AVOIDING GREENWASHING

NATASHA CAZENAVE
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Addressing greenwashing to support a sound transition

Once a niche area, the transition to a more sustainable economy is now a central focus of corporates, governments and investors. Companies communicate more and more on their roadmap to net zero and decarbonisation plans. Investors – institutional and retail – are increasingly interested in sustainable investments and expect to have access to meaningful sustainability disclosures to make informed decisions. The EU has set an ambitious agenda to lead this transition in which the financial sector has an important role to play to help finance this transition and channel the funds adequately.

While there is a high demand for ESG and sustainable investments, there is also a healthy dose of scepticism. Regulators fear that this specific 'rush for gold', combined with the lack of clear and consistent disclosures for sustainable products may result in misleading investors around certain sustainability claims such as relevant characteristics of funds marketed as sustainable and in turn potentially undermine investors' trust. Ultimately, there is a real risk of mis-selling that could impact investors and threaten to derail the global decarbonisation journey.

In order to address these issues, the work of ESMA to date has included the development of a disclosure framework under the Sustainable Finance Disclosure Regulation (SFDR) and the Taxonomy Regulation, notably to clarify the requirements to be met by products labelled as sustainable. These elements have been central to our objectives set for the next five years, and ESMA's willingness to make a decisive contribution to the fight against greenwashing.

Against that background ESMA has expressed concerns about the use of the SFDR provisions as de facto labels. And while we would welcome further clarity around minimum sustainability criteria for disclosures of financial products, the review of the underlying legal framework by the European policymakers will likely require a significant amount of time. In the meantime the practical implementation is proving challenging and the risk of greenwashing is increasing. Thus, ESMA's focus has been put on a few important pieces of work, in cooperation with the European and national authorities (i.e. other ESAs and NCAs).

The first initiative was launched with a consultation on draft ESMA guidelines on funds' names using ESG or sustainability-related terms, in November 2022. Preliminary analysis of the stakeholder feedback shows a recognition of the investor protection concerns stemming from greenwashing risks.

In parallel, the ESAs have been jointly collecting input to get a better understanding, and practical examples, of potential greenwashing practices. We received about 140 responses spanning from across 20 EU Member States and various sectors. Overall, ESMA's preliminary analysis corroborates greenwashing as a source of a serious concern. These findings will inform the ESMA report expected by May 2023, as well as any relevant follow-up work.

Furthermore, the ESAs were also tasked with reviewing regulatory technical standards on principal adverse impact indicators and certain product disclosures regarding decarbonisation targets. This is part of a joint ESAs consultation paper, which will inform a report expected by the end of October 2023.

As the regulatory framework gets clearer and tighter, both supervision and enforcement are equally key in the process of fighting greenwashing. Some authorities, notably in the United States, Germany and the United Kingdom have already taken enforcement action for alleged greenwashing. ESMA and the NCAs have been advancing work in the context of Union Strategic Supervisory Priorities. ESMA launched a Common Supervisory Action (CSA) in January 2023 on the application of MiFID II disclosure rules regarding marketing communications and advertisements across the EU, to gather information about possible greenwashing practices. Another CSA will likely take place later this year with a focus on the integration of sustainability risks and sustainability disclosures by asset managers with a focus on SFDR.

These examples represent only a part of ESMA's overall work on sustainability. We are also actively working on the sustainability reporting framework. We firmly believe that we should not take investors' interest in sustainable products for granted: Negative macro-economic developments – compounded by concerns about greenwashing – could lead to a flow of capital away from sustainable finance. Therefore, the framework must provide certainty and preserve investor confidence.

Only so can we support the allocation of the much needed capital to sustainability goals. ESMA will spare no effort to ensure full transparency to investors.

FAUSTO PARENTE

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Greenwashing: one of the barriers to the transition

The financial sector plays an important role in financing a timely transition to a more sustainable economy. Progress is being made with an increasing number of insurance and pension providers who are now offering products with sustainability features or making net zero commitments. However, in a context where the regulatory framework is yet to be completed and where there is constant evolution there is a risk that insurance and pensions providers make misleading claims about their sustainability credentials – i.e., what colloquially is referred to as greenwashing.

Greenwashing has an important impact as it can erode society's trust in the role played by the financial sector in financing the transition, making consumers less prone to invest their money in a sustainable way (for example in life insurance) or to purchase non-life insurance products from insurance undertakings with substantiated sustainability credentials. Indeed, the emergence of greenwashing cases, albeit none identified by the European Insurance and Occupational Pensions Authority (EIOPA) so far in the European insurance and pension sectors, is already having some possible spill-over effects.

A recent Eurobarometer survey carried out by EIOPA shows that in the European Union (EU) 63% of consumers do not trust sustainability claims made by providers. Further, greenwashing can create reputational and regulatory risks for providers, which for fear of being accused of greenwashing might reduce their sustainable offerings. Given its important impact, EIOPA is committed to tackling greenwashing.

The EU's sustainable finance regulatory framework already provides useful regulatory tools to tackle greenwashing. The Sustainable Finance Disclosure Regulation (SFDR) gives transparency to investors on how providers and products affect the environment or society. The Taxonomy Regulation (TR) gives clarity on what economic activities are environmentally sustainable. The new requirements in the Insurance Distribution Directive introduce sustainability objectives and preferences in the product manufacturing and advice processes. The Corporate Sustainability Reporting Directive (CSRD) will require the disclosure of detailed information on the impacts of entities on sustainability factors thereby substantially increasing the availability of sustainability data, including for the reporting obligations of providers.

However, there are some limitations – also because the EU has been a front runner in this sphere which is rapidly evolving. Both the SFDR and TR, in addition to their interrelation, introduce complex and sometimes unfamiliar concepts, which can be challenging for consumers to navigate and assess, and challenging for the industry to implement. Further, the SFDR was not intended to create labels but it is being used as a labelling regime, and the first CSRD reporting will only come in 2025 based on 2024 data. Additionally, while insurance providers will have to report a key performance indicator related to their underwriting activities under the Taxonomy Regulation, greenwashing in non-life insurance remains largely unaddressed by the current regulatory framework. These limitations coupled with a lack of clarity around what is and what is not greenwashing, can exacerbate potential greenwashing.

Tackling greenwashing is therefore imperative for restoring and strengthening consumer trust in the ability of providers to allocate resources sustainably and support a timely transition to a sustainable economy. The EU sustainable finance regulatory framework needs to be completed and to include a clear definition of greenwashing. Its implementation by providers and consequential supervision by competent authorities focused on the overall aims of the framework are crucial.

Tackling greenwashing to harness the financial sector's role in financing the transition.

EIOPA continues to take an active role in tackling greenwashing as this is essential to harness the financial sector's role in financing the transition. EIOPA is working with the other European Supervisory Authorities to respond to the EC's Call for Advice on greenwashing, which includes establishing a cross-sectoral understanding of greenwashing. EIOPA is also integrating the monitoring of and mitigating of greenwashing risks across all its supervisory tools and activities. Further, EIOPA took note of the recently proposed Directive by the European Commission (EC) on the substantiation of environmental claims to tackle greenwashing in business to consumer communications in all sectors of society.

JOS HEUVELMAN
Member of the Executive Board -
Dutch Authority for the Financial Markets

A consumer-oriented approach to enhancing sustainable finance legislation

Sustainability is one of the key priorities of the AFM supervisory strategy. Adequate and clear information on sustainability is essential for both the functioning of the sustainable finance market, and the objective to reorient capital flows towards sustainable investment. To ensure investor protection, maintain trust in sustainable investments and avoid unfair competition, greenwashing is an important risk that needs to be addressed.

Fortunately, existing rules that all information shall be fair, clear and not misleading also apply to sustainability claims. In addition, the disclosure obligations of the SFDR, CSRD and the EU Taxonomy will provide investors, supervisors, and market players with much-needed substantiation of sustainability claims.

Much focus has understandably been on these new mandatory sustainability disclosures. The standardized disclosure templates will allow stakeholders to compare and monitor progress, putting a strong check on the claims that are being made.

However, we should take note that the SFDR and CSRD are disclosure regimes. They do not stipulate what is sustainable and what is not. Nor do they provide limitations to usage of certain sustainability terms in marketing of products.

There is a persistent misconception among market participants that SFDR classifications, articles 8 and 9, can be used as a proxy ESG label for investment products. The SFDR, however, is not a labelling regime, nor was it intended as such. As such, SFDR classifications by itself are not a helpful guide for investors. And retail investors seem to agree. In a 2022 AFM consumer study, we found that only 3% of retail investors that seek to invest sustainably use SFDR classifications to guide their investment decisions.

When selecting sustainable investment products, most retail investors are primarily guided by marketing communication, prominent website information, or naming of products, the same study showed. Only a limited number of retail investors take the time to truly scrutinize mandatory disclosure documents. The study also found that consumer expectations on sustainable investments vary and often differ from most sustainable investments strategies offered, and that consumers find it difficult to select products that match their objectives.

We found that the most important objectives for sustainable investors are, in this order: 1) impact; investors want to make impact by bringing about positive sustainable change with their investment that would otherwise not have happened, also referred to as 'additionality'; 2) ethical; investors want to invest in companies that are in line with their personal norms and values, also referred to as 'value alignment' and; 3) return; investors regard sustainability as a way of achieving a better risk-return ratio.

To bridge the gap between the mandatory disclosures on sustainability, the expectations of sustainable investors, and the different sustainability approaches that are available in the market, there is a clear need for better consumer-oriented guidance. The need to provide clarity on the distinction between different sustainable investment approaches is heightened because the SFDR definition of sustainable investments leaves room for a broad interpretation of sustainability. We therefore need to introduce better, consumer-friendly classifications or labels.

The AFM strongly advocates a consumer-oriented approach towards better classifications and labels. This means taking into account their expectations and objectives. Much of the current legislative framework is geared towards value alignment strategies: investments in products that consist of companies that are already sustainable. Most sustainable investors, however, seek positive real-world impact.

The AFM strongly advocates a consumer-oriented approach towards better classifications and labels.

Classifications or labels should allow investors to recognize products that have an impact approach, either by investing new capital (direct impact), or through engagement strategies (transition). Moreover, they should allow investors to identify the distinction between these two approaches. This implies that market players should relate to these objectives when offering retail products and should make a convincing case that their product indeed suits these objectives.

To combat greenwashing and put a check on sustainability claims, the mandatory sustainability disclosure requirements of the SFDR, CSRD and the EU Taxonomy will be an important factor. However, to maintain trust in the market for sustainable finance, the AFM believes the legislative framework needs to be complemented by better, consumer-oriented categorization of products that takes into account the expectations and objectives of sustainable investors.

WANG LEI
Deputy General Manager -
Bank of China (Europe) S.A.

Impact and trends outlook of greenwashing regulation on banking sector

In recent years, there has been a growing awareness of the significance of sustainable development and the urgency of the decarbonization transition on a global scale, and the growing demand for sustainability-related products combined with rapidly evolving regulatory regimes and sustainability-related product offerings create a context that may be conducive to increased greenwashing risks. The European Commission (EC) has recognized the need for greater regulation of "greenwashing" risks and has taken action to request a Call for Evidence (CfE) from ESA. It can be foreseeable that the regulation on the risk of greenwashing is becoming stricter. In line with this theme, we have refined and elaborated several points of view as reference.

Firstly, data standards and risk identification shall integrate with the Taxonomy.

As the risk of green washing is becoming more and more prominent and regulation is in the schedule, it is a priority issue for the financial sector to refine and standardize the boundaries between green and non-green as soon as possible. The standards of EU sustainability have been becoming clear, standardized and rigorous. It has been put forward a tighter schedule and higher demands that financial sector needs to absorb and transform the Taxonomy into granular practical manual guidelines. However, recent EBA data shows that most of the exposure (65%) is to obligors whose main activity is in a NACE sector which is considered not to be part of the first two objectives of EU Taxonomy.

Therefore, we suggest that, on the one hand, the financial sector should strengthen the interface between green standards and NACE industry and risk data summation specifications; on the other hand, the banking sector should be fully prepared to integrate the greenwashing risk identification into all products and business lines.

Secondly, higher requirements are put forward on the internal governance and risk management of banks.

ESG represents a new transformation for internal governance and risk management in the financial sector, and greenwashing risk is an emerging type of risk derived from it, whose risk identification, assessment, measurement, monitoring, the deep involvement and strategic review of BOD, implementation by management and the roles of three lines of defense, shall be integrated and taken into account. In terms of internal management of banks, how to effectively implement risk monitoring and supervision through specification and qualification for the project of Bonds or ESG funds, and how to meet the standards throughout the loan life cycle for the LMA's Green loans and ESG-linked loans, etc., all of these measures must be formed with a "greenwashing" risk identification and assessment methodology and integrate it into each standalone-point risk for effective management according to the bank's strategy and risk appetite.

The third aspect pertains to information disclosure and market discipline.

It is foreseeable that further supervision of ESG transparency and market discipline in the EU which will promote the financial sector and their clients to effectively achieve sustainable goals and effectively prevent the greenwashing risks, while that would also increase the cost of meeting standards for the financial sectors. The EU has recently circulated the Corporate Sustainability Reporting Directive (CSRD), which regulates disclosure standards and key performance indicators and all members of states are required to transform it into delegated act within 18 months. In addition, the related European Sustainability Reporting Standards (ESRS) will also be implemented as a supplementary technical standards of the CSRD. We are also highly concerned about the legislative process and the phase-in requirements for banks to meet the standards.

It is a priority issue to refine and standardize the boundaries between green and non-green.

Finally, IT infrastructure and digitalization.

As aforementioned, the regulatory legislation and data standards are improving which raised a high standards and urgent requirements for our digital capacity and IT infrastructure. Hence, digital transformation is a fundamental and necessary support for green transformation ourselves as well as integration into the transformation of our customers. We will put our best efforts on the sustainable development.

MELISSA OCAMPO
Head of Sustainability Strategy, EMEA - SMBC Bank International Plc

Realising the potential of the EU taxonomy and avoiding greenwashing

SMBC Bank has set an ambition to make Sustainability central to our purpose and business strategy. For example, SMBC has made a strategic commitment to achieve Net Zero in our loans and investments by 2050 as a member of the Net Zero Banking Alliance, committed to the UN's Principles for Responsible Banking, and became a signatory to the Poseidon Principles to help reduce our maritime emissions intensity. These commitments are long term and built upon trust. Therefore, we recognise the importance of avoiding greenwashing in our business activities so as not to undermine these commitments.

European Union (EU) policymakers have rightly placed significant emphasis on driving investment towards toward truly sustainable economic activity, and they have committed substantial effort to defining this "North Star". As a global bank, we continue to consider this definition in the context of our broad international business, where we see different starting points and ambition levels. In a field as diverse and technical as sustainability, we believe 3 key ingredients are needed to direct capital toward truly sustainable economic activity: a supportive internal environment at the bank, a solid regulatory foundation in the market, and an ecosystem of enabling external partners.

Sustainability represents a vast transformation effort not just for banks, but for the whole economy. At SMBC, we are driving this transformation by building our technical capacity, focusing on corporate culture, and putting in place the necessary sustainable finance governance and oversight. Considering our technical capacity, we have invested in hiring a number of Sustainability experts within both our client-facing and support teams. This has allowed us to build technical frameworks and to stay abreast of leading practice through our involvement in several cross-industry organisations and initiatives.

Training across all levels of the organisation and very visible senior management support for Sustainability are helping to drive change in our organisational culture. For example, SMBC Group has recently appointed Paul Polman, a global sustainability leader and former CEO of Unilever, as a Global Advisor. Finally, oversight and governance are critical elements, with clear roles and responsibilities across the lines of defence for applying standards, escalating edge cases, and making empowered decisions.

As a large non-EU headquartered international bank, SMBC recognises the leading role that the EU is playing in the field of sustainability policymaking and nowhere is this more evident than in the technical rigour of the EU Taxonomy (EUT.) This is clearly a very useful resource for banks to point our capital toward the most sustainable assets and reduces ambiguity. One of the challenges this presents however, is that as an international bank it can be difficult to position EU Taxonomy aligned green assets alongside green assets in other jurisdictions.

We welcome efforts to harmonise taxonomy definitions across jurisdictions and the EUT provides a good starting point for this. There is also more that can be done to integrate the EUT operationally across the different markets we operate in; for example, there could be potential to capture when an asset passes some but not all screening criteria and relate these to assets held in other markets, subject to practical testing. This would allow investors to identify where investee projects are making progress but do not yet fully align to the EUT.

SMBC considers what is sustainable economic activity in the context of our diverse global business.

At SMBC, we also see opportunities for professional services providers to be key business partners in helping to realise the vision of the European Financial Reporting Advisory Group, with our biggest needs being in the areas of data and "operationalising" the assessment process. Data gaps continue to be a challenge, with some assets unable to be assessed for alignment as our counterparties cannot provide the needed data.

We believe EU Taxonomy focused products from existing data providers will be important to overcome this issue. Secondly, to empower client facing teams to understand what green assets are, we believe it would be helpful them to be able to assess Taxonomy alignment. We are considering how to streamline our alignment assessment process and how we can better use digital solutions, such as workflow tools to present the technical screening criteria in any easy to digest fashion.

Getting Sustainable Finance right is a process, and one that will likely outlast our careers. Having the fundamentals in place-- a supportive internal environment at the bank, a solid regulatory framework in the market, and an ecosystem of enabling external partners—will give us a strong foundation.

ANNA GREEN
Chief Executive Officer -
Sweden Branch - Zurich Insurance

Joining forces to realize the true potential of sustainable finance

The green transition will require unprecedented action by governments, companies, and citizens as well as additional investment. Clearly, the green transition will not happen without the support of financial markets channeling capital toward low-carbon industries and providing for the massive investment required in climate mitigation and adaptation.

Greenwashing presents a significant obstacle to the green transition as it impedes efficient capital allocation and a shared understanding of what is at stake for companies. It also makes it more difficult for financial supervisors to assess climate-related impacts and decarbonization pathways and confronts companies with new reputational and liability risks.

At Zurich we are committed to playing our part in delivering the green transition – as an insurer, investor, and employer. We have set an ambitious target for impact investment and have already deployed $ 6.3 billion in impact investments. By 2025, fully 5 percent of our proprietary investment portfolio will be allocated to climate solutions and investments benefiting society. Greenwashing impedes our dialogue with companies about sustainability and creates a barrier to the measurable and comparable metrics we all depend on to make the green transition happen. If this challenge is not addressed, there is a risk insurance companies – and other investors – will not be able to make sustainable investments at the pace and volume required.

However, when it comes to tackling greenwashing, it is important to distinguish between what is intentional and what is not. Firms should not be unduly penalized for trying to do the right thing and making honest mistakes in interpreting evolving regulation. With some key elements of the EU's sustainable finance framework still to be finalized, ambiguity and lack of consistency in some of the legislation that has been passed, and a lack of sufficient guidelines for enforcement, there is a clear risk of diverging interpretations. The mismatch in timelines and application dates for the various initiatives under the sustainable finance framework has the potential to create a structural legal risk of greenwashing for insurers. Widespread scarcity of reliable company-reported and third-party data further adds to this risk.

For Zurich, this is yet another reason to ensure sound governance and internal controls of sustainability claims. In Sweden, we see industry surveys and awards on sustainability. Clear standards and homogenous implementation of regulation will support the minimization of unintentional greenwashing and allow for more transparent follow-up on validated progress. Many of our customers are multinational companies with a global footprint which adds even more complexity.

As we cannot tackle the challenge of greenwashing on our own, what can policymakers do to help the insurance industry - and financial services in general - to be more impactful?

For decarbonization to be effective, we need a framework that delivers appropriate standards, and tracks progress and performance against those standards.

Even when unintentional, greenwashing has detrimental impacts across the entire value chain and must be addressed appropriately. An effective response requires a transparent framework that allows for some flexibility, comparability, and consistency across jurisdictions. To reduce the risk of unintentional greenwashing, regulatory frameworks should be completed and fine-tuned, while financial markets participants should be granted an adequate consolidation period to implement the new provisions. In the long-term, we hope that a global baseline of sustainability-related disclosure standards will be a key element in establishing the basis for sustainability-related capital allocation decisions.

Greenwashing presents a significant obstacle to the green transition.

Second, policymakers can help address the scarcity and poor reliability of data hampering sound investment and underwriting decisions. This could be achieved, for instance, by increasing transparency on the methodologies underpinning data sets, ratings, and other analytical tools. All actors involved should target efforts to building internal skills and resources – a very well-timed initiative in the "European year of skills".

Finally, adequate market incentives and tools to channel savings towards activities that truly foster the green transition will become increasingly important. For example, enhanced eligibility of climate-themed funds for favorable tax treatment in savings products (such as life insurance products) could help complement other climate-change-mitigation measures, such as carbon taxes.

SHERRY MADERA
Senior Vice President of Public Policy and Government Affairs - Mastercard

Empowering the consumer must be next stage of Europe's sustainable journey

It is no secret that Europe is at the forefront of sustainable finance policymaking. The European Green Deal has brought significant focus on the financial sector to promote sustainable finance. The top-down approach to sustainability in finance is well served. What about considering sustainable finance from the bottom up? The financial and purchasing actions by consumers can be a powerful tool to effect positive sustainability outcomes.

What people are buying is changing. Recent data shows over two-thirds of Europeans would buy environmentally-friendly products regardless of an increase in cost. It is not just what people buy that's changing, but how they buy it.

Over half of eurozone inhabitants now prefer to use card or other cashless measures to make payments. Digital payment systems provide a viable gateway to educate consumers about the sustainability of their purchases. As the backbone of commerce, payment networks can be harnessed to play an increasingly important part in Europe's climate mission.

Encouraging sustainable finance from the bottom up

While Europe's top-down approach has revolutionised sustainable finance – I believe there is immense untapped value in considering purchasing power sustainability. Typical daily payments of Europeans may seem small-scale, but they totalled over 1.8 trillion euros in the third quarter of 2022 – the power of many that can effect change.

Let's imagine that all those transactions were supported by data showcasing how environmentally friendly the purchase was. This would empower consumers to make more sustainable buying decisions and – by requiring increased supply chain transparency - would encourage sustainability in merchants and manufacturers.

Increasing the focus on how consumers spend and make choices will promote innovation. Already the European Commission is developing a Digital Product Passport to embed previously unavailable data on a product's sustainability credentials throughout its lifecycle in its product codes. This supports the circular economy and builds trust with consumers. We see evidence of this in the popularity of clothing resale apps such as Vinted, Depop and Verstiaire Collective.

Innovation is also taking place in the payments value chain. Allowing a consumer to see the carbon impact their purchases are making is a step in the journey Mastercard is taking by developing its European-born Carbon Calculator. Wider adoption of tools across the whole retail and payments value chain can accelerate action.

Making progress through power of collaboration

We believe in thinking as an ecosystem and value chain to ensure big picture goals have big picture solutions. The progress Mastercard makes towards our own goal – to become net zero by 2040 – is only possible thanks to the collaboration we foster with our customers and our partners.

Through the journey we've been on so far, it has become clear that the payment ecosystem has a role to play in sustainability. Payment networks exist to service consumers – to make their journey safe, efficient and effective. Applying this philosophy to the growing demand from consumers for conscious sustainable choices is urgently needed – from bank to merchant – to make a difference that will stand the test of time.

One example is the Priceless Planet Coalition – which unites communities, companies, and consumers in the restoration of 100 million trees worldwide, and 150,000 in Europe, by 2025. There is much more the payments ecosystem can and should do.

Our focus should be on turning every swipe or tap into an opportunity to fight climate change.

Fostering an inclusive and sustainable economy

Ultimately, we must foster a digital economy that's both inclusive and sustainable. To achieve this, we must address the mindset that more economic activity and financial inclusion leads to increased environmentally-damaging consumerism. Instead, our focus should be on turning every swipe or tap into an opportunity to fight climate change and support sustainability in all its forms.

Empowering a conscious consumer can harness a billion-person community to support sustainability. Through the payment network – we have an immense opportunity to provide Europeans with the information they need to drive more sustainable behaviour. When it comes to supporting European and global sustainability goals, this bottom-up approach can augment existing top-down sustainable finance. Consumers are asking for these solutions, so let's equip them with what they need to make a difference and contribute to a greener tomorrow.