GREENWASHING AND SEBI INITIATIVES TO CURB IT

Pradeep Ramakrishnan
General Manager
Department of Debt and Hybrid Securities
Securities and Exchange Board of India, Mumbai
pradeepr@sebi.gov.in

Abstract

With the rise of ESG as a major element in business, there is a need to granularly look at what is being termed as 'green', including the concept of 'greenium'. Even absent a greenium, the funds earmarked for 'green' could get deployed due to the deception/greenwashing, which is harmful to such funds as investors. This article attempts to unravel the maze that is greenwashing and also highlights the recent SEBI measures – among the first in the world by a regulator – to curb it.

Introduction – the term

Greenwashing is a portmanteau[1] of the words *'green'* and '*whitewashing'*.

It refers to misleading the general public into believing that companies, sovereigns or civic administrators are doing more for the environment than they actually are.

Greenwashing is also referred as "*green sheen*"[2].

Interestingly, the term originated in the 1960s, when the hotel industry devised one of the most blatant examples of greenwashing. They placed notices in hotel rooms asking guests to reuse their towels to save the environment. The hotels enjoyed the benefit of lower laundry costs[3].

What is it?

In short, Greenwashing is a practice adopted by companies by way of an advertising spin, essentially using public relations mechanisms to give a spin to projects that are less green than they are touted to be. This leads to a market for such goods, which is in reality based on deception. Nowadays, the scope of greenwashing has expanded to apply to fictitious environmental reporting or even activism as well as deceptive marketing practices.

Greenwashing is when an organization spends more time and money on marketing itself as environmentally friendly than on actually minimizing its environmental impact. It's a deceitful marketing gimmick intended to mislead consumers who prefer to buy goods and services from purportedly environmentally conscious brands.

Why greenwashing – '*greenium*'

Funds borrowed for *'green purposes'* generally command a *greenium* - A '*greenium*', or green premium, refers to pricing benefits based on the logic that investors are willing to pay extra or accept lower yields in exchange for sustainable impact[4]. '*Greenium'* is fast becoming part of finance dictionaries. Companies need debt for achieving sustainable goals as well as transitioning to green business. Towards this, they borrow funds and since the purpose is noble, investors, particularly institutional investors are willing to settle for a lesser return than a conventional bond or a bond that is used for 'brown' purposes. Thus a company is able to borrow funds at a low rate.

Greenwashing is also present in climate and environment related disclosures in the reports on sustainability and climate combat that companies put out to the public. To avoid this, the FCA, UK, has provided certain guidelines to companies, as under[5]:

"Where you are making net zero commitments, we encourage you to consider the TCFD's guidance on Metrics, Targets and Transition Plans, and to ensure that your disclosures are not misleading."

"We remind you of the direction of travel in corporate reporting on climate change and other sustainability matters, as set out in the Government's Roadmap on Sustainable Investing. We intend, subject to our usual public consultation processes and cost benefit analysis, to adapt our regime to reference forthcoming International Sustainability Standards Board (ISSB) standards – so, we strongly encourage you to continue to deepen your familiarity with the TCFD's recommendations and further improve your internal processes to ensure that you are ready to disclose effectively against the ISSB's standards once finalised and adopted."

[1] *A portmanteau is a blend of two words.*
[2] *https://www.britannica.com/topic/greenwashing*
[3] *https://www.investopedia.com/terms/g/greenwashing.*
[4] *https://www.undp.org/blog/identifying-greenium*
[5] *https://www.fca.org.uk/publications/newsletters/primary-market-bulletin-42*

The COMPETITION and Markets Authority in the UK published its Green Claims Code for companies in 2021.

Seven Sins of greenwashing[6]

TerraChoice, in 2007, identified the seven sins of greenwashing, as follows:

Sin of the hidden trade-off

A claim suggesting that a product is green based on a narrow set of attributes without attention to other important environmental issues. (environmental issues in making of paper, for example)

Sin of no proof

An environmental claim not substantiated by easily accessible supporting information or by a reliable third-party certification. (E.g. Plastic, tissue paper)

Sin of vagueness

A claim that is so poorly defined or broad that its real meaning is likely to be misunderstood by the consumer.

Sin of worshiping false labels

A product that, through either words or images, gives the impression of third-party endorsement where no such endorsement exists; fake labels, in other words.

Sin of irrelevance

An environmental claim that may be truthful but is unimportant or unhelpful for consumers seeking environmentally preferable products.

Sin of lesser of two evils

A claim that may be true within the product category but that risks distracting the consumer from the greater environmental impacts of the category as a whole. (Organic cigarettes, for example)

Sin of fibbing

Environmental claims that are simply false.

Recent instances of greenwashing:

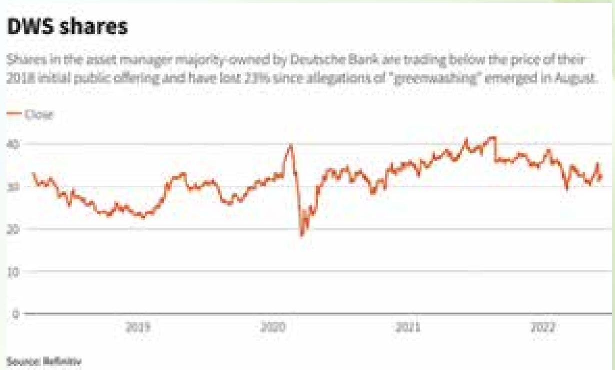
It is pertinent to discuss a few recent international cases on greenwashing.

Case of DWS

First, the case of DWS, an associate company of Deutsche Bank, which exaggerated the green credentials of investments it sold to investors. In fact, in May 2020, DWS showcased its sustainable investment credentials, saying it will use artificial intelligence to identify companies with climate risks.

In 2021, one Desiree Fixler, a former head of sustainability at DWS, blew the whistle and stated the company overstated how it used sustainable investing criteria to manage investments. Initially DWS denied the allegations – Its Board, in July 2021, cleared any wrongdoing on the part of the company - but in June 2022, German regulator BaFIN found that the ESG factors had not been taken into account in many investments marked as 'ESG investments' and sold to investors.

This was after both the SEC, USA and BaFIN had launched separate investigations in August 2021. The CEO of DWS also had to reign in the wake of the investigations. The impact of greenwashing on the scrip of DWS can be seen from the below graph:



(Image source: Reuters, June 2022)[7]

Case of Goldman Sachs

In November 2022, Goldman Sachs Asset Management agreed in November to pay $4 million to the SEC, USA to settle alleged violations of its own environmental, social and governance policies and procedures[8]. In this case, the asset manager required staff to complete a questionnaire for every company it planned to include in the ESG investment portfolio prior to their selection. However, the SEC, USA, found out after investigations that *"personnel completed many of the ESG questionnaires after securities were already selected for inclusion and relied on previous ESG research, which was often conducted in a different manner than what was required in its policies and procedures"*[9].

"Today's action reinforces that investment advisers must develop and adhere to their policies and procedures over their investment processes, including ESG research, to ensure investors receive the advisory services they would expect to receive from an ESG investment," said the SEC in its Goldman Sachs charge press release.

In May 2022, BNY Mellon paid a penalty of $1.5 million for misstatements and omissions in its statements related to ESG funds. The SEC, USA said that "*it represented or implied in various statements that all investments in the funds had undergone an ESG quality review, even though that was not always the case.*"

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[6] *https://www.ul.com/insights/sins-greenwashing*

[7] *https://www.reuters.com/business/finance/deutsche-banks-dws-allegations-greenwashing-2022-06-09/*

[8] *https://www.ai-cio.com/news/walter-kress-receives-cios-2022-lifetime-achievement-award/*

[9] *https://www.sec.gov/news/press-release/2022-209*

SEBI and the regulatory framework on greenwashing

Nowadays, companies are increasingly tom-toming their environmental, social and governance-related (ESG) credentials in an attempt to tap the investors eagerly awaiting such avenues to invest money, thus looking to have climate- and socially-friendly impact. Hence there is an increasing need for regulators to look into such issues with an eagle eye. SEBI has also taken a step in this regard.

Recently, SEBI revised its green bond framework, applicable for green bond issues after April 1, 2023. Pursuant to the review of the green bond regulatory framework, the following changes have been brought in by SEBI:

- *Expanding the scope of 'Green Debt Securities' by revising the definition through the of SEBI (Issue and Listing of Non-Convertible Securities) Amendment Regulations, 2023 ("Amendment Regulations")*
- *Enhancement of disclosure requirements and mandating third-party reviewers through amendments to existing Chapter IX of the Operational Circular and*
- *Guidance on avoidance of green-washing through introduction of Chapter IX-A to the existing Operational Circular, and*

As part of the same framework, SEBI has also released a list of '*Dos and don'ts on Greenwashing'*, vide circular dated February 3, 2023. SEBI is one of the few regulators to issue such a list and it is expected to act as a strong deterrent to the deceptive practice.

1. Regulation 2(1)(q) of the SEBI (Issue and Listing of Non-Convertible Securities) Regulations, 2021 (NCS Regulations), defines "green debt security" and Chapter IX of the Operational Circular dated August 10, 2021, *inter-alia* provides the initial and continuous disclosure requirements for entities issuing/ proposing to issue green debt securities.
2. The extant framework of '*green debt security'* was reviewed recently and consequential changes were brought in the SEBI (Issue and Listing of Non-Convertible Securities) Regulations, 2021 vide Gazette notification dated February 02, 2023. In the process of consulting the stakeholders, comments/ representations from the market participants, particularly investors, were also received to address the concerns of *'greenwashing'*.
3. While there are no universally accepted taxonomies on greenwashing, the generally accepted definition of '*Greenwashing'* is, '*making false, misleading, unsubstantiated, or otherwise incomplete claims about the sustainability of a product, service, or business operation'*.
4. SEBI has said in its circular that to address the concerns of market participants, regarding greenwashing, an issuer of green debt securities shall ensure the following to avoid its occurrence:

   i. While raising funds for transition towards a greener pathway, it shall continuously monitor to check whether the path undertaken towards more sustainable form of operations is resulting in reduction of the adverse environmental impact and contributing towards sustainable economy, as envisaged in the offer document.

   ii. It shall not utilize funds raised through green bonds for purposes that would not fall under the definition of *'green debt security'* under the NCS Regulations.

   iii. In case any such instances mentioned in (ii) above come to light regarding the green debt securities already issued, it shall disclose the same to the investors and, if required, by majority of debenture holders, undertake early redemption of such debt securities.

   iv. It shall not use misleading labels, hide trade-offs or cherry pick data from research to highlight green practices while obscuring others that are unfavourable in this behalf.

   v. It shall maintain highest standards associated with issue of green debt security while adhering to the rating assigned to it.

   vi. It shall quantify the negative externalities associated with utilization of the funds raised through green debt security.

   vii. It shall not make untrue claims giving false impression of certification by a third-party entity.

Conclusion:

Newer white collar delinquencies continue to evolve and are discovered every other day. Greenwashing is one such wrongdoing. It is important for companies that market ESG to establish equitable policies and procedures governing ESG factors. They have to ensure compliance with such policies and procedures so that they are able to provide investors with true information about their products and services. Regulators across the world are dealing with greenwashing in their own way. SEBI has been one of the few regulators to come out with an explicit circular on what constitutes greenwashing and how the same can be avoided by companies.

It is important companies avoid greenwashing in issues of green bonds by claiming that they are green when they are not or make false claims in the BRSRs. In case they launch green bonds, they must undertake due diligence before attaching sustainability or climate friendly labels to them. For example, proper reporting of emissions, logical and unbiased assumptions where needed, financial claims with proper proofs, labels denoting the true nature of the product etc. The potential and material impact of the risks shall be included in the financial statements. It is also important that the Board of companies also sensitize and institutionalise ESG systems. MA