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How investors, authorities can check greenwashing and boost green financing

By Nand Gopal Anand Harshit Dusad and Vrindesh Patel |  09 October, 2020

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Financial institutions, governments and central banks across the globe have started introducing regulations or offering incentives for green bonds, green loans and green insurance.

India, too, has seen movement in the green finance sphere. For instance, the corporate social responsibility activities under the Companies Act, 2013, include “ensuring environmental sustainability”.

The green bond issuance guidelines by the Securities and Exchange Board of India and priority-sector lending guidelines by the Reserve Bank of India are paving the way for green financing in India.

Some Indian lenders have also taken a few steps towards this goal by issuing green bonds or introducing green loans. The establishment of the Indian Green Building Council (IGBC), a body for certifying construction of green buildings into Certified, Silver, Gold and Platinum categories, is another move in this direction.

In 2018, the Asia Pacific Loan Market Association, the Loan Market Association and the Loan Syndications & Trading Association jointly introduced the first global industry-wide framework on green finance documentation in the form of “Green Loan Principles” (GLP). The GLPs provide a category of projects that can be classified as “Green Projects”.

The GLPs lay down four important components of Green Loans to track the use and management of proceeds, the process for project evaluation and selection, and the reporting requirements by the borrowers. They also include certain covenants and penalties in cases of default and “Greenwashing” to be provided in the loan documentation.

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Greenwashing is the practice of using green funds towards non-green projects. Companies and industries have been indulging in greenwashing by touting their projects to be environmentally viable when they are actually not.

It is, therefore, important to not only develop ways to minimise the occurrence of greenwashing but also inculcate the thought process with a willingness to achieve the same. At the industry level, following steps can be taken to minimise greenwashing incidents:

Defining Green Finance: It is important to provide a definitive definition for "Green Finance" and ascertain standards for the same. This will help institutions to analyse whether a project is green. With such contours in place, it will become difficult for companies to mislead institutions or investors regarding the green aspect of their projects.

Green Certification Councils: Setting up of green certification councils by governmental authorities may be an effective way to minimise greenwashing. While some countries have started establishing such councils in a few industry sectors (such as the IGBC in India), this should be adopted in more sectors.

Statutory Green Audits: Statutes should provide for compulsory audits of the green project claims made by organisations. In the event of any misleading claims, penalties should also be prescribed.

Greenwash Taxes: All entities that indulge in greenwashing should be penalised with high taxes, which can be used towards environmental protection measures. This will act as a deterrent.

While the above steps are to be taken at an industry level, investors should also take steps at their level to ensure their

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investment is not used for non-green purposes. These steps may include the following:

Definitive provisions in documentation: Investment documents or loan agreements should contain provisions as regards representations on the environmental benefits associated with the project, covenants on the criterion vis-à-vis environmental protection, disclosures on the actual benefits and hazards faced with the project, and penalties for any misrepresentation or misleading claim made by the entity.

Regular inspections: Investors should conduct regular inspection of projects to ensure that all information provided by the entity is true and accurate.

Certifications: As a pre-condition to their investment, investors should request entities for green project certifications from the relevant authorities. Further, such certifications should be renewed at regular intervals.

Sharing information: Investors should be allowed to share all information available with them with other investors of the green project. It will ensure transparency and accuracy of information.

In addition, an effective legal framework or initiative to promote and regulate green financing should be put in place.

Recently, the RBI has recognised that a policy action is needed to boost green financing and address certain challenges such as greenwashing, non-standard definitions and imbalance between the long-term nature of green projects and the short-term interest of investors.

The ultimate goals and benefits that can be reaped through green financing will boil down to the unified approach to be

adopted by governments, central banks, financial institutions, private enterprises and the public at large.

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