Executive Summary

This paper analyzes investment funds’ disclosures related to environmental, social, and governance (ESG) information through the lens of investors to understand the nature of disclosure issues that could give rise to a perception of greenwashing. A perception of greenwashing can arise when investors struggle to understand the underlying sustainability characteristics of a fund, irrespective of the intent or veracity of the disclosures.

Comprehension of the sustainability characteristics of a fund is challenging when there are inconsistent disclosures, omissions of key information regarding the sustainability goals or strategy, unsubstantiated sustainability claims, or undue emphasis of certain features that could appear to exaggerate the actual sustainability characteristics of a fund.

To understand the nature of these disclosure issues, we analyze product disclosures for a sample of 60 investment funds that are marketed to retail investors and that incorporate ESG factors in the investment process. The sample includes 30 funds from the European Union and 30 funds from North America. Through our review of product disclosures, we identify what disclosure improvements are needed to improve investor comprehension and alleviate concerns about the perception of potential greenwashing. Positive actions by firms to address the issues raised can help mitigate investor concerns regarding potential greenwashing in the investment industry.

Greenwashing is a complicated, contextual, and nuanced issue, and the review of documentation alone might not evidence its existence. Therefore, investors should conduct thorough due diligence prior to any investment in order to provide more assurance that managers are following procedures and fairly representing the sustainability characteristics of their fund.

The mission of CFA Institute is to lead the investment profession globally by promoting the highest standards of ethics, education, and professional excellence for the ultimate benefit of society. As such, our aim is to help promote disclosure best practices for the sake of market integrity.
Key Findings

- We found five instances of ESG-related information that would likely confuse an investor and may create a perception of greenwashing. Poor-quality disclosures raise questions, create confusion, and contribute to the perception of greenwashing on the part of investors, irrespective of the intent or legality of the disclosures provided. Inconsistency of disclosures (where information provided in a given document does not align with the information provided elsewhere) was the primary issue we encountered in our sample.

- Greenwashing is difficult to uncover and prove on the basis of documentation alone. Access to internal records and/or third-party research is not available to retail investors, but such information is often needed to investigate whether a fund is presenting its sustainability characteristics accurately. Furthermore, this analysis requires judgment and thus may result in different conclusions on the perception of greenwashing.

- The context-specific nature of greenwashing risks can make it difficult for investors to obtain a clear picture of how ESG factors are incorporated into the investment process, objectives, and stewardship activities of a retail fund. This finding underscores the need for consistent product disclosure standards to better enable comparability.

- We observed problematic disclosures related to fund names, screening criteria, fund reporting, ESG terminology, and ESG-related impact claims and developed recommendations to address these issues.

Introduction

Greenwashing is a major concern in the investment management industry. In 2021, 59% of institutional investors identified greenwashing as a challenge in the ESG investment process, according to the Schroders Institutional Investor Study. Additionally, in a global 2020 CFA Institute member survey, 78% of investment professional respondents believed that there was a need for improved standards around ESG products to diminish greenwashing.

Public awareness of greenwashing has increased because of regulatory enforcement actions and skepticism about corporate climate commitments.

Greenwashing can damage trust and confidence in the investment industry, leading to ESG fund outflows and undermining investment firms' broader sustainability credentials and objectives. It can also result in investors misallocating assets to products or strategies that do not align with their investment goals. The investment industry must address greenwashing concerns to maintain fair and efficient capital markets, protect investors, and hold investment firms accountable for their claims.

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5 In general, "ESG" describes an investment framework that is used to evaluate the sustainability of a given company or activity in relation to profits and risks. "Sustainability" is a broader term that describes an investment philosophy that aims to seek fair outcomes for all and recognizes that corporate activity and investment decisions have spillovers in an ecosystem. Sustainable investing aims to minimize the depletion of natural and social resources.
Regulators have defined the concept of greenwashing in a variety of ways.\(^6\) Rather than attempting to define greenwashing ourselves, we instead focus on instances where a reasonable investor would likely be confused or potentially misled about the underlying sustainability characteristics of a fund, thus creating a risk of a perception of greenwashing. This investor perspective allows us to highlight areas where disclosures could be improved without making definitive claims about the severity or legality of the relevant disclosures. We identify four main ways that can make it difficult for an investor to understand a fund’s sustainability characteristics: omission, unsubstantiated claims, inconsistency between fund materials, and exaggeration. These terms are not exhaustive or mutually exclusive.

The purpose of this research is thus to help promote disclosure best practices for sustainable investment funds and increase investor trust in the sustainability characteristics of these products. We analyze fund literature in a sample of North American and EU funds, gauge the nature and extent of potentially confusing ESG-related information, and provide recommendations for best disclosure practices.

**Literature Review**

There is a relative lack of literature evaluating the extent of greenwashing in investment products from a global comparative perspective. PwC analyzed more than 220 “Article 8” and “Article 9” funds (according to the EU Sustainable Finance Disclosure Regulation, or SFDR) from 20 providers based in Switzerland, in the EU, and internationally in February 2022, but this analysis did not include funds distributed in the United States.\(^7\) The study found that disclosures are often too vague, there are inconsistencies regarding the meaning of various investment strategies across firms and within the same financial institution, and there is confusion around achieving true impact.

In addition, the academic literature focuses primarily on corporate greenwashing, rather than the narrower topic of greenwashing in mutual funds, which is the focus of this paper. Among those studies that do look at greenwashing in investment products, few address the issue of disclosure comprehension and salience in retail funds.

For example, one study examined the extent to which ESG mutual funds deliver on their promises.\(^8\) It analyzed fees, average ESG fund ratings, and portfolio-company votes of ESG funds versus non-ESG funds. The study found clear differences between the two groups regarding the average ESG fund ratings and voting patterns of the funds. The authors made clear, however, that the study does not evaluate or identify whether funds align their investment strategies with how the funds are marketed or portrayed.

A similar study, titled “Defining Greenwashing,” evaluated portfolio-company votes and ESG ratings for ESG funds.\(^9\) It found that 34% of self-labeled ESG funds in the United States are “greenwashers” (according to the authors’ definition), that these funds are more likely to underperform, and that retail investors do not distinguish between greenwashers and true ESG funds (although institutional investors do). These findings indicate the risks to retail investors of misinformation and poor investment outcomes arising from greenwashing. This study does not, however, account for the granularity present in the various pecuniary and nonpecuniary investment objectives of ESG funds.

\(^{6}\)See, for example, PwC, “Greenwashing and Greenwishing—A Regulatory View” (2022, Table 1, p. 13). www.pwc.ch/en/publications/2022/greenwashing-and-greenwishing.pdf.


Further, another study highlights the current ambiguity regarding what constitutes an ESG fund and how to achieve a sustainability impact—an ambiguity that makes funds prone to allegations of greenwashing. The authors noted that greenwashing may be intentional to gain market share but may also be unintentional because of the lack of a common ESG definition and inconsistent use of ESG terminology. The authors also asserted that ESG funds can only truly be green by having a positive sustainability impact, achieved through the transmission channels of shareholder engagement and/or capital allocation. They found, however, that very few ESG funds commit to a voting strategy aligned to sustainability objectives. In addition, the study reported that when it comes to capital allocation, most ESG funds deviate only marginally from their (non-ESG) benchmarks. These findings further illustrate greenwashing perception risks.

The European Supervisory Authorities (the European Banking Authority, the European Insurance and Occupational Pensions Authority, and the European Securities and Markets Authority) published their progress reports on greenwashing in the financial sector in May and June 2023. The reports put forward a conceptual framework for greenwashing across the authorities’ respective remits and shared quantitative analysis of greenwashing across sectors. The reports described the high-risk areas of greenwashing that include misleading impact claims, misleading information about engagement on ESG issues with investee companies, inconsistent fund names, and insufficient governance around ESG implementation.

In its report "Sustainable Finance and the Role of Securities Regulators and IOSCO," the International Organization of Securities Commissions (IOSCO) found that the majority of the market participants it consulted suggested greenwashing was an important issue. One of the challenges identified by IOSCO was the lack of standardization and clear guidance on disclosures, taxonomies, and differing regulatory approaches to sustainable finance. It identified recommendations for regulators with the aim of improving sustainability-related practices, policies, procedures, and disclosures in the asset management industry.

Investor education plays an important role in preventing greenwashing and protecting investors. Another IOSCO report noted that investor education can strengthen understanding of sustainability concepts, facilitating disclosure comprehension and increasing awareness among investors of sustainability-related risks.

In sum, this literature provides contextualization of greenwashing risks in investment products and identifies the most problematic areas regarding definition of terms, investment processes, and the regulatory environment. Our research builds on these studies by providing an investor view of perceived greenwashing issues and uses illustrative examples to highlight where disclosure improvements are needed to facilitate investor comprehension.

Methodology

In the following, we summarize our scope of research, sample selection, inputs, and assessment criteria.


Scope of Research

Our primary research goal was to review investment fund documents for instances where disclosures may not fully or fairly reflect the nature of a fund's sustainability characteristics (measured according to ESG criteria), viewed through the lens of an investor. The intent is to identify the disclosure issues that could give rise to a perception of greenwashing on the part of a reasonable investor, irrespective of the legality or compliance of such disclosures with regulatory requirements. In doing so, we aim to highlight examples where disclosure practices could be improved and to encourage firms to consider the salience of the information provided over and above mere “box-ticking” compliance considerations. A primary example of this type of disclosure discrepancy is when a fund's marketing materials are inconsistent with the fund's prospectus.

We focused our research on publicly available product disclosures because we did not have access to funds' internal documents and records, which are usually evaluated by auditors and regulators.

There are numerous ways in which investment fund disclosures might confuse or potentially mislead an investor about a specific ESG-related aspect of a fund. We chose to focus on four common areas of concern that could give rise to the perception of greenwashing on the part of an investor. These areas, which we describe next, are not mutually exclusive. This list is not exhaustive; rather, it summarizes the most frequent problems.

• **Omission**
  Omission is the failure to disclose a meaningful piece of information, such as changes to an investment strategy; details about investment and analytical methods, criteria, and processes; and definitions of metrics and key terms.

• **Unsubstantiated claim**
  An unsubstantiated claim is a claim made without qualification or that is not supported with appropriate evidence. Unsubstantiated claims may or may not be true, but they can be potentially confusing because no evidence is presented that would allow for an evaluation of the claims. Unsubstantiated claims may be seen in the context of statements regarding real-world impact, comparisons to benchmarks, and alignment with or contribution to the Paris Agreement, the UN Sustainable Development Goals (SDGs), or other sustainability-related goals.

• **Inconsistency**
  Inconsistency is a discrepancy of certain information. An inconsistency could be, for example, a discrepancy between the information presented in two different documents, a discrepancy between a fund's name and its investment objectives or strategy, or a discrepancy between stated investment policies and the measurement of outcomes.

• **Exaggeration**
  Exaggeration is an overstatement of certain information. An example of exaggeration is when a fund claims that ESG considerations are of primary importance in the investment process when ESG considerations are just one type of many similarly weighed considerations.

Sample Selection

We selected 60 funds—30 from the United States and Canada and 30 from the EU. We used Morningstar’s sustainable funds US landscape report as of 31 December 2021 and obtained the Canadian fund information from Canadian Investment Funds Standards Committee fund data as of December 2022. For EU funds, we used eVestment’s ESG-focused universe with the latest available UCITS (Undertakings for Collective Investment in Transferable Securities) fund data as of December 2022. From these databases, we selected a random sample of funds marketed to retail investors as having ESG-related characteristics. We then used ESG data from Refinitiv to confirm the funds’ ESG-related characteristics.
To evaluate a broad range of strategies, we qualitatively evaluated whether our fund sample had a sufficient variety of ESG-related strategies and characteristics. We swapped out funds where applicable to create a comprehensive sample of ESG funds based on asset class, asset size, fund manager, and ESG-related strategy (ESG integration, impact, screening, engagement, thematic, active ownership, index tracking, and a combination of these strategies).

**Exhibit 1** provides a breakdown of the funds in our sample by type of strategy, and **Exhibit 2** provides a breakdown of the funds by level of assets under management (AUM).
Note that European funds account for approximately four-fifths of the global sustainable fund universe (by number of funds and AUM), according to Morningstar. In comparison, our sample is split evenly between European and North American funds by design to enable a fair evaluation of disclosures under the respective jurisdictions.

As Exhibit 1 illustrates, more than three-quarters of the funds in our sample are equity funds, compared with approximately 50% of all ESG and responsible investing funds in the Refinitiv database.

By fund size, approximately 82% of the funds in our sample have less than $1.5 billion in AUM, as shown in Exhibit 2. In comparison, approximately 90% of all ESG and responsible investing funds in the Refinitiv database are below this size threshold.

Inputs

We evaluated each fund's publicly available product disclosures. We reviewed each fund’s prospectus, annual report, statement of additional information, Key Investor Information Document (KIID), and fact sheet, as applicable to the relevant jurisdiction. For robustness, where available, we also reviewed stewardship, engagement, and proxy voting guidelines; fund commentary; newsletters; impact reports; and proxy votes. For EU funds, we also examined their Sustainable Finance Disclosure Regulation (SFDR) disclosures.

Assessment Criteria

We identified instances where we could pinpoint a specific inconsistency, exaggeration, omission, or unsubstantiated claim in a fund's product disclosures that might confuse an investor about a specific ESG-related aspect of a fund such that it may give rise to a perception of greenwashing.

Assessments of this nature are necessarily subjective because they require interpretation of claims and information. To minimize the subjectivity of our assessments, both authors reviewed the marketing materials and fund literature for the 60 funds, using consistent criteria according to the four areas of concern previously outlined, and compared findings. A third researcher reviewed the assessments made by both authors, and our paper includes only examples where all three individuals agreed with a given assessment.

We found many instances of disclosures that did not meet our criteria but that still may be ambiguous. However, we determined that these cases would not likely rise to the level of creating a perception of greenwashing, but we do address them in the recommendations for improved disclosures.

We did not assess compliance with laws and regulations, as this is the competence of the applicable regulatory authority. The scenarios we present are intended to convey instances where a reasonable investor would likely struggle to comprehend the underlying sustainability characteristics of a fund.

Results

We discovered that the different regulatory environments in North America and the EU were associated with a difference in the types of potentially confusing information we documented. The SFDR in the EU jurisdiction has likely helped mitigate potentially confusing information because the regulation requires additional ESG disclosures to describe the fund's environmental and social objectives, characteristics, methodologies, data sources, engagement policy, and due diligence/limitations to the data. A Canadian Securities Administrators (CSA)

An Exploration of Greenwashing Risks in Investment Fund Disclosures: An Investor Perspective

staff notice explains how existing securities regulatory requirements apply to ESG-related investment fund disclosures. The notice also provides best practice guidance for disclosures that are not required but would bring greater clarity to ESG-related fund disclosure and sales communications.\textsuperscript{15} The United States currently has no comparable disclosure requirements. Providing this level of detail on the ESG aspects of the fund brings a greater level of transparency into how the fund is managed and how it considers ESG issues in its investment process and decision making.

Overall, we found five cases in which a specific inconsistency, exaggeration, omission, or unsubstantiated claim in a fund’s product disclosures might confuse an investor about a specific ESG-related aspect of a fund, thus giving rise to the risk of a perception of greenwashing (which we collectively term “problematic disclosures”). We found three cases from North American funds and two cases from EU funds. \textbf{Exhibit 3} presents the number and percentage of the cases in our sample.

We acknowledge that these results indicate a relatively small prevalence of problematic disclosures (less than 10% of the sample), which might be expected given that our sample—retail funds—consists of regulated products. We do see room for improvement, however, in the quality of ESG-related disclosures.

The most common type of problematic disclosure was inconsistency, as illustrated in \textbf{Exhibit 4}.

\begin{table}[h]
\centering
\begin{tabular}{|l|c|c|c|c|c|}
\hline
\textbf{Region} & \textbf{Number of Funds with Problematic Disclosures} & \textbf{Percentage of Funds with Problematic Disclosures} \\
\hline
North America & 3 & 10.0\% \\
EU & 2 & 6.7\% \\
\hline
\end{tabular}
\end{table}

\textbf{Exhibit 3. Summary of Findings by Region}

<table>
<thead>
<tr>
<th>Category of Problematic Disclosures</th>
<th>Percentage of Total Sample</th>
<th>Number of Funds</th>
<th>Percentage of North American Funds</th>
<th>Number of North American Funds</th>
<th>Percentage of EU Funds</th>
<th>Number of EU Funds</th>
</tr>
</thead>
<tbody>
<tr>
<td>Inconsistency</td>
<td>5.0%</td>
<td>3</td>
<td>3.3%</td>
<td>1</td>
<td>6.7%</td>
<td>2</td>
</tr>
<tr>
<td>Omission/unsubstantiated claim</td>
<td>1.7%</td>
<td>1</td>
<td>3.3%</td>
<td>1</td>
<td>0.0%</td>
<td>0</td>
</tr>
<tr>
<td>Exaggeration</td>
<td>1.7%</td>
<td>1</td>
<td>3.3%</td>
<td>1</td>
<td>0.0%</td>
<td>0</td>
</tr>
</tbody>
</table>

Cases of Problematic Disclosures

Here we provide illustrative examples of the types of problematic disclosure issues we encountered. The intention is to highlight areas that are in need of attention and have the potential to create a perception of greenwashing.

Inconsistency

We observed three funds, one from North America and two from the EU, that had discrepancies in the presentation of their screening criteria. One fund had investment exclusions on its website that were different from the information stated in the prospectus, and two funds had differences among their respective fund documents regarding their screening criteria thresholds. These inconsistencies among fund documents and websites can cause confusion as to what restrictions the funds are following.

**Scenario 1**

One North American fund presents a list of "investment exclusions" on its website but has a caveat in its prospectus that indicates a more expansive investment universe than the investment exclusion list would permit.

The fund's website lists the following items as investment exclusions: oil, coal, nuclear power, weapon manufacturers, gambling, tobacco, and socially irresponsible business practices. The website does not provide any criteria that would serve to define these items, but it does characterize some of them, to a degree, by describing their negative environmental and social impacts.

The fund's prospectus does not discuss the investment exclusions that were stated on the website. Although we realize exclusions are not required to be disclosed as part of the principal investment strategy in the prospectus, including these details will provide a more comprehensive understanding of the ESG approaches and how ESG issues are considered in the management of the fund.

The prospectus does state that the fund is allowed to invest in some conventional energy companies that have significant involvement in developing or producing renewable energy—in this instance, implying that the companies could currently be involved in oil or coal. There is no disclaimer on the website that would indicate to an investor that the exclusions were not categorical. Thus, an investor could be confused as to whether the fund is allowed to invest in oil or coal based on the discrepancy between the website and the prospectus. In our view, the list of investment exclusions presented on the fund's website might lead an investor to believe that the fund would not hold shares of companies that are significantly involved in the excluded areas, and there seem to be no mechanisms in place to prevent such investments.

**Scenario 2**

We found two EU funds in which the exclusions presented in their prospectuses are inconsistent with the exclusions presented in other fund documents.

The first fund has three inconsistencies. First, the sustainability policy has an exclusion related to palm oil whereas this exclusion is not listed in the prospectus. Second, the prospectus has an exclusion related to nuclear energy that is omitted in the sustainability policy. Third, the sustainability policy has a revenue threshold of 10% for company revenue derived from thermal coal, whereas the prospectus has a revenue threshold of 20% for company revenue derived from coal power production. It is unclear whether thermal coal and coal power production are different measures. If not, then there is an inconsistency in the threshold. Even if these are different measures, the prospectus and the sustainability policy each have an exclusion that does not appear in the other.
The second fund has two inconsistencies. First, one set of SFDR disclosures in a standalone document states a revenue threshold for tobacco of 5%, whereas the prospectus states a revenue threshold for tobacco of 25%. Second, the standalone SFDR disclosure states a fossil fuel extraction revenue threshold of 5%, whereas the prospectus states a thermal coal mining revenue threshold of 10%. Again, there is some uncertainty as to whether these are technically different measures, but given that thermal coal mining is one type of fossil fuel extraction, the thresholds should be aligned or reconciled.

In both cases, we believe an investor might be led to believe the funds’ exclusions are stricter than what they actually are, depending on which documents the investor reviews and the exclusion criteria that are in fact being applied.

**Exaggeration**

We observed a North American passive index fund that tracks a fossil fuel–free index with a fund name that indicates it does not invest in companies that own fossil fuel reserves. The methodology for the construction of the fossil fuel free index excluded most fossil fuel reserves; however, there is an exception to the exclusion criteria if the company holds metallurgical coal reserves. We understand that the fund is complying with its regulatory requirement to the extent that at least 80% of its assets are in the investments suggested by its fund name. Nevertheless, an investor might very well interpret the term “free” to mean the fund has zero exposure to any type of fossil fuel reserves. When the naming convention of the fund conflicts with the permitted investments, that can cause confusion. We recommend that where such conflict arises with regard to the naming convention of the fund vis-à-vis its underlying investments, the fund should clearly disclose the conflict in its fund literature and marketing materials to alleviate any ambiguity from the perspective of prospective investors.

**Omission/Unsubstantiated Claim**

One North American fund has an investment objective to provide a total return while seeking to maintain certain ESG characteristics, climate risk exposure, and climate opportunities relative to its benchmark. The prospectus and marketing materials further explain that the fund aims to invest in a portfolio of companies that are assessed to score better on these ESG criteria than the benchmark. The fund omits benchmark data and in doing so fails to adequately substantiate whether the manager has delivered on the fund's objective.

Although the fund manager discloses the fund’s ESG rating, weighted average ESG quality score, and weighted average carbon intensity in its fact sheet, it does not report the same measures for the benchmark. The fund's brochure and monthly commentary also omit the benchmark's measures, and these measures are not published by the index provider either. An investor may be confused regarding the fund's sustainability performance given there is no ability to compare the fund's ESG characteristics with those of the benchmark.

If a fund is using a benchmark to highlight its sustainability performance, we recommend disclosing the ESG characteristics of the fund and the benchmark. Doing so facilitates a proper comparison, allowing investors to determine whether the fund is meeting its sustainability objectives.

**Recommendations**

Our recommendations are intended to address the types of problematic disclosures illustrated in this paper and also a broader set of problems that we encountered as we sought to understand funds through their marketing materials and other statutory product disclosures.
In several of our recommendations, we refer to the CFA Institute Global ESG Disclosure Standards for Investment Products (hereafter, the "ESG Disclosure Standards"). These voluntary, global standards are based on the principles of fair representation and full disclosure and are designed to show how a fund or strategy incorporates ESG information or issues into its objectives, investment process, and stewardship activities. The ESG Disclosure Standards can be applied to any fund or strategy that incorporates ESG information irrespective of how the fund or strategy is named, labeled, or categorized.

**Fund Names**

- Fund names that imply a prohibition or absence of certain investments should have an investment policy that prohibits those types of investments and a reliable method for implementing the policy. A fund that has a name that indicates that it is free from ("free") or excludes ("ex") a certain type of investment should not permit that type of investment in the fund, or at the very least, the level of exposure permitted by the fund should be clearly disclosed in the fund literature and marketing materials.

- Firms should not use ESG-related terms in the fund name when such terms are not directly and strongly associated with the fund's objective, principal investment strategies, or investment policy. The fund's implied investment focus (per its name) should align with and be in proportion to the key ESG factors in the fund's principal investment strategies or investment policy and its holdings. We recommend that if a firm includes ESG-related terms in the name of its fund, the terms should be clearly and consistently defined in the fund literature and marketing materials.

- ESG integration funds that do not use any other ESG investment approach should not include "ESG" or other ESG-related terms in the name of the funds. ESG integration funds are funds that have ongoing consideration of ESG factors in an investment analysis and decision-making process with the aim to improve risk-adjusted returns. ESG factors are generally no more significant than other factors in the investment analysis process and therefore should not be included in the fund's name to avoid overemphasizing the importance of one set of factors.

**Screening**

- Screening criteria should be consistent across fund documents and the fund website.

- If a fund has an exception to a screening rule that is directly relevant to the name of the fund, the fund objective, or the principal investment strategy, then this exception to the rule should be fully and prominently disclosed in marketing materials. In addition, the fund prospectus or the marketing materials should direct the reader to where the full screening criteria can be found. Clear and prominent signposting to the prospectus should be made for further details regarding the screening criteria.

- Screening criteria should explicitly state the revenue thresholds, if used, for the screening criteria. They should avoid vague language, such as "seek to avoid" or "avoid sectors with material or significant exposure," which can cause confusion regarding the level of exposure the fund will have to certain sectors. Provisions 2.A.9 and 2.A.10 in the ESG Disclosure Standards provide best practices for disclosing ESG screening criteria. Screening disclosure should include the characteristics evaluated, the revenue threshold for the screening criteria, whether the investment is excluded from the portfolio or is otherwise eligible for inclusion in the portfolio if criteria are met, and any exceptions to the screening rule.

Reporting

- If a fund claims in its proxy voting policy that it will vote for or will generally vote for certain ESG-related proposals, then the fund should disclose its rationale for instances when it votes out of alignment with the voting policy. Publicly disclosing voting rationale can help address any potential confusion on the part of investors surrounding the fund's proxy voting practices. Such disclosure is particularly helpful given that many funds vote on ESG-related proposals on a case-by-case basis.

ESG-Related Terminology and Metrics

- ESG-related terminology and metrics should be defined in all marketing materials or fund legal documents where they are referenced. Provision 2.A.11 of the ESG Disclosure Standards addresses portfolio-level ESG characteristics, including ESG-related portfolio measurements, metrics, ratios, scores, or ratings. It stresses the importance of disclosing the ESG characteristics that are being evaluated and how they are measured or calculated. We recommend following this guidance and providing sources for third-party metrics so that investors can better understand how these metrics support the fund's ESG claims.

ESG-Related Claims and Impact

- Funds that highlight alignment with or contribute to third-party sustainable development goals should be mindful of overstating the sustainability-related characteristics of their holdings. Alignment with these alone does not constitute an impact objective. Provision 2.A.19e of the ESG Disclosure Standards states that "if investments are made with the intention to generate positive, measurable social and environmental impact alongside a financial return, then the investment manager must disclose how the attainment of the impact objectives will contribute to third-party sustainable development goals if there is a stated intention to do so."

- When making a sustainability-related or impact claim, firms should provide evidence to support the claim. As stated in Provision 2.A.19 of the ESG Disclosure Standards, best practices for funds that have an impact objective include disclosing the impact objective in measurable terms, progress toward the impact objective, and the time horizon over which the impact objective is expected to be attained.

Summary

In the following, we summarize our recommendations for investors, asset managers, and regulators.

For Investors

There is a wide array of sustainable investment products that provide for a great deal of investor choice. Some of these investment products, however, may not be doing exactly what they say they are doing. We recommend that investors not rely solely on marketing materials and closely examine the fund's offering documents, as well as any sustainability reports.

For funds that use ESG integration, it is helpful to examine disclosures regarding their integration process to understand how the fund managers are incorporating ESG considerations and into which activities ESG considerations are included, particularly in relation to fundamental analysis, investment decision making, and stewardship activities.

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For funds that have a positive change or real-world impact objective alongside a financial objective, we also recommend reviewing the fund's impact report or other methodology reports for disclosures on how the fund's impact is measured, monitored, and reported. In this way, investors can better gauge the extent to which their goals and expectations align with the impact characteristics of the fund.

**For Asset Managers**

Most of our recommendations are directed at asset managers. While we recognize that many aspects of the investment process contain proprietary information, we found that the funds that prominently disclosed their ESG-related investment practices, including how ESG factors are considered in their investment process, objectives, and stewardship, carried comparatively less issues. We recommend full disclosure and fair representation of the fund's sustainability claims or objectives. The use of plain language rather than ESG terminology or jargon should be the standard. If ESG terminology is used, however, the terms should be defined, including (where relevant) how they are calculated. For example, rather than state that the fund uses ESG integration, firms can describe in plain language that the fund considers ESG factors in the investment analysis and decision-making process with the aim to improve risk-adjusted returns.

One area of concern relates to fund impact claims highlighted by asset managers, primarily in their marketing materials. One of the more common frameworks that funds in North America and the EU use is alignment with or contribution to the UN SDGs. We recommend caution when it comes to making claims of individual investors’ real-world impact. Impact should be carefully defined and measurable. We believe that conservative estimates of impact generally will help reduce instances of potentially confusing information.

**For Regulators**

Problematic disclosures could give rise to a perception of greenwashing. If the management of the fund does not match how the fund is described, investors could be potentially misled on the ESG-related aspects. Although added disclosures could be beneficial, complex regulatory frameworks can increase costs and compliance burdens, especially in the short term. We did find some EU funds that downplayed their sustainable investment objectives owing to the complexity of the SFDR and EU Taxonomy regulatory landscape. We believe that further clarification and guidance from regulators will help asset managers as they create and promote their sustainable funds. Regulators should also work to harmonize terms and definitions so that there is a common understanding of these issues across jurisdictions.

It is easier for investors to analyze a fund's sustainable investment process when a fund's full sustainability-related information is in at least one document. This issue is particularly relevant when considering the overall message of the product; jumping from impact reports to marketing materials to the legal language for the fund can sometimes make it difficult to understand the fund's overall objective and means to achieve its objective. Consolidating the fund's sustainable information with appropriate signposting on other fund materials to that document allows investors to examine the claims being made more simply and in greater detail.

**Conclusion**

Upon completion of our research into 60 North American and EU funds, we found that less than 10% of our fund sample had disclosure issues that could give rise to a perception of greenwashing. This analysis showed that managers, for the most part, are appropriately disclosing their ESG approaches. We do see room for improvement in the quality of disclosures, however, as noted in our recommendations. The review and analysis of each fund's publicly available product

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disclosures was time consuming and, in some cases, caused us confusion and a lack of understanding on how ESG issues were considered in the investment process, decision making, and stewardship activities. Some managers disclosed very granular-level details of their investment approach, and others omitted such detailed descriptions.

Although our findings indicate a relatively low prevalence of problematic disclosures, investors and regulators should be vigilant regarding other greenwashing risks. For example, a broader exploration into greenwashing risk in corporate- or issuer-level disclosures may result in a greater prevalence of problematic disclosures.

Greenwashing is complicated and difficult to uncover, and it requires a thorough review of product disclosures to make a judgment as to whether a fund is presenting its sustainability characteristics fairly. It is difficult to determine intent when problematic disclosures are identified, and individual investors might have different conclusions as to whether or not they felt misled. At a minimum, poor-quality disclosures raise questions, create confusion, and contribute to concerns about the perception of greenwashing. It can be difficult, however, to prove greenwashing on the basis of documentation alone. Investors typically do not have access to the internal records, nor do they have the resources (e.g., third-party research/raw data), that they would need to analyze, review, and determine that a fund is not doing what it says it is doing.

Regulators are the main actors with a view into the prevalence of greenwashing, but their examinations are confidential. Firms and investors generally do not have access to the full information regarding the context and underlying issues of specific enforcement or inspection actions. Therefore, concerns about greenwashing are likely to persist until the quality of disclosures improves. To avoid the risk of a potential violation, firms can proactively try to improve the quality of their disclosures. Our study helps highlight areas that firms may want to pay particular attention to.

The ESG Disclosure Standards do not address all possible greenwashing risks, but they can help firms fully disclose and fairly present how ESG information or issues are considered in a fund's objectives, investment process, and stewardship activities.

Our scope of analysis is limited to North America and the EU. Future studies could build on this research by gauging the extent to which the prevalence of problematic disclosures in these markets changes over time. The analysis could also be extended to other markets that offer ESG investment products.

Areas for future research also include a deeper analysis of the consistency between proxy voting guidelines and outcomes, which could provide a greater understanding of how sustainability objectives and impact goals are being attained through engagement.
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