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THEMATIC

In this report:

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'Greenwashing' could be the next risk for ESG industry

Appetite for environment, social and governance (ESG) has increased since the Covid-19 pandemic. It kick-started interest in businesses/investments that use money in a "good" manner. And the pace of green businesses/investments and demand from institutional investors gained momentum. The buzz is also present in finance. Banks are gearing more towards green investing strategies to meet the rising demand of clients.

However, the pursuit for sustainable businesses/investments from niche to mainstream raised some concerns. Fears are that some businesses/investments are taking shortcuts by labelling their corporate exercises as environment friendly, even in the absence of impactful green initiatives. They take advantage of the gap faced – variations in standards and a lack of third-party verification.

Are banks really going green with sustainable financing? More and more banks have made headlines on their commitments to being green or sustainable. But there is no common standard or framework to adhere to. Another challenge is the varying and complex nature of borrowers and lenders. Understanding complicated businesses/investments can be problematic. Commitments involve setting a target date to increase green or sustainable finance are what NGOs will look for to ascertain if banks are changing their behaviour away from "business as usual" and uphold their commitments to green and sustainable finance.

Some bankers will privately argue that their loan books will, to a varying extent, reflect the economies to which they lend to, and it is ultimately down to policymakers to change companies' behaviour. And companies cannot be the only ones. There needs to be a macro policy framework.

Given that it is difficult to quantify the "green behaviour", claims of greenwashing by the banks are likely to stay for a while. A tighter oversight is needed. There is a need for greater transparency in relation to green and sustainable financing. The selection process adopted by banks should be made transparent. This would help reduce the level of greenwashing. There is also a need to address human resource imbalances in terms of capabilities i.e. to what extent green and sustainable financing is covered. It must go beyond the existing CSR.

- Appetite for environment, social and governance (ESG) has increased since the Covid-19 pandemic. The pandemic raised public interest in sustainable living. Restrictive movements such as lockdowns and movement control orders either stopped or reduced the capacity of economic operations. However, it kick-started interest in businesses/investments that use money in a "good" manner.

- The pace of green businesses/investments and demand from institutional investors gained momentum. This is despite a lack of agreement on universally accepted standards. Governments began using the green concept as a catalyst to stimulate the economy and create employment by committing to cleaner and greener environmental targets. Green bond issuance accelerated in the past year as a by-product of the Covid-19 pandemic. Malaysia's green finance market touched US$1.3 billion (RM5.38 billion) in 2019 — the fourth-largest market in Asean, after Singapore, Indonesia and the Philippines. Some U$200 billion worth of global green bonds were issued for environmental projects in the first nine months of 2020.

- And the buzz is also present in finance. Today, there is sustainable finance, green finance and impact investment. They all revolve around the same platform of finance. It basically means investing in companies that follow the 17 SDG's (sustainable development goals) as stated by the United Nations such as decent work and economic growth, reduced inequality, responsible consumption, production and etc.

- More specifically, "sustainable finance" focuses on ESG considerations when making investment decisions that will turn longer term investments into sustainable economic activities. "Green finance" is a structured financial activity which is created to ensure a better environmental outcome. "Impact investment" focuses on investments made into companies, organizations and funds with the aim of generating a measurable and social as well as environmental benefits alongside financial returns.

- With a growing awareness to save the planet, people's mindset has changed. For instance, the corporates and big clients now focus more on green investments like green bonds, ESG ETFs etc. Banks are gearing more towards green investing strategies to meet the rising demand of clients.

- The pursuit for sustainable businesses/investments from niche to mainstream raised some concerns. The heightened interest among investors and stakeholders related to ESG led to some businesses/investments taking shortcuts by labelling their corporate exercises as environment friendly, even in the absence of impactful green initiatives. They take advantage of the gap faced – variations in standards and a lack of third-party verification since it is not mandatory at present and the definition of "green" (which is wide" and diluted) – to rename their products or investment as "green" even though they do not necessarily contribute to the environment.

- Some of the recent controversial incidents include a green bond issuance by the operator of China's Three Gorges Corp in Europe. It was heavily criticized as it polluted water and damaged the surrounding ecosystems. And there are asset managers who repurpose old unpopular company funds and mark it as ESG-compliant without providing supportive data for such claims. It is further complicated by the inclusion of companies in green indexes. The risk of abuse and "greenwashing" is high due to the standards that may not be as high or as tight as they should be.

- In short, while in pursuit of ESG, there is one common hurdle, which is "greenwashing". Greenwashing is a process where a business provides false information or misleading information on a product to be environment friendly. It is a claim to deceive consumers into believing the product is environment friendly. In other words, businesses/investments use misleading information to gloss over their bad behaviour. For instance, a business could claim that its product is made from recycled materials or it enjoys energy-saving benefits. It could be partially true or totally untrue.

- Thus, it is important for ESG-driven businesses/investments to evaluate the environmental impact. For example, if the businesses/investments plan to reduce carbon intensity, there is a need to have a carbon reduction mandate. The mandate must outline a clear and objective target that can be used as metrics to establish a carbon-intensity index. This in turn could be used by institutional investors to design their portfolio that focuses on businesses/investments. They will be then able to carry out informed decisions as opposed to what is happening now.

- But there is a challenge on the actual availability of a product that is a truly ESG compliant. With no clear-cut criteria on compliance and what is investable, what could happen is that one group may say it is not ESG-friendly while another says it follows the ESG criteria.

- And so, there is a need to check if ESG-related activities undertaken are approved by an independent third-party verifier. Public disclosures of green metrics and targets that have been audited by a certified third-party would help evaluate the authenticity of the ESG-related activities. There must be some form of legislation and regulators need to step up given that the number of ESG rating and scoring providers is booming, making it difficult for one to make sense of the different scorings and ratings, especially when there is no clarity on the underlying methodology. The European Union has put forward a plan that from 2021 onwards sets up performance thresholds and minimum safeguards meant to help investors and companies transitioning into a greener economy.

Are banks really going green with sustainable financing?

- More and more banks have made headlines on their commitments to being green or sustainable. Such pledges come with a cost from the NGOs. While banks' commitment to being green or sustainable is a step in the right direction, they fail to go far enough in areas like fossil fuels and other sectors. And it is difficult to assess the real economic impact from green or sustainable commitments.

- A key problem with green or sustainable pledges is that they are often inconsistent. There is no common standard or framework to which they all adhere to. Another challenge is the widely varying and complex nature of the borrowers and lenders, and the commitments rather than just the lending arms. Understanding complicated businesses/investments can be problematic.

- Commitments typically involve setting a target date to increase what is defined as green or sustainable finance. NGOs will look for evidence as to whether banks change their behaviour away from "business as usual" and uphold their commitments to green and sustainable finance. Banks will come under fire if the NGOs perceive that the banks are merely identifying opportunities for scaling up green and sustainable financing. For example, underwriting green bonds came under strong criticism with critics arguing that it did not constitute any "additional" green finance.

- Some bankers will privately argue that while they have an important role to play in the transition to a low-carbon economy, they cannot be expected to drive it. Their loan books will, to varying extent, reflect the economies to which they lend, and it is ultimately down to policymakers to change companies' behaviour.

- Bank financing decisions and product offerings play a significant role, but they cannot be the only ones. There needs to be a macro policy framework, which is beyond the banks' responsibility. Nevertheless, banks will certainly play their role which is on the upside.

- Given that the "green behaviour" is difficult to quantify, claims of greenwashing by the banks are likely to stay for a while. A tighter oversight is needed. There is a need for greater transparency in relation to green and sustainable financing. The selection process being adopted by bank should be made transparent. This would help reduce the level of greenwashing.

- There is also a need to address human resource imbalances in terms of capabilities i.e. to what extent green and sustainable financing is covered. This means going beyond the existing CSR, expanding the training of current staff by evaluating the quality of training programmes as not all programmes are created equal with the focus should be on the science behind ESG integration, and creating diverse teams that cover the complexity of ESG factors. Non-financial data becomes more science-driven and more people with scientific backgrounds, be it from the E, S, or G areas, must be hired.

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