# Greenwashing: Let’s be real!

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Greenwashing has entered the investment industry lexicon with a vengeance in recent years. With the dramatic growth of ESG investing – at least until 2022/23 – it is perhaps not a surprise that many products do not (yet) meet the claims of investment providers. Through the whole value chain financial organizations are considering how to protect themselves from accusations of greenwashing. With European regulators set to issue a joint report on greenwashing in May 2024, regulatory risk – with financial and reputational consequences – is set to be “top of mind” in the coming years.

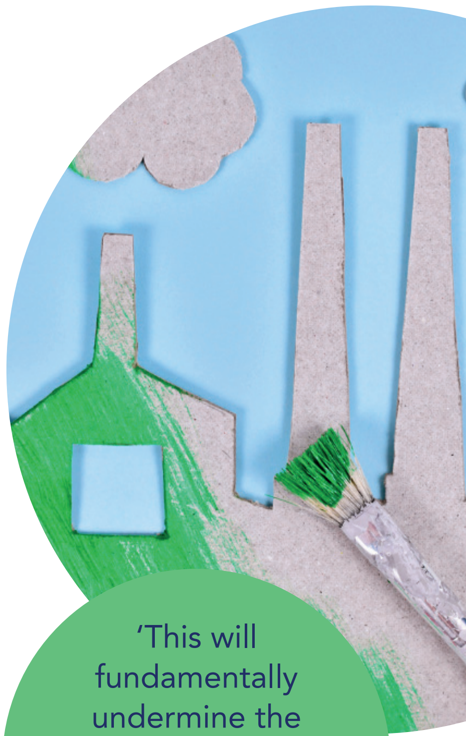
## Trust at risk

However, the conversations around greenwashing should not simply be about regulations and compliance, but also about ethics and integrity.
Greenwashing fundamentally challenges the trust placed in the financial sector. More than that, however, greenwashing can lead to a misallocation of capital. Investors allocating money with the intention to actively contribute to sustainable environmental or social outcomes may inadvertently be supporting companies which are responsible for the harmful activities they are seeking to address. This will fundamentally undermine the ambition of such investors - and policymakers - to address our societal and environmental challenges. And thus ultimately the confidence of clients and perhaps society as a whole in ESG investing.

## Disconnect of expectations versus reality

There is a clear disconnect between retail investors expectations when they allocate their savings to sustainable investment products and the real-world outcomes of that investment. How can industry stakeholders bridge the gap between the esoteric terms used in ESG investing – made worse by the pained terminology of the regulations – and their end customers? Investment firms, banks and advisors should be very clear about their definition of what is sustainable or “green”.

For example, investing in the gas industry may be green according to the EU Taxonomy, while this may be different in the mind of the end customer.



‘This will fundamentally undermine the ambition to address our societal and environmental challenges’

## Communication challenges

Greenwashing isn't just a communications problem. Commitments typically begin at the CEO and Board level. Investment, marketing, and compliance teams are sometimes left trying to meet promises made in annual reports, interviews or even social media, which have not been worked through completely. Communication professionals are ultimately transmission channels for the strategy and business model of their organization and need to align with the top-down objectives.

## Transparency is not the silver bullet

Sustainable Finance regulations have a key role to play in curbing greenwashing, but currently they may be contributing to the problem and not providing a solution. By focusing on disclosures and yet not providing precise definitions they have added to the confusion. The assumption is that transparency will allow investors to compare all products and make informed choices… and investors will then choose the most sustainable funds. But the evidence is that many retail investors – and indeed professional investors – find the regulations too confusing to navigate, do not have the time or inclination to read reams of pages of small print, or compare hundreds of competing investment products. And yet even this skirts the real issue that ultimately the vast majority of investment funds are not going to have world changing outcomes. Despite their claims and labels.

## The data swamp

The sustainable finance regulations also place a heavy emphasis on being able to substantiate the sustainability claims of investment products. This has put the availability and quality of ESG data at the heart of sustainable investing. But as the ESG data industry has exploded, so the purpose of the data becomes blurred. Which of the thousands of data points being reported actually prove whether an investment is sustainable? Clearly there needs to be some objective evidence to back up the sustainability claims of the investment provider. But there is a growing risk that the purpose of the data is being lost under the sheer volume, with ever diminishing returns. And yet the common refrain is that more data is needed. To what end is no longer clear.

## Back to reality

Perhaps the whole industry – including the regulator – is guilty of intentional greenwashing by implying that an investment fund is going to end global warming, bring about equality and save the rainforests by simply investing in companies which are trying to do 'less bad'. Greenwashing shouldn't kill our sustainability dreams, but both the industry and the regulators need to temper its claims with reality. We need more focus on actual goals.

'By focusing on disclosures and yet not providing precise definitions the regulations have added to the confusion.'

# Call to action

## 1. Communication: more alignment needed

Greenwashing is more than just a communication issue but the disconnect between industry definitions and investor expectations is still a problem. Retail investors often expect direct outcomes from their investments (return on investment ánd a better world). Sales and marketing communications need to be clearer about the real-world impacts and limitations of investment products. Often sustainability labelled funds do not actually contribute directly to sustainability goals but merely do no harm to the planet. Communication professionals are ultimately transmission channels for the strategy and business model of their organization and need to align with the top-down objectives.

## 2. Stop pledges & commitments: openly discuss the outcomes of investment

There needs to be a more honest dialogue and it should come from the top of organizations. Perhaps more effective sustainability leadership is not through making long-term commitments which cannot be met, but in openly discussing what can and cannot be achieved by allocating capital to traditional investment funds and what choices and tradeoffs need to be made along the way. Involve the whole organization in this dialogue.

## 3. How to define sustainability: ESG as a lens

The investment industry needs a common understanding of what is sustainable. Many professionals may not themselves know what sustainability really means. ESG is a lens through which to understand factors which contribute to sustainability, and not sustainability itself. The industry can explicit the consequences of speeding up the process to, for example, the road to a carbon neutral economy and what choices and tradeoffs need to be made to get there.

## 4. Transparency distracts: policy action should be more direct

The sustainable finance regulations such as SFDR do not automatically lead directly to greater sustainability. Sustainable disclosures should not be considered as a substitute for more direct policy action such as taxes on carbon or incentives for clean energy. EU policymakers are putting far too much emphasis on financial market rules to deliver their sustainability goals. Bolder action is needed, the financial markets are not the drivers but the enablers.

## 5. Better regulation instead of more

We need better regulation, not more. Whilst acknowledging the inherent limitations of the disclosure frameworks, significant improvements are still required. The lack of additionality – and with it real-world contribution to sustainability – is not addressed or clearly communicated. The strong evidence is that the SFDR is not used in the way it was designed to be used and poorly understood by retail investors (and some professional investors) and may be an impediment to sustainable investments. The introduction of fund categories is an improvement but there is still a lag in clear causality between investment and outcome.

# Call to action

### 6. Sustainable investments must have a realistic risk profile

Sustainability outcomes cannot be achieved without more risk, as measured by traditional risk tools such as tracking error. Investment committees are more wary about products with higher risk profiles. However, there are currently a finite number of companies which deliver real sustainability outcomes. Be wary of sustainable funds with similar risk profiles as traditional products.

### 7. Navigate the data swamp

Data is necessary to support sustainable investments by demonstrating delivery on (sustainable) investment objectives but it should not be the ultimate arbiter of what is sustainable. By effectively outsourcing the definition of sustainability to their data providers, investment managers are putting too much emphasis on data as an outcome rather than a supporting tool, and also increasing their own greenwashing risk exposure. At the moment the lack of data can be used as an easy explanation not to move further into sustainable investing.
An important factor could be the initiative of the European Commission that aims to strengthen reliability and comparability of ESG ratings.

### 8. Industry standards to build trust

Stronger Industry standards, underpinned by a consistency of shared language of what sustainability means to investors, are required to build trust. We do not advocate a full standardization of sustainable investment because this will stifle innovation. But as it stands today the definitions are simply too broad and as a result too confusing to investors. Neither the industry nor the regulators seem to be able or willing to create that common understanding. Perhaps investors should therefore be the arbiters of what is sustainable, as long as it's based on the actual impact of their (potential) investment. Critical thought and assessment within organizations will always be key to make the best choices. Companies should have permanent education programs in place to ensure that the professionals involved are skilled for their tasks.

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## Outcome of round table meetings DSI and EY

This white paper is a result of multiple round tables that DSI organized together with EY over the course of 2023. It reflects the most important issues that emerged in conversations with industry professionals. These professionals are specialists in marketing, compliance and investing, and work at banks, pension funds and asset managers. They deal with the issues discussed on a daily basis and provide insights that could be overlooked by policymakers during the process of creating new rules for the financial sector.

With this paper, DSI wants to actively contribute to the lively discussion about greenwashing. The recommendations can be taken to heart by both the financial sector, regulators and legislators.

DSI focuses primarily on professionalism and integrity in the financial sector and the investment industry in particular. These two focus points are of great importance to this topic. The paper emphatically does not aim to tell a comprehensive story about greenwashing.

For more information and background on this research, please visit www.dsi.nl

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