ESAs Call for evidence on better understanding greenwashing

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BANKING STAKEHOLDER GROUP

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General considerations

The BSG welcomes the ESAs Call for Evidence (CfE) on better understanding Greenwashing. The growing concerns expressed by society about the credibility of sustainable strategies and investments makes it necessary to provide a harmonized definition to the concept of Greenwashing, a term which may apply to many stakeholders from both the private (and possibly the public) sectors, while one of the major goals of the recent development in sustainability ESG-related regulation has already been to provide a framework of definitions to reduce the risk of greenwashing. Therefore, as a first consideration, coordination with other international authorities is crucial to achieve a common definition of Greenwashing at global level, while such definitions should also be applicable beyond the financial/insurance sector.

The publication of this CfE is very timely as part of the development of an ambitious ESG regulatory framework at European level (taxonomy, disclosures, SFDR, CSDD, etc). However, many of the regulations are still being developed and are not yet in force, therefore the CfE should leverage on the expected benefits of the upcoming regulatory framework and seek to complete potential gaps, rather than focus on the current gaps, at a time where most disclosure and commitments remain largely voluntary, and therefore follow a variety of format, concepts, definitions and methodologies.

Not only the regulatory framework is under construction, but useful, harmonized and comprehensive data provided by corporates is, as of today, not yet available. This should be taken into account when defining Greenwashing.

It is also imperative to have a clear and common definition across jurisdictions. The market can only continue to flourish if regulators build a common framework around what is considered environmentally or socially sustainable. The BSG fully supports the work of the ISSB, to provide international sustainability standards, covering both corporates and financials. We suggest that the ESAs and the Commission liaise closely with ISSB, and potentially the FSB, IOSCO and BCBS in the thought process about the definition, regulation, and supervision of greenwashing risks.

It is premature to establish a greenwashing concept very broad so to include not only climate, but also broader environmental goals, and "social and governance" goals. We do not have yet a common understanding of nature-related, and social goals, not even in Europe. Then to progress speedily on an agreement on a definition of "greenwashing" it is preferable to leave aside for the moment objectives other than the climate ones for which we have some quantitative objectives and common metrics.

Greenwashing can have very serious reputation and legal risks, which companies, including banks, take very seriously.

The BSG agrees that greenwashing can be intentional or unintentional. From a consumer, investor, lender, and broader society point of view, what matters is the accuracy of the representation, at entity or product level, rather than the intention behind the outcome.

Indeed, there are two levels of greenwashing, an intentional or grossly negligent, and a slightly negligent one. However, the two should involve different reactions: in the first case, a punitive action, such as a sanction, seems appropriate, while in the second case the imposition of a corrective action, adequately disclosed to the market, seems sound enough to pursue the objectives of the rules on greenwashing. In the second cases should be included scenarios where greenwashing is a consequence of an unclear legal framework or rules that may give rise to different interpretations.

For those reasons, we consider that to define the notion of greenwashing, a preliminary reflection on what tools the authorities have at their disposal to deal effectively with the phenomenon is necessary. Some tools are already envisaged by the Union legal system, but we think that a complete mapping of the existing tools is necessary. As we highlight in the examples below, in some cases, the legal framework confers to European and national authorities' powers that can be very useful to contrast greenwashing behaviours, but there is the need to avoid overlapping regulations and an appropriate system of cooperation among different authorities to avoid an overload of obligations on companies.

For instance, at entity level, when it comes to compliance with the CSRD, the first place to check is the auditor, and the second place is ESMA with the national enforcement authorities. Given that the ESG disclosure framework is built within the same architecture than the financial disclosure framework (EFRAG, ISSB), the same sanctions should apply to ESG-related misrepresentations, and the sanction framework is already in place, notably as part of the Market Abuse Regulation and Directive. It should be noted that this framework applies to both corporates and financials (at least those which have listed instruments). It remains to be seen how to deal with the broadened CSRD scope.

While the sanction framework in case of misrepresentation exists, it is an "ex-post" approach, when a breach in disclosure is identified. Such ex-post sanction framework should not be duplicated at the level of the EBA. What may be incorporated in regulation and supervision is to ensure ex-ante that the banks have the adequate processes in place to ensure quality ESG information is collected and reported. Such ex-ante approach is already largely covered in the ECB supervisory expectations, and in case of lack of preparedness, already translates into a P2R surcharge (cf ECB recent report). The CSDDD is also increasing very significantly the duties of financial institutions as regards ESG related data quality.

This does not cover all potential greenwashing areas (outside CSRD) and it needs to be considered how to set up effective supervision and enforcement there, even in situations where authorities may not previously have had a mandate to address misleading claims about products or services, or may have de-prioritised such supervision relative to prudential matters

As regards product/instrument level greenwashing, an important piece of legislation, on the ex-ante side, is the SFDR, which has entered into force in august 22, and covers all investment products (including bank products). As can be expected from such a wide-ranging framework, further work is ongoing to provide needed clarifications, as regards in particular the definition of article 8 and art 9, and we can observe some reclassification of investment funds due to these clarifications. Another relevant piece of regulation avoiding greenwashing is the benchmark regulation, which regulates the ESG labels and indices. The EU Green Bond Standard is also providing a "gold standard" as regards the scope of instruments that can be eligible, by linking it closely to the EU taxonomy. Such standard is intended to be much more restrictive than existing market practices such as ICMA Green Bond Principles. It remains to be seen whether and how the market will develop and whether those 2 standards will coexist.

It should be noted that all those legislative initiatives aim at defining "what is green", therefore reducing the greenwashing risk, but do not include a transition dimension. For example, sustainability linked bonds or loans, impact bonds or loans, which are instruments related to the improvement of certain KPIs, are developing fast, but are not (yet) subject to a clear regulatory framework. However, those products are likely to be the backbone of the implementation of the Green Deal, given it is essential that the financial system is incentivized to finance the transition of those that are not yet green, and not only what is already green.

One way to make progress in this direction is to leverage on the transition plans, that are due to be disclosed by companies and banks under ESRS and ISSB standards, as well as Pillar 3 for banks. More work is needed to ensure the credibility of those transition plans, that should be benchmarked against sectorial pathways to be defined by governments, in line with science-based targets and available technologies. Indeed, banks cannot be accountable to drive the transition of their clients.

As regards the ex-post sanctions framework, applying at product level, the Unfair Commercial Practices Directive has already been amended in 2021 to include greenwashing among the unfair commercial practices. To the extent that this directive is properly transposed into all EU member states, national competition authorities have the mandate and power to sanction greenwashing as any other "unfair commercial practice".

The space that may be relevant for regulators and supervisors, as for entity level greenwashing risk, is the ex-ante review of internal processes implemented by the banks to ensure compliance with the ESG product-level standards enumerated above. Part of these expectations are already embedded in the Loan Origination and Monitoring guidelines, and in the ECB expectations in the management of Climate related risks. As ESG regulations enter progressively into force, it is fair to expect that this will become a growing area of focus for supervisors, including on the application of the taxonomy, and other standards.

Up to today Greenwashing is related, in the marketing world, to companies trying to appear more environmentally friendly than they really are. However, some considerations regarding financial institutions need to be taken into account. Rather than being too specific in identifying all different actions that may generate a perception of Greenwashing, Sanctions should be applied only when those criteria are met ::

- The greenwashing definition should refer only to **actions repeated over time that give rise to behavioral practices** or even to individual actions or facts only if they have an important economic value in the company's financial statements. This is a way to avoid, increasing the costs of internal controls for companies to counter conducts that are irrelevant for ESG purposes.

- It is essential to relate greenwashing to a **damage** (although it does not necessarily have to be demonstrated in monetary terms) caused mainly to market integrity and/or customer protection due to misleading information or material omissions that could affect the decision making process around the sustainable product value chain, when imposing a sanction or a penalty.
- It has to include an element of **negligence and/or intentionality** in order not to mix "suspicion of greenwashing" and "evidence of greenwashing", especially taking into account the above mentioned lack of data quality at this early stage.

Overregulation should be avoided, that is, the ultimate definition of Greenwashing should not hinder financial institutions' voluntary long-term commitments such as the Net-Zero Banking Alliance (NZBA). In particular, ESAs should not duplicate the claim management process that already exists as part of MAR/MAD at entity disclosure level, and as part of the Unfair Commercial Practices Directive. Instead, they should establish close cooperation with the agencies in charge of enforcement of those sanctions, at national and European level, in order to share information about patterns, and generic issues on which ex-ante regulation or supervision would deserve to be strengthened.

Finally, it is also important to find the right balance between consumer protection and other companies' shelter (including financial institutions) from unsubstantiated Greenwashing allegations which can lead to reputational risks which can be difficult to repair. In particular, in an area where the lack of data, approved methodologies and definitions remains problematic, financial institutions should benefit from a "safe harbour" framework, as exists in some other jurisdictions.

Please see below response to some of the questions raised in the Questionnaire, in line with the introductory comments.

Response to questions raised in the CfE

Questionnaire

Q A.1: Please provide your views on whether the above-mentioned core characteristics of greenwashing reflect your understanding of and/or experience with this phenomenon and whether you have anything to add/amend/remove.

The definition of Greenwashing should include an element of **intentionality or** negligence**,** given that at this early stage there is a clear lack of data quality and of a fully-fledged and harmonized regulation. It is also very critical not to mix "suspicion of greenwashing" and "evidence of greenwashing". And, most importantly, "best efforts" approaches to contribute to ambitious voluntary goals should be taken into account. We refer to the introductory part of this response for further detail.

The greenwashing definition should refer to **actions repeated over time that give rise to behavioral practices** and to individual actions or facts where these are of material importance in context, for example in relation to the company's financial statements or claims made in advertising the institution or its products or services.

Q A.2: Do you have or use a specific definition of greenwashing as part of your activities? If so, please share this definition.

The definition of Greenwashing should include the characteristics commented above: relate greenwashing to a damage caused mainly to market integrity and/or customer protection and include an element of negligence and/or intentionality.

Q A.3: Market participants could potentially play three main different roles (trigger, spreader, receiver) in any given occurrence of greenwashing**.** For instance, a corporate issuer can trigger greenwashing by understating its carbon emissions. This misleading claim could be communicated to both investment managers, ESG data providers and/or other market participants some of whom might continue to spread the misleading claim to the end investors/consumers, who will be the receiver of greenwashing.

Q A.3.1: Do you agree that market participants could be involved in three different ways in greenwashing, as described above?

a) Yes
b) No

Q A.3.2: If no, could you please further elaborate on the roles market participants could play in greenwashing, including on potential alternative or additional roles to the ones identified above?

It would be better to identify in which phases/stages of the current value chain banks are more prone to face greenwashing risk and create the controls accordingly.

Q A.9.1: Please indicate below if you have any comments regarding the communication channels of potentially misleading sustainability-related claims?

It is our understanding that the above mentioned misleading sustainability-related claims are of the same nature as general misleading claims but apply to sustainability related products. We do consider that they should be tackled exactly in the same manner as any other type of misleading information, using existing channels and procedures