Greenwashing and how to avoid it: An introductory guide for Asia's finance industry

Japan edition

updated October 2023

AIGCC
ASIA INVESTOR GROUP ON CLIMATE CHANGE

ClientEarth

ABOUT THE AUTHORS

This guide was co-written by ClientEarth and the Asia Investor Group on Climate Change, together with external consultant Daisy Mallett.

ClientEarth is a non-profit organisation that uses the law to create systemic change that protects the Earth for – and with – its inhabitants. It tackles climate change, protects nature and stops pollution, with partners and citizens around the globe. In Asia, we work with the private sector, civil society and government regulators to support the net zero transition through capacity building and legal analysis on topical issues on climate change, sustainability and the environment. From our offices in Europe, Asia and the USA we help build a future for our planet in which people and nature can thrive together. www.clientearth.asia/

The Asia Investor Group on Climate Change (AIGCC) is an initiative to create awareness and encourage action among Asia's asset owners and asset managers about the risks and opportunities associated with climate change and low-carbon investing. AIGCC provides capacity for investors to share best practice and peer-to-peer learning on sustainable investment, risk management, corporate engagement and policy advocacy. With a strong international profile and significant network, AIGCC represents the Asian investor perspective in the evolving global discussions on climate change and the transition to a greener economy. AIGCC members come from 11 markets and with over USD 31 trillion in assets under management. www.aigcc.net

The original version of this report was released in April 2023. This is an updated version of the original report, with a focus on Japan. Notable updates have been indicated in the report by way of a new flag symbol. NEW!

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FOREWORD

By Satoshi Ikeda

Tackling greenwashing has become a major issue for many financial authorities around the world. This is because as retail investors and institutional investors who prefer sustainable investments increase their market presence, the credibility and integrity of sustainability claims are becoming important factors in making investment decisions. In other words, as sustainability is taken into account in investment decisions, the credibility and integrity of sustainability information will be closely related to investor protection and the proper functioning of capital markets that is reliant on accurate information. This is what draws the attention of financial authorities, and it is against this backdrop that some authorities are taking enforcement actions to remedy greenwashing, as helpfully covered in this report.

In this way, the issue of greenwashing has become one of the core issues for financial authorities, but the judgement of what is and is not greenwashing is not a clear bright line. This is why this report comprehensively identifies best practice for avoiding allegations of greenwashing. A particularly difficult case is where the judgment of the credibility and integrity of sustainability credentials includes future predictions. Of course, this also applies to investment decisions based on factors other than sustainability. All investment decisions contain forward-looking elements. What makes greenwashing decisions especially difficult is that today's sustainable investment decisions may rely on highly uncertain future projections, such as the use of innovative technologies to achieve the 1.5°C target of the Paris Agreement. In general, 60% of the 1.5°C target is achievable with already commercialized technologies, while the remaining 40% must rely on technologies that have not yet been commercialized or are under development.[1] Having regard to the high uncertainty of technological development, it would be difficult to make a determination of greenwashing based only on the failure to achieve the envisaged outcome. If that were the case, companies would hesitate to raise funds by promoting the technology's sustainability potential. As long as a certain number, if not all, of the investors are in good faith reasonably confident of the feasibility of achieving the sustainability outcome, having been given truthful evidence to inform their perspective, such a case should not be called greenwashing. On the other hand, when it becomes clear at a certain stage of technological development that the initially envisaged sustainability outcome cannot be realized, and the sustainability credentials are still advertised, it should be judged as greenwashing. Furthermore, if it is known from the beginning that such sustainability outcomes cannot be realized and the technology's sustainability is still advertised, the pernicious effects of greenwashing is extremely high.

In short, greenwashing judgments are often difficult to make. I hope that AIGCC and ClientEarth's newly published *Greenwashing and how to avoid it: An introductory guide for Asia's finance industry - Japan edition* will be of help in advancing these discussions further from the current thinking.

Satoshi Ikeda
Chief Sustainable Finance Officer
Financial Services Agency of Japan

FOREWORD

By Herry Cho

The impact of climate change is particularly acute in Asia, as the region is one of the most climate vulnerable areas globally. The challenge to balance economic growth together with managing climate vulnerabilities requires a multi-faceted approach. There is an increased awareness regarding the role that businesses need to play in mobilising climate action from the bottom-up.

Sustainable finance has therefore become a critical focus. Growing awareness of the risks from climate change, and the urgency to act to prevent its most catastrophic consequences, have driven investors to invest 'green', creating an unprecedented green market opportunity. Likewise, the expectations that consumers place on companies, investors, and regulators to incorporate aspects of sustainability and respond to climate concerns are at an all-time high.

Since the Paris Agreement in 2015, the financial sector has been actively engaging on understanding the impact of climate change on investments and proposing solutions to address climate issues – for example, by developing sustainability-related financial products that have been contributing towards nationally determined contributions and beyond, and sector-specific net zero goals. As investors advance their climate action strategies, they will face raised scrutiny and expectations from their stakeholders.

The lack of global consensus and uniformity has at times allowed certain actors in the financial markets to substantiate insufficiently with respect to the impact of their products or practices on climate action. In other cases, well-meaning investors have not been spared from greenwashing allegations due to a lack of market clarity on claims that are 'green.'

Regardless of investors' intentions, greenwashing can have a devastating effect on the overall market and its crucial role in climate finance, especially given its nascent stage in Asia. This may lead to a loss of public trust in the short-term and prevention of effective allocation of resources for impactful climate action in the long-term.

At SGX Group, we have been actively looking at mechanisms to ensure transparency of intentions of financial institutions that operate in the sustainability space. We recently launched the SGX Sustainable Fixed Income initiative, with an aim to help investors identify fixed income securities that meet recognised green, social or sustainability standards.

Investors will benefit from the assurance that these securities have been independently checked to align with recognised standards, as well as continued public disclosures of material developments that may affect alignment with the recognised standards.

The use of transparency as a mitigant against greenwashing also flows through in products we develop including with partners. For example, both Scientific Beta's (SGX Group's subsidiary) Climate Impact Consistent Indices and our work with MSCI on the recently launched Climate Action Indices were designed with a rules-based and transparent methodology to allow investors to understand how the climate indicators drive decarbonisation and support the transition in the real economy.

Greenwashing and how to avoid it: An introductory guide for Asia's Finance Industry is a useful report for all stakeholders in the financial sector, including regulators, to better understand what greenwashing is, where greenwashing concerns currently stem from, and how greenwashing may evolve in the future.

The report provides guidance and practical steps to guard against greenwashing risks that we hope financial institutions find useful and can implement. The forward-looking approach of the report is particularly helpful for institutions to reflect on and **evaluate their climate governance and communication strategies to ensure transparency of their intentions on climate action.**

HERRY CHO
Managing Director
Head of Sustainability and Sustainable Finance
SGX Group

COMMENTARY

AIMING FOR MORE CREDIBLE SUSTAINABLE FINANCE

NEW! Sustainable finance has expanded significantly in recent years. As the volume of financing increases, it is a natural trend to turn our attention to the qualitative aspects. This is because no matter how much sustainable finance expands, it will not solve environmental and social issues unless its content is truly green and socially responsible, including in terms of decarbonization. As a result of this disconnect, there have been cases where financial products and investment institutions claiming sustainable finance have been criticized as greenwashing.

However, aside from the obvious greenwash, where a product or fund is called ESG and has no actual substance, it is not easy to judge what constitutes greenwash, given that whether or not it can be called sustainable is related to the evaluation of "quality." This report attempts to approach this difficult issue from the legal side, as well as provide practical solutions for financial institutions. I salute that effort.

Of course, whether or not it is called greenwashing is not determined solely by law, but also depends on the process adopted by asset managers, scientific evidence, and social consensus on what standards society expects. The judgment criteria are still in flux, but I believe they will mature through various discussions, including through this report. Sustainable finance itself will therefore continue to rise to a higher level.

I hope that those who practice sustainable finance will not be discouraged by the criticism of greenwashing; and that instead, their financing practices will advance as the judgment and evaluation criteria will become clearer, and they will gain a greater sense of confidence that their practices will not be called greenwashing.

Takeshi Mizuguchi
President, Takasaki City University of Economics
Chair of the Expert Panel on Sustainable Finance, Financial Services Agency

A. EXECUTIVE SUMMARY

This is an introductory guide intended for players in the Asian finance sector, including asset managers, banks, institutional investors, and regulators, to understand issues surrounding the growing phenomenon of greenwashing in the industry. It addresses the prevalence of greenwashing in financial markets in Asia, and provides an overview of the various forms of regulation and guidance being developed to address it. It provides a typology of enforcement action being taken by a variety of regulatory bodies and actors against greenwashing across the globe, and identifies cases at the greenwashing frontier. It also provides guidance on measures to guard against greenwashing risk. This special Japan edition shines a spotlight on initiatives that relate to the Japanese financial market.

Greenwashing poses a risk as it has the potential to significantly impede the green transition by distorting the financial markets and undermining the allocation of capital to the green transition. While civil society has been key to identifying and prosecuting greenwashing, regulators are also increasing their scrutiny of this issue.

Regulators and international bodies have begun introducing standards and guidelines. Regulatory standards and guidance have been rapidly evolving, being issued at the international, regional, and domestic levels. Standards and regulations that can be used to help identify and prevent greenwashing when used comprehensively, have been observed to fall into one of five categories: (1) climate disclosure and accounting, (2) labelling standards, (3) standards on green ratings and criteria, (4) green taxonomies, and (5) net zero integrity standards. All these seek to address the various aspects in which greenwashing can arise in the finance sector.

Enforcement action against greenwashing is also on the rise, with a variety of regulators and actors commencing enforcement proceedings against companies they consider to be misleading the market. The types of greenwashing which have attracted enforcement action include: (a) brand greenwashing, which relates to the overall greenwashing of an organisation's profile, activities, and ambitions, (b) fund / product greenwashing, which relates to the mislabelling or mis-selling of products, (c) greenwashed financing, whereby "green" financing is provided to assets that are themselves greenwashed, and (d) financial reporting greenwashing, where financial institutions make false or misleading statements in relation to environmental-related disclosures. These claims have had a multitude of legal foundations which draw upon existing laws and regulations. Additionally, a n**ew wave of greenwashing cases** is emerging that may well attract legal sanction too. These include "transition-washing", greenwashing via offsets, and greenwashing claims brought by competitors.

This guide provides key recommendations to guard against greenwashing risk. These are summarised under the 'five pillars' as follows:

1. **Screen your green:** Scrutinise the accuracy and credibility of any green statement;
2. **In good and green faith:** Be transparent about how green objectives are integrated into the financial product and/or its financial objective;
3. **Walk your green talk:** Ensure the company or fund's green image is consistent with the internal actions of the company or fund and their actions in relation to third parties;
4. **Observe the changing shades of green:** Expectations and regulations are rapidly evolving, so monitor developments in relevant jurisdictions;
5. **Be alert to green duties:** Know your legal and fiduciary duties to investors, beneficiaries and stakeholders.

In setting out the above, this guide aims to assist the Asian financial industry in identifying greenwashing risks within their own organisations and those that they invest in, and help in identifying relevant considerations for mitigating them. The guide is also intended to assist regulators in Asia, bringing attention to the forms of greenwashing which are emerging, and providing an overview of the types of regulation and legal action taking place in Asia and beyond.

B. GREENWASHING: AN OVERVIEW

There is a critical and urgent role for sustainable finance to prevent and protect against the impacts of climate change in Asia. The rising awareness of the impacts of climate change has resulted in an immense green market opportunity for investors.

However, this appetite for environmentally sustainable financial products has grown in tandem with the level of greenwashing in the market. This has occurred in a developing regulatory landscape, with inadequate guidance and oversight as to what constitutes a 'green' financial product or company, and how these should be marketed. Across Asia, combating the greenwashing phenomenon means closing this regulatory gap and taking appropriate legal action. However, this has led to a complex and evolving landscape for which clarity on identifying an ever-expanding typology of greenwashing claims, and the frameworks meant to address it, has become difficult.

This practical guide seeks to address that challenge. It analyses greenwashing in the context of financial markets in Asia, providing an overview of the types of greenwashing to be alert to, and the legal and other risks associated with such greenwashing. Both international and regional regulatory developments to tackle greenwashing are also covered, alongside guidance provided to support financial institutions in minimising the risk of greenwashing allegations.

The finance sector, as the gatekeeper of capital, not only has a significant responsibility in this global climate crisis, but stands in a unique position to drive truly 'green' markets. By unpacking the "green sheen" and explaining what is required to make and support green claims, this guide aims to assist the financial industry in achieving those ends.

A DEFINITION

There is no settled definition of greenwashing. Nevertheless, in the context of the finance industry, greenwashing generally refers to the false, deceptive, or misleading statement / representation of the nature and extent to which a financial product, investment strategy, or company has a positive environmental or climate impact.[2] It occurs where a company suggests that that they have a net positive or net neutral impact on the environment, in circumstances where their business model or activities or products may actually cause environmental harm. It is also now more widely accepted that greenwashing does not require intentionality, i.e., greenwashing may be deemed to be committed regardless of whether the entity engaged in greenwashing intended to deliberately mislead.[3] The range of enforcement actions reviewed would suggest that an assessment is usually made considering the overall circumstances, with a focus on how the representation / statement is perceived.

While the term greenwashing is sometimes applied to include misleading conduct in relation to social or governance matters, its classic context is within environmental claims. This guide is limited to greenwashing in the specific context of environment-related matters.

THE PROBLEM WITH GREENWASHING

Across geographies, greenwashing claims have been seen through various sectors, including in the retail sector,[4] utilities sector,[5] automotive sector,[6] aviation sector,[7] and the fossil fuel sector.[8] See Table 1, at page 17. Typology of greenwashing cases worldwide. Indeed, studies have found that up to 40% of green claims made globally are misleading.[9]

One of the areas of greenwashing that most elicits concern is that within the financial sector. In the context of increasing attention in tackling climate change and the international goals to transition to net zero, greenwashing in the financial markets is a major problem because it:

a. misallocates capital, thereby endangering the green economic transition and the global commitment to the Paris Agreement temperature goals;
b. makes it challenging for the market to make fair and accurate comparisons between companies and track a company's progress against its commitments;[10]
c. can result in an uneven playing field between companies engaging in greenwashing and those who have genuinely "greened" operations (and incurred the associated costs of that greening); and
d. reduces investor confidence in green products, inhibiting consumer uptake of green products.

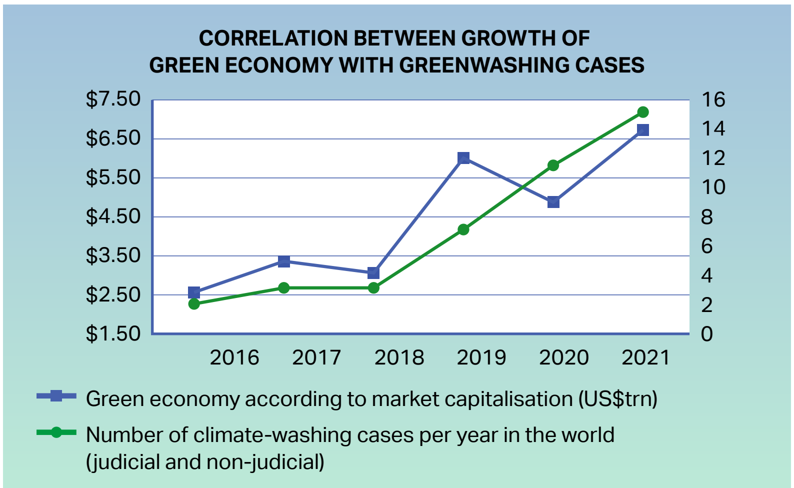


Fig. 1. A graph demonstrating the size of the global green economy (Source: FTSE Russell) growing alongside the number of climate-washing cases between 2016-2021 (Source: Climate Social Science Network). While these do not reflect figures for 2022 and 2023, the 2023 Global Trends in Climate Change Litigation report recognizes an increase in climate-washing cases filed between 2022-2023, predominately against corporations, suggesting a continuation of this upward trend.

TRACKING THE RISE

There are several reasons why greenwashing within the financial sector is on the rise. One reason is the green finance opportunity, valued by one account at $5 trillion across all sectors in Asia by 2030.[11] Green investment products are appearing across asset classes and geographies, capitalising on the consumer interest in the "E" of ESG investing.[12] Companies are increasingly marketing or labelling themselves or their products as "green", or attributing environmental benefits to them.[13] Examples of these products include green managed funds, green listed equities funds, green infrastructure funds, green private equity investments, sustainability-linked bonds, and green bonds.

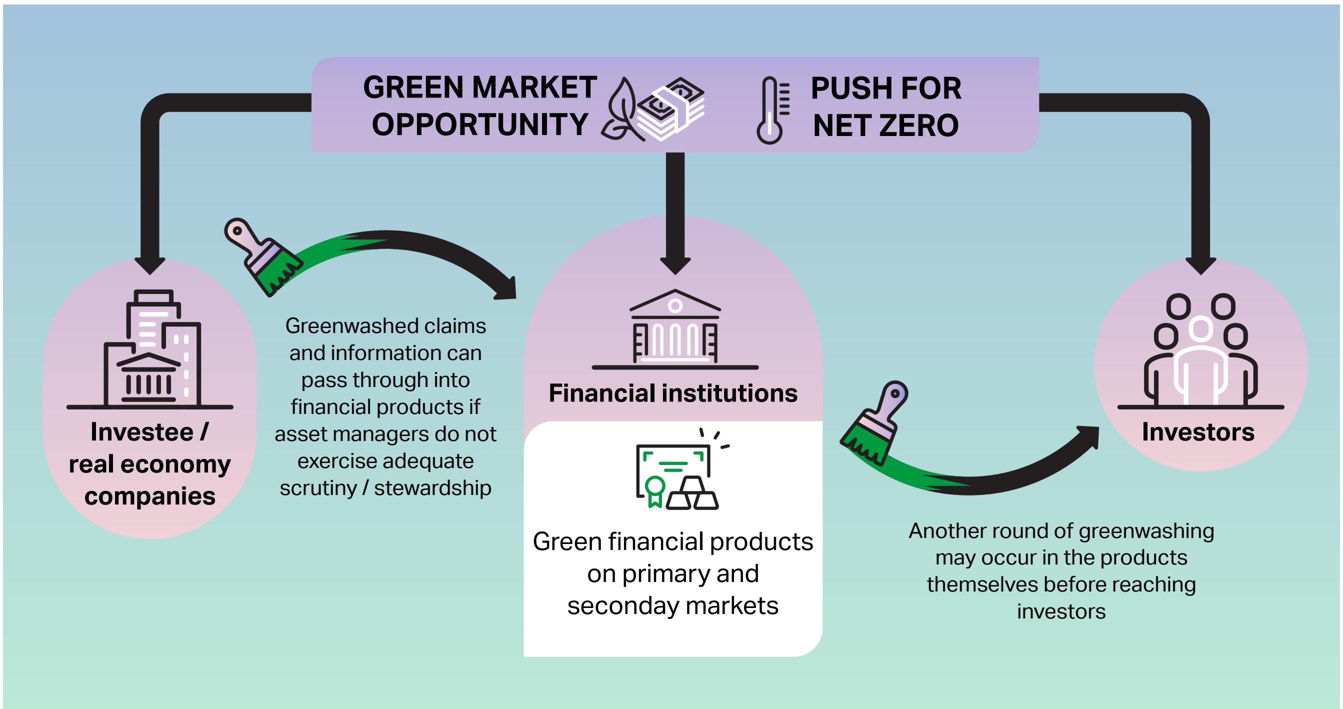


Fig 2. In the investment chain, there are two stages of greenwashing – those that are generated from the claims and information by the investee companies themselves, and those that arise from the financial institutions.

Second, in response to both the climate emergency and increasing investor demand, many financial institutions have made net zero commitments or stated they will align their emissions with the Paris Agreement temperature goals. There has been a significant number of net zero initiatives: Net Zero Asset Manager initiative,[14] Net Zero Asset Owner Alliance,[15] Paris Aligned Asset Owners,[16] Net Zero Banking Alliance,[17] and Net Zero Financial Service Providers Alliance.[18] These net zero initiatives have achieved strong uptake in their membership by financial institutions, including those headquartered in Asia. The challenge for these financial institutions is to achieve these net zero commitments across their complex organisations and value chains, in the timeframes demanded by the best available science on the climate crisis. These challenges are compounded by a lack of clarity regarding how labels and commitments are to be translated into practice in this emerging landscape, creating an environment where the risks of greenwashing are substantial. Net zero initiatives are also having to navigate and assess whether their signatories' commitments are credible, to ensure they are not using these networks to greenwash their credentials.

HEIGHTENED SCRUTINY

Regulators around the world are taking notice. For example, the United Kingdom's (UK's) Financial Conduct Authority, as part of its 2022 strategic plan states: "We will identify where firm practices do not meet our expectations (e.g. greenwashing) and intervene swiftly to protect consumers."[19] The Australian Securities and Investments Commission made 35 interventions against greenwashing in the nine months to March 2023, which included 23 corrective disclosure outcomes, 11 infringement notices, and in one case, the commencement of civil penalty proceedings.[20]

In Asia, the scrutiny of greenwashing is now also accelerating. Greenwashing is being flagged by regulators around the region as a serious issue. Research from the Hong Kong Monetary Authority has found that "greenwashing is not uncommon in the global green bond market, as about one-third of corporate green bond issuers are found to have a poorer environmental performance after their initial green bond issuance."[21] Likewise, Japan's former commissioner of the Financial Services Agency Junichi Nakajima[22] announced increased scrutiny of green claims to protect investors from greenwashing. Yi Gang, Governor of the People's Bank of China is reported to have identified greenwashing as a "moral hazard" and explained that supervision must be strict.[23]

The estimated green investment needed in ASEAN alone is US$200B per year till 2030… The stakes are high, making it critical for the market to have accurate climate information to drive decision making. The biggest threat to this right now is greenwashing.

Tan Boon Gin
CEO of SGX RegCo

One important way to address greenwashing is providing clear and enforceable standards and to encourage organisations to implement them comprehensively. As such, a raft of new standards to identify and prevent greenwashing are being introduced at the international, regional, and domestic levels. So far, these have fallen into five main categories (as seen in Fig 3). These allow analysts and investors to compare climate credentials of different investments. Additionally, they increase the market's confidence in companies' green claims and credentials, thereby freeing up capital for investment in the green economic transition.

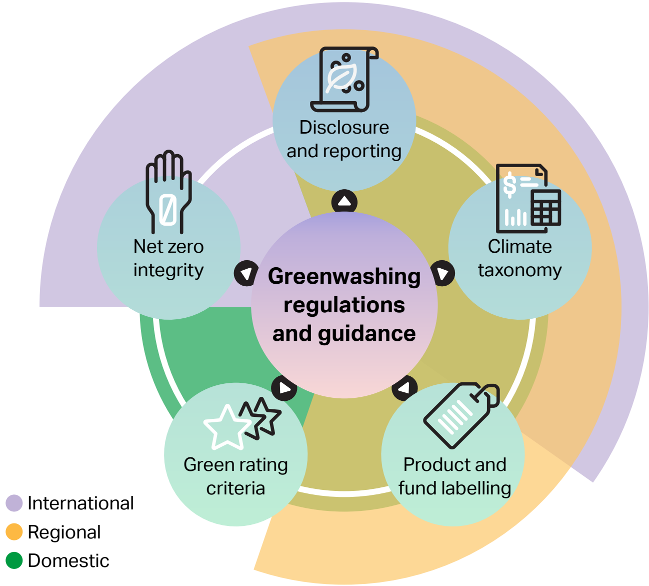


Fig 3. The five main forms of greenwashing-related regulation and guidance are found at the international, regional, and national levels.

INTERNATIONAL DEVELOPMENTS

Before turning to the five categories of greenwashing regulation and guidance, we turn to the internationally promulgated standards which have played a role in setting the landscape. Recognising that greenwashing "has the potential to severely undermine investor confidence in sustainable finance and threaten efforts to combat climate change", the International Organisation of Securities Commissions **(IOSCO)** has issued a call to action to financial markets' voluntary standard setting bodies and industry associations to adhere to IOSCO's Good Sustainable Finance Practices.[24] In doing so, they promote good practices among asset managers and ESG ratings and data providers to counter the risk of greenwashing.

Key international standards and guidance for climate disclosure reporting include the Taskforce on Climate-Related Financial Disclosure **(TCFD),**[25] Science Based Targets Initiative **(SBTi)**'s Financial Sector and TCFD Reporting Guidance,[26] Sustainability Accounting Standards Board's Climate Risk Technical Bulletin.[27] In addition, the International Sustainability Standards Board recently issued standards on climate and sustainability more broadly,[28] with the aim of creating a global baseline of sustainability and climate related disclosure requirements for the capital markets.[29] These new standards were endorsed by IOSCO and welcomed by Asian financial markets, including Japan.[30] The development signals a significant shift in the market, delivering high quality, globally comparable sustainability information for the capital markets, and informing companies about what and how they need to disclose.

In parallel with mounting disclosure expectations and obligations, businesses and financial institutions are increasingly expected to make and improve the credibility of their net zero commitments. The UN High-level Expert Group on the Net Zero Emissions Commitments of Non-State Entities has established leading recommendations in its report, 'Integrity Matters: Net Zero Commitments by Businesses, Financial Institutions, Cities and Regions' **(UN Net Zero Report).**[31]

CLIMATE DISCLOSURE STANDARDS

Effective disclosure is key to a green transition and the prevention of greenwashing. In most jurisdictions reporting against climate disclosure standards is still voluntary, but mandatory disclosure standards are being introduced. These include the European Commission's disclosure requirements under the Sustainable Finance Disclosure Regulation **(SFDR)**[32] and Corporate Sustainability Reporting Directive **(CSRD)**.[33] In June 2023, the European Supervisory Authorities published Progress Reports on Greenwashing in the financial sector, putting forward a common high-level understanding of greenwashing applicable to market participants across banking, insurance and pensions.[34] In the US, the Securities and Exchange Commission has proposed standards for public companies to disclose their audited Scope 1 and 2 greenhouse gas emissions, and Scope 3 emissions where material. Certain climate disclosures have also been proposed for funds with ESG labels.[35] In Australia, a consultation is currently underway on mandatory disclosure of climate-related financial risks, which is proposed to come into force in the 2024/2025 financial year.[36]

Rules and guidelines are also being introduced to inform financial institutions of what regulators expect in relation to the management and/or disclosure of climate risks in ESG investments. In Asia, some of the key guidelines include:

NEW!

In **Japan**, there has been a notable development in the sustainability-related disclosure regime.

The Financial Services Agency of Japan ("FSA") has updated the Stewardship Code in 2020, setting out its expectations for financial institutions to disclose their voting records and recommending that institutional investors should disclose how they integrate sustainability into their strategy.[37]

Separately, companies that are listed on the Tokyo Stock Exchange are required to disclose a fundamental policy for addressing sustainability-related issues, in accordance with the Corporate Governance Code.[38] Companies that choose to not comply with this provision must explain the reason for doing so.[39] Moreover, since 2021, companies listed on the Prime Market are required to disclose information relating to climate-related risks and opportunities based on TCFD's disclosure scheme or its equivalent.[40]

In 2023, the FSA revised the Cabinet Office Ordinance on Disclosure of Corporate Affairs, a public disclosure rule delegated under the Financial Instruments and Exchange Act of Japan (FIEA). The Ordinance came into effect on 31 January 2023, and modified the requirements for the securities registration statement and annual securities report (Disclosure Documents) by creating a dedicated section for sustainability-related matters and requiring listed companies to provide annual sustainability disclosures on (i) "Governance" and "Risk Management," and (ii) "Strategy" and "Metric/Target" (depending on its materiality).[41] Importantly, sustainability-related disclosures often contain forward-looking statements which may trigger liability for false statements under the FIEA. The FSA updated the Guideline for Disclosure of Corporate Affairs to clarify circumstances where such liabilities do not immediately arise, even if the actual outcome differs from the forward-looking statement.[42]

The Sustainability Standards Board of Japan ("SSBJ") announced that by 31 March 2025, it will issue the Japanese equivalent of the International Sustainability Standards Board's IFRS S1 "General requirements for the disclosure of sustainability-related financial information" and "IFRS S2 Climate-related disclosures."[43] This is expected to further strengthen Japan's disclosure standards.

China's central bank has issued guidelines on environmental information disclosure for financial institutions[44] and its Ministry of Ecology and Environment has issued rules requiring certain high emissions companies and listed companies that have violated environmental laws in the previous year to provide specific disclosures of environmental information and carbon emissions.[45] In addition, the State-owned Assets Supervision and Administration Commission (SASAC) of the State Council recently published a notice to standardize the compilation of ESG special reports of listed companies held by central enterprises.[46] It encourages listed companies held by central enterprises to introduce third-party professional institutions to verify and evaluate ESG special reports on the basis of their own reliability commitments, and issue evaluation reports to enhance the credibility of the disclosed ESG information. In June 2023, the ISSB opened an office in Beijing, in order to further ISSB's strategy for emerging economies and act as a hub for stakeholder engagement in Asia among other activities.

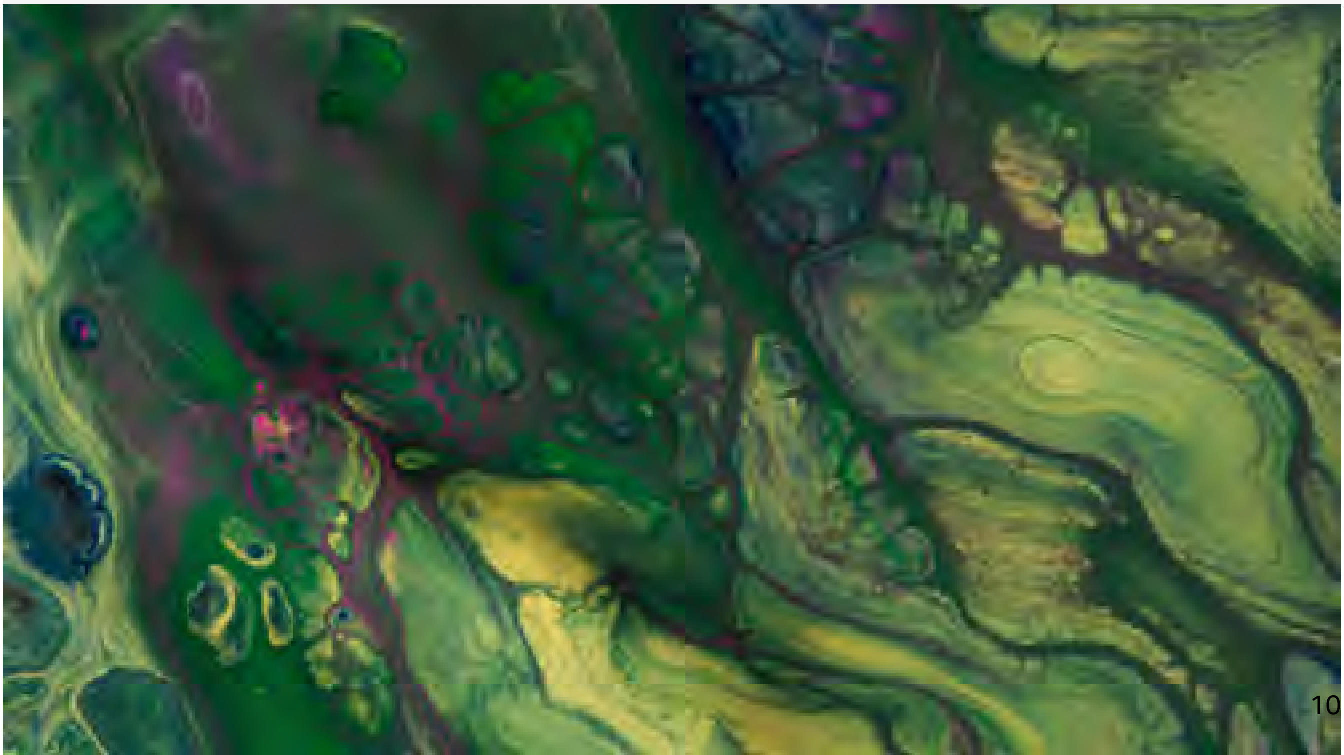
Hong Kong's Securities and Futures Commission (SFC) has updated its circular on the requirements for ESG Funds to disclose information relating to their investment objective and investment strategy, and a revision of the SFC Fund Manager Code of Conduct to require the management, and disclosure of climate related risks by fund managers.[47] The Stock Exchange of Hong Kong held a consultation on its proposal to enhance climate-related disclosures under the ESG framework to align them with ISSB standards.[48]

India has reporting standards requiring emissions data from certain listed entities.[49] The Securities and Exchange Board of India recently established regulatory requirements for ESG funds' portfolio and stewardship activities.[50]

Singapore has issued Guidelines on Environmental Risk Management to financial institutions and has also published information papers on the environmental risk management practises of banks, insurers and asset managers which identify good risk management practices by financial institutions and highlight where further work is needed.[51]

Thailand has released guidelines on the management and disclosure of climate-rated risks for asset managers.[52]

In the **Philippines,** a guideline has been issued on banks' sustainable investments and their management of risks associated with green financing.[53]



The response from industry to increased disclosure obligations has been mixed. While many in industry call for more guidance from regulators, others are concerned about increased legal risk relating to forward looking statements, and more regulatory complexity in navigating different rules in different jurisdictions. There is also a desire for more guidance from regulators and training for not only financial institutions and other product issuers, but also investors, so that they understand new taxonomies and can identify their investment preferences and distinguish between different product categories.[54]

LABELLING STANDARDS

There are a growing number of rules and guidelines relating to product and fund labelling. These assist consumers in comparing financial products and reduce greenwashing. Such rules and guidelines include the proposed European Securities and Markets Authority **(ESMA)** rules for ESG fund labels,[55] the European Commission's proposed Green Claims Directive,[56] the UK's Financial Conduct Authority's proposed restrictions on the use of terms "green" and "ESG" and "sustainable",[57] the Australian Securities and Investment Commission's (ASIC) list of 'don'ts' for issuers to consider when preparing communications about sustainability-related products,[58] and the US Securities and Exchange Commission's proposed amendments to the Investment Company Act of 1940 (the Names Rule) in order to address the use of ESG terminology, among others.[59]

In Asia, notable developments include:

NEW!

In **Japan**, the Ministry of the Environment ("MOE") has established the *"Green Bond and Sustainability-Linked Bond Guidelines 2022"* and *"Green Loan and Sustainability-Linked Loan Guidelines 2022."*[60] The guidelines set out the elements to be included in financial products with sustainability labels as well as practical measures for achieving them, in order to prevent greenwashing and enhance their credibility.[61]

The FSA has also announced new guidelines for funds which have ESG factors in their names and investment strategies, in response to concerns over greenwashing of these investment products. Following the FSA's publication of the *"Progress Report on Enhancing Asset Management Business 2022"* ("Progress Report"), which describes the FSA's suggestions to the asset management companies which handle ESG investment trusts,[62] the FSA revised the *"Comprehensive Guidelines for Supervision of Financial Instruments Business Operators, etc."* ("Guidelines") which came into force on 31 March 2023.[63] The Guidelines are, in their nature, a description of the "thinking" of the supervising authorities, and asset management companies are expected to take note of them. In practice, the Guidelines are highly effective, as an obvious deviation can lead to enforcement action.[64]

The Guidelines provide that only an "ESG investment trust" can use terms such as *"ESG, SDGs (Sustainable Development Goals), green, decarbonization, impact, sustainable, etc."* in the name of the trust, in order to avoid a misleading impression. The Guidelines define "an ESG investment trust" as *"a publicly offered investment trust fund which (i) considers ESG as a key factor in the selection of investment assets, and (ii) describes it in the 'Objective and Characteristics of the Fund' section of the delivery prospectus."*[65] Therefore, only funds that consider ESG a "key factor" will be able to label their product as such. "A key factor" is defined as a factor that is crucially important for investment decision-making (e.g. no investment should be made unless it meets ESG-related criteria, investment, the proportion of investment should be determined based on ESG criteria, etc).[66] In other words, there is no quantitative threshold for what constitutes an "ESG investment trust",[67] and each asset management company should individually determine which of their investment trusts, if any, falls under the definition of an "ESG investment trust".[68]

The revised Guidelines also provide guidance on prospectuses of "ESG investment funds" in relation to investment strategy, portfolio construction and reference index, periodic disclosure, and due diligence and operation status in case a third-party provider is involved. In addition, the revised Guidelines require procuring adequate resources to implement operations and monitor the implementation status, as well as conducting appropriate due diligence for the use of ESG ratings or data provided by a third party.

In **China,** the China National Intellectual Property Administration (CNIPA) is reportedly refusing to register trademarks including the word "green".[69]

The Monetary Authority of **Singapore** has issued Disclosure and Reporting Guidelines for Retail ESG Funds.[70]

STANDARDS ON GREEN RATINGS AND CRITERIA

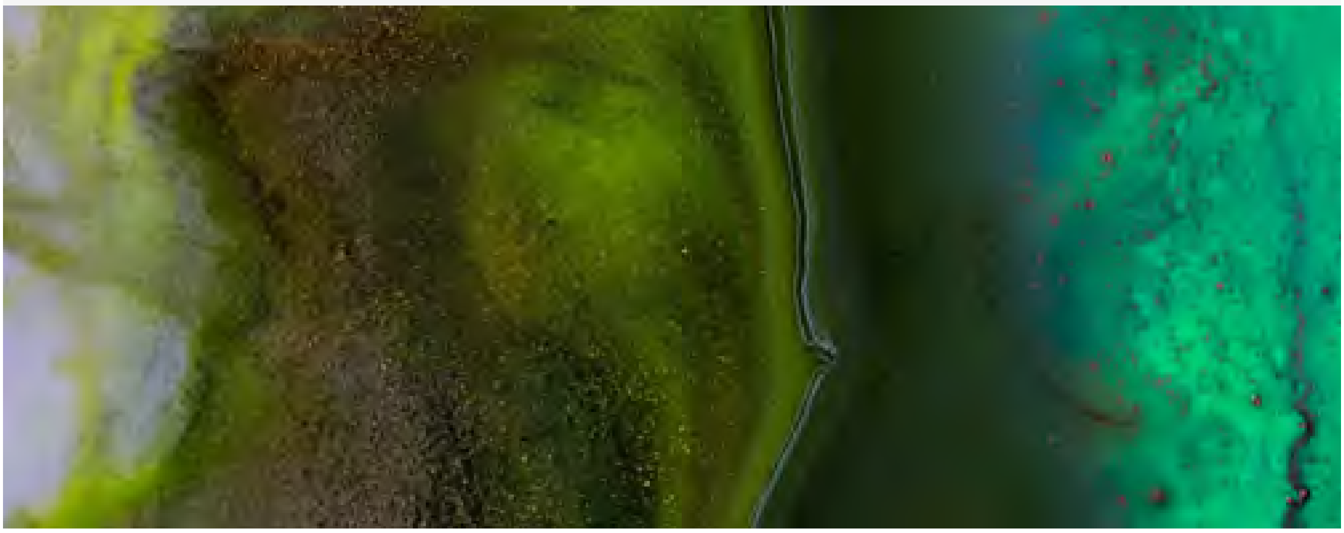
Rules are being created to harmonise or guide comparisons between companies' performance on ESG factors. This is critical because many participants in the markets rely upon third party ratings agencies and certifiers to evaluate companies' and products' green credentials, given the complexity of such analysis. For example:

NEW!

In 2022, the FSA published *"The Code of Conduct for ESG Evaluation and Data Providers"* ("Code of Conduct").[71] The Code of Conduct includes advice to ESG evaluation and data providers and recommendations to investors and corporations to ensure proper use of ESG evaluation and data throughout the investment chain. ESG evaluation and data providers are required to comply with the Code of Conduct, and if not, explain why they decided not to comply with it. The Code of Conduct also expects investors and corporations to carefully examine the purpose, methodologies and limitations of ESG evaluation and make proper disclosure of their approach to ESG evaluation and data. Japan was the first country to take such measure with respect to rating agencies and data providers. A group of leading ESG evaluation providers in Japan, including S&P Global, endorsed the principles-based code of conduct.[72]

The Securities and Exchange Board of **India** has approved new rules for rating a company on environmental, social and governance issues, to aid investors comparing the green credentials of different companies.[73] Additionally as of July 2023, ESG rating agencies are now required to obtain certification to operate in India.[74]

In **South Korea**, the Financial Supervisory Service has issued new guidelines to enhance transparency on credit rating agencies' certification of ESG bonds.[75]



GREEN & TRANSITION TAXONOMIES

Efforts are being made to create green or climate taxonomies. The aim is to establish a common language and clear definition of what is sustainable by means of a classification system for sustainable economic activities, in order to more clearly direct capital to sustainable projects. The global frontrunner on this front is the EU's Taxonomy for Sustainable Activities.[76]

In Asia some notable domestic developments on green taxonomies include the following:

NEW!

Japan reportedly does not intend to introduce a green taxonomy. However, the Ministry of the Environment has provided an illustrative list of eligible "Green Projects" in Annex 1 of the "Green Bond and Sustainability-Linked Bond Guidelines 2022" and "Green Loan and Sustainability-Linked Loan Guidelines 2022," referenced in the Labelling Standards section above. The list is based both on current Japanese market practices as well as the eligible Green Project categories in the ICMA's Green Bond Principles. Additionally, the industry-specific "technology roadmaps for the transition to decarbonization," developed by the Ministry of Economy, Trade and Industry (METI) and the Ministry of Land, Infrastructure, Transport and Tourism (MLIT), have been viewed by industry as an unofficial taxonomy on transition finance. Roadmaps have been developed to specifically address carbon-intensive industries, including iron and steel, chemical, electricity, gas, oil, pulp and paper, cement, automobile, aviation, and shipping to achieve a transition to a carbon-neutral economy. The roadmaps aim to assist financial institutions in determining whether certain companies' strategies and initiatives toward decarbonization match the qualifications for "transition finance," as defined by the Japanese Government.[77]

Indonesia has released a taxonomy to support businesses in describing their green activities.[78]

Malaysia has issued its Climate Change and Principle-based Taxonomy[79] (climate focused sustainability taxonomy for the financial sector) and its Securities Commission has released its Principles-Based Sustainable and Responsible Investment Taxonomy for the Malaysian Capital Markets, which aims to guide classification of economic activities that qualify as sustainable investments.[80]

Singapore's Green Finance Industry Taskforce is developing a taxonomy to identify activities that can be characterised as green or transitioning towards green, to tackle greenwashing in sustainable finance and guide financial institutions.[81] It is noteworthy that the latest consultation includes specific criteria on the managed phase-out of coal-fired power plants.[82]

The Bank of **Thailand** and Thailand's Securities and Exchange Commission published the first phase of its sustainable finance taxonomy in July 2023.[83]

In **Vietnam** there is a draft decision on green project classification (though this is still in development).[84]

Given the number of these taxonomies being created at a national level, there is some attempt to create uniform taxonomies across jurisdictions. The ASEAN taxonomy for sustainable finance aims to be the reference point for classification of sustainable projects and activities in ASEAN.[85] It is an initiative focusing on environmental objectives, which is currently in development with its second version released in 2023. In addition, China and the EU are developing a Common Ground Taxonomy on Climate Change Mitigation.[86] There are also specific initiatives such as the Climate Bonds Initiative's Climate Bonds Taxonomy.[87]

The challenge for organisations in navigating this rapidly evolving patchwork of voluntary and compulsory standards and guidelines relating to green claims, green products and green investments is significant, as is the task for regulators attempting to encourage and enforce compliance.

NET ZERO INTEGRITY

Recognising the urgency of addressing climate change, net zero commitments have been made by a large number of organisations globally. As at the end of 2022, according to one analysis, 73% of the world's largest financial institutions had made a net zero commitment.[88] Of these, as high as 65% have set interim targets identifying specific decarbonisation goals to be met prior to 2050.[89] While this is positive progress, there is continuing concern about the credibility of these commitments. According to the World Benchmarking Alliance, only 2% of leading financial institutions have applied interim targets across the institution's financing activities.[90]

> **We urgently need every business, investor, city, state and region to walk the talk on their net zero promises. We cannot afford slow movers, fake movers or any form of greenwashing.**
>
> António Guterres
> UN Secretary General

Guidance is beginning to emerge to address these issues. The most significant development to date is the UN Net Zero Report,[91] establishing leading recommendations in respect of net zero commitments for non-state actors.

The UN Net Zero Report recommends that entities making net zero commitments should:

a. not build, invest, lend or underwrite any new fossil fuel supply;
b. not be involved in, invest in or lend to any companies involved in deforestation or other environmentally destructive activities;
c. immediately cut the company's own emissions across the value chain. This should include both absolute emissions reductions, as well as emissions intensity reductions, and should address emissions across their full value chain (scopes 1, 2 and 3);
d. have a comprehensive and transparent net zero transition plan, which is based in science and verified by third parties, with interim targets (for 2025, 2030 and 2035), and demonstrating how all parts of the business align with those interim targets and long term net zero targets;
e. report transparently and regularly on plans and progress to net zero by 2050;
f. for interim emissions reductions required by its net zero transition plan, not rely on voluntary carbon credits;
g. high integrity carbon credits should be used for beyond value chain mitigation;[92]
h. invest in a just transition, by participating in developing country-led initiatives to decarbonise and provide renewable energy access;
i. align policy, engagement and lobbying efforts, including memberships in trade associations, with the goal of reducing global emissions by at least 50% by 2030 and net zero by 2050; and
j. align stewardship activities (including proxy strategies) with decarbonisation policies.

Full details on the best practice for net zero commitments are found in the UN Net Zero Report itself. Following the UN Net Zero Report, the UNFCCC Secretariat has developed a Recognition and Accountability Framework to establish a process to monitor and analyse voluntary net zero alliances and initiatives and enhance transparency and accountability of entities making net zero commitments. Other useful guidelines for net zero integrity include the Science Based Target's Initiative's Corporate Net Zero Standard and its forthcoming standard for net-zero targets for the financial sector, as well as ISO's Net Zero Guidelines and the Investor Agenda's Investor Climate Action Plans, among others.[93]

D. ENFORCEMENT ACTION AGAINST GREENWASHING

Adressing the problem of greenwashing relies extensively on adequate enforcement measures. Regulators are therefore increasingly focusing on enforcement of and compliance with standards and other legal prohibitions against greenwashing.

Recent regulatory moves globally include the US Securities and Exchange Commission setting up a Climate and ESG Task Force Enforcement Division and the Commodity Futures Trading Commission's (CFTC's) establishment of an Environmental Fraud Task Force, to combat fraud and misconduct in derivatives and relevant spot markets, including the carbon markets. In Australia, the Australian Securities and Investments Commission has been issuing numerous fines for companies' greenwashing – it most recently stated that it would "up the ante" in 2023 and move from fines to court litigation, including in relation to superannuation funds and retail investment funds. Notably, regulators are now regularly cooperating across jurisdictions on enforcement actions against global entities.[94]

Regulators in Asia are at a more nascent phase in enforcement action against greenwashing. To date, there have been no reported fines by regulators in the region. Yet, there are signs that regulators across Asia may soon ramp up their activities. The South Korean Ministry of Environment has reportedly launched a greenwashing investigation into domestic oil and steel companies SK Energy, SK Lubricants and POSCO,[95] following claims of greenwashing by a civil society organisation. It has additionally issued a draft law introducing fines for companies that mislead the public about their environmental impact.[96] Hong Kong's Securities and Futures Commission issued its Agenda for Green and Sustainable Finance, announcing that *"there is a clear consensus that regulators should ensure green finance initiatives are properly regulated and market integrity and investor protection are maintained."*[97]

NEW! In Japan, the FSA made some enquiries to asset management companies that included the term "ESG" in their funds, to clarify how ESG was being considered.[98] Companies' sustainability disclosures can now be subject to enforcement by the Securities and Exchange Surveillance Commission (SESC). While not a climate-specific case, it is notable that the SESC in Japan recommended administrative disciplinary action against maneo market Inc on 6 July 2018, due to false representations for the solicitation of funds. Maneo market Inc. misrepresented that the fund capital would be used to invest in renewable energy projects, including solar and biomass, despite the fund capital being used for other purposes.[99] Explicit greenwashing claims have also emerged in relation to non-financial products, where the Consumer Affairs Agency ("CAA") of Japan have recently taken several enforcement actions in the form of administrative orders against companies for false labelling of products as biodegradable without any reasonable ground for such a claim.[100]

The number of greenwashing claims in courts across the globe is rising exponentially. To date, claims against corporations for greenwashing have largely been initiated by non-governmental organisations (civil society), concerned citizens, or with the help of whistle-blowers. Rulings against corporations have mainly come from advertising standards bodies, as well as from financial sector and competition and consumer regulators. That said, enforcement by environmental regulators is also on the rise.[101] While complaints / notices lodged by concerned citizens and non-governmental organisations continue to grow, competitors have also been seen to seek enforcement against greenwashing companies. Where a company's greenwashing can be identified to have caused economic loss to third parties, claims, and in particular class actions by shareholders and consumers, may also arise. As more climate reporting regimes become compulsory, central banks and other authorities administering these reporting requirements will also be expected to pursue enforcement action.

CLASSIFYING FORMS OF GREENWASHING AND ENFORCEMENT ACTION

The growing multitude of greenwashing claims in the financial sector, together with the enforcement action these attract, can make for a dense and confusing landscape. The typology in the table at page 17 (i.e., Table 1) assists in navigating this landscape. It classifies greenwashing into various categories, together with corresponding examples (in the public domain) of claims in relation to those categories where possible. Where certain types of activity could conceivably be regarded as greenwashing, hypothetical examples to illustrate the legal risk are provided.[102]

While many of the examples of existing greenwashing claims are in jurisdictions outside Asia, there are some notable examples which demonstrate certain jurisdictions in Asia already being active in identifying and seeking to prosecute greenwashing.[103] As noted by the Asian Development Bank, climate change litigation is not a distant risk but a current reality in Asia.[104] The greenwashing investigations that are currently active in Asia do not for the most part include court actions. It may be that the approach in Asia has tended towards notifying alleged greenwashing actions to regulators, rather than directly initiating court claims. Either way, pressure on companies accused of greenwashing in Asia is expected to intensify, both from civil society and regulators.

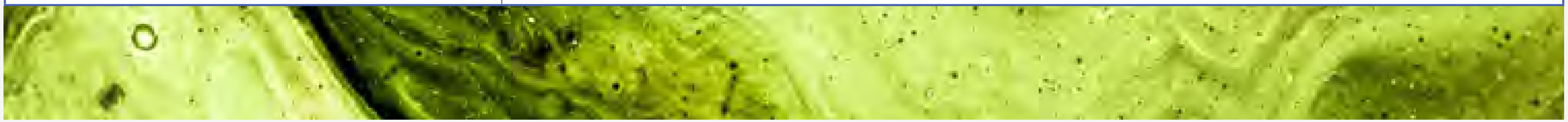
TABLE 1. TYPOLOGY OF GREENWASHING CASES WORLDWIDE

Types of greenwashing conduct	Illustrative examples
I. BRAND GREENWASHING: **Greenwashing of the organisation in overall terms, e.g. profile, activities, and ambitions** a. *Brand / reputational greenwashing:* claiming the company's business model is more environmentally sustainable than it actually is b. *Net Zero / ESG claim greenwashing:* company issuing unsubstantiated statements or claims, or action plans which do not meet emission target goals or align with green statements or with no credible implementation plans	• HSBC, a bank, was found by the UK's Advertising Standards Authority to be misleading in relation to its green advertisements because it omitted information about its financing of high greenhouse gas emissions companies, leading to the mistaken understanding that HSBC was making a positive overall environmental contribution[105] • Enviva, a producer of wood pellets, was sued by shareholders via a class action relating to its alleged false statements regarding its environmental sustainability in its business, operations and compliance policies[106] • Santos, a gas producer, is being sued by civil society organisation for its company-wide net zero emissions by 2040 and "clean energy" claims, which are alleged to be based on unproven carbon capture and storage technology[107] • TotalEnergies has been sued by civil society organizations over its net zero marketing campaign[108] • Royal Bank of Canada is being investigated by Canada's Competition Bureau for charges of misleading advertising, with its marketing material allegedly suggesting it was aligned with the Paris Agreement and that it aimed to achieve net-zero emissions by 2050[109] • Delta airlines is the subject of a class action lawsuit in the US, alleging that Delta's claim to be "the world's first carbon-neutral airline" by its use of offsets mislead consumers in violation of state consumer protection laws and laws prohibiting unfair and fraudulent business practices[110] • Australian mining giant Glencore is being sued by civil society organizations, claiming the company's continued expansion of coal production is inconsistent with its public net zero commitments[111] • The US Massachusetts Attorney General's Office filed a consumer and investor fraud lawsuit against ExxonMobil in state court, charging the fossil fuel company with systematically and intentionally misleading consumers and investors about its role in causing climate change.[112] More than a dozen other consumer protection lawsuits have been filed against the oil majors in US courts over misleading consumers regarding climate change.[113]

Types of greenwashing conduct	Illustrative examples
II. PRODUCT GREENWASHING: **Mislabelling / mis-selling products as green or with vague green claims when the product is only partially green or the green attributes are not a significant aspect of the overall environmental impact of the product, or there is a gap between the green product label / concept and implementation of its strategy**	• South Korea's SK E&S gas company was brought before the Korea Fair Trade Commission by a civil society organisation in relation to its description of a new "CO2-Free" gas development.[114] In response to the claim, SK E&S has modified its language to now claim the development is "low carbon"[115] • South Korea's SK Lubricants has been notified to regulators for its claims to sell carbon neutral engine lubricants.[116] It is reported that the South Korean Ministry of Environment has launched a greenwashing investigation into SK Lubricants as well as SK Energy and POSCO[117] • BNY Mellon paid a $1.5 million penalty due to the SEC's investigation for alleged misstatements about ESG attributes of mutual funds it managed[118] • Goldman Sachs Asset Management (GSAM) was investigated by the SEC for green claims made relating to its ESG funds in circumstances where there were no written policies or procedures for ESG research for a period, and once they were in place they were not consistently followed. GSAM was fined USD 4m[119] • DWS, German asset manager and part of Deutsche Bank Group, was investigated by the SEC, the BaFin and the Frankfurt prosecutor for allegedly misrepresenting some of its ESG activities. DWS is expected to pay EUR 21m to regulators[120] • Superannuation trustee fined by ASIC[121] for misleading consumers regarding the extent of negative investment screens of companies in carbon intensive industries[122] • Global Forestry Investment directors convicted of fraud following an investigation by the UK's Serious Fraud Office, in relation to allegedly green forestry investment funds in Brazil. Authorities in the UK and Brazil co-operated in the investigation, which resulted in the directors being jailed for fraud for 11 years[123] • Italian textile manufacturer won an injunction against a competitor company Miko S.r.l. requiring Miko S.r.l. to stop promoting environmental benefits of its products derived from petroleum[124] • Tlou Energy, an energy company, was fined by ASIC for false and misleading sustainability statements for its misleading claims relating to its development of a "low emissions" gas project and "carbon neutral" electricity[125] • Black Mountain Energy Limited, a listed energy company, was fined by ASIC for claiming that it was creating a natural gas development project with "net-zero carbon emissions", which was alleged by the regulator as not having a reasonable basis or being factually incorrect[126] • Mercer Superannuation (Australia) Limited, the trustee of the Mercer Super Trust (a pension fund), has been sued by ASIC in respect of alleged greenwashing claims which appeared on its website[127] • Whistle-blower complaint against JBS, the world's largest meat processor, to the SEC regarding alleged misleading and fraudulent "green bonds" it issued which were based on its commitment to achieve net zero by 2040. The complaint was that its emissions in fact increased, and its omission of key information regarding actual number of animals slaughtered per year[128]

TABLE 1. TYPOLOGY OF GREENWASHING CASES WORLDWIDE

Types of greenwashing conduct	Illustrative examples
III. GREENWASHED FINANCING: **Financial institutions providing green finance or finance for green objectives (whether by way of debt, equity, bonds etc) in assets (e.g. corporations, financial products, projects etc) that are themselves greenwashed** a. lenders provide "green" financing for projects that are "non-green" or which are used for non-green purposes b. lenders provide corporate financing for high emissions companies for their "green energy transition", when that company is still expanding fossil fuel production c. financial institutions finance sustainability-linked bonds, transition bonds or green bonds and such bonds are used for sustainable / transition / green <u>and</u> non-sustainable / non-transition / non-green purposes d. asset managers invest in underlying companies / assets that are greenwashed e. banks provide "transition finance" for a high emissions company to reduce its emissions, but with an emissions path which is not Paris-aligned or consistent with International Energy Agency's net zero pathways that limit global warming to 1.5°C with no / limited overshoot[129]	• BNP Paribas (similar to other non-financial sector leaders in France) is being sued by civil society organisations in France based on the French Duty of Care law[130] • Commonwealth Bank of Australia is involved in a legal claim with a shareholder seeking to investigate its financing of fossil fuel projects and its alleged non-compliance with its own ESG framework[131] • JERA Co. Inc, a Japanese power generator, has been notified to the Singapore Exchange in relation to its alleged failure to fully disclose risks relating to its USD 300m bond issue[132] • Class action filed against the Australian government for not disclosing the risks of climate change to sovereign bond investors.[133] While this claim is not in respect of a green product (the bonds are sovereign bonds, not green bonds), it provides an example of the claims that may also be brought against issuers in the future **Hypothetical scenarios that could be characterised as greenwashing include:** • Sustainability-linked bond issued by reference to sustainability targets that are irrelevant, or too low to have any meaningful climate impact, or which have already been achieved • Describing corporate financing for a fossil fuel company as "green finance" when the fossil fuel company plans to undertake a renewables development, but is also expanding its fossil fuel business • Issuing a green or sustainability-linked bond to finance infrastructure for high emissions industry (e.g. cement, aviation, fossil fuels), that is constructed with green building certification and/or will use renewable energy, or to finance projects to burn fossil fuels more effectively, e.g. 'clean coal' projects[134]

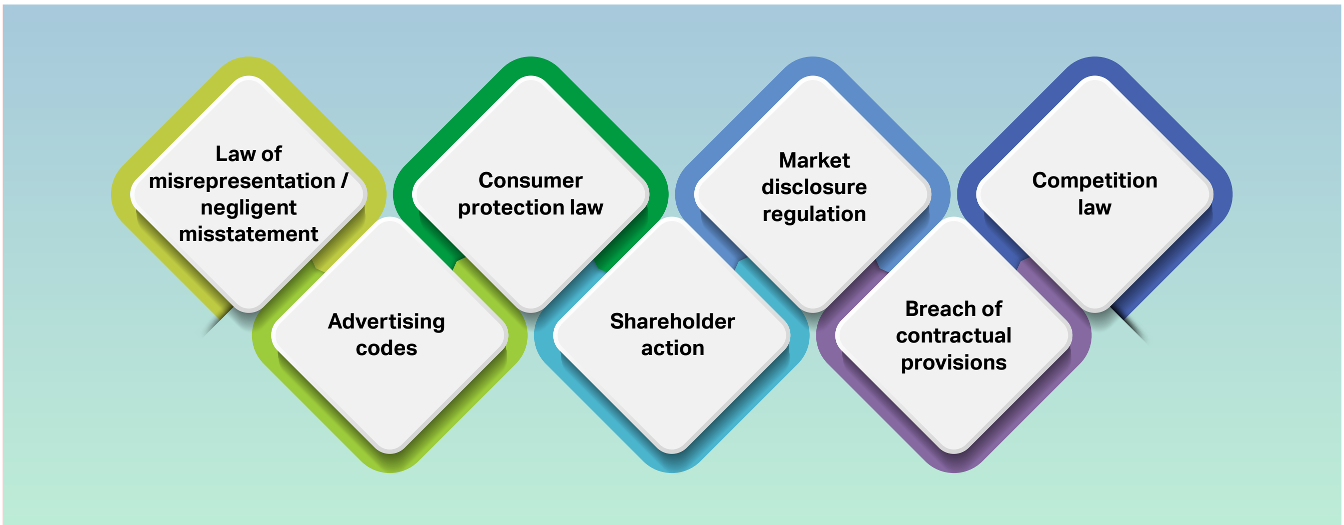


Types of greenwashing conduct	Illustrative examples
IV. FINANCIAL REPORTING GREENWASHING: Financial institutions making false statements or omissions pursuant to disclosure-based regimes, or failures to make adequate financial disclosures of relevant environmental risks of its business, financing, or investments and thereby underrepresenting its exposure to such risks	• Shareholders of the Commonwealth Bank of Australia sued the bank for the issuance of its 2016 annual report, in that it failed to disclose climate change related business / investment risks[135] • A civil society organisation has reported TotalEnergies to the French market regulator for allegedly underreporting its carbon emissions based on Total's own disclosures as compared to emissions standards used by the French state environmental agency[136] • Complaint against Just Eat to UK's Financial Conduct Authority regarding its annual report potentially misleading investors and exposing them to the risk of greenwashing by being led to believe its business / product is "sustainable" without disclosing a Paris-aligned strategy or aligning with emissions reduction commitments in countries where it operates[137] Shareholders of Exxon filed a derivative lawsuit against the company's directors and senior officers for misleading the public about climate change and its impacts on Exxon's business.[138] **Hypothetical scenarios that could arise with more mandatory disclosure regimes include:** • claim against a Financial Institution's reporting of its scope 1, 2, or 3 emissions being incorrect or incomplete or without disclosing relevant assumptions • claim by purchaser of a company in a mergers and acquisitions context, where the purchaser relied on climate reporting in the public domain or in due diligence that was misleading or incomplete. Claim for losses based on reliance on climate representations or warranties, including claims that the purchaser would not have purchased the company absent the false or misleading climate disclosure

LEGAL GROUNDS FOR CLAIMS AGAINST COMPANIES FOR GREENWASHING

Typically claims against companies for greenwashing arise out of existing laws and regulations in each jurisdiction, not due to specific climate laws.

These claims have a variety of legal foundations, and include the below:



Most of the above legal avenues for greenwashing claims have real world examples, demonstrating the wide range of legal bases that can be used to found allegations of greenwashing.[139]

In addition, there are increasing concerns about the legal risk of actions being taken against fiduciaries for their failure to manage and disclose climate risk (which may be inconsistent with their company's publicly stated climate commitments). These include claims for breaches of fiduciary duties by trustees for failure to act in the best interests of fiduciaries by omitting to disclose or manage climate risks;[140] and directors' duties breach claims against directors for their failure to fulfil their duty of care and diligence to the company relating to their management of the company's climate risks.[141] Also, where a company is in breach of disclosure rules, this could be the basis for a claim against directors for their failure to exercise due care and diligence. An example of a recent case against directors for failure to adequately manage climate-related risk is that against Shell's board of directors in the UK for alleged breach of their duties under the UK's Companies Act.[142]

CONSEQUENCES OF GREENWASHING

As noted above, greenwashing not only distorts the financial markets and undermines the allocation of capital to the green transition, but it also has direct impacts on the companies involved.

The direct consequences of greenwashing to the companies involved in greenwashing or associated with those companies are varied, and differ across jurisdictions. They include:

a. reputational damage and backlash against social license to operate or grow;[143]
b. orders to remove advertising / labelling of products / funds;[144]
c. fines and other sanctions imposed by regulators;[145] and
d. damages if loss is caused to shareholders / customers / competitors / contractual counterparties.[146]

Specifically in relation to greenwashing in the context of financial products, the consequences beyond the individual entities involved are also immense. They potentially include:

a. the repricing of the greenwashed financial product / company;
b. reduced ability of the company engaging in greenwashing to access capital markets / reduced demand for the financial product;
c. the repricing of the financial product asset class;
d. capital exodus from the financial product / category if large scale greenwashing in the product category is identified;[147]
e. negative impacts and reduced capital availability across other green asset classes (e.g. green bonds greenwashing activity impacting green equities, green index funds, ESG funds);
f. negative impacts on the financial stability of and investor confidence in green investment classes generally; and
g. reduced global progress on tackling climate change.

GREENWASHING OF TRANSITION FINANCE

NEW!

The International Platform on Sustainable Finance and the G20 Sustainable Finance Working Group[149] have now clarified that transition finance should be focused on supporting the progressive decarbonization pathways of carbon-intensive entities and their activities, rather than targeting only low- or zero-emitting economic activities and technologies (the domain of green finance). Two of the most prominent categories of transition finance products are sustainability-linked bonds (SLBs) and loans, and explicitly labelled transition bonds and loans.

Whilst transition-labelled bonds and loans provide financing tied to specific uses of proceeds -similar to green financial products, sustainability-linked product characteristics vary depending on whether the fundraiser, such as an issuer, achieves pre-defined sustainability objectives. Most commonly, this involves increasing the interest rate or coupon where a fundraiser fails to meet such objectives.

The underlying nature of transition finance increases the risk of transition-washing. While green finance products target projects that are immediate or near-term in their impacts, transition finance requires an investor to assess the credibility of a fundraiser's transition strategy in the short-, medium- and long-term.

Such an assessment is a complex exercise, particularly because, in many hard to abate industries, there is a lack of consensus on the technologies and economic activities that can credibly be said to be part of Paris-aligned sectoral pathways in different jurisdictions. Corporate transition planning efforts, sustainability assurance and the related regulatory frameworks, are also all generally in their infancy. Targets set by the company are often difficult to compare to peers or wider goals such as the Paris Agreement, and there have been concerns that some of the transition bond issuances, for example, have been 'business-as-usual' by another name."[150]

Ultimately, transition-washing may be most likely to occur where:

a. transition finance is provided for the development of unproven "low emission" technologies. In fact, these technologies facilitate carbon lock-ins; and/or
b. transition finance is provided to an entity which uses the financing for purposes not aligned with Paris-compliant sectoral transition pathways and/or in ways can be described as "business as usual"; and/or
c. transition finance is used for credible transitional purposes, but the fundraiser's overall transition strategy is nevertheless not executed on a trajectory that is sufficiently rapid, or adopted across sufficient product lines, to align with the Paris Agreement temperature goals.

These risks will necessarily be heightened if transition finance is provided to a fundraiser that has not prepared and disclosed a credible transition plan or strategy, including interim and long-term science-based targets supported by concrete plans and capex commitments to meet those targets.

Internationally, policymakers, regulators and industry initiatives are attempting to address these concerns, as exemplified by:

- the G20 Sustainable Finance Report (October 2022)[151]
- the OECD Guidance on Transition Finance (October 2022)[152]
- Climate Bonds Initiative, 'Transition finance for transforming companies' (September 2022)[153]
- International Capital Market Association (ICMA), Climate Transition Finance Handbook (June 2023)[154]
- Net Zero Banking Alliance, Transition Finance Guide (October 2022)[155]
- International Platform on Sustainable Finance, Report on Transition Finance (November 2022)[156]

Japan has been an early adopter of transition finance. Guidelines produced by the Financial Services Agency, Ministry of Economy, Trade and Industry (METI) and the Ministry of Environment in May 2021 define transition finance as finance: *"supporting the fundraiser who have set their target consistent with the Paris Agreement and satisfied the elements set forth in these Guidelines."* These elements include having a Paris-aligned climate transition strategy with science-based emissions reduction targets applicable to those parts of a fundraiser's business which are material from an environmental perspective. These guidelines have been supplemented by a series of policy measures, notably: the Japanese Government's adoption of the Basic Policy for Realization of Green Transformation: Roadmap for the Next 10 Years ("GX Basic Policy"), which includes the issuance of GX Transition Bonds, a carbon levy targeting fossil fuel importers and an emissions trading scheme;[157] METI roadmaps setting out specific technologies and economic activities for key industries;[158] and a Bank of Japan scheme offering low-interest refinancing to financial institutions providing transition finance.[159] Investors and financiers in Japan seeking to mitigate transition-washing risks should adopt a robust approach in first obtaining information regarding, and then scrutinizing and assessing, fundraiser transition plans at the pre-transaction stage, and progress against those plans post-transaction.

The FSA, MOE and METI's recently published *Transition Finance Follow up Guidance*, designed to help *"improv[e] the credibility and effectiveness of transition finance"*, further urges fundraisers and financiers to have a shared understanding of the fundraising company's transition strategy and to have frequent dialogue on strategy, targets, and decarbonization efforts, in order to confirm the fundraiser's progress. Notably, the Guidance recognizes *"criticisms [of…] potential greenwashing associated with transition finance, particularly in sectors where decarbonization technologies are not yet viable."*[160]

The *Follow Up Guidance* also discusses steps investors and financiers can take to engage with a fundraiser post transaction where progress against the transition strategy is slow or changes in the business or technological environment require the transition strategy to be updated.

At both the pre- and post-transaction stages, investors and financiers can supplement their scrutiny of fundraiser transition strategies by consulting internationally recognized sectoral transition pathways, such as the *IEA Net Zero roadmap,*[161] and transition plan standards, such as the report of the UN High Level Expert Group on the *'Net Zero Emissions Commitments of Non-State Entities'*. Given the early stage of development of assurance markets (which Japan has sought to address with its recently introduced Code of Conduct for ESG Evaluation and Data Providers), investors and financiers are recommended to maintain in-house climate finance expertise and not rely on second party opinions alone.

THE NEXT FRONTIER OF GREENWASHING CLAIMS

Beyond the above categories of greenwashing cases, this rapidly evolving area has seen emerging, even creative, forms of greenwashing which the regulatory regime will need to contend with in the future. Our expectation is that the next frontier of actions against companies considered to be engaging in greenwashing relevant to financial institutions may include:

a. **"Greenwashing by association"** – intermediaries or asset managers who include companies in their green portfolios based on the portfolio company's greenwashing, and represent their portfolios to be green, may be liable for misleading green representations. Likewise, companies who have joined net zero alliances but do not meet their commitments may be greenwashing by virtue of their association with the net zero alliance. Similarly, companies who claim to be green, but are also funding organisations which lobby against Paris-aligned goals, may also be found to be greenwashing.

b. NEW! **"Transition-washing"** – institutions may be greenwashing if they provide "transition finance" through products such as transition-labelled or sustainability-linked loans or bonds, to emissions-intensive corporations where: the company being financed does not have a credible emissions reduction strategy or transition plan; and/or some or all of the finance is not in fact used in good faith to implement the company's emissions reduction strategy or transition plan; and/or some or all of the finance is not used for any of the uses of proceeds stipulated in contractual documentation (where applicable). Credibility is assessed based on alignment with Paris Agreement temperature targets and internationally, regionally and/or jurisdictionally recognized sectoral pathways such as the International Energy Agency's (IEA) 'Net Zero by 2050' roadmap for the global energy sector.

c. **"Greenwashing via offsets"** – where a company markets a financial product as green but relies wholly or in material part on the purchase of voluntary carbon credits to support this claim, i.e., the increasingly contested practice of 'offsetting'. Claims on this basis have already been brought in Sweden against dairy company Arla, and in the Netherlands against Dutch airways KLM, in relation to their use of carbon offsets to describe their high emissions activities as carbon neutral or carbon offset.[162]

d. **"Greenwashing claims brought by competitors"** – industry policing competitors' green claims. We expect to see more claims by companies against their competitors for greenwashing, like that brought in the Italian courts[163] for one company's greenwashing of its products causing damage to another company's competitive green advantage.[164] Competition law authorities are also expected to open up more investigations into competition law infringements.

GREEN-HUSHING?

There is concern that increasing regulation and allegations relating to greenwashing may lead to "green-hushing", where companies under-report or do not disclose their green credentials to avoid scrutiny or having to properly substantiate them. While these behaviours by companies are possible, we expect that given the immense green market opportunities, companies are likely to continue wanting to showcase their green credentials. Apart from the suggestion that green-hushing may itself be a form of greenwashing (and may ultimately still be subject to legal sanction),[1] companies are increasingly under mandatory legal obligations to make climate disclosures (regardless of whether their product lines or services are specifically focused on green industries or investments). Regulators are also reacting to "green-hushing," with actors like the Australian Securities & Investments Commission (ASIC) warning against unpreparedness when it comes to forthcoming climate disclosure requirements. As such, it could be less risky to make specific, clear, and accurate disclosures relating to material climate risks and other information, including forward looking climate risks than in omitting such information entirely. In this way, being transparent in identifying the limitations and uncertainties of the disclosures made would likely be a better course than "green-hushing".

E. GUARDING AGAINST GREENWASHING: THE FIVE PILLARS

Greenwashing is an area of significant legal and commercial risk, not only for the Asian financial sector as a whole, but also for individual financial institutions and their officers. To mitigate this risk, we set out below relevant points to consider to guard against greenwashing or being associated with greenwashing by third parties.

SCREEN YOUR GREEN

Scrutinise the accuracy and credibility of any green statement.

1. **Accuracy of claims:** avoid vague terms and ensure your statements can be fully substantiated. Green claims should be objective, accurate and have sufficient specificity regarding the objective of the product:

    a. Consider what different members of the audience for these claims might understand by them and make reasonable efforts to ensure that no one would be misled by them. For example, if it is a "fossil fuel free" fund, consider if the fund is invested in companies that distribute fossil fuels or whose core business is servicing the fossil fuel industry.
    b. If a financial product is stated to have an environmental impact, explain what that environmental impact is,[165] e.g. if the fund has a negative screen on fossil fuel companies or a specific sector focus, explain the environmental impact of that screen / sector choice. Explain the investor impact, which is the change that the investor creates (e.g., by allocating capital to the investee company and identifying which specific investee company initiatives are due to the investment capital).[166] Explain also the investee company's impact in the real economy (e.g., investee company has increased capital to expand its technology to reduce the emissions intensity of existing manufacturing processes).
    c. Where repeating or adopting green representations by third parties (e.g., investee companies, banks' clients, or ESG data providers), ensure you have either scrutinised those representations to determine that they are credible, or made clear that they are the third party's representations, not your own. For example, where an investment advisor is marketing a green financial product, they should make clear that the green claim is the issuer's claim, not the adviser's own representation.
    d. Ensure information is consistent across different channels, from product disclosure statements to social media. Resist any temptation to exaggerate green claims (even in less formal media channels and advertising).
    e. Consider warnings and disclaimers, making clear what the product or business does not do, if that would ensure a reader would not be misled.

2. **Past, present, and future statements:**

    a. Be mindful of past green claims and consider whether they are still accurate or need to be updated.
    b. Claims about a present business model or product should be made only where they provide a real benefit, not where they are insignificant or irrelevant. For example, if a sustainability-linked bond provides for the attainment of key objectives, the action needed to achieve those objectives should not be negligible, irrelevant or already achieved. If highlighting your organisation's green efforts, consider whether this might be misleading considering the overall profile of your organisation's business, for e.g., in continuing to finance fossil fuels.
    c. If making statements about the future, ensure you have a reasonable basis for making those statements (i.e. if you have a goal for emissions reductions, ensure that you have a reasonable basis for expecting to achieve those emissions reductions) and that you intend to pursue any announced plans to make good on the statement.

3. **Net Zero Commitments / membership of Net Zero Alliances:**

    a. The UN Net Zero Report[167] establishes leading recommendations for companies' net zero commitments.[168] While its recommendations are not law, companies should familiarise themselves with this report in order to manage their greenwashing risk. It is anticipated that many of the UN Net Zero Report's recommendations may be translated into regulatory requirements across jurisdictions.

    b. In relation to net zero alliances, it is important to understand what commitments your organisation has made in joining the alliance, and what action is required to meet them, including whether the alliance requires the disclosing of targets and any consequences for failure to disclose such targets (for example, the Net Zero Asset Managers alliance will delist members if they do not provide required disclosures of targets[169]). In addition, if you have joined an alliance but have not developed a transition plan to achieve net zero throughout your operations, consider whether you have a reasonable basis for your claim to achieve net zero, and whether this may give a misleading impression to the market.

IN GOOD AND GREEN FAITH

Be transparent about how the green objectives are integrated into the financial product and its financial objective.

1. **Clearly articulate investment methodologies:** explain whether the green statement aligns with the core approach to managing the investment product. In the case of a managed fund,[170] consider whether the green principles are integrated into the investment strategy (including whether the investment selection within the fund is consistent with the green claim) and if the investment methodology is explained, including any weighting between green principles and other relevant investment considerations. Are there qualifications to this approach or materiality thresholds (and if so what are these thresholds)? Do these qualifications make the overall product inconsistent with the green claims? Explain whether the approach is one of negative screening or impact.

2. **Manage investee companies/ holdings in accordance with green claims:** engage in adequate due diligence prior to investment, demand transparency on the underlying holdings, insist upon emissions and other environmental impact data (including reporting of environmental incidents, progress against their own green targets etc), and scrutinise the credibility of their net zero pathways (for example, against the UN Net Zero Report standards), alleged climate impacts, the data relied upon, and assumptions made. Be transparent about stewardship activities with investee companies and proxy voting. Be clear about your organisation's expectations of "transition" activities, and engage with companies to ratchet up their net zero ambitions and transition plans.

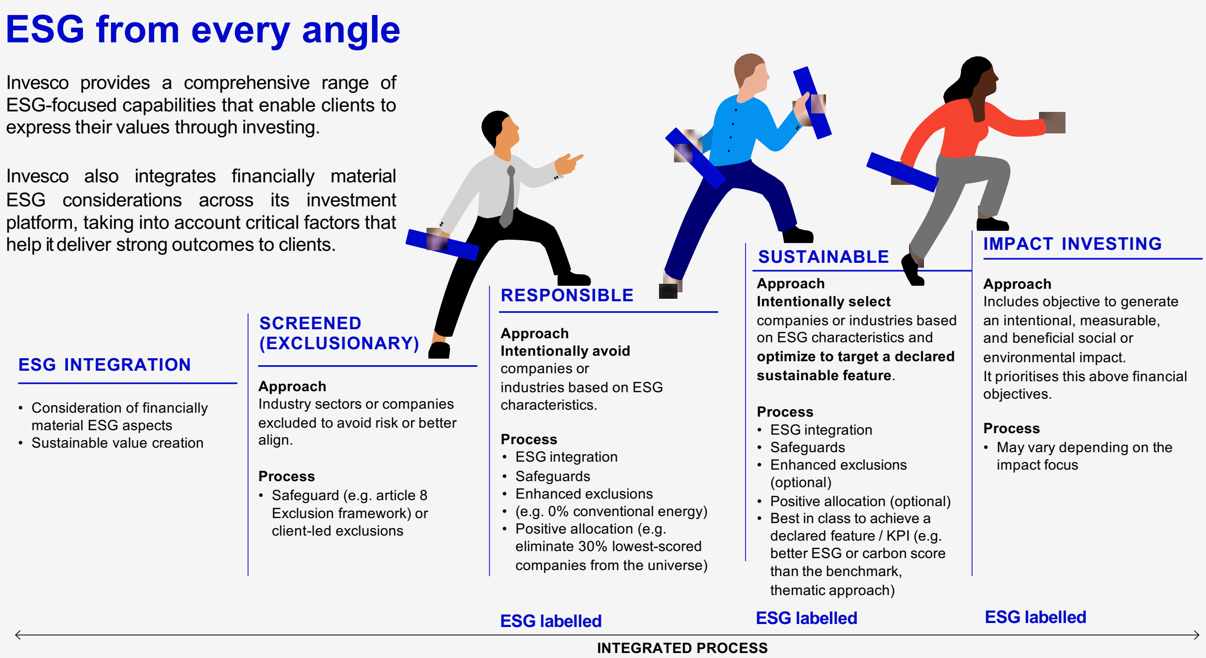
3. **Manage green financing:** ensure that any label being applied to a sustainable finance product, whether green, sustainable, sustainability-linked or transition, is consistent with credible international guidelines, for example those published by the International Capital Markets Association, or published taxonomies. Consider ensuring that a high-quality third party opinion is obtained to verify the appropriateness of the relevant label.

4. **Influence over the index:** if the issuer has influence over the benchmark index against which its product's performance is measured, disclose the fact and nature of that influence. Absent this, an investor may assume the issuer has no influence when it in fact does.

5. **Data:** identify data limitations and explain the consequences of those limitations to the product or organisation's green strategy. Explain / scrutinise data sources relied upon. Identify whether data is incomplete or non-standard or limited in other respects, and what is being done to address these limitations. Explain whether the data is third party audited and how often it is updated. Identify whether third party ratings organisations are relied upon. Ensure your organisation has sufficient internal capacity to analyse that data.

INVESCO CASE STUDY: CREATING AN ESG INVESTING NOMENCLATURE

With investors having differing ESG objectives and approaches, Invesco has created an ESG investing nomenclature to enable investors to express their values through a spectrum of approaches and requirements in their investments. To create greater transparency for investors, Invesco's ESG nomenclature provides five different ESG strategies. This is set out in the infographic below:



Source: *Invesco Stewardship Report (2021 ESG Investment Stewardship Report)*

Increased regulations to address greenwashing risks, such as ESG fund disclosures and requirements, have helped create clarity in defining ESG investing. However, challenges remain in navigating regulatory differences across regions.

One way Invesco navigates these different regulations is by having a proprietary internal framework that maps the ESG investing approaches onto the different regulatory requirements across the global geographies. For example, in accordance with the fund nomenclature, the ESG Integration and Screened (Exclusionary) approaches would not be regarded as or capable of being labelled an ESG product under the HK SFC's or Singapore's MAS ESG Fund Disclosure Circular / guidelines. However, the Responsible, Sustainable, and Impact Investing approaches may be, if the strategy includes ESG factors as a key investment focus (negative screening alone would not be sufficient).

It is Invesco's view that having a clear framework of ESG investing objectives alongside a standardised nomenclature of ESG approaches aligned to varying regulations will help facilitate better understanding and clarity amongst investors when thinking about sustainable investing.

WALK YOUR GREEN TALK

Ensure the company or fund's green image is consistent with the internal actions of the company or fund and their actions in relation to third parties.

1. **Align labelling of the financial product with stewardship:** to the extent the financial product's investment strategy includes stewardship (including engagement with management and the use of shareholder rights), this stewardship should be active and aligned with the green statement / product label / net zero commitment and there should be transparent reporting on this stewardship and on proxy voting. Advocacy and lobbying should be consistent with the green claim.[171] In the context of a fund, explain whether stewardship activities are carried out for all investments or only some, and if only some, why in relation to those investments only. Explain the degree of influence the fund's stewardship has and report on the outcome of those stewardship engagements.

2. **Ensure the organisation acts in accordance with internal green policies:** for example, if the organisation has climate or other ESG policies, including any validly passed shareholder resolutions related to climate commitments, ensure that they are complied with across the organisation including across business units and roles. This will often require systems and controls and board-level oversight to ensure compliance with such policies.

3. **Third party verification:** obtaining objective and robust external assurance of climate reporting[172] will provide additional analysis to the company's assessment and lend credibility to the market.

4. **Internal capability:** consider whether additional internal skill or capacity is required to address the green objectives and reporting obligations. Ensure adequate training so that marketing functions within the organisation or those distributing the financial product understand the green claims and investment strategies. While doing so, refrain from exaggerating any green or sustainability credentials of staff in order to guard against risks of "competence greenwashing." [173]

ABRDN CASE STUDY: ONE FINANCIAL INSTITUTION'S APPROACH TO TRAINING STAFF ON ESG RISK

At abrdn, there is a focus on training to ensure the long-term success of its sustainable investing approach. This is true particularly given increasing regulatory expectations, including the MAS Guidelines in Singapore, which explicitly ask asset managers to equip their staff with the adequate expertise on environmental risk management.

To do so, abrdn launched a global sustainable investing learning and development program. Accessible to all staff across their Investments Vector, it is tailored to the roles and responsibilities of each team, with compulsory and recommended training sessions on a wide-range of topics – from the fundamentals of sustainable investing to regulations and proprietary tools and research. Within this program, a particular emphasis is placed on greenwashing, so that staff understands what it means, its potential implications and how to avoid it.

In parallel, abrdn recently hired a dedicated ESG specialist in their APAC Compliance team, to track ESG regulatory developments across the region, advise on regulatory compliance matters, conduct relevant training and assist in developing internal ESG-related compliance policies and procedures, all of which contribute to reducing risks of greenwashing.

OBSERVE THE CHANGING SHADES OF GREEN

Expectations and regulations are rapidly evolving, so monitor developments in all relevant jurisdictions.

1. **Monitor mandatory reporting obligations:** know your climate / sustainability disclosure obligations – consider if you are operating in a jurisdiction where sustainability or climate disclosures are compulsory, or if they will soon be. If so, ask if you have the requisite data needed to comply. Additional questions to ask to comply with potential obligations might include: are there any restrictions on the use of green terminology where your product is offered? Are there requirements that must be met in order to certify bond issuances as "green", or finance as "transition finance"? As a rapidly evolving space which differs by jurisdiction, you should keep updated on developments in the jurisdictions you invest or offer products.

2. **Monitor industry and stakeholder expectations (even where there is no mandatory reporting obligation) arising from net zero commitments/ alliances, market practice or soft law:** understand your customers', clients', investors' and other stakeholders' green expectations and incorporate them into your approach to your green products, financing activities, overall investment strategy and reporting. Inconsistent definitions of well used terms such as 'green', 'sustainable', and 'transition finance' across jurisdictions means that reliance is better placed on international standards linked to credible climate science rather than local market practice when managing sustainability communications and marketing.

BE ALERT TO GREEN DUTIES

Know your legal and fiduciary duties to investors/ stakeholders.

1. **Ensure directors and fiduciaries are acting in the best interests of the company/ their members by** managing climate risk in their funds / companies / finance portfolios and making appropriate disclosures. The precise nature of such legal and fiduciary duties will likely depend on the laws of the jurisdiction in question. Nevertheless, given the systemic risks climate change poses, this will often require monitoring and reporting on such risks regularly, including to the board, with internal audits of the assessment of these risks.

2. **Consider whether governance strategies are effective** to ensure ongoing compliance with green investment strategies, financing policies, and other green commitments. In most instances, these should be aligned with relevant science-based decarbonisation pathways – this may require such information or expertise to be specifically resourced or externally provided. Consider if these responsibilities are owned by senior leadership and overseen by the board, and even whether executive leadership's KPIs should be tied to green outcomes to align incentives with performance on green metrics.

F. CONCLUSION

Against the backdrop of the climate crisis and the accompanying push for a net zero economy, the cases of greenwashing are likely to grow – both in prevalence and variety. This has led to a smorgasbord of regulation and guidance meant to address this phenomenon, both within the Asian finance industry as well as internationally. By sorting these regulatory developments into five main categories, this guide aims to provide clarity on how greenwashing is currently being addressed by regulators and international bodies.

Additionally, the risk of legal claims being initiated against financial institutions in Asia by regulators, civil society and private actors is significantly increasing. With an extensive review of the most significant enforcement actions taking place against greenwashing, a typology of cases emerges that can be classified into (1) brand greenwashing, (2) product greenwashing, (3) greenwashed financing, and (4) financial reporting greenwashing. Financial institutions in Asia can learn from the lessons of the legal actions that are taking place across the globe and that are now beginning to emerge in the Asian region. Horizon scanning of greenwashing cases at the frontier also provides insight as to where legal and regulatory action may occur next.

With the above developments traversed, this guide provides some key recommendations for the Asian finance industry on how to avoid greenwashing, or being associated with it. While not intending to be exhaustive or conclusive, the five pillars can aid Asian financial institutions to consider how they might manage and mitigate greenwashing risks within their own organisations and those they have dealings with, raising the bar of best practice for all those engaging in the green transition.

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