# Due Diligence is Key in Identifying Greenwashing

## Key Takeaways

- Greenwashing is an unsubstantiated claim to deceive consumers into believing that a company's products are environmentally friendly.[1]
- With the growth in impact and environmental, social, and governance (ESG) investing, there is concern over falsely labeled funds or investments.
- Effective research and due diligence helps distinguish greenwashing from truly sustainable investing strategies.

## Background

The recent growth in impact, sustainable, and ESG investment options is producing an unsought side effect — greenwashing. Greenwashing, as defined by Investopedia, is "the process of conveying a false impression or providing misleading information about how a company's products are more environmentally sound. Greenwashing is considered an unsubstantiated claim to deceive consumers into believing that a company's products are environmentally friendly."[2] Recent media attention has created controversy over the financial industry's greenwashing investments, or making false claims about the sustainability of their products, to make money off of a popular trend, rather than taking meaningful action against climate change.[3] But many funds really are more sustainable than others, says Karen Wallace, Morningstar's director of investor education. And she believes it's worth investors putting in the effort to find investments that align with their values if that's important to them.[4] **This is why due diligence is key in identifying greenwashing.**

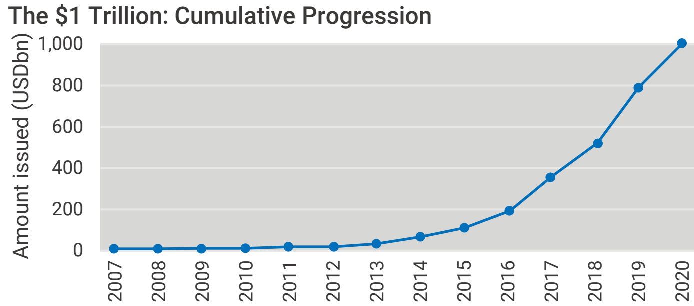
> "There was a lot of media attention on greenwashing throughout the year. As a pioneer in impact and ESG investing, CCM seeks to invest in high-quality, well-researched bonds that have positive societal impacts, requiring transparency into the use of proceeds and measurement of their anticipated corresponding impact. We must be able to quantify and report on the expected impact and/or detail the qualitative benefits of the investment. Similar to the evaluation process for any investment, due diligence is key in identifying greenwashing."
>
> **Jessica Botelho, Director of Impact and CRA Research**

## Growth of Impact and ESG Investing

The ever-increasing awareness of the impacts of climate change has helped create a growing demand for financial products and services that help mitigate its effects. Sustainable investing in the U.S. continues to grow at a rapid pace, with net flows of $51 billion in 2020, more than doubling the total for 2019 and 10 times more than the flows seen in 2018.[5] These inflows drive traditional asset managers to add new products labeled impact or ESG. At the end of 2020, sustainable open-end funds and exchange-traded funds available to U.S. investors numbered 392, up 30% from 2019.[6]

And it is not only investment managers joining the trend. Issuance of green bonds by companies has skyrocketed over the past 10 years. The green bond market kicked off in 2007 and remained under $100 billion of cumulative issuance for the first eight years. In 2016, the market doubled to over $200 billion of cumulative issuance, and at the end of 2020, there was over $1.1 trillion of cumulative issuance. This exponential rise in green bond issuance was in line with the rise in impact and ESG investing, with many companies seeing additional benefits to issuing a green bond, including a positive stock price response; improvement of environmental footprint, such as significant reduction of CO2 emissions volume post-issuance; an increase in ownership by long-term and green investors; and cheaper sources of financing.[7]

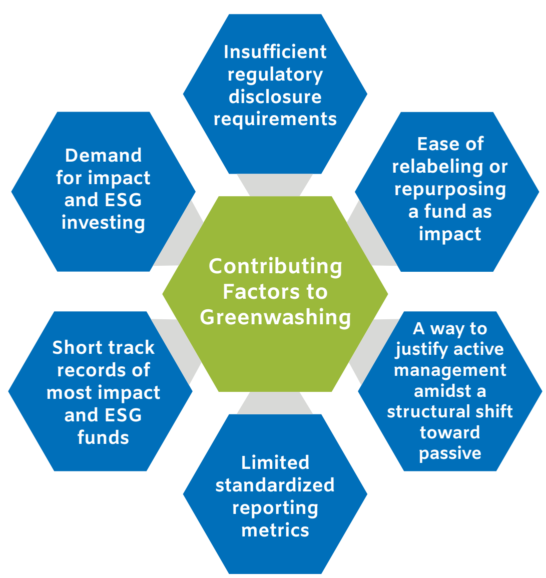
**The $1 Trillion: Cumulative Progression**




*Source: Climate Bonds Initiative 2020*

## Contributing Factors to Greenwashing

The growth of impact and ESG investing has sparked concerns that some fund managers may deceptively endorse ESG practices to attract flows from responsible investors.



## Fact vs. Fiction

The impact and ESG investing industry has dispelled a number of myths through much academic and practical research over the years. Given the massive growth in the industry and increased skepticism in regard to greenwashing, it is important to look at fact vs. fiction in the space.

| FACT | FICTION |
|---|---|
| More scrutiny, tranparency, and standardization in the field is necessary. | All companies issue green bonds solely for the sake of appearances and marketing. |
| Pretending to do good can lead to a false sense of security. | Well-intentioned investors cannot facilitate the flow of capital toward this environmental cause. |
| Some fund managers' claims of "green" are inconsistent with their goals. | There is no good or intentional work being done to fight climate change. |
| Impact and ESG mangagers must be diligent and vigilant in their examinations of securities in their portfolios. | Investors, advisers, and/or consultants are not responsible for verifying the validity of a fund manager or company's claims. |

## CCM's Impact and ESG Approach

Our impact and ESG research methodology centers around transparency and reporting. First, we have a clear definition of our impact and ESG policies and processes, which for fixed income is based on our use of proceeds analysis. The issuer must be clear on the intent of bond proceeds and the project selection criteria as well as the process, future metrics, and/or reporting. Every investment must align with one or more of our 18 impact themes (full explanation of our themes can be found here).

Ongoing monitoring is critical, which includes the issuer reporting within the anticipated and acceptable time frame, the proceeds being used for their original intent/project selection, and the issuer providing the relevant metrics and details for both quantitative and qualitative evaluation. Finally, we created a proprietary internal impact model and reporting system where we track and monitor the positive impact and ESG attributes of every investment and report back to clients on these metrics and outcomes.

## Due Diligence is Key in Identifying Greenwashing

**As an investor trying to decipher the validity of an impact and ESG fund, due diligence and research is critical to avoid greenwashing. These suggestions may help in the research process:**

- **Verify the managers'/ funds' history and track record.**
- **Identify how ESG policy changes have impacted portfolio composition and/or performance over time.**
- **Confirm ESG thesis on securities by asking for security-level ESG analysis.**
- **Perform in-depth holdings analysis.**
- **Look for consistency with stated policies.**
- **Identify potential "gray" areas that don't fit within stated policies.**
- **Read the fund prospectus.**
- **Ask for written impact and ESG policies.**
- **Understand how impact and ESG policies are set, implemented, and evaluated.**
- **Ask for examples of impact and ESG investments and who is involved in the selection process, criteria, and evaluation.**
- **Ask hard questions and don't be afraid to confront something that seems unclear.**

## The Bottom Line

Due diligence is critical in identifying greenwashing, similar to the evaluation process for ***any*** investment. We are hopeful that some recent initiatives and increased due diligence will help provide more clarity, greater insight, and increased transparency into impact and ESG investing practices to help avoid greenwashing.

## About CCM

Community Capital Management, LLC (CCM) is an investment adviser registered with the Securities and Exchange Commission. Headquartered in Fort Lauderdale with employees in Boston, Charlotte, the New York City area, and Southern California, CCM was founded in 1998 and manages approximately $4 billion in assets. The firm believes a fully integrated portfolio — one that includes environmental, social, and governance (ESG) factors — seeks to deliver strong financial performance while simultaneously having positive long-term economic and sustainable impact. CCM's strategies utilize an innovative approach to fixed income and equity investing by combining the positive outcomes of impact and ESG investing with rigorous financial analysis, an inherent focus on risk management, and transparent research. For more information, please visit: www.ccminvests.com.


[1] *https://www.investopedia.com/terms/g/greenwashing.asp*
[2] *Ibid*
[3] *https://www.cnbc.com/2021/04/23/what-to-know-about-greenwashing-in-sustainable-investments.html*
[4] *Ibid*
[5] *https://www.morningstar.com/articles/1019195/a-broken-record-flows-for-us-sustainable-funds-again-reach-new-heights*
[6] *https://www.morningstar.com/articles/1026261/us-sustainable-funds-continued-to-break-records-in-2020*
[7] *https://www.climatebonds.net/*