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Greenwashing in Banks

Current Trend

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Concept

- The term greenwashing implies any dishonest practices used by businesses to represent themselves as more sustainable. This action occurs either by giving a false impression or providing misleading information related to the sustainability of a product/service and any environmental practice. Despite that financial institutions work to improve their public image and attract environmentally conscious customers and stakeholders, many are accused for overstating their sustainability efforts. This concept is gaining a special increased importance in the financial and banking sectors.
- Misleading communication around environmental and social topics not only impedes progress towards collective goals, but also damages trust with customers and investors

Background

- According to Deloitte, sustainable finance products (SFPs) have been at the forefront of the financial institutions market trends, particularly in the post-pandemic business strategies. Global reports indicate that a significant percentage of customers/investors search to deal with banks that demonstrate a high level of commitment towards sustainability. Despite this orientation, EU and UK banks face the most scrutiny over their environmental policies, net-zero pledges and financial instruments such as sustainability-linked bonds. Universal banks and global systemically important banks in Europe tend to have higher exposure to carbon-intensive sectors. This is because these sectors are dominated by large companies which typically enter financial relationships with larger banks. The analysis of the sustainability company “Sustainalytics” covering 15 large banks show that the number of litigation incidents related to the environmental and carbon impact of products increased twelvefold between 2020 and 2023. Larger banks attract more scrutiny from regulators due to their role in the global economy and their ability to mobilize capital for green financing.
- Regulatory bodies globally are beginning to investigate claims of greenwashing. In 2023, greenwashing in the financial sector became a central concern for U.K. and EU regulators. The European Banking Authority (EBA) noted that greenwashing risks were on the rise for banks. The Network for Greening the Financial System (NGFS) identified greenwashing as an emerging risk for the financial sector. UK Financial Conduct Authority’s (FCA) revised greenwashing rules with the aim of raising public

and industry expectations for how banks and investment firms should align their financing activities with global climate goals. Similar regulations are emerging in other regions, increasing pressure on banks to provide transparent and verifiable data regarding their environmental impact.

Importance of addressing Greenwashing in banks

- Greenwashing should be considered as a priority issue for banks and the financial services sector in most jurisdictions. The risk of greenwashing, and consequently the focus by regulators, consumers, and environmental groups, has increased exponentially as consumers/investors proactively seek 'sustainable', 'green', and 'planet friendly' products/investments. They are also challenging greenwashing via regulatory complaints, lawsuits and other action.

- Banks expect increased scrutiny of ESG credentials from regulators, shareholders, customers as well as other stakeholders. Banks should be proactive in mitigating the risk of allegations of misleading statements or greenwashing to avoid enforcement action and complaints, particularly, regulatory investigation and censure, civil litigation and the negative financial impacts arising from reputational risk.

- The business risks from greenwashing litigations include costs of damages and legal costs. Moreover, banks with high exposure to carbon-intensive industries may face credit risks. Lastly, if a bank is investigated for greenwashing, and particularly if it is found liable, the reputational risk will be significant. It can negatively impact its credibility, deposit growth, reputation as a player in sustainable finance, and eventually its competitive position in the sustainable financing business. When consumers discover discrepancies between a bank's claims and its practices, trust is eroded. Additionally, banks perceived as greenwashing may face divestment or lower stock valuations.

- With the heightened scrutiny around green products and services, and the higher risks associated with both financial and reputational loss, banks have a material interest in ensuring greenwashing risks are mitigated in their governance frameworks. To retain the confidence of their clients, banks need to manage their own greenwashing risks, as well as potentially passing on greenwashing risks to third parties which support them. It is worth noting that legal risk may become a much larger concern. It could spark new litigation from NGOs, clients, investors, and large shareholders that are concerned with a misalignment between a bank's stated strategy and its actual progress against its net-zero targets.

Challenges

1. Lack of Standardization

- The lack of universally accepted definition of what constitutes "green" or "sustainable" banking leads to varied interpretations. The diverse reporting standards: Different frameworks (GRI, SASB) create confusion, making it difficult to assess the credibility of claims.

2. Regulatory Gaps

- Regulators want to stamp out greenwashing to boost consumer and investor confidence and help encourage more cash towards sustainable investments, although there is no legal definition of what greenwashing is yet. The risk frameworks and control mechanisms have not evolved sufficiently to effectively identify, assess, and manage the risks associated with greenwashing. Many regions lack robust regulations specifically targeting greenwashing in the financial sector. Even where regulations exist, enforcement can be weak, allowing misleading claims to persist without consequences.

3. Customers Awareness

- Many customers may not fully understand sustainable finance products, making them vulnerable to misleading marketing. The abundance of information regarding sustainability can overwhelm consumers, making it difficult to distinguish genuine efforts from greenwashing.

4. Internal Challenges

- Shifting to genuine sustainability practices can face resistance from within the organization, especially if it conflicts with profit-driven motive. Banks may struggle to allocate sufficient resources to implement meaningful sustainability initiatives.

5. Market Competition

- As more banks promote sustainability, the pressure to engage in green marketing increases, leading some to resort to greenwashing.

Addressing the challenges of greenwashing in banks requires concerted efforts from regulators, banks, and customers. By fostering transparency, accountability, and genuine commitment to sustainability, the banking sector can work towards rebuilding trust and contributing meaningfully to environmental goals.

Practical Cases

Several practical cases illustrate how banks can engage in greenwashing, highlighting the need for greater transparency and accountability in sustainability claims. The cases can have several forms similar to:

1. Launching marketing campaigns emphasizing high commitment to climate initiatives while investing heavily in fossil fuels and industries with high carbon footprints.
2. Promoting for a sustainable investment fund with the participation of companies that have questionable environmental practices.
3. Claiming carbon footprint decrease based only on selective data without considering investment portfolio high emissions.

In 2021, for example, an NGO filed a legal complaint against Deutsche Bank, Barclays, Axis Bank, DBS Bank with the U.S. Securities and Exchange Commission (SEC) over greenwashing claims related to sustainability-linked bonds. These claims could be material for banks in light of the concerns flagged by UK financial regulators over the design of these bonds, such as inadequate incentive to meet sustainability goals, weak targets, and conflicts of interests.

In 2023, the Canadian Competition Bureau started an investigation against Royal Bank of Canada (RBC) over claims that the bank made false and misleading statements about its environmental policy, following a legal complaint from an NGO. The complaint required a fine and order against RBC to remove all statements the company made about tackling climate change due to its continuous finance to the fossil fuel industry.

Five of the world's biggest banks – Citibank, JPMorgan Chase, Itaú Unibanco, Santander and Bank of America are "greenwashing" their role in the destruction of the Amazon, according to the guardian's article that indicates that their environmental and social guidelines fail to cover more than 70% of the rainforest. The institutions are alleged to have provided billions of dollars of finance to oil and gas companies involved in projects that are impacting the Amazon, destabilizing the climate or impinging on the land and livelihoods of Indigenous peoples. The analysis found that on average, 71% of the Amazon is not effectively protected by the five banks' risk management policies. The majority of financing by the big five comes in the form of syndicated general corporate purpose bonds. These bonds, which are standard practice, are for broadly defined purposes and require little or no follow-up once an agreement is signed. This potentially makes it difficult to apply due diligence guidelines on specific environmental or social concerns.

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