The Risk of "Green Washing" in Local Pilot Projects of Transition Finance: Standard Difference, Incentives Distortion and Prevention

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Abstract. There are significant differences between China's local pilot programs for transition finance, such as the assessment cycles, information disclosure, identification of transition activities, and incentive policies. The fragmentation of the transition standard provides an opportunity for the "Greenwashing" behavior. This article systematically compares the differences in standards between pilot programs in areas like Shandong, Chongqing, Huzhou, Zhejiang, and evaluates the effectiveness of the current prevention mechanism. Research shows that the classification method is more effective in suppressing the risk of greenwashing compared with the principal method. The third-party assessment has deficiencies in terms of standard uniformity and post-event tracking. The information platform is currently facing the problem of data silos and uneven quality. The national unified standard should clearly define the quantitative requirements for "Substantive transformation", design a dynamic KPI and phased incentives-related mechanism, construct a unified information disclosure platform relying on the carbon market infrastructure, and establish a third-party verification access and annual verification system.

Keywords: Transition finance local pilot projects, risk of Greenwashing standard differences, prevention mechanism

1. Introduction

Transition finance is becoming one of the fastest-growing areas in the Green finance system. Its core idea is to support carbon reduction activities that guide funds towards high-carbon industries. Since the year 2021, cities like Huzhou, Zhejiang, Shandong, and Chongqing have already started the local pilot projects of transition finance. There are significant differences among various regions in terms of KPI assessment cycles, information disclosure, determination of transformation projects, and incentive policies (Interest subsidies, Low-cost funds). This kind of standard difference may create "Green washing" risks, such as the enterprise decision of choosing the loosest pilot program carried out, "Transformation labeling", but the actual transformation efforts were inadequate. Or the financial institutions give priority to supporting "Low-hanging fruit" type projects to meet the assessment targets. Once the action of "Green washing"

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spreads, the "Function" of the new transition financial policy will decrease. It may also lead to chaos in the capital chain and slow down the carbon neutrality/carbon reduction process of the entire society.

Based on the transition finance and the Greenwashing risks, the academic world has already accumulated a certain scale of research. From the aspects of the overall development of transition finance, Zhang systematically concludes the typical facts of Chinese-style traditional finance [1]. Liu compared 17 local transition finance directories that have been published in China based on research by the National School of Development at Peking University. Which clearly indicates that the classification method is more effective and resultful than the principal method in reducing the risk of "Green washing[2]. She also indicates that the transition finance is still at the exploration stage, which necessitates further defining transition activities and attaching importance to the risk of Greenwashing. Some of the scholars have focused on the identification of greenwashing behavior at the enterprise level, and others identify the essence of greenwashing: To gain more environmental resources, support policies, and social support, the firms adopted a regulatory arbitrage behavior [3]. Furthermore, research has proved that green finance can significantly inhibit greenwashing, especially by inhibiting the firm's greenwashing risks, and improve their real ESG performance[4]. However, the current research still has its weaknesses: First, the existing research on the green finance risk of transition finance lags significantly behind that of green finance; the systematic documents for local pilot projects were limited. Second, the mechanism analysis of how standard differences specifically give rise to greenwashing behavior is mostly logical deduction, lacking substantive support. Last, the systematic reviews regarding the insufficiency of policy assessment and the effectiveness of prevention mechanisms are still blank.

This article systematically concludes the policy documents and the actual evidence of the domestic transition finance pilot program, comparing the key differences of project identification, assessment cycle, information disclosure and incentive policies between various pilot regions, and analyzes how these differences have led to the Financial institutions' preference for "low-hanging fruits" and greenwashing behaviors such as "transformation labeling" that exists in firms. Then, illustrate the effectiveness of the current prevention mechanism (Third-party assessment, information platform, and tracking of fund usage). The official research discovered that the vague standard will usually lead to the leaning of the incentives to the short-term indicators, increasing the greenwashing risks. In addition, the introduction of third-party verification and dynamic KPI assessment can effectively curb speculative behavior. The degree of standardization of information disclosure is directly proportional to the efficiency of fund allocation.

2. The progress and standard differences of local pilot projects in transition finance

2.1. Concepts, Definitions and Policy Background of Transition Finance

The transition finance is an area with the most growth potential in the Green financial system, it's core function is to fund substantive carbon reduction activities in high-carbon industries. Different from the idea of "Pure green" project supported by the traditional green financial system, the transition finance focuses more on supporting the "Brown industry" like steel, concrete, chemicals, to transform them towards the Green direction[5].

In recent years, China has attached great importance to the institutional construction of transition finance. And the year 2024 is the key year for the setup of the top-level transition finance. From the "Opinions on Accelerating the Comprehensive Green Transformation of Economic and Social Development" to the "Guidance Catalogue for Green and Low-Carbon Transformation Industries", and then to the "Guiding Opinions on Further Strengthening Financial Support for Green and Low-Carbon Development", a group of top-level policies has been rapidly introduced. Under the regulation of the dual carbon goals, China's financial institutions have already become the necessary participant and supporter of the transition finance[1].

Zhang indicates that the transition finance in China is still in the developing stage, they are facing challenges such as the inadequacy of standards and road maps, relatively weak information and data foundation related to the industry and projects, and a defective product design mechanism.

2.2. Local Pilot Layout

Since 2021, in China, provinces such as Zhejiang, Huzhou, Hebei, Chongqing, and Shanghai have successfully formulated the pilot plans for the transition finance, becoming experimental fields for institutional innovation in transition finance across the country. Due to the Green Finance Report of the Bund, Until May, 2024, a total of 31 local standards for transition finance have been designed in Zhejiang, Chongqing, Shanghai, and other places. 23 of them have already been published officially[6]. Liu's statistics are more comprehensive: Until October, 2024, a total of 17 transition finance catalogues have been published by all provinces, municipalities and regions across the country[2].

Looking at the pilot content, the experiments in various regions mainly include three aspects: The first is to define the technical path directory of "Transformation activities", the second is to design financial products related to transformation performance, and the third is to offer supporting policies such as financial incentives and fiscal interest subsidies. "From looking at the issuing institutions, the transition finance directories in most regions are jointly announced and released by the industry's financial regulatory authorities and competent authorities"[2]. For instance, the "Guidelines for the Transformation of Finance Work of the Steel Industry in Hebei Province was jointly published by 6 departments, including the provincial development and reform

commission, the department of ecology, the provincial local financial supervision Bureau, the department of industry and information technology, and the People's Bank of China, Hebei Branch. The "Directory of transformation finance support projects in Chongqing Municipality (Version 2023)" was authorized by the Chongqing Branch of the People's Bank of China, the Municipal Development and Reform Commission, the Municipal Commission of Economy and Information Technology, the Municipal Financial Regulatory Bureau, and other departments [2].

2.3. Standard Differences in Key Technical Dimensions

There are remarkable differences among standards in various regions in the following four key directions:

First, the selection of methods for identifying transformation activities. Nowadays, the international standards for defining transition finance are based on principles law, classification law, or a combination of both. The principle law mainly follows the "No significant damage" and avoiding the "Carbon lock-in" principles, and the classification law formulates a classification catalogue of projects/industries by clearly listing the suitable transitional economic activities; Liu believed that compared with the principle method, the classification method is a better choice for China's transition finance system: "It is more clear and measurable, avoid the risk of "Green washing", drive the flow of funds to the zero-carbon transition, and accelerate the alignment of transition financial projects among different areas and regions"[2].

Second, the different industries in different regions, most of the directories fundamentally cover necessary high-carbon industries, and some pilot programs have also involved local characteristic industries to better suit local conditions. The transformation finance program of Huzhou has chosen "81" industries that not only include the "Energy intensive and high pollution" industries that the country has put focus on, such as non-ferrous metals and chemicals, paper making, which involves local industrial characteristics. On the specific content of industry coverage, Chongqing's catalogue explicitly indicates the six industries of the transition finance support projects: Agriculture, chemicals, energy, steel, building materials, and nonferrous metals[7].

Third, the arrangement of the KPI assessment cycle shows remarkable differences in the assessment periodic length and frequency among various regions. For example, Huzhou has published an annual test and dynamic adjustment model, and proposed the "Management Specifications for transition finance loans" in the year of 2024. This has become the first transformation planning document in China's banking industry[8]. Other areas like Shandong adopt a mid-term assessment and three-year cycle approach. The difference in the assessment cycle is directly related to the incentive mechanism for businesses/enterprises to carry out transformation behaviors. However, the overlong cycle may ultimately lead to the speculative behavior of "No transfer after receiving funds".

Fourth, the differentiation of information disclosure requirements. There is a great variety in the intensity of information and the level of detail for transforming the enterprise. "In Huzhou, it is asked to publish the disclosure of the carbon emission data

and the method of emission reduction calculation. "Outline for the preparation of transformation plans of financing entitles" has been set to create a uniform template for firms from 8 aspects: Enterprise profile, transformation goals, transformation plans, transition financing, safeguard measures, fair transformation, information disclosure, and commitment and responsibility [9].

The fifth and last is the flexibility of incentive policy design. All of the pilot programs formulated different financial and monetary supporting tools: Huzhou launched the combination of financial and monetary policy due to the transition finance, providing a loan interest subsidy for the enterprise that achieves their transition goal or was set on the transition enterprise list. Shandong's scheme focuses more on the financial excitement and the ESG evaluation exam, part of the pilot even provides excitement through a separate listing of re-lending quotas and risk compensation mechanisms [7].

Based on the current situation, Zhang believed that the current transition finance market and the product categories in China are limited, which mainly concentrate on the reduce-carbon project areas, and it is necessary to accelerate the diversification of market goods/services and the standardization of the transformation financial market[5]. The Bund green finance report also indicates that problems like the lack of authority, differences in transition finance standards in various regions, lack of exciting policies still occur in the application and the formulation of the regional transition finance standard[10].

2.4. Conceptual Identification of Greenwashing Risk

The word "Greenwashing" can be defined as the enterprise's decision through selective information disclosure or fake commitment to gain environmental resources and supporting policies. "Zhang, Li indicates that, because of the low costs of "Green washing", it has become a temptation that part of the investment enterprise can't endure, restricting the realization of the dual carbon goals"[11].

2.5. The Labeling Behavior of Transformation at the Enterprise Level

First, to define arbitrage. In the pilot project of the principal law, enterprises defined low-standard activities like "Improve energy efficiency by 2% as a transformation behavior, but the actual emission reduction effect was tiny. "Ma indicates that enterprises are insufficient in formulating transformation plans, creating a chance for the occurrence of greenwashing"[8]. Second, the regional arbitrage. Enterprises register their business in places with loosened standards to obtain transition financial support. Tian suggested that the difference between the local and national/industry standards is the dominant inducement for the emergence of the risk of greenwashing[12].

Third, the "KPI avoidance" mechanism, in the pilot project that has a long assessment cycle, firms can choose not to physically invest in the first two years after receiving the fund, which they only finish the minimum amount of emission reduction targets before the assessment node, forming the speculative model of "Getting money and invest later". Just as the Bund Green Finance Report Institute revealed, the current financial support industry is still facing multiple bottlenecks in its low-carbon

transformation: Many industries have not formulated their low-carbon standards, which makes the financial institution hard to clearly identify transitional and high-carbon activities. The absence of this standard makes "KPI avoidance" covert.

2.6. The Low-hanging Fruit" Preference of Financial Institutions

"The financial institutions tend to first support the project with lower emission reduction difficulty". A survey by the Green Finance Institute of the Central University of Finance and Economics shows that 83% of the banks being interviewed strictly limit the line of credit, 68.3% of the bank strengths their pre-loan investigation, 84.2% of the institutions believe that they need to strengthen the transition standard supply, to prevent the occurrence of "Greenwashing" financing[13].

An, Y., Xia, J., Sun, X.C suggested that a regulatory framework should be produced to monitor the transition enterprise, choosing the most suitable transition finance tool[5].

3. Evaluation of the Effectiveness of the Existing Prevention Mechanisms

3.1. Third-party Assessment and Certification

The advantages are that, until August, 2025, 80% of the domestic traditional bonds are certified by a third-party evaluation. Wang indicates that the independent third-party assessment and certification can identify green projects through professional institutions, making sure that all of the green bond frameworks published by the floater match the standard. "People's Bank of China also explicitly proposed to improve the management mechanism of third-party assessment, standardize the evaluation process, and completely apply the professional role of third-party assessment institutions "[14].

However, there are several disadvantages, first is the inconsistent standard, the assessment frameworks adopted by different third party institution very greatly, insufficient to compare. Zhang, Li discover based on the simulation of the four-party evolutionary game model, that when the market is in the primary stage of "Green transition", when there is imperfect market supervision and reward and punishment mechanisms, the selection strategy made by the financial institution and the third-party may promote the occurrence of the enterprises' "Green washing" behavior.

Second, the issue of independence, because the third-party evaluations were paid for by the publisher, there is a possibility of conflict of interest. Also, part of the certification report is criticized as the "Stamping service", which didn't actually restrict the Greenwashing behavior.

Third, the lack of ex-post follow-up, most of the evaluations only focus on the pre-release stage, the annual verification of transformation performance is merely a formality, lack of punishment mechanisms. "Regions like Huzhou have already explored the continuous tracking of the completion of enterprises' transformation plans through local information platforms"[7].

3.2. Transition Finance Information Platform

Until 2025, part of the pilot project has already been established or is constructing the transition finance information management system. In Huzhou, the system of "Green loan pass" and "Transition finance information management" has been set. They've also collected information such as the progress of transformation projects and the enterprise carbon emission data. Zhejiang has published provincial group standards, which include the "Basic requirements for Green finance information service platform.

The first flaw in this area is the data silos problem. The data of different pilot program platforms are not related, which means financial institutions couldn't get the complete environmental performance data while firms raise funds across the regions. The report from the Bund also indicates that the dispersion of information and data resources, the disclosure of carbon emission-related information, and the incomplete statistics are important bottlenecks restricting financial institutions from supporting low-carbon transformation[6].

Second, the data quality, the carbon-emission data completed by firms, lacks third-party verification; these data are less convincing and may contain mistakes. Tian points out that the rate of environmental information disclosure by enterprises is low, and problems of delayed disclosure have occurred. The insufficient comparability and authenticity of the data have led to the deviation of green fund allocation from the precise track[13].

Third, the limited platform activity level, some platforms are only used for supervision reporting, and they are not often used by investors and financial institutions: "The value of information sharing has not been fully explored." And the article "Research on information disclosure of transition finance: From the perspective of financial institutions" provides a systematic discussion on this.

3.3. The Balance Issue Between Incentive and Restraint Mechanisms: Evaluation Based on Research Evidence

The current incentive policies include low-cost funds, risk compensation, interest subsidies, and inclusion in ESG evaluation, etc. To some extent lowers the financing costs of transforming enterprises.

However, there is an imbalance between incentives and restrictions on the policy design. The first is the short-term oriented incentives, the annual test incentives prompt the firms to select the "Short and fast" emission reduction measures, and give up deep technological innovation that requires 3-5 year period. Tian clearly stated that a massive amount of resources is spent on the low -carbon transformation of traditional high-energy-consuming industries, and less of them are put into the frontier industries such as new energy and carbon capture.

Second, the possible boosting effect of incentive policies on green washing: The current incentive tools focus more on the "Scale expansion" rather than "Effect verification", to some extent worsens the Greenwashing risks, not relieve. "Also, as local governments play a core role in rectifying the phenomenon of "Greenwashing" in the market, they should set up a thorough reward and punishment system"[11].

Third, the continued restrictions on the financial burden, the local financial interest subsidy relies on the local financial resources, which means that, after the possible reduction of subsidies in the future, some transformation projects may not continue. The research from the IIGF official website also reveals a structural imbalance-72.3% of the investigated institution's non-green loans are at the percentage of 90%, which means that the percentage of transition financials still remains low in the overall operation.

4. Conclusion

This article identifies three systemic flaws in China's transition finance pilot programs. First, the fragmented standards create the regulatory arbitrage space: Each region has its unique directory and rules, which allows firms to choose the loosest standard. For "Transformation labeling", the lack of comparability across local standards is well-known. Second, the structural imbalance between incentives and restrictions, the current policy focuses more on "Providing and policy" while punishment mechanisms for greenwashing remain weak, which lowers the cost for greenwashing and makes it persistently attractive. Third, the weak construction of information infrastructure, unified carbon emission accounting standards, enterprise environmental performance databases, and qualification management of third-party certification bodies are still incomplete. These three weakness mutally reinforce each other, forming the institutional origin of greenwashing risks in the transition finance.

To get rid of these issues, four targeted improvements on the national unified standard should be set: First, define "Substantive transformation" by setting the minimum emission reduction thresholds and reducing the pseudo-transformation(Can see reference from the "No major damage" principle). Second, design a dynamic KPI test through the rolling goals and phased incentives to prevent the firm's action of "Getting money first and paid later". Third, Reinforce the third-party verification through annual tracking, blacklist penalties, and an accreditation system. And last, connect information platforms via a national carbon market infrastructure to achieve cross-regional data integration. The future research should empirically test the relative effectiveness of principle vs. classification-based standards, evaluate the real market reactions after the establishment of new national standards, and further explore the causal link between corporate transformation behavior and incentive design by using asymmetric information.

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