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Anti-Greenwashing Initiatives and their Ripple Effect-An Europian Way

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Abstract
This article addresses the proactive measures taken in Europe to combat greenwashing, mainly targeting asset management companies. Notably, the Sustainable Finance Disclosure Regulations (SFDR) have been introduced to enforce sustainability-related disclosure requirements. To make sustainable investing more transparent, substantial initiatives to enhance the environment and society must be disclosed, fostering a more profound understanding among consumers and investors and contributing to environmental protection. As Europe advances to combat greenwashing, it raises the possibility of similar initiatives emerging in the Japanese investment trust market to instil confidence among market participants. This article explores suspected cases and issues related to greenwashing while contemplating future challenges in this evolving landscape. It also speaks about promoting sustainability investments by asset management companies.

Keywords: Greenwashing, Disaster, Global Warming, Investments, Environment

Introduction

The global spotlight is on the escalating frequency of natural disasters, driving heightened concern for climate change worldwide. Governments globally are unveiling greenhouse gas reduction targets in response to the growing interest in mitigating climate change. Despite these efforts, the United Nations Environment Program (UNEP) warns that even if nations achieve their targets, the global average temperature will rise by 2.7°C by the century's end. The Paris Agreement 2015 aimed to cap the temperature increase below two °C, preferably at 1.5°C. The COP26 Glasgow Agreement in 2021 further emphasized the commitment to limiting the rise in temperature to 1.5°C. In tandem with global efforts to curb rising temperatures, sustainable investments—strategies focused on long-term development sustainability and economic decarbonization—are experiencing rapid growth. However, within sustainable investments, the term "Greenwashing" denotes deceptive practices where investments or products may seem environmentally friendly but lack substantive efforts toward environmental consciousness, merely presenting a green façade.

This article addresses the proactive measures taken in Europe to combat greenwashing, mainly targeting asset management companies. Notably, the Sustainable Finance Disclosure Regulations (SFDR) have been introduced to enforce sustainability-related disclosure requirements. To make sustainable investing more transparent, substantial initiatives to enhance the environment and society must be disclosed, fostering a more profound understanding among consumers and investors and contributing to environmental protection.

As Europe advances to combat greenwashing, it raises the possibility of similar initiatives emerging in the Japanese investment trust market to instil confidence among market participants. This article explores suspected cases and issues related to greenwashing while contemplating future challenges in this evolving landscape.

Analysis of Temperature Rise by the United Nations Environment Program (UNEP)

Presently, global attention is riveted on the escalating frequency of natural disasters. To illustrate, in June 2021, Canada experienced a record-breaking heat wave at 49 degrees Celsius, while Germany faced unprecedented flood damage in July due to heavy rains and floods in Henan, China. The world is witnessing a wildfire surge, primarily attributed to rising temperatures. In light of these events, urgent global measures to combat climate change are imperative. The United Nations Environment Program (UNEP) released its "Emissions Gap Report 2021" in October, indicating that countries' greenhouse gas reduction targets are insufficient, with a substantial gap between current targets and actual efforts. To limit temperature rise to 2°C by 2030, a 30% reduction in greenhouse gas emissions is required, and for a 1.5°C limit, a 55% reduction is necessary. However, as of September 2021, the announced reduction targets are only 7.5%, highlighting a significant disparity. The report underscores the need to accelerate the transition to a decarbonized economy for effective climate change mitigation, as the current trajectory could lead to a 2.7°C temperature increase by the end of the century.

Shifting Dynamics in the Balance of Sustainable Investments

Amid the pressing concerns of climate change, sustainable investment has garnered global attention. This investment strategy, emphasizing long-term development sustainability, involves qualitative evaluations based on non-financial information alongside quantitative financial analysis. The "Global Sustainable Investment Review 2020" by the Global Sustainable Investment Alliance (GSIA) revealed a 15% increase in worldwide sustainable investment balance, reaching $35.3 trillion in 2020 from $30.6 trillion in 2018. While Europe saw a 13% decrease, the U.S. and Japan experienced a 42% and 34% increase, respectively, indicating a rising trend. Individual interest in sustainable investing is also on the rise, as highlighted by the Morgan Stanley Sustainable Signals Individual Investor Survey in October 2021, where 99% of Millennials expressed at least "somewhat interest" in sustainable investing. Despite this surge in interest, concerns persist regarding the substantive credibility of some sustainable investments.

What is Greenwashing?

Greenwashing is a phenomenon where an investment's outward appearance or label suggests environmental friendliness, but implementing green practices is minimal. For instance, a fund claiming to be low-carbon may include investments in companies emitting substantial amounts of greenhouse gases.

Suspicions of Greenwashing Raised in Various Countries

The issue of greenwashing, where claims of environmental responsibility lack substance, has been identified in numerous countries. On August 1, 2021, The Wall Street Journal reported

suspicions raised against Deutsche Bank Group's asset management company, DWS, for potentially exaggerating its sustainable investment efforts. Allegations from the group's former sustainability chief, supported by an investigation into internal email exchanges and presentation materials, suggest that the disclosure of sustainability initiatives was overstated compared to the actual practices, leading to suspicions of greenwashing. Despite managing over $540 billion in assets, internal assessments need more adherence to sustainability goals or strategies. The company is currently under investigation by the U.S. Securities and Exchange Commission but has not provided an external explanation. Additionally, in Japan, suspicions were raised about nearly 400 billion yen in domestically managed investment trusts sharing the same name within the same series. The Financial Services Agency sought an explanation from the asset management company in December 2020, expressing concern about the selection criteria for the investment trust.

Unintentional Greenwash

Conversely, it has been acknowledged that greenwashing may occur unintentionally, partly due to variations in ratings and data provided by different sources. This issue arises from various rating and data providers' differing definitions and coverage ranges. The International Organization of Securities Commissions (IOSCO) published the "Ratings and Data Product Providers" Final Report on November 23, 2021, discussing the challenges associated with ratings and data in the context of unintentional greenwashing.

Addressing the issues of unclear definitions, inconsistent measurement criteria, and ambiguous measurement methods, it has been noted that the broad scope of ratings and data is prone to bias toward specific industries and regions. The industry's absence of regulation and standardization poses a risk of "greenwashing" and potentially misinformed investment decisions based on unreliable information.

Efforts to Avoid Greenwashing in Europe

SFDR Regulations (Sustainable Finance Disclosure Regulations): Trends and Management Companies' Response Status

Amid these challenges, combating "greenwashing" is gaining prominence. In Europe, as part of the drive for sustainable finance, the Sustainable Finance Disclosure Regulations (SFDR) have been in effect since March 10, 2021. These regulations, stemming from the European Commission's 2018 action plans, aim to enhance environmental and societal conditions, fostering a sustainable society. SFDR embodies "sustainability-related disclosure obligations" for asset management companies and institutional investors, urging them to disclose sustainability risks and more information. The goal is to empower investors with rigorous information for sound investment decisions, thereby preventing "greenwashing." Disclosure requirements encompass acknowledging potential adverse impacts, establishing information disclosure rules for financial products, and enhancing transparency on each product's contribution to sustainability. The SFDR consists of Level 1, outlining the main rules, with critical ones being "sustainability risk" and "sustainable investment." "Sustainability risk" refers to situations where changes in the environmental, social, or governance environment adversely affect investment value.

Conversely, "sustainable investment" contributes to environmental and societal betterment, covering aspects like environmental protection, social issue resolution, and good governance practices. Disclosures at the financial product level vary based on sustainability contribution levels. And Level 2, providing detailed technical standards. Initially slated for January 2022, Level 2's implementation has been postponed to January 2023.

Sustainable investment funds necessitate clear sustainability objectives, alignment with chosen indexes, and detailed disclosure on achieving objectives. “Light green funds” focus on environmental and social promotion, while “dark green funds” are committed to sustainable investing. In this context, the European Investment Trusts Association (European Fund and Asset Management Association) released statistical data for the first time in November 2021 that funds held net assets of 3.7 trillion euros, which constitute a 22% share of the European investment trust market across European countries.

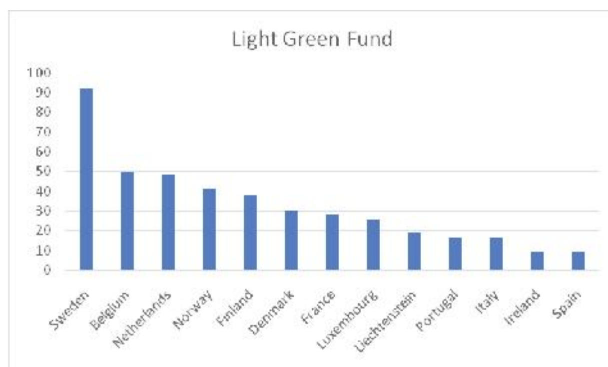

Figure 1 Domestic market share of “Light Green” fund (2021 1stQ)

Sweden	Belgium	Netherlands	Norway	Finland	Denmark	France	Luxembourg	Liech-tenstein	Portugal	Italy	Ireland	Spain
92	50	48	41	38	30	28	25	19	16	16	9	9

Fig1 illustrates the breakdown of market shares by fund nationality. The funds tend to have exceptionally high shares in the Nordic countries, with a longstanding history of engagement in investments. For example, in Sweden, past or existing requirements for information disclosure have contributed to increased certifications. The more relaxed standards for being considered a fund-promoting investment in Japan have also played a role in this certification surge.

Regarding the nine funds, as shown in Fig2,

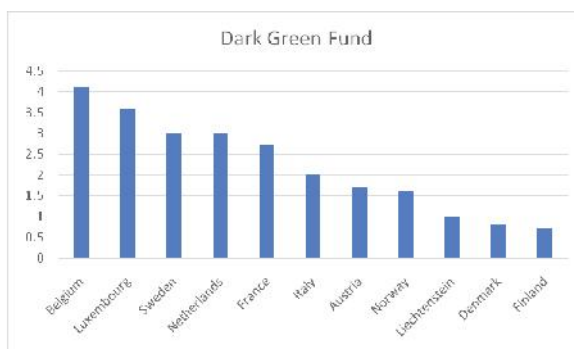

Figure 2 Domestic market share of “dark green” funds (2021 1stQ)

Belgium	Luxembourg	Sweden	Netherlands	France	Italy	Austria	Norway	Liechten-stein	Denmark	Finland
4.1	3.6	3	3	2.7	2	1.7	1.6	1	0.8	0.7

Their share in each country is still considerably lower than Article 8 funds. Its share in the European investment trust market is 2%, ranging from 0% to 4% in other countries. The reasons behind this discrepancy are the absence of Level 2 implementation, the strict disclosure requirements, and the high certification effort standards.

In the U.K.: Regulation (Sustainability Disclosure Requirements)

In October 2021, the U.K. Government unveiled the Sustainable Investing Roadmap, "Greening Finance: A Roadmap to Sustainable Investing." As part of this roadmap, regulations were introduced for sustainability disclosure requirements. Subsequently, in November 2021, the U.K. Financial Conduct Authority (FCA) released draft regulations open to public comment. Simultaneously, a proposal was made to introduce a "sustainable investment label." The objective of these regulations aligns with the European initiative – enhancing the disclosure of sustainability-related information to aid individual and institutional investors in understanding sustainability risks and opportunities, thereby contributing to a green economy. The regulations target a broad spectrum, including listed companies, asset managers, asset owners, and financial products. The discussion paper introducing the proposed rules also emphasizes the companies' awareness of these regulations.

However, there are three critical differences between the U.K. and European regulations. Firstly, the U.K. regulations broaden the target group for disclosure requests to include general consumers. The aim is to extend the literacy of sustainable investing to general consumers, raising awareness and promoting sustainable societies. Secondly, the U.K. regulations establish minimum compliance standards in the sustainability certification process. Specifically, a holding percentage of certified sustainable assets will be mandated, requiring an increase over time if the threshold is unmet. Companies are also recommended to set investment grade standards, apply positive and negative screening methods, and develop stewardship policies. This approach allows for the measurement of their contribution to sustainability. Thirdly, the U.K. regulations make introducing a "sustainable investment label" mandatory. However, the European regulations also include "light green" and "dark green," making the labels slightly different despite sharing the same name. The U.K. regulations encompass a "sustainable investment product label" and a "responsible investment label."

The "Sustainable Investment Product Labels" are categorized into "Sustainable Impact," "Sustainable Compliant," and "Sustainable Transitioning," each pursuing financial returns while retaining sustainable elements or objectives. On the other hand, the 'responsible investment' label does not set specific sustainability goals but considers crucial factors affecting risk and return, aiming for long-term returns. Additionally, as a minimum compliance standard, ESG analysis capabilities must be demonstrated organizationally, along with the ability to carry out stewardship. Through these labels, investors can assess the extent to which sustainability elements are incorporated. The UK SDRI regulations are currently in the draft stage, and their content may evolve based on public comments received.

Consideration for Avoiding "Greenwashing" and Promoting Sustainability Investment by Asset Management Companies

Given the Financial Services Agency's reinforced stance, what efforts will asset management companies be required to take to avoid "greenwashing"? First and foremost, a substantive plan

that can be communicated internally and externally needs to be developed based on the above discussion. Establishing a robust system for conducting ESG evaluations is imperative. Currently, impact investing, aiming to generate social or environmental impact alongside pursuing investment returns, is gaining interest. It is crucial to accurately measure the effect on sustainability when evaluating such investments appropriately. Collecting diverse data across various areas is necessary to advance the sophistication of measuring this impact contribution. For instance, in the environmental domain, efforts could be directed at measuring progress in environmental protection by gathering data on actual carbon dioxide reductions, fuel efficiency improvements, waste control, and more.

However, as mentioned earlier, challenges exist regarding data reliability. There are limitations to the available data. Therefore, potential future initiatives may involve collaboration with companies and research institutes evaluating green-related products. Improving data reliability will also help mitigate the risk of the "unintentional greenwash" mentioned earlier. Asset management companies must navigate the dual objectives of generating returns and promoting sustainability. Regarding the latter, they will increasingly be required to implement measures to avoid the "greenwashing" described above.

Conclusion

As global interest in climate change issues grows, outstanding sustainable investments are rising. Concurrently, there is a surge in awareness regarding investment products. In response to potential "greenwashing," regulations are starting to be enacted in Europe. While the Financial Services Agency in Japan has sounded the alarm regarding investment products, comprehensive regulations similar to those in Europe have yet to be introduced. In the future, both the Financial Services Agency and asset management companies are likely to make progress in their efforts to elevate sustainability disclosure to the same level as Europe. Asset management companies, conscious of sustainability outcomes, are anticipated to advance efforts toward truly sustainable investing.

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