EBF
European Banking Federation

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EBF response to the ESAs Call for evidence on better understanding greenwashing

Key points

- **Sustainability** has been **attracting considerable and growing attention** over the last years
- With increasing regulatory developments and industry initiatives related to sustainability, **greenwashing claims have naturally begun to arise** as well
- With two thirds of the European economy being financed by **banks**, the latter **have played and will continue to play a crucial role in the transition** to a more sustainable economy.
- However, not only is the financial sector highly dependent on the sustainability claims of their clients and counterparties, but there are also other **several elements beyond the control of the financial sector** which are contributing to increased greenwashing claims, including:
    - **Lack of clarity and consistency of EU regulation** addressing greenwashing that is just coming into effect or about to do so, combined with short implementation times
    - **The sustainability data gap** and the **lack of a single approach to the use of proxies and estimates** across sustainable finance regulations
- The resulting increased risk of wrongful greenwashing claims and potential reputational implications **may finally deter financial institutions** from increasing transition and sustainability financing and the development of sustainable financial market products

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- In this context, we **support the objective of a focused approach to greenwashing** covering all sectors of the economy based on the following elements:
    - link to the damage caused mainly to market integrity and/or customer protection due to misleading information of material omissions that could affect decision-making processes around sustainability
    - the presence of gross negligence and/or intentionality
- Finally, we see great value in **building on existing initiatives**, enhancing legal clarity and addressing areas of uncertainty or the lack of appropriate sequencing throughout the sustainable finance regulatory framework

Concept of greenwashing

In our view, greenwashing is currently understood to encompass different actions, whatever their nature, that generate a perception of being more environmentally friendly than they really are or could be evidenced (unsubstantiated claims) and can occur in any sector. We note that this consultation only covers greenwashing in the financial sector, however these subject merits broader-based consideration as many examples of **greenwashing originate outside the financial sector**. A large part of financial institutions' sustainability status and claims are based on corresponding sustainability claims from their customers and counterparties. So any initiative limited to the financial sector will be incomplete, potentially misleading and less effective than it could be if the base were broader.

We support the objective of a **focused approach to greenwashing,** as greenwashing claims have increasingly been arising in a context of growing sustainability-related regulatory developments and industry initiatives. As a result of these developments, companies' sustainability commitments are increasing, as well as substantial need for funding to support the transition to a sustainable economy**.** The risk of wrongful greenwashing claims may lead to reputational risk issues which may deter financial institutions from increasing transition and sustainability financing and the development of sustainable financial market products**. The perception of greenwashing also undermines trust** in the market for sustainable finance products. This can hold back the demand from investors, and ultimately reduce the impact of efforts to channel finance in support of sustainability objectives.

A clear and focused approach to greenwashing covering all sectors of the economy will help address the risk of unfounded allegations of greenwashing. We are in favour of establishing **unambiguous principles** that companies can follow to eliminate the risk of greenwashing (e.g., claims must be substantiated, claims must not omit or hide important relevant information conditioning a client's decision; comparisons must be fair and meaningful, etc.). **However, attempting to be too specific in defining all actions or activities leading to greenwashing may be counterproductive**. We also do not believe a **hierarchy of topics can be established based on their degree of greenwashing risk**. Preference should be given to an overall approach to greenwashing that will provide clarity and consistency while avoiding an overly broad definition.

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Therefore, we support the objective of a focused approach to greenwashing covering all sectors of the economy based on the following elements:

1. **link to the damage caused mainly to market integrity and/or customer protection due to misleading information or material omissions that could affect decision-making processes around sustainability**
2. **presence of an element of gross negligence and/or intentionality.**

The notions of intentionality or negligence imply that a firm can be at risk of greenwashing if it has failed to comply with legal requirements or voluntary frameworks against which it has claimed sustainability. **Actions of misrepresentation that do not involve the elements of gross negligence and/or intentionality should be treated differently**.

Lack of clarity and consistency of EU regulation addressing greenwashing that is just coming into effect or about to do so, combined with short implementation times and insufficient maturity of ESG data and ESG methodologies could create the foundation for possible **unintentional misrepresentation** which might occur in any stage of the product lifecycle despite the best possible due diligence. Where a market participant **has no intent and has not been negligent in using or communicating information, which has been provided by a third party or based on proxies, that market participant or its action should not itself be assessed as greenwashing**. This is an important distinction as it is nether appropriate, nor practicable or proportionate to hold market participants liable for misleading statements made by third parties **unless they have themselves intended to mislead or been negligent in using or communicating the misleading information.**

Besides addressing greenwashing practices in the financial sector and beyond, we believe measures should be adopted to **protect companies, including financial institutions, from unsubstantiated greenwashing allegations** which increase the reputational risks and have an impact on the level of confidence on financial markets. A company cannot be at risk of greenwashing if such failure is due to external exceptional circumstances, in particular in the current environment characterized by the following elements:

- unclear, inconsistent, unenforceable, or unstable regulatory requirements, including definitions, and requirements that do not apply to all market players equally, which may lead to diverging interpretations by competent authorities and other stakeholders.

- The current sustainability data gap and the lack of a single approach to the use of proxies and estimates across sustainable finance regulations

- Currently the economy is not sustainable and is, at best, in transition while the rules of the game are evolving rapidly. This may create a mismatch between

authorities' and civil society's expectations from market players and the actual impact of market players' actions to green the economy.

The above-mentioned elements result in a rather volatile environment for financial market participants to produce and market sustainable financial products. Greenwashing accusations under these circumstances would, in our view, be wrong because **financial institutions are merely the recipients of these situations** for which they cannot be held responsible. They cannot be at risk of greenwashing if such failure is due to external circumstances over which they have no control.

A broad concept of greenwashing will pave the way for more greenwashing claims against the financial market participants in a situation where the regulatory framework and data are still maturing. As this will eventually be to the detriment of the green transition, unintentional or passive misrepresentation of sustainable features should therefore clearly be treated differently. Alternatively, for the first few years and until regulations are stabilized and high-quality data becomes available, "safe harbour" provisions or similar might be envisaged. In any case, it is important to enhance legal clarity, legal certainty and address areas of uncertainty or lack of appropriate sequencing throughout the sustainable finance regulatory framework.

Examples of unintentional misrepresentation

Examples of regulatory requirements as a potential source of unintentional misrepresentation

Although regulatory uncertainty should not be confused with greenwashing, it is important to consider that the regulatory framework at this point leaves the definition of key issues to the discretion of financial market participants, just as a continuous flow of third level guidance has a real impact on how "green products" are viewed and produced. As an example, the "reclassification" of several SFDR Article 9 funds to Article 8 should not be regarded as a sign of prior greenwashing but as a demonstration of how legal uncertainty and further guidance on the interpretation of SFDR have an impact on the market. Furthermore, sequencing issues between regulations are hampering due implementation when part of the "regulatory foundation" required for successful implementation of another regulatory requirement has not yet been in put in place. An example of this is the MiFID/IDD suitability requirements which came into force on August 2nd, 2022. There was a lack of data (e.g., taxonomy data not yet existing, SFDR-template data requirements to be published only January 2023, third party data which is not mature) and the definition of "sustainable investments" was not yet mature. Also, currently there is an ESMA consultation on Guidelines on funds' names using ESG/sustainability-related terms, which could have an impact on already implemented requirements.

Insufficient data quality as a source of unintentional misrepresentation

It is broadly acknowledged that data availability and quality do not yet meet the requirements for financial markets 'participants when they manufacture green financial products, advise customers and disclose sustainability-related information. In the same vein as regulatory guidance, data can, and will, change as the reporting from non-financial companies improves, just as the knowledge and definitions of what can be considered sustainable will evolve. A current lack of reliable and comparable ESG data is a key challenge for financial institutions, which often depend on third parties for such data. If this information turns out to be incorrect or incomplete, they run a greenwashing risk, even if they have previously conducted their due diligence on the third-party provider and have taken measures to work with credible sources. **If financial institutions use data/ESG indexes or proxies from third parties, they should be able to rely on them and not be held responsible for any shortcomings**. It should be acknowledged that a "best efforts" application of the data that is available at this point does not constitute greenwashing, if more accurate data becomes available at a later stage.

Current and future regulation and developments

Existing legislation

Currently, **different expectations as to how to manage greenwashing** can be found in EU legislation, for example in the EU Taxonomy Regulation (same as MiFID Delegated Regulation (EU) 2021/1253 and IDD Delegated Regulation 2021/1257)A definition of greenwashing is provided in the SFDR Delegated Regulation 2022/1288 in recital 16 as the practice of gaining an unfair competitive advantage by recommending a financial product as environmentally friendly or sustainable, when in fact that financial product does not meet basic environmental or other sustainability-related standards".

Also, while the Directive on Unfair Commercial Practices does not provide specifics on greenwashing as such – but the Guidelines[1] issued last year offer a definition of greenwashing and clarify that the Directive provides a legal basis to ensure that traders do not present environmental claims in ways that are unfair to consumers. As the Directive also applies to financial markets, it should be taken as a reference to define the basis for proper market communication (both at product- and entity-level), including with regard to the misuse of sustainability labels.

It is of paramount importance to consider the existing framework in place and appreciate that many existing principles and legal frameworks already apply to address misleading statements. Examples include financial promotion, conduct of business rules, misrepresentation, fraud, unfair consumer commercial practices, disclosure rules etc.

[1] https://eur-lex.europa.eu/legal-content/EN/TXT/PDF/?uri=CELEX:52021XC1229(05)&from=EN

In fact, it would be of great value to harmonize current legislation on unfair commercial practices with that on sustainable finance (SFDR, Taxonomy Regulation) and make them complementary as far as greenwashing issues are concerned. This particularly concerns the use of the terms "sustainable" or "ESG" to qualify financial products. It is also important to note that greenwashing risks are to a large extent being incorporated into the risk and compliance assessments already taking place. This follows from provisions already laid down in marketing legislation, UCITS, AIF and disclosure regulations.

The current legal framework (on sustainable finance but also more broadly on conduct of business and investor protection) can already contribute to preventing greenwashing risk and should be fully considered, together with initiatives underway, when considering any future work on greenwashing. To avoid increasing complexity, the **ESAs should build on the legislative framework already in place**. Building on the existing EU initiatives such as for example the EU GBS or voluntary EU label should be one way to address greenwashing and enhance confidence in sustainable products. A " label related to transition finance (see section below) might also be considered as labels have the advantage of being more understandable by consumers than reams of information.

Upcoming initiatives

Regulatory work is also underway in several further areas including:

- ESMA Guidelines on funds' names using ESG/sustainability-related terms;
- EBA technical work on green loans and mortgages;
- Commission revision of the Prospectus Regulation including dedicated requirements, where relevant, for ESG-related debt securities;
- A legislative proposal is expected on oversight of ESG Ratings and ESG Data providers.

In addition, jurisdictional approaches such as the FCA's proposed anti-greenwashing rule, as well as definitions from IOSCO, are emerging at international level. We urge the European Commission to coordinate efforts at global level to agree with an internationally aligned definition as well as an internationally aligned liability regime.

With regard to future regulations, there are certain points that need to be considered across the value chain from the product design phase as well as ongoing monitoring, from two different perspectives:

- Under products manufactured, it is necessary to consider aspects such as labelling (financial instruments: green bonds, investment funds, derivatives; banking products: deposits, loans…), transparency and adequate ESG rating firms.

- Under market distribution, it is necessary to consider aspects such as transparency and suitability.

Transition Finance Framework

Concerning the **definition of what could be considered sustainable**, the EU Taxonomy defines what can be considered a sustainable activity. However, many activities are not (or not yet) included in the taxonomy and there is no objective basis for labelling these activities. Even more importantly, there is no definition of **what could be considered as transition finance** – the financing of activities or companies in their transition to net zero. As recognized by the G20 in its recent report, despite the rapid growth of the green and sustainable finance markets, financing efforts have mostly focused on green activities, while support to the broader range of investments needed for the climate transition of the entire economy, including GHG-intensive sectors and firms, has been more limited. UNEP FI attributes this relatively limited amount of transition financing to two core issues: i) insufficient appreciation of the need to mobilize greater amounts of capital to carbon-intensive sectors to reduce emissions in line with net-zero goals, and ii) the absence of clearly defined labelling standards by existing initiatives and a lack of transition-specific taxonomies.

As further stated in the G20 report, an **effective framework for transition finance** can support the whole economy's transition and improve the ability of sectors or firms to gain access to financing to support their transition to net zero emissions, mitigating potential negative effects of a disorderly transition. A transition finance framework may not only provide incentives and opportunities to promote more sustainable-aligned products or businesses and contribute to transparency and financing ESG activities/products, **but also reduce the risks of greenwashing**, increase transparency and understanding of the real contribution of financial and non-financial sector to net zero objectives.

Further recommendations

The **existing varying regulatory definitions** are indeed problematic. Therefore, it is important not only to provide an **unambiguous concept of greenwashing but ensure its consistent uptake in all EU legislative initiatives, existing and future.** It is also important to review the coherence of the existing regulatory framework, increase its usability and undertake a gap analysis to identify subjects potentially impacted by greenwashing that are already covered by the current legislation and address areas of uncertainty that could increase greenwashing risk.

Recommendations:

- A single approach on the use of proxies and estimates should be set across EU regulations, and a list of acceptable proxies should be defined at EU level for FIs to choose from, thus improving comparability of disclosures and reducing the risk of unintentional misrepresentation.
- ESG ratings and ESG data providers should be regulated at EU level to enhance transparency on their methodologies and reliability of ratings and data, thus reducing the risk of unintentional greenwashing
- Benchmark administrators should be subject to the SFDR to enhance the transparency and understanding of benchmarks

- While we strongly support that transition plans that must be science-based, Net Zero aligned and audited will be required as of 2024 (CSRD), the definition of science-based sectoral transition trajectories would help comparability as well as reduce the risk of unintentional misrepresentation.

We believe further focus should be on **effective implementation of the existing legislation**. We would encourage the ESAs to take into account both the existing sustainable finance framework and the ongoing workstreams to ensure any future initiative on greenwashing would be targeting the missing pieces of the wider framework in a consistent manner, rather than adding a new layer of rules. As mentioned above, stability of the legal framework to prevent greenwashing risk requires the following:

1. **Avoid adding complexity to an already rich framework:**
    - Conduct of business rules and investor protection rules must apply irrespective of whether we are in an "ESG-related" case or not;
    - ESG-related transparency requirements: SFDR, CSRD, Pillar 3, BMR, EUGBS aim to prevent greenwashing risks
    - Risk management: Pillar 3 disclosures; Integration of climate and environmental risks into banks' risk management; Climate stress tests can help address greenwashing risk
2. Stability also requires **green "grandfathering",** i.e., what is claimed as green in year n (with transparency on why it is claimed to be green, e.g., Reference to the EU taxonomy or to another framework that is publicly available) cannot be accused of being greenwashing in year n+x due to the evolution of the framework in the meantime**.**
3. Stability finally requires that any **future approach to greenwashing include the current references to greenwashing** found in the existing legislation such as in recitals of the Taxonomy regulation and in the SFDR.

Impact of greenwashing risk on voluntary long-term commitments

It is important to understand the impact of risk of greenwashing accusations on voluntary long- term commitments. Voluntary commitments such as NZBA which are assumed on a "best effort basis" to support the Paris agreement's objective do not only depend on financial entities. The fact that governments or other stakeholders may not play their part, or that uncontrollable or unexpected external factors (like the war in Ukraine) occur along the way, undermining or delaying the final goal pursued under such voluntary commitments, should by no means be a liability for financial institutions or be treated as greenwashing.

When voluntary commitments rely on robust global frameworks and standards such as NZBA under the assessment and scrutiny of recognized international organizations (UNEP), those recognised standards and respective performance audits should serve as sufficient safeguards. Signatories to the NZBA, for instance, assume their commitments on the basis that they can only succeed in achieving their objective by working together with customers and other stakeholders, who must also play a key

role. Banks make these commitments with the expectation that governments will follow through with their own commitments to ensure that the objectives of the Paris Agreement are met.

Fear of greenwashing accusations linked to the possibility of being ultimately unable to achieve a global objective, or to achieve it in the agreed timeframe, due to external influences beyond a bank's control may disincentivize further uptake of voluntary commitments and can also generate an exit effect, especially taking into account the lengths of such commitments, the diversity of actors involved and the complexity of the current geopolitical context.

Greenwashing "value chain"

Any regulation needs to consider accountability and responsibility for greenwashing across the "value chain" of financial institutions. Roles such as "spreader" and "receiver" cannot be considered clear-cut: it would be more appropriate to define who is "responsible", who is "complicit" – and who is neither - given the immense reputational risk involved (one example to consider be that of an asset manager using information from a corporate that was rated by an agency, with a distributor distributing the fund). It should be made clear that a financial market participant indirectly involved in a greenwashing occurrence is not responsible in the same way as those involved intentionally or due to negligence. Banks are dependent on the quality of information provided by corporates, EPCs for retail etc. Safeguards are needed for market participants along the sustainable investment value chain when they are not ultimately responsible for spreading greenwashing (once their best efforts to counter its risks, such as risk-management and reputational risks, have been ascertained) and those at the receiving end of greenwashing, such as investors and consumers.

Role of external verifiers and rating providers

Another topic to be addressed is the role of external verifiers and rating providers, as third-party validation will play an essential role in addressing greenwashing. It would be appropriate to have a register of external verifiers authorized by the European authorities in order to ensure that they meet the requirements for verifying entities regarding greenwashing matters with an appropriate management of potential conflict of interests.

Education

Moreover, it is relevant to consider that even if the European legislative framework on sustainable finance regulates different aspects of financial institutions' behaviour and actions related to sustainability (e.g., reporting, disclosure, labelling, etc), legislators should do more to support these institutions and their workforces in their ongoing acquisition of new skills and know-how as the sustainable finance regulatory field evolves and brings new technologies, methodologies and data.

The ESAs and market regulators should also have a role to play in "educating" and disseminating information on robust standards and global frameworks to ensure that all stakeholders can make well-founded opinions.

Social aspects

Even though uncertainties still exist concerning the environmental aspect of ESG, this is the most well-defined aspect for now. The "social" part of ESG includes more elements that are purely qualitative, more elements for which quantification/metrics are difficult and likely more differences between EU nations. All this could enlarge the interpretation of "social" and, potentially, the risk of "greenwashing" accusations.

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