Greenwashing Explained

As global awareness of the impacts of climate change continues to grow, consumers and investors are seeking - and in some cases, demanding - sustainable products and socially responsible investment opportunities to drive positive change.

There is increasing pressure for political leaders to act and address the threat of climate change. In his first speech as President of COP28, which will be hosted by the UAE in Dubai in November 2023, HE Sultan Al Jaber said the UAE is committed to making this "a COP of action".

In turn, the need for change has created top-down pressure for financial market participants to act. This, combined with the bottom-up pressure from investors and consumers, is expected to bring significant growth in sustainability-related investments in global markets in the next few years. This is welcome news. However, an unfortunate knock-on effect of this drive has been an increase in both the risk and incidence of greenwashing.

What is greenwashing?

Greenwashing refers to claims by an organisation that misrepresent the sustainability features, action or impact of its activities, practices or products.

In the financial sector, greenwashing can affect a myriad of financial markets participants across the value chain of sustainable investments and sustainable products. Greenwashing varies in scope and severity from confusing or inappropriate use of sustainability-related terminology to deceptive marketing practices and outright fraud.[1]

Examples of greenwashing include[2]:

- Describing an investment, or an investment fund, as green or sustainable when only a small part of the investment or fund's objectives could be described as such.
- Labelling a product, investment or project as having green, environmental or climate change prevention objectives but failing to allocate all or a part of the funds raised from investors to achieving these goals.
- Describing an activity, product or service as green or sustainable without monitoring and verifying outcomes, so that the environmental and sustainability benefits are not truly understood, achieved or demonstrated.
- Reporting that an activity, product or service has delivered positive outcomes, i.e., "green benefits", without having fully or properly verified that this is the case.

---

1 As set out by IOSCO recently when outlining its action plan for mitigating greenwashing in financial markets (IOSCO Final Report on Retail Investor Education in the Context of Sustainable Finance Markets and Products, August 2022, available here).

2 For actual recent example please see: Revealed: more than 90% of rainforest carbon offsets by biggest provider are worthless, analysis shows | Carbon offsetting | The Guardian

The financial sector faces growing scrutiny from its stakeholders, shareholders and regulators seeking assurance that their declared sustainability-related actions, decisions and products can be clearly demonstrated as having the stated positive contributions. The risk of greenwashing increases when organisations cannot demonstrate clearly and unequivocally that their actions, decisions or products have a measurable impact on sustainability as stated, for example, in their disclosures, reports or product documents.

One critical element to consider when weighing the risk of greenwashing is "additionality". In the absence of specific taxonomies or industry decarbonisation or environmental pathways, a company's action, project or product should be labelled "green" only when it can demonstrate its effective contribution towards lowering carbon emissions and when such reduction is additional to what would have happened regardless of the project happening.

Why is greenwashing bad?

Greenwashing can have a wide-ranging impact on the success and integrity of sustainability-focused financial markets, the soundness of financial firms and the stability of the wider financial system, as well as on investor protection and consumer confidence as it…

…undermines the drive of many market participants to help deliver meaningful actions to address climate change.

Greenwashing can prevent the growth of necessary levels of trust in sustainability-labelled financial products and, as the trust decreases, ultimately undermine the attempts to address climate change.

…raises concerns over the ability of financial firms to identify and manage sustainability-related risks efficiently.

As a source of financial risk, greenwashing can have broader repercussions for the well-functioning of capital markets, the stability of the financial system and ultimately the allocation of capital in the economy.

…misleads consumers and investors as to the effectiveness of their financial decisions in mitigating climate change.

Greenwashing can hamper the ability of consumers and investors to understand fully the characteristics of sustainable financial products and to make informed investment decisions. It can reinforce misperceptions about their performance and risks.

How can it be prevented?

Transparency is key to preventing greenwashing.

Transparency has many facets, the key one being disclosures:

- Appropriate, clear and relevant corporate disclosures are a primary safeguard for investors and consumers that the information they receive is sufficient for taking informed decisions[3].

- Disclosures relating to securities such as bonds or sukuk, which can reference either specific projects or general corporate transition goals[4].

- Other types are product-level disclosures when an investor needs to have sufficient and clear information and data indicating whether a financial product (e.g., a structured product or an index fund) uses the 'green' label justifiably[5].

In addition, ESG verification and certification bodies as well as data providers have a crucial role to play in this process given the strong reliance on their independent expertise and insight by investors, regulators and the public.

Lastly, coupled with disclosure is the need to educate investors about greenwashing and how it can be identified and addressed, for which the responsibility lies with both regulators and the financial industry. Although knowing how to identify greenwashing will not necessarily prevent it, more awareness amongst market players, including investors and consumers, may help them avoid being blind-sided by attractive-looking but empty 'green' claims that do not hold true.

DFSA's stance

We have taken steps to raise awareness amongst market participants about the risks of greenwashing. We have recently published two Markets Briefs.

- The first, published in November 2022, outlines the DFSA's best practice guidelines that we expect issuers on the DIFC markets to heed when issuing ESG bonds and sukuk[6].
- The second, published in April 2023, emphasises ESG-related disclosure considerations for issuers and reporting entities under the DFSA rules[7].

---

3 There are numerous disclosure and reporting standards worldwide (e.g. GRI, SASB), many f which have been converged into the International Sustainability Standards Board' upcoming standards.

4 The vast majority of the world capital markets rely on the voluntary ICMA's bond standards applicable to various types of financing on the ESG spectrum including green, social, sustainability-linked and transition. There are also other standards, for example on climate bonds by the Climate Bond Initiative. Our just published Markets Brief 26 refers to these as possible options for DIFC issuers.

5 Product-level emerging standards are beginning to emerge as voluntary (e.g. CFI Institute) or mandatory (EU).

6 Available on the DFSA's website here.

7 Available on the DFSA's website here.

Level 13, The Gate, PO Box 75850, Dubai, UAE
Telephone: +971 (0)4 362 1500
Fax: +971 (0)4 362 0801

We are also actively engaging at national and international levels to help develop global frameworks on ESG matters that seek, amongst other goals, to address greenwashing practices by bringing more transparency to this area.

Ultimately, combatting greenwashing involves efforts from all sides - not only from the regulators but also from the corporate and financial sectors, investors and consumers - to ensure that it becomes a practice of the past.