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18/05/20

Sustainability: "Beware of a pig in a frog suit"

[L. Burke Files DDP](#)[CACM, President,](#)[Financial Examinations &](#)[Evaluations, Inc](#)[\(/articles/authors/l-](/articles/authors/l-burke-files-ddp-cacm-president-financial-examinations-inc/)[burke-files-ddp-](#)[cacm-president-](#)[financial-](#)[examinations-](#)[evaluations-inc/\)](#)[< \(/articles/2020/june/the-new-eu-blacklist-and-other-inventions-of-the-seriously-deluded/\)](/articles/2020/june/the-new-eu-blacklist-and-other-inventions-of-the-seriously-deluded/)[> \(/articles/2020/april/cayman-in-grand-court-decision-reinforces-effective-cooperation-in-cross-border-disputes/\)](/articles/2020/april/cayman-in-grand-court-decision-reinforces-effective-cooperation-in-cross-border-disputes/)**Cayman****Grand****Court****Decision****Re...**



As I was researching this article and making grumbling noises, my son asked me, "Dad, what are you writing about?" I cheerily replied, "Sustainability and the hedge fund industry." His further inquiry was – "What type of sustainability? Energy, environment, biodiversity, climate, gender parity, culture?" I smiled back and said, "Yes, I think all of those".

His comments clued me into seeing "sustainability," the way it is being used is a suitcase word.

A suitcase word is a word that has packed into it a lot of multiple meanings and emotions such as consciousness, morality, experiences, and right and wrong. Suitcase words are the type of words that are most likely to cause misunderstandings and conflict.

They also, when one tries to define them, are most likely to cause defensive reactions to any questioning.

Type in "Hedge Fund Sustainability" as a search term and what is displayed is a load of disambiguated thoughts, ideas, feelings, definitions, myopic viewpoints - in short, rebels without a clue. The idea of one definition of sustainability and how to account for sustainable actions and generate reports that swoon to that awful tag line of the "triple bottom line of – planet, people, and profit" is a miasma. (See side bar on competing standards) As they stand, the standards are confusing, contradictory at best, and mostly counterproductive. The confusion and contradictions cause another problem in a company's strain to meet a moving target, and that is called Green Washing, but we will get to that.

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It seems there are many axes to grind: climate action, cultural diversity, biodiversity, corporate social responsibility, environmental stewardship, sustainable development, sustainable fashion, climate change, data security, food security, social reporting, responsible consumption, and all followed by that awful triple tag line. Ok, I sound like a Grinch, maybe a bit. I, for one, am a champion of opportunity for all regardless of gender or background. Why? It is fit and proper and profitable! Why should a business hire someone who is less qualified because they belong to all of the nice county clubs?

I am simple. As an investor, I demand profit, not prophet. As long as my investments are not involved in illegal activity, I am fine. Why would I prefer to invest in a company with a lower profit margin because they use green energy that costs three times as much? Why would I buy into a company that only hires one gender, or race, or religion? I want the best people – period.

It is the bottom line for me. Why do I want to invest money in a company that is sacrificing itself to climate change? I am investing for profit.

Despite my impeccable reasoned view, investors are now selecting in favour of funds that only invest in sustainable companies. Investor pressure is driving fund managers to select for and invest in companies that report to be sustainable. In my last unscientific survey of Fortune 500 company literature, it appears that about 77 per cent have some reporting on sustainability. Again there are so many competing standards and opinions it leaves companies open for improper reporting, but improper according to who? The discontinuities in what is and is not sustainable are an open invitation to mischief. This chasm of interpretations is, in part, what led the NY Attorney General to file a Securities Fraud lawsuit against ExxonMobil, alleging allegations that ExxonMobil misled investors about the risks posed to its business by climate regulations.

"Justice Barry Ostrager sided entirely with Exxon on the claims brought against it by the New York Attorney General's Office, saying that he found all the company's witnesses to be truthful and that the state had failed to present any evidence that convincingly cast doubt on their testimony."

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While he praised Exxon's executives for "rigorously discharging their duties in the most comprehensive and meticulous manner possible", the judge excoriated the attorney general's case, saying it failed to establish that any investor was misled." [i]

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In short, Attorney General Letitia James and her staff "failed to establish by a preponderance of the evidence" of any shareholder fraud. Since there was no one required standard on what is, to this date, mostly voluntary reporting, how can anyone be found guilty? The mischief of litigation for publicity is and will continue to be a problem.

Many companies are doing an outstanding job of mischief in something called "Green Washing." The companies make their company seem much more environmentally friendly through public relations stunts with *de minimis* changes to actual operations. *Truth in Advertising* named and shamed 11 different companies for green washing.

"There's nothing clean about diesel engines that spew pollutants at levels way over the legal limit. But that seems to be the scandal of the day in the automotive industry.

Volkswagen's emissions-cheating scandal in which it admitted to rigging 11 million of its own "clean diesels" with devices designed to cheat emissions may have garnered the most headlines, but several car manufacturers have faced similar allegations in recent years, including BMW, Chevrolet, Ford, and Mercedes-Benz. In the case of Mercedes-Benz, class-action plaintiffs alleged that the luxury carmaker's BlueTEC vehicles, which are marketed as "clean diesel" and "Earth friendly," release nitrogen oxides at levels more than 65 times higher than what the EPA allows." [ii]

This is to be expected, not accepted, but expected. There is increasing pressure to be seen as green. There is an increased demand for green companies, there is fractured regulatory pressure, and unfocused investor sentiment that leads to mere cosmetic changes. So what do most companies do? They select the most reasonable standards to which they can compare themselves to without actually changing their business model. They just claim to be green. The companies prepare nice four-coloured brochures, with

pictures of trees, fish, fields of grain, a picture of the sustainability team, a letter from the Chairman, and one last shot of a happy family with a puppy playing in an outdoorsy place for good measure. The better looking the brochure, in my book, the more likely it's green washing.

Of all of the standards I have read, the most comprehensive and thorough are the standards set forth by the Sustainability Accounting Standards Board (SASB). The least helpful are the UN's Sustainable Development Goals (SDG). The SASB took time and focused in on measurable events and choices. They have also taken the time to develop sustainable standards for a variety of industries, as one can presume there is a world of difference between standards for mining as opposed to professional services. What is very disheartening is you, as a company or a fund, cannot use the SASB standards unless you, or your sustainable auditor, pay the SASB for the right to use their standards. As for the UN, they cobbled together a bunch of inchoate wants.

So, is the whole sustainability thing working? No. It is nice to say one's business is sustainable as opposed to not sustainable. This is part of the emotions generated in a suitcase word. It should be nice, but it is not. There are just too many competing standards, too many opinions, and social causes that frankly, businesses are not designed to address. Much of what is being desired under sustainable is rightly the function of law that either enables or prohibit certain activities.

Sustainable reporting is expensive. It is not affordable for most. Many experts talk about how sustainability is profitable. Again, the push back as the data shows that most of the companies that have initiated sustainable development or actions have found it is not profitable. What many companies focus on are small changes crowed as major achievements such as using recycled paper, capturing rainwater, buying electric vehicles, and smacking on the roof a few solar panels. It is an act in public relations and virtue signaling. The standards also draw in elements not though as sustainable activities such as data security, gender, and race diversity, and professional integrity. Many of these elements are already required, albeit in a different form, by SOX, the General Data Protection Regulation (GDPR), any one of a number of national hiring and recruitment standards, and good governance.

So if one is looking to invest in sustainable business, what does one need to look for? A clue that the business may not be working at sustainability would be the aforementioned coloured brochure. A clue that the company is working at sustainability would be a formatted report, much like an audit, discussing what they are doing, the financial and operational impacts of their sustainable initiatives, and someone prepared to discuss their work who is not a media relations person. The report will also discuss which standards the company chose to use to compare its operations and results.

In all honesty, as fund managers and directors, we look to the company for the company's self-disclosure and discussion of their financials and sustainability. If they claim to be sustainable and they have the colour brochure, that may be good enough. The risk we take is the gap between any claim made about our sustainable investment strategy and our diligence in confirming the claims made by a company in which we have invested.

So, I am going to invest for profit. I assume, in most cases, the company is engaged in legal businesses, and yes, there are some industries in which I will never invest. If laws change, the burden of sustainability compliance will fall equally to all, as opposed to profit self-sacrifice. From my increased earnings based upon my choice to invest for greater profit, I can use a portion to donate to the charities and causes I choose.

Might there be a pig under the shiny green frog skin? For now it is most likely.

Side Bar on competing concepts and standards, there are more

European Green Deal and building on the 2018 Action Plan on financing sustainable growth, the European Commission (EC) has launched a consultation on its renewed sustainable finance strategy.

European Commission launched an initiative to review the European Non-Financial Reporting Directive.

The European Lab Project Task Force on Climate-related Reporting has issued, 'How to improve climate-related reporting – A summary of good practices from Europe and beyond'.

UN's ISAR reporting in Sustainable Development Goals (SDG)

ISO 14001 is the international standard that specifies requirements for an effective environmental management system (EMS)

ISO 26000 is defined as the international standard developed to help organisations effectively assess and address social responsibilities that are relevant and significant to their mission and vision; operations and processes; customers, employees, communities, and other stakeholders; and environmental impact.

ISO 14001 is an Environmental Management System (EMS) which gives organisations a systematic approach for measuring and improving their environmental impact.

Sustainability Accounting Standards Board (SASB) has established industry-specific disclosure standards across environmental, social, and governance topics that facilitate communication between companies and investors about financially material, decision-useful information.

The Global Reporting Initiative (GRI) promotes the use of sustainability reporting as a way for organisations to become more sustainable and contribute to a sustainable global economy.

The Climate Disclosure Standards Board (CDSB) seeks to promote and advance climate change-related disclosure in mainstream reports through the development of a global framework for corporate reporting on climate change.

The International Organization of Securities Commissions (IOSCO) board has published a report on 'Sustainable Finance and the Role of Securities Regulators and IOSCO'. The report was prepared by the IOSCO's Sustainable

Finance Network (SFN) and notes as one aspect multiple and diverse sustainability frameworks and standards, including sustainability-related disclosure.

One can add to these standards many more specific standards, such as FairTrade, Rainforest Alliance, Organic, etc.

Footnotes:

[i] Inside Climate News, December 10, 2019, <https://insideclimatenews.org/news/10122019/exxon-ruling-climate-investor-fraud-new-york-case-impact> (<https://insideclimatenews.org/news/10122019/exxon-ruling-climate-investor-fraud-new-york-case-impact>).

[ii] Truth In Advertising, April 17, 2020, <https://www.truthinadvertising.org/six-companies-accused-greenwashing/> (<https://www.truthinadvertising.org/six-companies-accused-greenwashing/>).

ABOUT THE
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Mr. Files is President of Financial Examinations & Evaluations, Inc. He is an international financial investigator and due diligence expert who has run cases in over 130 countries and has visited over 100 countries. Mr. Files has tackled investigations running from a few hundred thousands dollars to over 20 billion. Along the way he became familiar with the knowledge of what people need to do, for due diligence, preventing corruption, and to avoid helping criminals launder money. He brings this experience of hands on investigating and problem solving experience to his lectures on Due Diligence, AML, and Anti-Corruption. Prior to founding FE&E, Inc. he served as the Director

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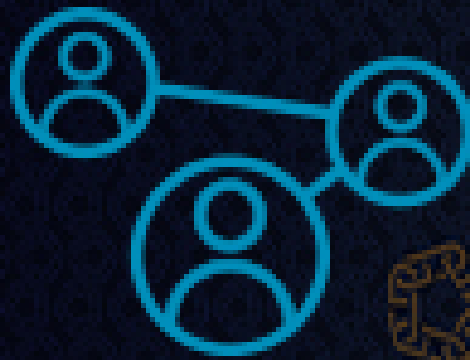


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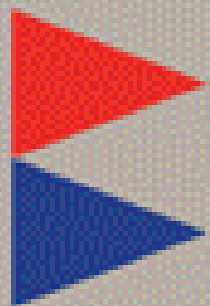


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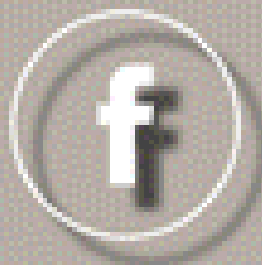
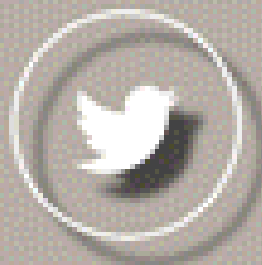
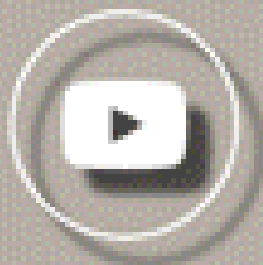
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