business technology, data management and programme management office teams.

Mark has in-depth knowledge of the European ESG landscape and has spearheaded the development of

new ESG solutions for the firm's clients. He has authored several articles and has been asked to speak at various industry events on topics relating to institutionalising operations for various fund and investor types and how technology can support investment decision-making and compliance.

### Andrew Rabinowitz

Andrew Rabinowitz is the Co-CEO and member of the Board of Directors of K2 Integrity. Over the past 30 years, he has served as a consultant, lawyer, co-founder of RBaby Foundation, which help to create the standard for pediatric emergency rooms, and President and COO of a global multibillion-dollar asset management company he helped lead and grow. A core focus throughout his career has been issues surrounding diversity, inclusion, philanthropy, equality, justice, good health and well-being, innovation and infrastructure. He came to K2 Integrity to create and start an ESG business. He has a strong commitment to ESG, and believes certification, education and training is the next step in ESG evolution.

### Neelam Sharma

Neelam Sharma is Chief Business Development and ESG Officer at K2 Integrity. She has more than 15 years of experience developing custom programmes that help clients address evolving risk and regulatory landscapes. Her expertise and skills support the scalability and market adoption of K2Integrity's ESG offering. Her objective is to oversee the development of artificial intelligence / machine learning algorithms to support the automation, scalability and repeatability of K2 Integrity's ESG program.

## About the Maples Group

The Maples Group is a leading service provider offering clients a comprehensive range of legal services on the laws of the British Virgin Islands, the Cayman Islands, Ireland, Jersey and Luxembourg, and is an independent provider of fiduciary, fund services, regulatory and compliance, and entity formation and management services. Our team of highly experienced lawyers and professionals work with leading investment managers and institutional investors around the globe to implement ESG policies and frameworks into their operational infrastructure. This is further supported by market-leading solutions for ESG data, reporting and certification, as well as an ESG-specific ICAV platform for European distribution. In addition, the Maples Group has the expertise and services to offer additional legal structures to an ICAV including, trusts, partnerships or contractual funds, and to provide these solutions in either Ireland or Luxembourg. The Maples Group distinguishes itself with a client-focused approach and adaptable solutions that create value and enhance effective management.

## About K2 Integrity

K2 Integrity is the preeminent risk, compliance, investigations and monitoring firm, with a global reputation in helping clients address their risks, regulations and compliance requirements through investigations, analytics, advisory excellence, independence and insight. These core capabilities are embedded into our ESG certification. K2 Integrity has a longstanding history of developing governmental legislation and policies, as well as a proven track record in assessing, designing, and implementing certification and training. We leverage global regulatory standards and apply our relevant risk assessment and "gap analysis" tools to monitor and address the evolving ESG landscape.