POLICY BRIEF

BEYOND THE 'GREEN APPROACH' TO TACKLE GREENWASHING

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FÉDÉRATION EUROPÉENNE DES FINANCES ET BANQUES ÉTHIQUES ET ALTERNATIVES

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Executive summary

On 15 November 2022, the European Supervisory Authorities (ESAs) launched a call for evidence seeking input on potential greenwashing practices in the EU financial sector. The growing demand for Environmental, Social, and Governance (ESG) investments and recent efforts to redirect private capital towards sustainable activities create room for greenwashing. This practice may take different forms and have different origins, but the results are dangerous for the transition to a sustainable economy. Greenwashing is not just an issue for regulators and policymakers, but for society as a whole.

FEBEA contributed to the call with its perspective and recommendations stressing the fact that the current approach to sustainable finance should be improved.

Key messages

- The rapid acceleration of the EU's sustainable finance policy has made it difficult to distinguish between genuine green claims and unsubstantiated greenwashing.
- Greenwashing behaviour reflects an approach to business culture that believes that ethics can be implemented ex-post showing a compliant approach in a fraction of their business traditional operations.
- This implies a discrepancy between a company's intrinsic values and identity, its corporate image and its activities that does not promote the expected profound transformation that lies behind the spirit of the political effort.
- The technicality and fragmentation of the current EU regulatory and policy framework for sustainable finance has led to an increase in greenwashing.
- Greenwashing practices, when unveiled, undermine trust in the banking and financial sector.
- FEBEA calls for a holistic and comprehensive approach to greenwashing, taking into account both the social and governance dimensions of the phenomenon.

The main issue

In recent years, starting with the launch of the EU Action Plan on Sustainable Finance in 2018, a growing number of banks and financial actors have started to develop public climate strategies, targets and various green financial instruments, claiming to reduce or eliminate their contributions to climate change. Despite these claims to be "sustainable", "green" or "earth friendly", there is a growing gap between political intentions and reality. The rapid acceleration of the EU's sustainable finance policy has made it difficult to distinguish genuine green claims from unsubstantiated greenwashing, due to the combination of traditional corporate cultures with a strong focus on economic returns and the growing supply and demand for sustainable banking and financial products.

In general, greenwashing has received relatively more regulatory attention than other sustainable finance-related phenomena. Beyond the EU, other countries such as the UK, Australia, Canada and Switzerland are seeking to strengthen their regulatory and enforcement frameworks. At the EU level, the European Supervisory Authorities (ESAs) launched a call for evidence on greenwashing in November last year. The aim of this exercise was to gain a better understanding of the phenomenon by gathering input from a wide range of stakeholders. The survey consists of a general section on the definition and dimensions of greenwashing and three ESA-specific sections.

The results of this survey will be published in an ESAs progress report expected in May 2023, while a second and final report is expected next year. The input from these reports will be used by the European Commission to improve the framework for sustainable finance and greenwashing.

Implications

The survey provided an opportunity to share FEBEA's and our members' perspective on the issue. In our view, greenwashing behaviour reflects an approach to corporate culture that does not adequately incorporate an ethical perspective, or at least believes that ethics can be implemented after the fact. This implies a discrepancy between a company's intrinsic values and identity, its public messages and its activities.

Thus, greenwashing goes beyond misleading sustainability claims about a specific product, but is also about a company's overall operations and their (social) impacts. This means that it is not enough to have specific green products in the portfolio to be considered "green", or to sign a voluntary net-zero climate pledge to be considered a climate leader. Sustainability must be embedded in a company's core values and strategic vision. It is the result of a clear commitment from all stakeholders throughout the value chain. And it takes into account the (social) impacts of the company's own operations or specific 'green' products. It is also about accountability, based on a genuine interest in making the specifics of its activities transparent and accessible. Sustainability means reconciling the social dimension, with the governance and environmental dimensions. Otherwise, it is just greenwashing.

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Unfortunately, the technicality and fragmentation of the current regulatory and policy framework for sustainable finance has led to an increase in greenwashing. On the one hand, there is a lack of consistent definitions of what is sustainable and green: from the Sustainable Finance Disclosures Regulation (SFDR) to the Taxonomy, from the Insurance Distribution Directive (IDD) to the Markets in Financial Instruments Directive (MiFID) Delegated Acts, there is a proliferation of different approaches and interpretations. On the other hand, the complexity and technicality of these regulations has led to confusion and misunderstanding about what is sustainable, making it difficult to verify.

Furthermore, as stressed by the European Securities and Market Authority (ESMA) in the last Trends, Risks and Vulnerabilities report – Risk Monitor “the misuse of the SFDR as a labelling and marketing tool rather than a disclosure rule has increased greenwashing in the industry”.

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Finally, the inclusion of natural gas and nuclear energy as sustainable investments in the taxonomy regulation has undermined the concept of sustainable finance and efforts to meet the EU's commitments under the 2015 Paris Agreement. More recently, in its response to the call for evidence, the Securities and Markets Stakeholder Group (SMSG) highlighted the risk of "green-bleaching", i.e. the possibility that a financial market participant may decide not to label its products as sustainable in order to avoid additional regulatory and legal risks.

Beyond the loss of credibility for a company, the consequences of greenwashing include the ethical damage to consumers and the whole society and the undermining of trust in the entire financial and banking industry, as well as in policy-makers who are committed to fighting the practice. Indeed, greenwashing undermines trust in sustainability claims as a whole, as consumers may assume that all 'eco' claims are misleading. The result is a progressive erosion of the financial industry, including those companies that are genuinely committed to sustainable finance.

Recommendations

For the Regulator and Policy-Makers

As representative the ethical finance movement, we propose that regulators :

- Improve the quality of the regulatory framework by revising the approach of the current sustainable finance framework: this also means starting to focus on the corporate activity as a whole and taking into account the social impact generated by a green activity or product.
- Provide coherent and comprehensive definitions of what constitutes sustainable and green investment and broaden the definition of greenwashing to include the social 's' and governance 'g' dimensions.
- Exclude nuclear energy and natural gas from the list of sustainable investments in the Taxonomy Regulation.
- Provide a definition of what activities do not comply with the "do no harm" principle.
- Improve cooperation and dialogue between regulators, supervisors, the sustainable and ethical banking and finance industry and community-based organisations to build and monitor genuinely sustainable finance, contrasting greenwashing.
- Improve the transparency of ESG-rating.
- Building capacity and know-how in the field of sustainable finance.
- Incorporate regulatory measures to orient governance to a more accountable behaviour.

And... **What can we do as clients to protect ourselves from greenwashing?**

As consumers and customers, we can decide where to put our money by choosing financial providers that are genuinely committed to making and leaving the world a better place. This also means being able to make informed choices and demanding more transparency and coherence from our banks and financial providers in clear connection

For customers

Conclusions

Tackling misleading sustainability claims is crucial to ensure the transition to a sustainable economy. Greenwashing is more than the practice of making unclear or unsubstantiated environmental claims; it reflects a cultural approach to business that fails to value customer trust and community responsibility. Despite improvements, the current regulatory framework for sustainable finance provides little clarity. The main limitation is the overall approach to sustainable finance, which has led to greenwashing. Going beyond the current "green" approach will be essential, by adding the social and governance dimension to avoid lack of transparency, fragmentation and wasted efforts.

Focus on Greenwashing regulatory framework

Greenwashing in the banking and financial sector is a major concern for the EU, as it could undermine efforts to move towards a sustainable economy. Over the years, the EU Parliament and the Commission have developed several instruments to prevent greenwashing, such as:

The Unfair Commercial Practices Directive - UCPD (No 2005/29): the Directive covers B2C commercial practices and provides a legal basis to ensure that organisations do not use misleading sustainability claims. Last March, the EU Commission proposed some amendments to the UCPD. The EC proposes to add unfair commercial practices (such as a green claim) that mislead consumers from their sustainable choices. The amendments will enable consumers to make informed choices and contribute to more sustainable consumption. If the EU legislator adopts these amendments, the UCPD could lead to a ban on greenwashing.

The Corporate Sustainability Directive (CSRD, No 2021/0104): the latest CSRD, which will come into force in 2022, will apply to large public companies with more than 500 employees and all listed companies from 2024 and to SMEs from 2026. The CSRD will replace the current Non-Financial Reporting Directive (NFRD) by extending the scope of its requirements. In fact, the CSRD requires standardised reporting on ESG aspects, which are specified in the European Sustainability Reporting Standards (ESRS).

Green Claim Directive (proposal): last March, the European Commission adopted a proposal requiring companies to substantiate claims they make about the environmental aspects or performance of their products and organisations using. The draft report on empowering consumers has been adopted by the European Parliament's Internal Market and Consumer Protection Committee. The draft report now has to be adopted in plenary before negotiations with the Council can start.

While focused on the financial market, the EU has developed the following initiative within the framework of sustainable finance:

- The Sustainable Finance Disclosure Regulation (No 2019/2088): this regulation requires financial market participants and advisors to provide regulated and uniform disclosures on the integration of ESG aspects at company and product level.
- The EU Taxonomy Regulation (No 2020/852): this is a classification system that identifies economic activities that contribute to ESG objectives. Currently, the "green" taxonomy has been developed, which describes economic activities that contribute to climate change mitigation and adaptation, and the protection of water and marine resources.
- The European Green Bond Standard: this is a voluntary standard to support and expand the green ambitions of the green bond market. The standard is aligned with the Taxonomy Regulation. Recently, EP negotiators and the Swedish EU Presidency reached an agreement that will enable investors to identify high quality green bonds and companies by improving the reporting process using standards and external verifiers. These improvements could reduce greenwashing.

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FEBEA – the European Federation of Ethical and Alternative Banks and Financiers – is a non-profit association based in Brussels. It gathers 33 financial institutions whose aim is to finance social and solidarity economy (SSE) and projects with social, environmental and cultural value in 17 European countries, serving more than 700,000 people.

Its objective is to support the exchange of experiences and promote cooperation between social economy and social finance practitioners.
Each FEBEA member is integrated in the SSE Sector in its country, focusing on mobilising savings and equity from responsible citizens and using these funds to finance sustainable development and local communities. FEBEA is member of GECES, the European Commission's expert Group on Social Economy and Social Entrepreneurship and of Social Economy Europe, the main European network of social economy practitioners.

FEBEA members finance:

- The creation of jobs, social employment in particular;
- Social enterprises and social economy;
- The non-profit sector and participatory economics;
- New forms of social entrepreneurship
- People or groups of people who are victims of social or professional exclusion or are unbanked;
- Sustainable development: renewable sources of energy, organic farming, biodiversity, etc.;
- International solidarity and fair trade.

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