New investment labels aim to help savers spot sustainable products—but won't always stop greenwashing

December 10 2023, by Stephanie Giamporcaro and Jean-Pascal Gond

Credit: Pixabay/CC0 Public Domain

From the nutritional traffic light system displayed on a box of cereal, to the efficiency ratings we look at when buying a house, ratings and labels help us work out how to spend money responsibly. A new scheme from the UK's financial regulator also aims to use them to help you invest responsibly.

The Financial Conduct Authority's (FCA) first sustainable investment labeling regime is part of a larger sustainability overhaul kickstarted by the UK government in 2021. This also includes the creation (still to be finalized) of a green taxonomy for UK companies—a set of thresholds and targets to gauge whether products or activities meet sustainable objectives.

The UK is not the first country to do this. In Europe, there are already several labeling schemes for investors in France, Belgium, Austria, Luxembourg and the Nordic countries. The French label was launched in 2016 by its treasury and has so far gathered the largest amount of assets under management.

Governments can play an essential role in ensuring financial markets become more sustainable and that the world remains on a 1.5°C trajectory for limiting climate warming. Our research on French sustainable investment labels suggests this is an innovative way for governments to help investors address their sustainability concerns.

Labeling challenges

Before these schemes, governments largely used principles or rules-based disclosure regulations to steer business towards sustainability. Such regimes encourage or mandate companies to disclose how they deal with environmental, social and governance issues. State-coordinated labeling regimes are a much more hands-on form of regulation.

The UK's new scheme will offer four sustainable labels to help consumers make choices about how to invest. Once firms are able to start using the labels in July 2024, investors can choose from: sustainability improvers, sustainability focus, sustainability impact and sustainability mixed goals. The categories were tested for two years using consumer research and stakeholder consultancy.

The FCA labeling regime is particularly interesting because its designers were able to learn from Europe's Sustainable Finance Disclosure Regime (SFDR). This scheme experienced challenges since launch in March 2021. It was conceived as disclosure-only, but ended up being quite prescriptive on technical sustainability requirements. As a result, the investment industry has been using the SFDR as a de facto labeling scheme.

Some market players have also used the SFDR as a marketing opportunity. They rebranded investment products using the word "sustainability" without equipping their investment strategy with evidence-based sustainability objectives.

As a result, what was designed as a pioneering regulatory tool that aimed to bring transparency and comparability to the industry ended up being seen—by investment companies as well as consumers, trade associations and regulators—as amplifying the risks of greenwashing and creating confusion for consumers.

These teething problems led the European Commission to announced a new consultation on the SFDR, which will close in December 2023.

Can the UK do better than Europe?

The FCA's sustainability labeling regime is explicitly aimed at fighting greenwashing. Funds will be required to use specific wording to gain authorization to sell products labeled sustainable. These funds will need to state their sustainability objectives and provide key performance indicators to show these objectives are on track.

For the sustainability focus category, in particular, the FCA wants objectives to be supported by an evidence-based set of indicators (most likely the UK green taxonomy, although it has not been finalized yet). However, because the FCA labeling scheme is deeply rooted in a principles-based approach, it will leave the definition of sustainability to the investment companies rather than providing one, as the European Commission has done.

In France, to qualify for one of these labels, funds must be audited by a third party. But the FCA has chosen to leave investment companies to decide whether to audit internally or through a third party. The FCA will provide authorization but will also monitor products to identify potential breaches.

Another striking difference with the UK labels is that the FCA does not take a position on fossil fuel exclusion. Until recently, France didn't either, but earlier this year, its minister of economic affairs, Bruno Lemaire, announced its label would now exclude fossil fuels to avoid consumer confusion when trying to invest sustainably.

This could also be a sticking point for British consumers who want to match their values with the contents of their investment portfolios.

Research on sustainable investing

The FCA has used consumer research to gauge British interest in sustainable investing, as well as the label system. The research showed consumers wanted labels with a grading system—similar to nutritional labels for food. Those surveyed also thought one label would be easier to understand than several.

So, it's interesting that the FCA has decided to opt for neither of these preferences. It has also said its four labels should not be seen as a hierarchy. Of course, the FCA will be keen to avoid the fate of the EU SFDR in this respect: some investment firms have spent the last two years trying to strategically upgrade and downgrade their funds in the so-called "light green" and "dark green" categories to avoid greenwashing accusations.

Of course, the FCA's ultimate aim with its labeling regime is to protect consumers from greenwashing. But the European experience certainly shows this is a difficult task, even with disclosure regulations and labels designed to guide investors.

Provided by The Conversation

Citation: New investment labels aim to help savers spot sustainable products—but won't always stop greenwashing (2023, December 10) retrieved 8 May 2024 from https://phys.org/news/2023-12-investment-aim-savers-sustainable-productsbut.html