HOW TO DISTINGUISH THE GOOD FROM GREENWASHING:
GREENWASHING RISK IN THE CANADIAN MARKET AND MITIGATION MEASURES FOR FINANCIAL INSTITUTIONS

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INTRODUCTION

The growth in environmental, social and governance (ESG) assets worldwide has been accompanied by the emergence of a range of new opportunities and risks along with increasing investor scrutiny. More than 75 percent of Canadian investors are concerned that companies frequently overstate or exaggerate their ESG progress when disclosing results,[1] and it is viewed as the most significant challenge facing ESG/sustainable finance globally. Financial institutions have raised concerns that sustainability claims may be overstated, unreliable or used to conceal other environmental risks. These concerns are not unfounded. There exists a talent gap in the industry, given how new these issues are, and we are still coming to grips with this risk. In a global survey of CEOs and other C-suite leaders, 58 percent admitted that their companies were guilty of greenwashing and 66 percent questioned if their company's sustainability efforts were genuine.[2]

Imperfect information prevents financial institutions from making informed decisions and fully understanding trade-offs. This results in exposure to unaccounted risks. Yet, demand for ESG investment products has consistently increased despite greenwashing concerns, and capital inflows into the ESG space continue to accelerate. Financial service providers in the Canadian market need to be particularly diligent in identifying greenwashing, and mitigating potential risks, as Canada is the fastest-growing market globally for ESG assets and the market with the highest proportion of sustainable investment assets (relative to total managed assets.)[3]

This paper (1) examines the conditions and factors driving greenwashing and risks facing financial institutions arising from this growing phenomenon, (2) covers the primary types of greenwashing and (3) recommends methods and indicators to identify and help minimize exposure to greenwashing risk, as well as actions to reduce the amount of greenwashing present in the Canadian market.

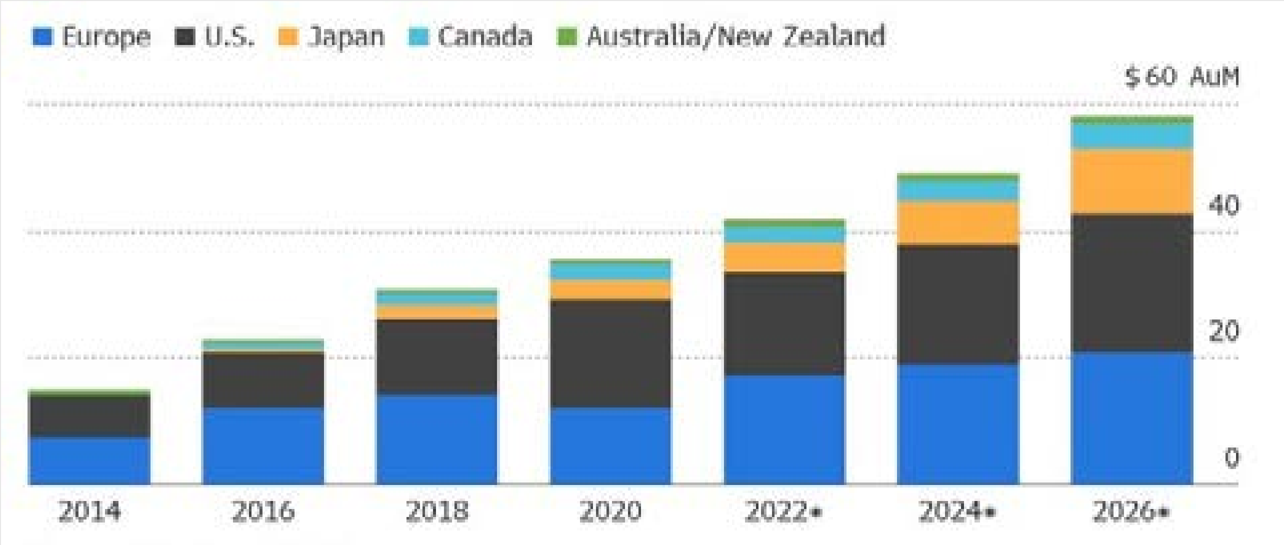
> Corporate greenwashing is characterized by firms advertising/promoting environmental credentials for their products and practices (or otherwise seeking to shape perceptions) that are materially inflated or even in contradiction to their performance.
>
> Financial firms are exposed to this risk through lending and investing in issuers and companies, and through the design of ESG or sustainability-labelled financial products.

1. DRIVERS OF GREENWASHING

In 2020, investments in the world's five biggest ESG financial markets – the United States, Europe, Australia/New Zealand, Japan and Canada - rose to US$35.3 trillion (Figure 1). Bloomberg Intelligence estimates the global ESG assets under management (AUM) will exceed US$53 trillion--more than a third of the world's total assets under management-- by 2025.[4] ESG investments in the Canadian market alone increased 48 percent from 2017 to 2019.

Since 2019, the Canadian market has had the highest proportion of sustainable investment assets and is currently the fastest-growing market globally. Those investing in the Canadian market face relatively high exposure to greenwashing risks in comparison to other developed-country markets. Increased greenwashing risk in Canada can be attributed to multiple factors including regulator response and investor demand. In some instances, these can combine to create a perverse incentive that worsens the risk of issuer greenwashing. Canada has traditionally used a principles-based approach to regulation, and the approach to ESG investment products has been no different. However, the Institute for Sustainable Finance found Europe and the UK are leading on sustainable finance issues, and that Canada has fallen

Figure 1: Global ESG products are set to exceed $50 trillion in the next five years



Source: *Bloomberg Intelligence*
Note: (*) indicates projections assuming a base scenario of 15% growth

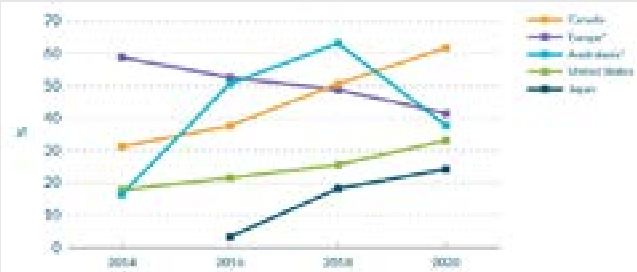
behind in the regulation of ESG assets.[5] Although exposing the industry to more risk initially, it is hoped the principles-based approach will lead to innovative practices, as the risk matures, without resorting to the need for stifling legalistic regulation. After all, no financial institution would purposely threaten their reputation on greenwashing.

A high proportion of sustainable investment assets, coupled with a rapidly expanding market fueled by capital inflows, can signal that a market is more susceptible to greenwash risk and can indicate inflated greenwash risk. Both these trends are indicators of greenwash risk as sustainable investing assets usually fall, or slow, after anti-greenwashing regulations are introduced. Following the introduction of anti-greenwashing rules, the European market for sustainable investment assets contracted by US$2 trillion between 2018 and 2020 (falling from US$14 trillion in 2018 to US$12 trillion in 2020.)[6] The decline resulted from regulators tightening the requirements used to classify responsible investments (Figure 2).

Since investor demand for ESG assets has outpaced the regulators' response to this market development in Canada, there is an incentive for certain issuers to engage in greenwashing (knowingly or unintentionally) to capitalize on demand. Following adoption of the Sustainable Finance Disclosure Regulation (SFDR), some assets that exited Europe were reallocated to markets with less stringent regulations, such as Canada. It is anticipated that this increasing market interest will continue driving capital toward ESG-branded investment products.

Regulations and upskilling of talent will help decrease the risk of greenwashing. This will help clarify what constitutes as greenwashing and ensure accountable officers will have the skills to identify the risks. The more mature and standardized the ESG space becomes, the less frequently greenwashing will occur. Sustainable finance regulations are evolving quickly in other jurisdictions. Canada must act to regulate sustainable finance or risk falling further behind its peers, such as the U.S. It must signal that it will move forward quickly to enact standards, regulations, and policies to combat greenwashing. Until regulations to prevent greenwashing are enacted in the Canadian market, it will not decline substantially, as

Figure 2: Proportion of sustainable investing assets relative to total managed assets 2014-2020



Source: *Global Sustainable Investment Alliance*
(http://www.gsi-alliance.org/wp-content/uploads/2021/08/GSIR-20201.pdf)

in other markets. Industry, associations and regulators are currently working together to develop mechanisms to counter greenwashing.

2. TYPES OF GREENWASHING RISK

Financial institutions which more capably identify and avoid greenwashing will reduce their exposure to potential litigation, financial, and reputational sustainability or ESG-related risks.

Litigation/Liability Risk: Those accused of greenwashing may open themselves up to legal action for misleading and deceptive conduct. Lawsuits seeking relief from climate change have already been filed in Canada, and it is anticipated that other types of ESG litigation will soon hit Canada's courts. Radha Curpen, co-head of Bennett Jones' LLP's environmental and Aboriginal law practice stated, "With the rise of ESG, there's inevitably going to be a rise in related litigation. The sheer breadth of the ESG umbrella suggests a vast playing field for lawsuits…a staggering range of litigation and regulatory risks. Companies need to remember that ESG obligations are not just voluntary, but are supported by both legislation and the common law, and that investors have broad and important expectations for ESG."[7]

Financial Risk: Greenwashing can present financial risk through multiple pathways. Greenwashing erodes trust in the sustainable finance market which negatively impacts those investments that are not greenwashed and, in turn, reduces transaction volume, hinders the price discovery mechanism and inhibits the growth of the sustainable finance market. In addition, misleading company claims can result in fines from a regulator. For example, Keurig was fined C$3 million and ordered to change misleading recycling claims on its packaging after leading Canadians to falsely believe their single-use coffee pods were recyclable. Regulator action to address greenwashing can cause share prices to decline and impact capital flows. After the U.S. Securities and Exchange Commission opened an investigation into Deutsche Bank's asset manager, DWS, over greenwashing concerns, the share price of DWS fell almost 10 percent.[8] Greenwashing can also change consumer sentiment, in turn reducing demand for certain products, such as single-use plastics.

Reputational Risk: Greenwashing can increase reputational risk at both the systemic and individual firm levels. It is vital to tackle greenwashing as it impacts the entire financial industry. It causes stakeholders to lose trust and become more skeptical of those actually doing the right thing, such as being transparent with performance data and reporting.[9] Individual companies have also experienced major financial losses and loss of social license and credibility due to scandals arising from greenwashing. The potential impact of reputational risks on individual firms will continue to increase as boards and C-suites adopt responsibility for greenwashing and ESG risks.

3. HOW TO SPOT GREENWASHING

It is encouraging that financial institutions are openly discussing the challenges stemming from greenwashing and trying to make better, more informed decisions about ESG and sustainability. Yet, how do financial institutions actually distinguish the good from greenwashing? The key indicators of greenwashing risk and accompanying example are listed in Table 1.

To Avoid Greenwashing:

- Issuer/company claims must be substantiated and supported by evidence.
- Issuer/company claims must be truthful and accurate.
- Issuer/company claims must be clear and unambiguously worded in a way consumers would find transparent, straightforward, and easily understood.
- Issuer/company claims must not omit or hide important/material/relevant information needed to make informed decisions.
- Comparisons must be fair and meaningful.

Source: *Competition and Markets Authority, Final Guidance for Businesses Making Environmental Claims.*

Table 1: Key Indicators of Greenwashing Risks and Examples

Theme	Indicators	Examples	Prompt Questions
Misalignment between companies' public stances on ESG issues and actual internal operations, strategies, and risk management	Inconsistency between a firm's voluntary sustainability reports, marketing and communication materials and their formal disclosures to investors or as required by regulation. Misalignment or inconsistencies can indicate greenwashing. High-profile symbolic actions which draw attention to minor or charitable issues while material risks are left unaddressed or unattended.	Symbolic actions examples include a bank offsetting its operational emissions while ignoring the climate impact of its investment portfolio or a clothing company publicly donating to UNICEF while leaving child labour in its supply chain unaddressed.	Are the ESG risks identified by the firm as material included in formal regulatory filings/ disclosures? Are the majority of ESG actions performative?
Use of vague, misleading language and terminology	The language used in ESG/ sustainability is generally imprecise. This leaves room for vagueness, exaggerations, obfuscation, hidden trade-offs, "lesser of two evils" arguments, and deception. Use of this language is especially indicative of greenwashing when not accompanied by specific examples or targets. A firm may use selective disclosure to highlight positive sustainability performance in one area while hiding the negative performance of another more important area. Another common tactic is overusing buzzwords. Phrases such as 'eco', 'sustainable' and 'green' are commonly used by companies but usually do not equate to any scientific standards. A firm may provide insufficient evidence for green/ESG or a sustainability claim may be unverifiable or lack robustness. In these cases, issuer data may initially appear attractive but does not hold up during closer examination.	Products are marketed as 'green' but are not certified or verified against a credible standard. In 2021, Swedish oil firm Lundin announced it had sold "the world's first-ever-certified carbon neutrally produced oil." Certification included Scope 1 and 2 emissions from production, and excluded Scope 3 emissions. Excluding scope 3 in emissions accounting is misleading as it limits comparisons between companies, and prevents investors from understanding all climate-related risks facing the firm, making other climate disclosures less useful. Eni was fined €5M in 2020 after running a marketing campaign that presented its palm-oil derived "Diesel Plus Biofuel" as having a positive impact on the environment, without mentioning the links between palm oil and deforestation.	Are green/ESG or sustainability claims unverifiable? Are sustainability claims or targets too good to be true?
Performative statements lacking action	Firm actions matter more than commitments/intentions when identifying greenwashing. To avoid greenwashing, look for detailed sustainability/transition action plans, backed by data with shorter-term interim targets. Modest targets that are clear, concise, credible and verified are preferable to more ambitious long-term targets without any supporting details.	Firms with vague net-zero commitments with no plan, targets or pathways. This is a marketing strategy to convince the public that these companies are more environmentally sustainable or have better ESG performance than they actually do. Some carbon-intensive manufacturers have been found to have published misleading ESG and climate commitments. For example, ExxonMobil advertised that its experimental biofuels could reduce transport emissions, while it has no company-wide net-zero target, and its 2050 emission reduction target does not include a vast majority of its product emissions.	Can information inform decision making or just descriptive which will likely lead to inaction? Are targets time bound and quantitative?

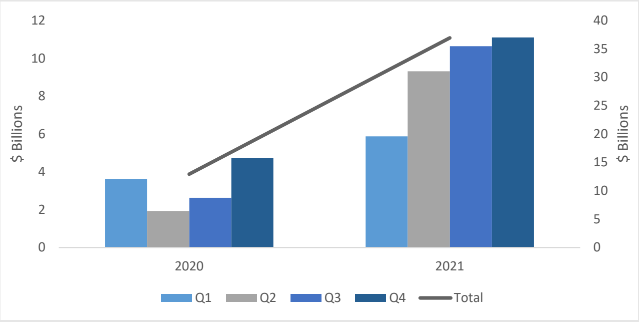
A cumulative risk lens can be applied to greenwashing. The more greenwashing red flags are present, the more likely that greenwashing is present or that a company is engaged in greenwashing. Greenwashing occurs on a continuum and comes in various "shades." As a result, greenwashing red flags may need to be scaled for severity based on individual investor priorities and preferences.

The volume of ESG marketing and labelling, in combination with non-uniform sustainability commitments and reporting, has made it increasingly difficult for stakeholders to discern which information is trustworthy and which is unreliable. In addition, greenwashing has become more sophisticated and is now rarely blatant. For example, companies will make climate commitments while quietly lobbying against new climate regulations. Even though greenwashing has become more challenging to identify, it can still be caught by applying the right resources and asking the correct questions.

Greenwashing risks can be clustered into three primary themes: companies' public stances on sustainability being misaligned with internal operations; the use of vague, misleading language and terminology; and performative statements lacking action. If a firm is engaged in greenwashing, it is common that tactics falling under multiple themes will be used. For example, a company may use misleading terminology after over promising.

Once the general categories of greenwashing are understood, financial institutions can take relatively simple, low-cost actions to identify greenwashing and help minimize exposure.

Figure 3: Total sustainable debt issuance in Canada 2020-2021



Source: *Bloomberg Intelligence*

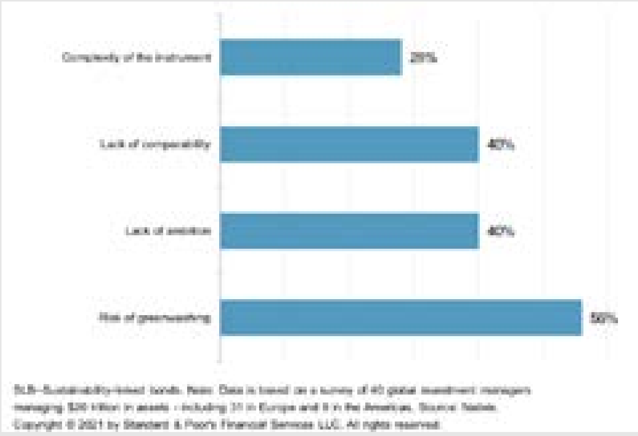
EXAMPLE OF GREENWASH RISK IN THE CANADIAN SUSTAINABLE DEBT MARKET

The market for ESG debt products has rapidly developed. The global ESG debt market exceeded US$4 trillion in 2021 and is expected to continue multiplying, with the issuance of sustainable debt reaching US$7 trillion by 2025.[10] Last year green, social, sustainability, and sustainability-linked bond issuance accounted for about 11 percent of total global bond issuance, despite the first products only being issued in 2019. In Canada, according to Bloomberg, the sustainable debt market tripled from C$12.9 billion in 2020 to C$36.9 billion in 2021. (Figure 3)[11]

Sustainability-linked debt instruments, such as sustainability-linked bonds (SLBs) and sustainability-linked bonds loans (SLLs), are the fastest-growing segment of the ESG debt market. In Canada, SLBs have grown from a negligible issuance of total sustainable debt in 2020 to 5 percent by the end of 2021, which is equivalent to C$3.46 billion. SLBs are desirable to issuers as they offer more flexibility than other green-debt instruments. Yet, this flexibility is why SLBs are the most susceptible to greenwashing.

In contrast to green bonds, the proceeds of which must be used for designated projects/purposes, sustainability-linked debt proceeds (or money raised through the investment products issuance) are considered "general corporate purpose" and are not subject to use restrictions. Rather, SLBs have

Figure 4: Risk of greenwashing is the main concern for SLB investors. Investor SLB concerns by type



Source: *Standard & Poor's Financial Services LLC* an adjustable interest rate dependent on meeting (self-defined) ESG performance targets (e.g., reducing greenhouse gas emissions.) In addition to proceeds potentially being used for activities undermining ESG objectives, greenwashing risk can stem from lax performance targets, inadequate penalties and discounts, insufficient domestic regulations, and the absence of a globally-accepted methodology for reporting. There are accounting concerns as the European Securities and Markets Authority has stated that companies are booking the value of sustainability-linked bonds and loans inconsistently because firms are applying varying valuation models.[12] As a result, the risk of greenwashing is the top concern of global investors regarding SLBs (Figure 4).

Greenwashing risks from SLBs are not isolated to the issuer but also extend to those involved in the issuance of the investment product (e.g., banks.) A recent example is the shareholder resolution on sustainability-linked debt standards filed by the shareholder advocacy group, Investors for Paris Compliance (I4PC), at the Royal Bank of Canada (RBC) annual general meeting (AGM). RBC shareholders voted on whether the bank should update its criteria for 'sustainable debt' to "preclude fossil fuel activity and projects facing significant opposition from indigenous peoples." The resolution was partly prompted by RBC's role in an early 2021 pipeline financing deal, which co-structured and financed an SLL for Enbridge Inc. RBC then served as a joint-lead manager of an SLB issuance with Enbridge later in 2021. The issuance was criticized for greenwashing as the SLB was completely voluntary with no use of proceeds and non-committed, self-imposed cost of capital step-ups. Enbridge stated that it "does not intend to allocate the net proceeds specifically to projects or business activities meeting environmental or sustainability criteria." In addition, despite Enbridge's pledge to be an ESG leader, these "transactions occurred during the height of conflict regarding Enbridge's expansion of the Line 3 oil sands pipeline, adamantly opposed by Indigenous peoples in Minnesota."[13] Later it was revealed the firm paid U.S. police US$2.4m to arrest several hundred protesters, including Indigenous group members, who opposed the construction of its Line 3 pipeline. I4PC stated that supporting the proposal would help RBC reduce compliance risk and reputational risk stemming from these transactions.

At RBC's April 2022 AGM, this shareholder proposal received eight percent of the vote - equivalent to over C$15 billion of stock.[14] Although eight percent may initially seem low, it is an above-average result for a shareholder proposal on a new topic, especially when management and proxy-service providers are recommending shareholders vote against it. Many shareholder proposals, currently receiving majority support, received support in the single digits when first introduced. In 2006, proposals on sustainability reporting received approximately eight percent support. In 2013, proposals on climate risk disclosure had 7 percent support, and in 2015, proposals on gender/racial equality received about 7 percent support.[15]

The compliance and reputational risks stemming from green debt and sustainability-linked investment products are not unique to RBC. Rather, all Canadian financial institutions involved in the issuance of these products have the potential to be exposed to greenwash risk based on the structure and conditions of the instrument. To mitigate greenwashing risks from SLBs, those involved in their issuance can enhance initial due diligence, increase monitoring of existing products, and set tailored internal SLB standards, which could include:

- Requiring issuers to establish sufficiently ambitious science-based performance targets,
- Requiring issuers to align with industry best practices and/or emerging international norms and guidelines, and
- Undertaking independent verification by a trusted third party.

4. ACTIONS TO MITIGATE GREENWASHING RISK

As voluntary standards and regulations evolve, financial institutions will have to continually improve and align. The following are some actions that firms can take today to develop a solid foundation against greenwash risk.

Due Diligence

It is well established that, when conducting due diligence or issuer research, institutional investors and others in the financial sector should assess potential greenwash to ensure informed investment decisions and prevent accidental exposure to unaccounted-for risks. Investor scrutiny of the transparency, robustness, and credibility of sustainability commitments and disclosures will continue to become more comprehensive and broader in scope, both at the individual instrument and issuer/firm levels. The most reliable method to identify greenwashing is to increase the scope and granularity of information used and develop clear processes for reviewing and monitoring investments. In addition, it is recommended that ESG processes be incorporated into existing credit or investment due diligence processes, rather than being separate, as this allows for more proactive ESG risk identification.

Additional tactics to minimize greenwash exposure include approaching greenwash risk from a place of healthy skepticism rather than cynicism, listening to (or at least considering) constructive feedback from critics, reviewing third-party endorsements/ESG credentials (and being wary of “pay-for-play” awards), and (although more time consuming) engaging directly with company executives.

Identifying greenwashing in individual instruments and investment products is similar to identifying corporate greenwashing. To identify greenwashing within green debt instruments, such as sustainability-linked bonds, investors must review ESG information in fund prospectuses which are subject to regulatory requirements and have information that has undergone rigorous internal reviews. Depending on the investment product, prospectuses contain information on conditions such as the use of proceeds.

ESG Talent

It is the responsibility of financial institutions to conduct the required research and due diligence to accurately determine potential greenwash risk exposure. The critical skill needed to identify greenwashing is ESG or sustainability literacy. The lack of agreed ESG standards, with metrics and comparable data, means asset managers have to rely a lot more on their judgment and expertise rather than on audited numbers and financial analysis. For example, an individual with inadequate expertise may be unaware companies that use more negative-sounding words, such as “spill” or “pollution”, are often more transparent about environmental risks and diligent about addressing them. Sustainability fluency is essential for (1) collecting the corporate information required to identify greenwashing and (2) analyzing the data to determine the presence of greenwashing and the likelihood that a firm will reach ESG/sustainability targets. In situations where information is imperfect, it is helpful to know that companies using active and numeric language have, on average, a 74 percent chance of reducing their future emissions, which is significantly greater than companies that only discuss mitigation efforts qualitatively.[16]

Many financial institutions concerned about greenwashing have internal talent and skills gaps regarding sustainability literacy. The sustainability/ ESG knowledge gap is significantly broader and more endemic than many assume. A study of sustainability and energy managers, from companies listed on the Financial Times Stock Exchange 250 index, found more than a quarter (27 percent) of respondents felt “out of their depth in their role,” with 34 percent stating a desire for more formal sustainability training. In addition, 74 percent of those at firms with commitments to procure clean energy lack the necessary knowledge to implement related policies.

It is imperative for companies to address the talent gap for sustainable literacy to avoid future greenwashing 'potholes'. A number of different strategies in upskilling talent as a risk mitigant exists, including implementing culture change, hiring external experts, and providing internal education for relevant employees. For example, ING has focused on upskilling, transparency and accountability to support a firm-wide strategy that is increasingly ESG/climate-centric, and Aviva delivers tailored mandatory climate training to employees.

Internal Controls and Processes

Financial institutions may lack internal processes and controls to enable ESG technical experts to raise greenwashing concerns or provide input on other ESG risks on investment and lending decisions in a timely manner. Strong and transparent internal controls and processes related to ESG integration, enable organizations to better identify material ESG risks, conduct necessary due diligence comprehensively, stay within designated ESG risk budgets, and make better capital allocation decisions.

It can be challenging to design processes to capture ESG expertise as well as to identify and prevent greenwashing. To change internal processes and controls to better identify ESG risk and integrate ESG considerations in investment decisions may require organizations to combat unconscious biases and change company culture. Research from the CFA Institute suggests traditional financial investors undervalue, or disregard, input from ESG professionals.[17] Organizational biases and greenwashing are important to overcome as evidence shows that markets do not adequately incorporate social responsibility (positive or negative) into pricing (except for the worst performers.)[18] Since the market is mispricing ESG performance, stock prices, credit, and company valuations are unlikely to reflect true ESG risk exposure. Mispricing can be captured and mitigated through a range of options including firm wide controls and/or adapted risk premiums.

To ensure consistency and comparability, it is recommended that systemic, firm-wide controls and processes be implemented, along with embedding ESG in institutional strategy. Components could include implementing new processes for: ESG risk identification, reporting ESG risks and opportunities, clear objective-setting, consulting ESG subject matter experts, setting "go-no-go" checkpoints, and regular performance monitoring. For example, HSBC has built timetables with key climate/ESG matters considered by the board, and tracks firm progress against recommendations.

Governance and Leadership

Organizational tone and culture regarding ESG are set at the top and, to produce the best outcomes, ESG should be embedded throughout a firm rather than siloed. The board and leadership need to set appropriate ESG risk tolerances that must be considered throughout investment decision-making processes and continually monitored within existing investments. If greenwashing is not actively addressed, ESG information may not be correct. Financial institutions will likely be exposed to unaccounted-for ESG risks, making it likely that the firm/deal ESG risk limits will be exceeded.

Setting an appropriate ESG risk appetite for organizations is increasingly important as the boards, CEOs, and other executives are increasingly exposed to heightened reputational risk stemming from firms' ESG performance. Boards are also starting to incorporate ESG/sustainability into their committee structures. For example, the Audit Committee may have oversight of any public reporting on these issues, the Risk Committee may oversee climate risk management and monitor targets, the Investment Committee may set strategy for responsible investment, and the Human Resources Committee may look to tie ESG/sustainability outcomes to tie to executive compensation. If board or C-suite remuneration is linked to ESG, or other non-financial performance indicators, it helps convey, to investors and other stakeholders, that the firm takes ESG seriously.

Research has found that the larger the financial institution, the more involved the board is in overseeing climate risks, as well as reviewing risk policy, framework, appetite, and reporting. According to the Harvard Law School Forum on Corporate Governance, best practices regarding ESG leadership within financial institutions are rapidly changing. ESG should be a stated priority for the C-suite and board, the head of ESG should report directly to the C-suite/CEO, and ESG should be perceived as a core component of an organization's business strategy.[19]

Counterparty Engagement

Financial institutions can help reduce greenwashing by exercising active ownership through engagement with investee companies. While there are multiple ways financial institutions can influence corporate behaviour, this is considered the most effective. The most common forms of engagement are direct communication with firms, collaboration with like-minded organizations, and shareholder/proxy voting. Engaging with companies to advance more transparent and standardized ESG disclosures will enable financial institutions to make more informed decisions. This ESG data is vital for financial institutions to successfully identify and assess ESG risks and integrate ESG into risk modelling.

The most common ESG reporting standard being advanced by financial institutions is the Taskforce on Climate Related Financial Disclosures (TCFD.) Financial institutions can engage with firms, as members of coalitions, or individually based on specific priorities. Investor groups advocating for TCFD adoption include Climate Action 100+ (the world's largest group of investors by assets under management) and a group of Canada's largest pension plan investment managers, informally known as the Maple8. Most financial institutions also set their own engagement priorities, such as encouraging the adoption of science-based targets for greenhouse gas emission reductions that incorporate Scope 3. Despite weaker regulations, as compared with global peers, Canadian institutional investors are more likely to be active owners and have robust engagement programs.

Technology for Monitoring and Analytics

Artificial Intelligence (AI) tools can be trained to identify the most material ESG factors for a company or sector. Smart algorithms will increasingly become a critical aspect of greenwash identification as the volume of non-traditional financial information doubles every few years.

Much of the potential for artificial intelligence in ESG investing comes from sentiment analysis algorithms. For example, Bloomberg's Environmental & Social News Sentiment Scores provide insight into companies' environmental and social behaviour on a daily basis, supporting early risk detection by scanning over 85,000 news wires globally. Factors that limit the effectiveness of AI today are significant inconsistencies in how issuers report on the same ESG metrics and rapidly evolving terminology.

5. CONCLUSION

Identifying and mitigating greenwashing will continue to be key components of ESG risk management. Even if the prevalence of greenwashing in the Canadian market declines, it will never be eradicated. Financial institutions identifying and avoiding greenwashing will reduce their exposure to potential litigation, financial, and reputational ESG-related risks.

This paper provides investors, and others in the financial services sector, tools to more confidently identify common types of greenwashing and assess current exposure to greenwash risks. This will allow investors to obtain a clearer and more comprehensive understanding of their ESG risk exposure and reduce exposure to unaccounted for risks.

Although greenwashing does present challenges for investors, it can be combated at the firm level with education to enhance ESG/sustainability literacy, increased due diligence, and strong internal controls and processes; and at a systemic level through better data, increased corporate disclosure, development of clear standards for ESG investment and lending products, and increased regulatory oversight that balances growth and innovation.

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