Greenwashing in Sustainable Finance: Defining the Problem, Analysing the Drivers and Paths to a Solution

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Abstract. As the concept of sustainability has gradually become an important part of mainstream values, sustainable finance and financial products of this category have been receiving more and more attention in financial markets worldwide. In the rapid development of sustainable finance today, many issues and controversies related to it have been increasingly concerned by academics and related practitioners, the most representative of which is the "greenwashing" issue. This paper discusses the definition of greenwashing through the perspective of legal studies, and further explores the causes of the problem, with a view to obtaining a unique solution path that is different from that of other disciplines.

Keywords: Greenwashing, Sustainable Finance, Information Disclosure, Financial Regulation

1 Introduction

Sustainable finance is one of the most significant concerns facing the global financial sector today, and it plays an important part in the implementation of the United Nations concept of sustainable growth. For one thing, sustainable finance can help achieve the overall goal of society's sustainable development by, effectively mobilising and allocating financial resources to satisfy the financial demands of economic entities in the regions of climate change mitigation, low-carbon transformation, and fulfillment of social responsibility. For another, it can serve as a guide for investors to incorporate the environmental, social, and governance (ESG) factors of the financial entities into their investment decisions, while increasing the amount of investors who want to invest in sustainable development. Investment decisions are influenced by governance (ESG) factors, which increase the dimension of measuring the value of economic activities and expand the boundaries of traditional financial value discovery.[1]

These days, in the realm of sustainable finance, greenwashing is becoming a critical challenge. Yet, in the global sustainable finance activities, even though the concept of ESG has reached a consensus, its development is still occasionally in

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trouble. [2]Among the many phenomena that prove the existence of difficulties, the most representative and valuable for analysis and research is the phenomenon of "greenwashing". As its name indicates, "greenwashing" means enterprises and their businesses and products, failing to follow sustainable practices or possess limited influences, but which have labeled their company image with "green". [3]Nowadays, with the increasing popularization of the notions of ESG and sustainability, "greenwashing" is far from being concerned with enterprises and consumers, it also spreads to every subject and all parts of the financial sector and the whole social industries. Besides, every capital, commercial bank and investor is under the challenge of "greenwashing". This study aims to comprehensively explore the causes of the developmental dilemma of "greenwashing" through the perspective of jurisprudence and to give some references for ameliorating this phenomenon and elevating the growth of the world's green consumption and financial markets.

2 Literature Review

Firstly coined by Jay Westervel, an environmentalist, in 1986, the term "greenwash" intended to highlight the distinctions between certain firms' environmental statements and their real actions. [4]This concept, combining "whitewash" and "green", has subsequently gained traction as a vital way to assess the environmental programs of enterprises. The previous study primarily focused on tangible industries. Delmas and Burbano (2011) explores the appearance of greenwashing in enterprises of consumer goods and high-carbon industries.[5]

The United Nations' 2006 statement of ESG norms witnesses a shifting focus towards the environmental stewardship responsibilities of the financial sector (UNEP FI, 2006). [6]Researchers who have explored the complexity of products of sustainable finance and the difficult way of discovering greenwashing include Lyon and Montgomery (2015).[7] From their studies, the intricate services and products provided by the financial sector possibly conceal the real environmental impact, leading to deceptive or exaggerative claims.

The discussions over regulatory remedies to greenwashing go on. Since 2018, the EU Technical Expert Group on Sustainable Finance and European Commission have taken the initiatives to cooperate to optimize regulations intended to end greenwashing, showing the EU's initiative (European Commission, 2018).[8] Nevertheless, criticisms from scholars such as Boiral (2013)[9] and Testa et al. (2018)[10] highlight how these codices are often short of the enforcement and specificity essential for practical deterrence.

This research expands on previous works by investigating the jurisprudential justifications for greenwashing. Using the EU's Sustainable Finance Disclosure Regulation (SFDR) and Non-Financial Reporting Directive (NFRD) as case studies, it will critically evaluate the efficacy of present legislation and evaluate their influence on company behaviour. Furthermore, as noted by Schaltegger and Hörisch (2017),[11] this study will take stakeholder activism's impact on regulatory changes into account. This research tries to reinforce sustainable finance's efficacy and integrity by proposing specific regulatory framework reforms via the synthesis of theoretical insights.

3 Categorization and Motivation Analysis of Greenwashing

3.1 Categorization, Definition and Case Study of Greenwashing Guided by the Law of Subject Differentiation

From the subject of the goods sold in activities of sustainable finance, greenwashing can be classified into greenwashing by financial institutions and by corporations. They both obviously influence the investment market of sustainable finance.[12] The most intuitive manifestation among them, is that greenwashing practices will decrease the confidence of investors in the financing and sustainable investment market, which is disadvantageous for financial assistance for obtaining sustainable objectives. The investigation revealed that "greenwashing" is the biggest concern of investors in responsible investment, with over 44 per cent of investors worried that the SG-related enterprises' environmental performance in which they invest does not conform to the facts.[13]

Generally, enterprises' greenwashing causes unduly positive consumer views on environmental performance by means of "deceptive communication", promoting the sustainability of factors like operations, processes or raw materials. For example, some listed companies like Volkswagen in their ESG reports, disclose excessive reductions of emissions or claim investments of large scale in the sector without putting them into practice. [14]Corporate greenwashing is more common and may have various forms, like false advertising, technical greenwashing, promotional content that is vague and generalised and so on. Also, it contains many types of industries. The European Commission, in early 2021, conducted its first investigation on greenwashing activities in online marketing of various sectors, like household equipment, cosmetics and apparel. [15] It found that 42 per cent of the products' environmental statments were alleged to be deceptive or overstated. What merits mentions is that, except the EU, the USA, and other countries or regions with more developed green finance, the majority of the regions or countries, like mainland-China, fail to have an authority to regulate greenwashing. Besides, available special laws are extremely inadequate. In this case, only a few greenwashing practices are punished by criminal or administrative laws, and the rest of them are restricted by the complaints and comments of advertising regulators, commissions of consumer protection, and other related individuals or organizations without substantive punishments.

Some financial administrators have precisely defined the financial institutions' greenwashing, and the punishments are very severe. The Financial Conduct Authority (FCA) of the UK takes financial greenwashing as promotion that depicts policies, practices or products of an organization having good environmental performance while they fail to;[16] the US Securities and Exchange Commission (SEC) considers it as bragging or wrongly representing ESG elements that are considered or incorporated into ESG factors' portfolio selection. [17] The European Parliament regards it as the behaviour of obtaining a competitive advantage, which is unfair, by means of promoting financial goods that are environmentally friendly, which fail to conform to their real situations. [18] Generally speaking, greenwashing conducted by financial institutions presents the financial products' introduction with labels like "carbon neutral", "ESG", "sustainable" and so on, which fail to generate actual and reasonably positive environmental interests, and exposure of environmental policies or initiatives that do not conform to their real situations. In the listing of funds, bonds loans and other kinds of financial goods, greenwashing conducted by financial institutions possibly happen. Yet, the circumstances exposed and filed a lawsuit by the administrator have paid much attention to the fund goods' greenwashing by enterprises of asset management, with the related parties being fined, a decreasing price of shares, or a changing senior administrative personnel because of the investors' worries.

3.2 Analysis of the Drivers of Greenwashing

3.2.1 Theoretical inTerpretation of the Major Internalities of Sustainable Financial Greenwashing.

One component that directly shows the needs of the shareholder supremacy hypothesis is to rise revenues or cut down costs. Greenwashing can increase a company's revenue or reduce the expenses caused in environmental protection, and thus, obtain economic interests. As a result, enterprises possibly choose to make the maximal earnings by engaging in greenwashing. Walker and Wan thoughy that greenwashing obviously affects purchase purposes of consumers in heavily polluting sectors or in societies where consumers have more awareness of environmental protection.[19] Environmental protection, in practice, needs many investments, but with relatively low expenses, greenwashing can produce high economic returns, gain policy assistance and attention from consumers. When administrative regulations and laws do not punish greenwashing adequately, and the economic interests of greenwashing outrun the financial expenses caused by the penalties, enterprises possibly participate in greenwashing without punishment.

The second is to obtain a competitive advantage, which, to some degree, shows the performance of stakeholder theory. As the expectations of sustainable growth of consumers keep growing, the enterprises' green image has become a crucial part of competition, and they are able to obtain a competitive advantage by means of satisfying green demands of consumers with greenwashing practices. Businesses' green pro-activeness are closely related with the industry competitiveness and the practices of other companies within the same sector. In an industry that is very competitive, firms are supposed to compete in every aspect. Aggressively advocating the idea of protecting environment, or even overstating ecological outcomes, firms can attract the customers with environmental consciousness with lower expenses and therefore, exceed their counterparts.

3.2.2 Theoretical Explanation of the Major Externalities of Greenwashing in SustainableFinance.

Originating in the 1970s, the information asymmetry theory claims discrepancies exist in the subjects' command of information in a market economy. In other words, significant asymmetry exists between different entities, and in transactions, often, the subject that has fewer messages is in an unfavorable situation. This kind of asymmetry is commonly found among those subjects in terms of sustainable finance, governments, monetary institutions, companies, as well as individuals included.

First of all, financiers, green credit borrowers and sustainable bond issuers included, are in an absolute information favorable situation, while green credit lenders or sustainable bond approvers and purchasers are in an information unfavorable situation. This information asymmetry causes 2 things: first, the financier reinforces information superiority by applying packaging and rent-seeking strategies to change a project that is unsustainable into a sustainable one that follows standards of sustainable bond or green credit. In turn, this results in a condition where the identification of sustainable projects is under the information inferiority. The financier aims to secure financial support at a reduced cost through this process. Secondly, the financier utilise the eligible sustainable initiatives by means of the financial business that is sustainable to get funds but fails to distribute them by observing the norms and invest them in projects that are not green or fields that do not benefit sustainable growth. Meanwhile, different from the direct practitioners in the sustainable economical market, the administrative departments are in an unfavorable situation concerning information. This includes inadequate access to information concerning the green credit and sustainable bonds' approval process, the fund management of at the following stage, and the influences of the environmental amelioration, which undermines the efficiency of governmental regulation directly, and creates a gap for practices related to "greenwashing". At last, the disadvantageous information status of the NGOs, the mass media and the public decreases the external parties effective supervision of finance with sustainability, rendering the timely observation and modification of "greenwashing" impractical.[20] Meanwhile, the inaction of the party with unfavorable information position will also make the asymmetry worse. For example, in the field of green credit, the financial institutions' defective internal management possibly causes inadequate acquisition of information, possibly giving a likelihood for borrowers to "greenwash". Moreover, the vague governmental issuance or approval of sustainable and green credit bonds, together with unclear process regulations, makes the information friction enhanced among the major parties .

This asymmetric information gap makes investors select improper financial tools while finding sustainable financial shares and goods in enterprises that support their own sustainable views. Prudent investors and speculators tend more to be enticed by information asymmetry to make false sustainable investments without sufficient investor rationality, which possibly make the condition worse.

3.2.3 Explanation of Greenwashing Dynamics as Shown in Sustainable Financial Practices.

During the course of concrete practice, this research contends that from three perspectives, the greenwashing dynamics in sustainable finance might be examined.

First, in order to observe regulatory demands or to avoid condemnation from the related parties.

At this phase, financial regulators in some regions or countries, like the EU, have taken the ESG ratings, ESG investment and financing, the scale, sustainable financial wealth, growth rate and so on, as metrics for evaluating financial institutions. While they are able to motivate financial institutions to participate responsibly in the financial market, there is still room for improvement in the definition of standards and review tools. Nevertheless, right now, financial institutions are engaged in promoting greenwashing. Meanwhile, as the UN's concept of sustainable development is promoted and as supportive or regulatory sustainability policies made by the international community, countries and regions, are strengthened, companies (even those in traditional industries that consume large amounts of energy) more tend to create a sustainable company image through engaging in or applying development approaches that are sustainable to prevent denunciation by the related entities.

Secondly, meeting the demands of the market.

For financial institutions: greenwashing will attract more investors and make their financing size enlarged. Judging from the investigation, over a quarter (28 per cent) of international investors in 2022 deemed that ESG served as a crucial factor for their strategies to make investments, and 34per cent and 29 per cent of them "accepted" and observed the stance of ESG. [21]Thus, to promote their competitiveness in the market and attract more asset administrators, capital and some other things, those financial institutions tend to exaggerate research and ESG investment abilities, and even label products of non-ESG. For companies: With more consumers putting the notion of sustainable consumption into practice, the "renewable", "natural","biodegradable" and "sustainable" contents are prompted to be included in the publicity of companies (especially those in the FMCG industry) . Judging from the GlobalData, 39 per cent of Asia-Pacific consumers are actively searching for toiletries and cosmetics with ingredients only from the nature. [22] "Sustainable" goods have a better sales volume, and also a premium occurs, which implies that consumers would like pay more money for the goods' ecological attributes. For instance, generally, "biodegradable" packaging is more expensive than the regular one. In contrast, in the capital markets, a company commitment and image with sustainability change into positive investor expectations of company value, which increases share prices.

Thirdly, cut down the financing and investment expense.

Taking the Green Finance Reform Pilot Zone in China for an instance, a few regions or nations have applied supportive fiscal policies or monetary policies for "sustainable" and "sustainable" financial goods. In this case, financial institutions can receive financial assistance like financial subsidies, refinancing and so on, when implementing related labelling or obtaining convenience and time-saving during the course of issuing/listing and promoting products, thus reducing capital costs and operating costs. Consequently, those institutions are able to have capital assistance by means of financial subsidies and transferring loans by adopting the related labelling, or get convenience and shorten their time during the course of promoting products like listing/issuance, which cuts down the operating and economic expenses. Meanwhile, companies are able to obtain better ESG ratings because of their "sustainable" company image, helpful for getting green loans, issuing green bonds, or being involved in indices and drawing in domestic and overseas funds.

4 Solution to the Greenwashing Problem From a Legislative Perspective

4.1 The Status Quo of the More Typical Regulations - Based on the Optimization Process of EU's Anti-greenwashing

The European Commission, in March 2018, released the EU Action Plan for Sustainable Financial Growth, which appeals for creating a system for classifying sustainable taxonomies or actions. In May, the European Commission revealed a sustainable financial framework, which states the investors' duties and the general layout of the taxonomy and puts forward the Commission's Technical Expert Group (TEG) to help develop such taxonomy.[23] In June 2019, the TEG took the lead to put forward a technical report concerning the EU Classification Scheme for Sustainable Finance ("EU Taxonomy") for 67 financial practices. In June 2019, the TEG firstly published a technical report concerning the EU Classification Scheme for Sustainable Finance (the "EU Classification") to show technical selection standards for 67 financial practices and offers primary guidance on using the Classification. The EU legislature, in December, published the "Regulation on the Establishment of a Framework for the Promotion of Sustainable Investment and Sustainable Disclosure in the Financial Services Sector (Revised)", creating the sustainable financial practice classification [24]

Besides, it shows detailedly the legislative foundation for the layout of classification, the ecological aims, as well as the connection between participants of economic market, enterprises, and even the EU's principal entities and the legal duties of its members. Judging from the layout put forward by the legislative classification, the EU Technical Expert Group revised the categorization program correspondingly. The EU Technical Expert Group handed over the EU Sustainable Development Plan to the European Commission in March 2020.

Final Report and Policy Recommendations of the Financial Classification Programme.

4.2 Drawbacks of the Current Legislation -Taking the EU Classification as an Example

As the most intricate and multifaceted sustainable classification approach and system for targeting financial flows that has ever been created, the EU classification also shows some drawbacks. Firstly, as James C. Scott, an anthropologist, noted in his work Seeing like a State, all metrics originate from power relations. The EU classification is also inevitably influenced by political elements. Against the backdrop of today's complex geopolitics, the classification of gas initiatives and nuclear energy has become an issue that is highly politicized. [25] The EU Parliament, on 6 July 2022, polled in support of 'green labelling' of nuclear energy and gas through categorizing investments in them as sustainable behavior, in strict situations. Lots of European countries, Austria and Luxembourg included, and certain NGOs, strongly objected this and thought that it was impairing the EU's sustainable finance categorization credibility. For the time to come, this categorization will keep being questioned and affected by political reconciliations, geostrategies, giant companies' interests and carbon commitments, and intensive debates will last in terms of biofuels, genetically modified organisms, nuclear energy and natural gas. Second, without an efficient and uniform tool for classification, the excessive criteria for classification also somehow indicates low efficient choices for practitioners, with heavy expenses for practical use and inefficiencies. Those investors possibly buy a premium for such assets, and administrative demands will keep increasing, together with the fact that the existing categorization fail to classify the level of environmental friendliness. Besides, it is impossible to know which activities green economy should be funded. The short of greenness classification of the present taxonomy together with the inadequate message on which activities of green economy provides funds possibly causes excessive administration and deterioration of the green bubble for the time to come, which may impair European enterprises and banks' already weak profitability and bring risks. Thirdly, many of the EU Taxonomy's technical criteria in the environmental aims still need further revision, and some imitations exist in applying binary judgements in multifaceted financial practices. For example, environmental interests are cut down.

It is still possible for the same initiatives to have the same classification, and several defined sustainable activities also cause other problems concerning sustainable development, which contains the influences of natural gas, wind and nuclear energy imposed on biodiversity. Besides, even as the social aims appear, many problems keep resisting categorical true and false judgements. For instance, the EU classification possibly cannot tell what is the optimal approach and purpose for establishing uninsulated schools in poor regions or well-equipped architecture in developed areas. It is because the currently defined unsustainable practices are not necessarily harmful for human growth, and sometimes, the optimal way to civilization is merely a compromise. Yet, these ideas may be beyond the EU classification's present technical framework and legislative depth, more serving as a choice within the history of the human social civilization. Hence, for a financial institution, it needs to do more than just expecting the future sustainable categorization.

As the breakthroughs become more disruptive in such fields, people need to do more to pursue them actively, by closely cooperating with stakeholders to search for the optimal solutions to obtain the prospect for sustainable human growth and to find new chances for development.

4.3 Exploration for Solutions

4.3.1 Both Regulators (particularly financial regulators) Home and Abroad Will Enhance their Management of Greenwashing Activities.

The UN High-level Panel of Experts on Net Zero Commitments for Non-State Entities issued the report called Integrity Matters: Net Zero Commitments by Businesses, Financial Institutions, Cities, and Regions, stressing the necessity to enhance voluntary and mandatory greenwashing management. [26]Indeed, several countries, like the UK and the EU, have established or are during the course of establishing related laws to bring in initiatives that have more rigorous punishments. For example, the UK Competition and Markets Authority, in 2021, released a detailed guidance on its schedule for taking action against deceptive green statements[27], and the European Commission, in March 2023, handed in proposals for Green Claims Directive legislation, which can be applied to almost all companies that sell services or products in the EU to fight against "greenwashing" in the labelling and advertising of the companies' products.[28] The Directive demands that when enterprises make "green claims" in terms of their services or products, they are supposed to observe the minimum specifications on how to make their statements substantiate and how to interact with them, and rigorous and specific regulations on certification, verification and review. Failing to observe those regulations possibly causes fines of 4 per cent of the yearly turnover of an enterprise at least and forfeiture of revenues from defective products.

4.3.2 Related Parties Will Further Advocate the Establishment of Definition Standards for Sustainable Finance and Requirements for Information Disclosure.

First of all, the uniformity and practical values of the definition standards have been elevated. For instance, the newly released IPSF's Common Classification Catalogue for Sustainable Finance contains 72 financial practices that are quite conducive to ameliorating climate change. It is also acknowledged by the China-EU Classification Catalogue and reinforces the green transition activities' performability in various sectors and gives a confirmable guidance for stakeholders both home and abroad.[29] Strengthening of ESG disclosure management is the second change. For instance, the People's Bank of China (PBOC), in July 2021, disclosed "Guidelines on Environmental Information Disclosure for Financial Institutions", the standard for financial sector, which shows requirements for financial institutions when they disclose environmental information in terms of its frequency, form, quantitative and qualitative content.[30] The U.S. Securities and Exchange Commission (SEC), in May 2022, revealed two changed rules to enhance the disclosure demands related to ESG for funds and to stop funds using ESG from making wrong or deceptive claims.[31] The China Banking and Insurance Regulatory Commission ("CBIRC"), in June 2022, released the "Guidelines on Green Finance in the Banking and Insurance Industry", demanding institutions of insurance and banking to reinforce their administration of internal control and disclosure of information and to build a mechanism to evaluate green finance. The "Programme for Improving the Quality of

Listed Companies Controlled by Central Enterprises," established and then released by China's State Council State-owned Assets Supervision and Administration Commission (SASAC), in November 2022,, requires that by 2023, every listed company of China's central enterprises should disclose their ESG reports.[32] Besides, the proposal that the first two Sustainability Disclosure Standards (ISDS) will be formally effective on 1 January 2024 indicates that, by 2025, applicable enterprises are supposed to finish their first disclosure report about ISDS-compliant sustainability.[33]

5 Conclusion

Greenwashing practitioners and stakeholders possibly suffer from greater losses or challenges. For one things, as the regulations intensify, the possibility of financial institutions or enterprises involved in greenwashing facing penalties rises. Judging from the previous cases, those entities involved in greenwashing possibly faced penalties of millions of dollars (or euros), and market capitalisation evaporation, change of crucial personnel. For another, greenwashing possibly led to the related parties to make poor choices for managing risks, which may bring loss of time or capital costs. First of them, wrongly judging the financial assets' climate risk exposure. Greenwashing practices expand the size of green and sustainable-oriented financial goods and hinders the evaluation of the total assets', including green assets', climate risk degree, causing financial assets' undue exposure to climate risk. Secondly, it underestimates the financial requirements for the industrial low-carbon transition. Tools for resource distribution at the macro level possibly do not conform to the financial needs of the green transformation course of the industry, which will affect carbon neutrality and carbon peaking. This is because of the differences in stability, effect and direction between the expectations of the green investments and financial market and the real circumstances that go with greenwashing practices.

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