Avoiding greenwashing in the financial sector

1. Introduction

A regulator stated that the European Union has developed an ambitious agenda to shift its economies to a more sustainable state. The financial sector has a critical role to play in financing this transition. Given the speed of the transition, more and more firms are making claims about moving to net zero, being green or offering green products. The risk of unsubstantiated claims or greenwashing is increasing. This matters because greenwashing could undermine investors' trust in the system and impede the sector's ability to finance the transition.

2. Definition and importance of greenwashing

A regulator noted that there is a growing interest in sustainable products. According to the European Insurance and Occupational Pensions Authority's (EIOPA) Eurobarometer survey, 25% of people are aware of green insurance products. Many providers are trying to portray themselves as being more conscious of sustainability. On the other hand, 63% of those surveyed do not trust the sustainability claims that providers make.

Together with the European Securities and Markets Authority (ESMA) and the European Banking Authority (EBA), EIOPA currently defines greenwashing as a practice whereby sustainability-related claims do not reflect the underlying profile of the product, entity, or service. It can be intentional or unintentional. There is also a concern from the industry side because there can sometimes be unconscious mistakes as a result of the fragmented means of achieving a complete legislative framework. This can be a point of attention for the supervisory community. Greenwashing can mean not giving information at all or giving incorrect information to clients. Now that there is an agreed definition, the European Supervisory Authorities will publish their progress reports, and then continue to work on the Commission's call for advice.

An industry speaker stated that greenwashing is a gap between reality and perception induced by false, unsubstantiated, or outright misleading statements or claims towards customers, investors, or employees on the sustainability of a product, service, or business operation. The green transition will not happen without support from financial markets in moving and channelling capital into low-carbon industries and supporting the huge investments that are needed. Zurich Insurance is fully committed to contributing to the green transition as an insurer, investor, and employer. Greenwashing is clearly an obstacle to the green transition. It impedes capital allocation, makes it more difficult to assess climate-related impacts and exposes companies to new reputational and liability risks.

An industry speaker stated that greenwashing originated at the very beginning of green development and is now at the top of the agenda. Greenwashing harms the commercial banking sector's credibility, which is its most vital asset. Investors invest in green bonds and many people invest in green-linked savings. They trust banks with their money, so any greenwashing is harmful. There are clear green development targets for 2030 and 2040 in the EU, the US and east Asia. All these targets have a tight schedule. Greenwashing will delay this schedule and the banking sector's efforts.

The EU is a frontrunner in addressing greenwashing. It has four pillars when assessing: disclosure and reports, taxonomy and ESG ratings, data, and modelling. Greenwashing happens at all four levels. There are false ESG ratings; false information is disclosed; there is false reporting and cheating in terms of classification or taxonomy; in terms of obtaining reliable and qualified data, companies will cheat. There are three pillars and three levels of greenwashing. The private sector, the banking sector and the insurance sector must be emptied of greenwashing at all levels. Regulators must issue guidelines and mandated conduct rules to follow in order to achieve real green development.

A regulator stated that supervisory authorities need to worry about greenwashing because there is a risk of losing trust and confidence in financial markets. The problem is that it is not clear what greenwashing is, so it is impossible for supervisors to get enforcement right.

3. Why is it difficult to avoid greenwashing and what is the way forward?

An industry speaker stated that the commercial insurance side of Zurich Insurance supports large, multinational, and complex customers with a global footprint. Zurich Insurance is dependent on comparable data and understanding what underpins that data in order to make sound insurance and investment decisions. Greenwashing impedes dialogue about sustainability. It creates barriers to measurable and comparable metrics. If these challenges are not addressed, insurers and other investors could be unable to make sustainable investments at the pace and volume required. The fast-moving and evolving regulatory framework and scarce data availability could also lead to an increase in unintentional

greenwashing. The lack of widely accepted definitions, standards and metrics is adding to that risk. Customers are facing challenges in the complex environment that they operate in, with different legislation in different parts of the world.

An industry speaker stated that SMBC EU considers the risk of greenwashing to be critically important in terms of its sustainability commitments, such as its membership of the Net Zero Banking Alliance and its status as a signatory to the Poseidon Principles. Greenwashing could impede SMBC's commercial opportunities as a bank and expose it to the risk of stranded assets. It is not enough to be one of the leading providers of financing for renewable energy projects. There is an ambition to further grow that. Greenwashing does not require intent, but rather a lack of data-driven standards, which the EU has had a leading position on in terms of oversight through the EU taxonomy. To address this, SMBC has invested in training, clearly documenting its standards and implementing transaction-level oversight.

SMBC is grappling with the question of gauging the materiality of impact from one market to another. SMBC EMEA covers the EU, the Middle East, the UK, and Africa, and acknowledges that its clients are starting from a diverse baseline, so applying a single standard is very challenging. The interoperability of standards would support the ease of measuring impact and speed up implementation, enabling SMBC EMEA to get to the real business of decarbonisation.

A regulator stated that there is already a regulation that information should be clear, correct and not misleading, so supervisors can already tackle the clear cases of intentional greenwashing. It is not worth focusing too much on grey areas as most people have good intentions, either due to intrinsic motivation or the fear of reputational damage. In the Netherlands, there are cases of firms underrepresenting the greenness of their activities for fear of losing their reputation.

To tackle greenwashing, it is best to go after the clear and intentional cases of greenwashing. Grey areas should be approached from a positive rather than negative angle. The best way to combat greenwashing in this grey area is to build a well-functioning and understandable system to channel the money to places where it is needed to green the world. This system includes the whole chain: issuers, financial markets, manufacturers, distributors, and marketeers. A clear taxonomy is needed, as well as good regulations that are clear, timely, and correctly ordered. The Sustainable Finance Disclosure Regulation (SFDR) is a start.

An industry speaker stated that Mastercard has a unique perspective as a bridge to the financial services industry that also touches the real economy. When discussing greenwashing, it is important to remember that the financial sector is trying to fight climate change and to better society. The centrality of data is an important point. The financial sector often talks about data not being good enough, but it is important not to make the perfect the enemy of the good. There is a growing database in ESG, sustainability and increasingly edge areas like biodiversity and nature-based solutions. Secondly, it is important to be specific about which data matters for decision-making and risk assessment. Mastercard uses data to communicate to clients about their carbon footprint.

The financial sector should think not only about the Corporate Sustainability Reporting Directive (CSRD) or European Sustainability Reporting Standards (ESRS) perspective, where the European Financial Reporting Advisory Group (EFRAG) is doing a fantastic job of defining what data is needed for transparency, but also about what is practical at the product level. Sustainable finance is not just about the asset management level, the insurance level, and the banking level. Financial institutions are allocating capital every day. The power of Mastercard having 3 billion customers around the world quickly starts adding up when considering the transactions that may be directed towards more sustainable means by using the data disclosed.

A regulator stated that it is important to guide investors to the right places. The Dutch AFM did a survey in the Netherlands and found that there is no full alignment between what investors say they want and what they do. They want to contribute, but most of the time they invest their money in companies that are already green, so the net effect is small. The current system pushes investors towards values alignment. They invest in companies whose values align with their own. That makes them feel good, but they are only investing in companies that are already green. It is clear that these investors need help.

SFDR is a disclosure regime. It was never meant to be more than that. In the survey, fewer than 5% of investors use SFDR to make decisions, so it is of limited use in guiding investors to the right places. To bridge this gap, there is a clear need for better consumer-oriented guidance. A system of labels and classifications is needed that allows investors to recognise products with an impact approach, either new capital or engagement at transition. When retail products are marketed, markets should relate the products to these objectives and make a convincing case that their products contribute to them.

A regulator noted that accompanying and educating investors to make sure they understand is an important challenge.

An industry speaker stated that there have already been several important disclosure regulations such as SFDR and CSRD. They are fundamental to green development and anti-greenwashing. Companies can provide their ESG ratings, but the banking sector's in-house system is vital. As an international bank, Bank of China has a single internal ESG rating that covers all assets and portfolios. Linked to that, the development of new modelling methodologies can address false information. Investment in IT infrastructure is needed in order to digitalise the green development process and systems, making data cleaner and more reliable so that investments are truly green.

The EU cannot do anti-greenwashing by itself because there is always arbitrage. Worldwide standards are needed. In 2021, the EU and China joined the Common Ground Taxonomy (CGT). Bank of China also issued CGT-backed green bonds. Without global standards, arbitrage will make it impossible to avoid greenwashing of financial products and real goods from all over the world. Therefore, any solution must be worldwide.

A regulator noted that the EU has an evolving taxonomy and is working to deliver on consistency. There are plenty more taxonomies outside the European environment and, as such, international consistency and interoperability is challenging, but essential.

An industry speaker stated that there are a huge number of frameworks and regulations, especially in the EU, but definitions are not completely harmonised. When making buying decisions or allocating capital through the financial systems, there is a worry about getting it right. This leads to some obtuse behaviours. At the corporate and product level, there is the concept of 'green hushing'. This is when an institution does not disclose its ESG credentials or sustainability metrics because of a worry about unintentional greenwashing. That happens at all levels, from the biggest asset managers through to individual households. There needs to be more granularity at the data set level to build strong frameworks that match up to the great work that has been going on at the principles level. The taxonomy is still not mapped to those data building blocks or data sets.

The data points are the foundations of the house. Nobody will buy a house with poor foundations. Each of those ESG or sustainability data bricks, if they are not really defined, might be estimates or proxy data. The financial sector is building regulations on top of that and deciding how to allocate capital. There can at least be movement forward with baseline data. The European Green Deal is a fantastic place to start because it has long arms into places that touch the consumer. Thinking about the circular economy directive helps in considering which data are needed in order to hold the financial sector to account. There is also encouraging thinking going on about a digital product passport. There are huge amounts of data points that can be rolled up into the corporate and financial level, but also back down into the consumer level so that consumers can make choices that are good for the climate.

An industry speaker stated that interoperability of standards between regions is a key issue for SMBC EU. The taxonomy category of transitional activities could be a practical concept to compare markets when looking at green loans in southeast Asia versus Europe or the Americas, especially in terms of intermediate performance. SMBC sees the risk of green bleaching when the gold standard is allowed to discourage meaningful, incremental progress globally. Data providers have an important role to play in streamlining and enabling comparability. SMBC will look to partners who provide those data sources to help make that practical and allow SMBC to remain competitive in the European market.

An industry speaker stated that greenwashing has the potential to alter the data and metrics used to make sound decisions. A company that is heavily dependent on its underwriting needs to be able to rely on the data points. In order to avoid greenwashing and realise the true potential of sustainable finance, the regulatory frameworks need to be completed and fine-tuned. Financial market participants need adequate time to fully understand and consolidate implementation of the new provisions.

Zurich Insurance also wants to see harmonised reporting frameworks for companies. In terms of international complexity, how the financial sector looks at data and interacts with different regulators is not to be underestimated. Transparency and common ground should be encouraged regarding the methodologies that underpin the data, such as rating models and analytical tools. Finally, market incentives and tools to drive savings and investments towards the green transition are increasingly important. That could include different vehicles in life insurance products to complement the carbon tax.

A regulator stated that supervisors need to help investors by simplifying the framework. The public consultation recently launched on SFDR is a step in the right direction. It is about avoiding jargon and helping people visualise the characteristics of different products in order to make well-informed choices. Financial literacy is one way to enhance people's understanding. Supervisors also need to help at the point of contact with people.

There are already some general requirements in place. Information needs to be clear, complete, and not misleading. For example, EIOPA published a guidance for distributors of insurance products on how they can integrate the sustainability preferences of the potential investor with the suitability assessment. A lot can be done to help clients, investors, or distributors to make informed choices.

In terms of regulation, the focus should be on consolidation and making existing regulations usable rather than introducing new ones. There is still something to be completed on the SFDR. The more important part is to implement it. The answer is to do the job as supervisors. Here, supervisors may be helped by technology, because a large amount of information needs to be checked. SupTech can help to screen what focus the supervisory community should have. Supervisors can also help in assessing the way in which products are sold.

For example, sustainability preferences can be addressed and considered in the suitability test and supervisors can monitor this via mystery shopping. In the recent review of the European Supervisory Authorities (ESAs) a coordination mandate has been given to the ESAs. When it comes to greenwashing, it is important to look at not only whether there is intention for greenwashing, but also other aspects. For example, whether the provider performed the necessary due diligence, acting with negligence when using information from third party services etc.

A regulator concluded that greenwashing is a risk to the credibility of individual firms and employers and the whole transition journey, so it is a material issue to tackle. Regulators can use SupTech tools and can already enforce existing regulation on clear, fair, and not misleading information. Regulators also need to continue working on the framework. There is an acknowledgement of the need for more clarity, better definitions and understanding, and international consistency.

If the data at the very beginning of the chain is not good, it will filter through reporting and disclosures. Besides the usual regulatory and supervisory tools, the most important feedback is to focus on the consumer and the end investor. The framework needs to work for the citizen. By considering consumer behaviours and incentives, looking at the point of sale and the advisers, and trying to make the framework understandable and simple, the financial sector will go a long way.