

Principal ESG Academy - What is Greenwashing?



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The word greenwashing is defined as “expressions of environmentalist concerns especially as a cover for products, policies, or activities”¹. Greenwashing is a play on the term “whitewashing,” which means using misleading information to gloss over bad behavior.

Sustainability has become a mainstream among asset managers and within investment objectives. This has led to some managers promoting unsubstantiated or misleading claims about the sustainability characteristics of their investment products, in a bid to appear more attractive. This is considered “greenwashing”.

According to Morningstar, greenwashing takes place when a fund makes unsubstantiated or misleading claims about the sustainability characteristics and benefits of an investment product². In other words, a fund markets certain sustainable characteristics without genuinely integrating them into client portfolios.

Companies can greenwash as well. Greenwashing is the process of conveying a false impression on how a company's products are more environmentally friendly than they truly are. For example, companies might make claims that their products are from recycled materials or have energy-saving benefits. Companies engaged in greenwashing typically exaggerate their claims or the benefits to mislead consumers.

How can investors avoid greenwashing? Ask the right questions!

Due diligence is key. Look beyond a fund's name and understand what the fund's objective is. What does the fund aim to do? What kind of sustainable approach is it taking? To what extent is the fund incorporating sustainable investments? Does it aim to invest in companies that offer solutions to make an impact and help address the world's biggest challenges? A glance through some of the fund's top holdings may also be helpful. There are also some third-party tools that enable investors to assess the sustainability profile of investment products.

Active engagement can help. Is the asset manager engaging with companies regularly to understand the latest sustainable developments? Is the asset manager trying to drive changes that it believes will boost sustainability? How would the fund manager handle its investments when sustainable issues were found? How many shareholder meetings did it vote in and how did it vote? Investors may find clues in the asset manager's annual sustainability report.

Look at what the asset manager is doing from a corporate sustainability perspective. What is the firm's ESG commitments? What recognitions have the asset manager/ parent company received in terms of sustainability? Is the investment firm a signatory to The Principles for Responsible Investment (“PRI”)? Does the firm utilize a centralized ESG governance committee that oversees different investment teams? If an asset manager is truly embracing sustainability, it should start from within.

As environmental, social and governance (“ESG”) related investment products continue to gain traction globally, authorities around the globe are developing initiatives to require enhanced disclosure on the ESG-related features of products to assist investors' understanding and assessment of whether these products meet their investment needs.

Europe introduced the Sustainable Finance Disclosures Regulation, or SFDR, in March 2021. The Regulation aims to trigger changes in behavioral patterns in the financial sector, discouraging greenwashing, and promoting responsible and sustainable investments³. In Hong Kong, the Securities and Futures Commission (SFC) had issued a new circular to provide further guidance on enhanced disclosure of ESG funds and with additional guidance for funds with climate-related focus in June 2021⁴. An emphasis on improving regulatory framework for ESG governance and disclosure around the globe should help address the problem of greenwashing over the time.

Before that, the best way to avoid being greenwashed is to know the right questions to ask and be willing to do some homework before making investments.

¹ Source: Meriam-Webster.

² Source: Morningstar. For details, please refer to:

<https://www.morningstar.com/articles/1062642/what-is-greenwashing-and-answers-to-your-other-questions>

³ Source: The Sustainable Finance Disclosure Regulation (SFDR). For details, please refer to:

https://ec.europa.eu/info/business-economy-euro/banking-and-finance/sustainable-finance/sustainability-related-disclosure-financial-services-sector_en and https://ec.europa.eu/commission/presscorner/detail/en/mex_21_1106

⁴ Source: The Securities and Futures Commission. For details, please refer to:

<https://apps.sfc.hk/edistributionWeb/gateway/EN/circular/products/product-authorization/doc?refNo=21EC27>

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