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Greenwashing (manifestation and prevention): Part 1: Manifestation: ‘How green is your wash?’

In this article, Jeremy Irving examines the form and nature of greenwashing as submitted in the June 2021 International Organization of Securities Commissions (IOSCO) report.

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Introduction

In June 2021 the International Organization of Securities Commissions ("**IOSCO"**) published a report: CR01/2021 Recommendations on Sustainability-Related Practices, Policies, Procedures and Disclosure in Asset Management (iosco.org).

The report considers the manifestations of ‘greenwashing’: “*the practice ... of misrepresenting ... sustainability-related practices or the sustainability-related features of ... products*”.

While the report focuses on the asset management sector, it is likely to have a fundamental role in the development of regulatory activity that seeks to instil environmental, social and governance ("**ESG"**) sustainability and responsibility in financial services ("**FS"**) markets in general. IOSCO’s website states its membership of regulatory bodies regulates more than 95% of the world's securities markets in more than 130 jurisdictions, including the UK’s Financial Conduct Authority.

This article examines the form and nature of greenwashing; a further article will examine its prevention.

Why wash green?

As IOSCO puts it: “*Across all sectors and industries, companies depend to varying degrees on natural, social and human capital to create and preserve enterprise value. These assets are not always captured on company balance sheets but can be critical for value generation. Companies’ dependencies on these assets, and how they protect and contribute to the stewardship of these assets, can therefore inherently influence investors’ decisions. For example, where companies depend on ecosystem goods and services that flow from natural capital assets – such as air and water filtration, food and water production, and climate regulation – investors would benefit from disclosures on the management of these dependencies to make informed decisions.*”

IOSCO states that “*Sustainability-related financial products, including green bonds, social and sustainable-linked bonds, green mortgage-backed securities, green loans, and sustainability-linked loans, have ... proliferated* ... [For example] *ESG-oriented investors ... [in] the first quarter of 2021, [generated] equity funds ... inflows in Europe* [of] *USD 89.8 billion, followed by fixed-income offerings* [of] *USD 33.7 billion ...*”

As firms seek to meet the growing demand for ESG products, IOSCO refers to a “*temptation ... to take advantage of consumers’ favourable view of* [such] *products ... without designing or modifying ... products and services* [to have] *a real impact.*”

Shades of greenwash

IOSCO comments on greenwashing at both a firm (enterprise-wide) level and product level.

With the aim of creating a condensed and easily-used framework, we have taken IOSCO’s examples and categorisation of greenwashing activity and ascribed gradations of apparent green ‘colour’ within the ‘wash’.

1. ‘Green in name only’

This type of wash can be seen where firms fail to live up to ESG-related legal, regulatory or public obligations or commitments.

IOSCO cites the 'Point of no Returns' study by Shareaction finding that 51% of asset managers that were signatories to the UN Principles for Responsible Investment

- “*showed little evidence of appropriately integrating responsible investment across their assets* ...
- [and those which had] *expressed support for the*Task Force on Climate-Related Financial Disclosures [“**TCFD**”] *framework but* ... *not yet published a report in accordance with the framework, only 38%* ... *were planning to do so in the next reporting year*”.

On TCFD disclosures, the FCA has asked for feedback next month on its consultation papers (see eg CP21/17 for asset managers, life insurers, and pension providers).

2. ‘Superficial green’

This wash can be seen in inconsistencies between a firm’s stated or implicit position, and its actions, on ESG issues – eg:

- no or only token gender, ethnic and other social diversity at the executive level;
- nominal management structures and processes for ESG issues that have no substantive operational empowerment or function (eg an ‘ESG risk committee’ that has no means of preventing greenwashed marketing messages for products).

Another example is where a product includes “ESG” or “sustainability” in its name, but:

- “*its investment objectives only state that it seeks to* [invest in] ... *global equity securities* ... [o]r *mining and oil, and the investment strategies disclosure does not* [clarify when] ... *this could happen,* [or] *why*”; or
- “*only uses a limited negative screening strategy to exclude investments in* [certain] *controversial* [sectors, eg] *weapons and does not materially consider ESG factors in the rest of its investment strategies*”.

3. ‘Unclear green’

“*A product’s marketing materials indicate that the product uses corporate engagement, proxy voting and shareholder proposals to achieve its socially responsible investment objectives, but the product’s prospectus does not disclose these approaches in its investment strategies disclosure, and the summary of the product’s proxy voting policy disclosed in the product’s disclosure documents does not explain how proxy voting is used to meet its socially responsible investment objectives.*”

“*A product claims that every euro invested in it will directly lead to the delivery of a certain number of health appliances for poor communities, without providing evidence for this claim.*”

IOSCO notes that occurrences like these comprise “*one of the most prevalent types of greenwashing* ... [The 2019-Paper-by 2^investing initiative asserted that of] *85* [EU investment] *products* [that] *made impact claims in their marketing* ... *only 2* ... *were* ... *not* ... *misleading.*”

4. ‘Blantantly pseudo-green’

“*A product claims to use a negative screening investment strategy to screen out all companies that are involved in the oil and gas industry, but the product’s portfolio in fact holds securities of companies in the oil and gas industry*”.

“*A product claims that* ... [it] *will achieve greater* [CO2] *reductions than from recycling, going vegan or not driving a car, despite a lack of evidence disclosed to substantiate the claim, as well as a lack of explanation of how such impact is being calculated or measured* ...”

Greenwash ingredients

Who’s rating the ratings?

IOSCO comments on the “*proliferation of* ... *ESG rating providers and* ... *the lack of reliability and consistency in ESG data and ratings* ... [including] *a lack of transparency about* [their] *methodologies* [especially if] ... *providers themselves rely on information from corporate issuers*”: “... *there may be systemic over-reliance* ... *on opaque ESG data and ratings* ...”

A green ‘Tower of Babel’?

IOSCO also notes the absence of “*agreed-upon definitions for* ... *sustainability-related* [concepts], *such as “impact fund”, “sustainable fund”, “social fund,” “low carbon funds” and “Paris-aligned funds”* ... [or even] “*ESG strategies such as “ESG integration” and “negative* *screening".*"

Materiality is material

As IOSCO recognises: "... *different* [reporting and disclosure] *lenses have been associated with the differing information needs of investors (financial materiality) vis-à-vis other stakeholders, such as customers, employees, suppliers and civil society* ([ESG] *materiality). Reporting on both dimensions is often referred to as applying a double materiality lens.*"

"*The ... Alliance of Sustainability Reporting Organisations ... has recently demonstrated that materiality is in fact a dynamic concept. Sustainability-related topics may become more material over time in response to changes in ... operating environments and investor expectations. The distinction between investors and other stakeholders' information needs ...* [by reference to] *'enterprise value' and 'impact' is not helpful for defining information that will help investors determine enterprise value.*"

Skills shortage

IOSCO has also found that "*The skills and expertise required to ... integrate sustainability-related risks and opportunities are another significant challenge ... and ... are important components in* [setting and using] *sustainability-related metrics ... risk management procedures and ... prevent*[ing] *greenwashing.*"

Conclusions

The IOSCO report is evidence that FS markets are not yet meeting properly the hopes and expectations of customers for products that contribute substantively and effectively to environmental, social and governance sustainability and responsibility. Meeting these expectations will involve a 'supply / demand' dialogue between investors and FS firms' senior managers. Our next article will address what this dialogue needs.

This article was first published by Thomson Reuters.

Read Part 2: The genesis of 'ESG Compliance' →

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