EFAMA

European Fund and Asset Management Association

CALL FOR EVIDENCE RESPONSE

Brussels, 10 January 2023

EFAMA's RESPONSE TO ESMA's "CALL FOR EVIDENCE ON GREENWASHING"

INTRODUCTION

EFAMA welcomes ESMA's call for evidence on potential greenwashing practices in the EU financial sector. The fund industry takes greenwashing risks and its responsibility very seriously. To tackle these concerns head-on, EFAMA is in constant exchanges with the ESAs and other stakeholders to ensure a clear and harmonised understanding of what constitutes greenwashing. This is indispensable given that the sustainable finance (regulatory) landscape is still a nascent area and in constant flux, creating a climate of uncertainty. The growth in both demand and offer of sustainable financial products, combined with unprecedented regulatory reforms, are creating additional and increasing risks for financial markets, financial market participants, and – mostly importantly – the end investor.

This situation is reinforced by the fact that the existing regulations are not always harmonised or consistent with each other (between domestic regulations and national competent authorities, but also among sectors of the financial industry, due to a European sectorial approach). This creates an uneven regulatory playing field which is a material risk for all market actors and could have prejudicial and detrimental impacts on the confidence of the investors and Financial Market Participants (FMPs), even before the market has had a real chance to develop market standards and best practices. As such, we consider it crucial to first have a unified understanding of the core attributes of greenwashing within the market and to have harmonised supervisory action to address greenwashing risks. Otherwise, this could have the potential to severely undermine investor confidence in sustainable finance and threaten efforts to transition to a more sustainable economy.

To address this challenge, EFAMA believes that the term greenwashing should be considered in a proportionate manner, taking into account all current market and regulatory conditions. In particular, we see frequent claims of "greenwashing" that imply a universally agreed definition of what constitutes a sustainable product, which is not the aim of the existing regulatory framework. Currently, the most important component to assess greenwashing is whether a firm's disclosures fail to meet the requirements to be 'fair, clear and not misleading'. This is developed in more detail later in our response.

Based on the current situation, EFAMA endorses initiatives to create, first and foremost, a consistent and harmonised approach of common sustainable finance-related terms, at both the European and international levels. This should ensure that key concepts are applied consistently and therefore contribute to avoiding greenwashing and misselling to end investors.

Last but not least, we would like to point out that more time would have been required to provide more developed responses to this call for evidence, given the importance of the topic and its inherent technicalities. Consulting with our industry expert was made harder than necessary due to the CfE being carried out at the end of the year and the holiday season. Nevertheless, we highlight below some elements that will better define, in a proportionate manner, what constitutes greenwashing so that this does not lead to unintended consequences rendering FMPs permanently accountable for lack of available data and lack of legal or regulatory clarity, all outside of the control of the fund industry.

QUESTIONS AND ANSWERS

Question 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.

1. ***Greenwashing as either misleading others using factually incorrect sustainability claims or sustainability claims that are not, or cannot be, substantiated***

We believe greenwashing within the financial sector consists of **two components** that should apply in combination:

(i) knowingly misrepresenting sustainability-related practices or features of a product;
(ii) with the objective or intention to mislead or induce the receiver of the sustainability claim.

Where there is no intention to mislead or induce the receiver of the sustainability claim, there may still be greenwashing in case of gross negligence[1] on the financial market participants making the claim (for example: making a statement about sustainability credentials without necessarily ensuring that the appropriate processes and controls are in place that ensures that those claims are followed through).

Misrepresentation of information can take many forms. This can include both over-disclosing to give the impression that an ESG strategy is more material than it is or under-disclosing with the aim of obscuring material information that enables a client to make an informed decision. We agree with ESMA that omitting information can be factually incorrect. Omissions can be subtle. For example, a claim or text may focus more on positive impacts while paying less attention to negative impacts. However, we disagree with ESMA that the second element of the definition relating to the intention to use this incorrect and material information or omission of information to mislead investors is not equally critical. On the contrary, we consider that this second component related to intention is a key factor to determine whether an action falls in the greenwashing remit.

Misleading consumers or investors with the intention to mislead is fundamentally different from unintentional mistakes or changes in data reported due to additional availability and/or enhancement of calculation methodologies. There is no doubt that when an action of greenwashing is committed intentionally, it should not be tolerated nor accepted by anyone. This should be addressed in the same way as other misleading practices that could occur relative to traditional financial attributes, such as regarding risk or performance (and should be enforced similarly as falling under Art. 19(2) MiFID).

Against this background, we highlight three important market and regulatory conditions that need to be taken into account when trying to better understand greenwashing in a proportionate manner, namely, (1) existing legislative frameworks, (2) reliance on third-party ESG rating and data providers, and (3)

1 Gross negligence: person/entity may have committed their actions deliberately but did not necessarily intend to cause harm/greenwash. It is more than mere carelessness or failure to act, it is behaviour likely to lead to foreseeable harm

simple client communication. A summary of these conditions is set out below.

(1) Existing legislative frameworks

To avoid duplication and overlapping of regulations, we would like to stress that, such kind of malpractice is already strictly prohibited by **existing laws applicable across industries** (e.g. criminal laws, consumer laws, and financial laws). For instance, the asset management industry is already well regulated: with numerous obligations to comply with professional conduct rules, always act in the best interest of clients and communicate in a fair, clear, and not misleading manner.[2]

In addition, several **Sustainable Finance legislations** (SFDR, TR, and CSRD) have been designed to tackle greenwashing and even reference the term greenwashing. As such, recital 11 of the Taxonomy Regulation states that "greenwashing refers to the practice of **gaining an unfair competitive advantage by marketing** a financial product as environmentally friendly, when in fact basic environmental standards have not been met." The recital supports the notion of **intentionality** as "practice of gaining an unfair competitive advantage by marketing" implies an intentional action/omission in order to gain an advantage.

Another example on the **international** level is the **IOSCO** definition which defines greenwashing as "the practice of **misrepresenting** sustainability-related practices or the sustainability-related features of investment products." Reference is made to the notion of misrepresentation which includes the aspect of **intent** as well as **gross negligence.**

It is important that the existing regulatory framework and possible gaps are first identified before introducing any new legislative requirements. **New guidance around greenwashing should be embedded into the existing frameworks, and there should be a consistent and harmonised approach on both the EU level and the international level.**

(2) Reliance on third parties ESG rating and data providers

As mentioned above, for greenwashing to be present there has to be intentionality. However, due to **asset managers relying on other service providers to build their ESG strategies, they should not be held responsible for the omissions and errors of others.** This is particularly relevant when it comes to ESG data and ratings which represent a significant cornerstone of asset managers' sustainability practices. The liability for errors must remain with the provider and this liability should be considered as part of the wider discussion regarding a regulatory framework for ESG data and rating providers.

This does not by any means weaken the asset managers' requirement to undertake proper due diligence before onboarding ESG data and rating providers and continue to be vigilant throughout the ongoing contractual relationship. It is also important that disclosures are transparent regarding the use of third-party data (including limitations on the use of this data) and implications with regard to sustainability performance which may vary depending on the provider and methodology used and

[2] The existing regulations in the asset management industry enable national competent authorities to act against any miscommunication as they cover aspects of the marketing communication promoting investment management services and funds:

- the marketing communication for retail clients cannot use excessively technical wording;
- the marketing communication content should be consistent with the legal and regulatory documents of the promoted fund and with the other marketing documents of the same funds;
- specific rules apply on the choice of the denomination of the funds, the disclosure on risks, past performance and costs but also on sustainability-related aspects (for instance, information on the sustainability-related aspects of the promoted fund should not outweigh the extent to which the investment strategy of the product integrates sustainability-related characteristics or objectives), etc…

associated data quality and coverage.

(3) Simple client communication

Another challenge that asset managers face is the fact that retail audiences are often overwhelmed by information which increases the risk of perceived greenwashing. However, granular information is pivotal to understanding the investment strategy. For example, many firms when setting exclusions will specify a revenue threshold above which a holding will be excluded – such as, where a company derives more than 5% of revenues from tobacco – particularly in instances where an extensive list of exclusions is being applied. However, in trying to communicate to clients in a simple and understandable manner, the product may only state that the product excludes tobacco companies. Furthermore, the complexity of the regulatory framework, which uses concepts that are very difficult to comprehend for retail investors (PAI, DNSH, and Taxonomy), adds to this general confusion. For example, the concept of "do no significant harm" is deeply misleading for consumers given the scientific evidence that only where there is no human activity there is zero negative impact on the environment: at best, what we can collectively do is have a positive contribution and mitigate or reduce the negative impacts as much as possible. **We believe that some judgment, therefore, needs to be applied on whether simple client communications were intended to make it as clear as possible for the client or whether they were intentionally set out to mislead to get an unfair advantage.** The key in these instances is ensuring that the communication (regardless of whether this relates to ESG or not) meets the fair, clear, and not misleading requirements.

2. *Not all factually incorrect sustainability claims are greenwashing*

The concept of greenwashing should consider the available information at the time a sustainability claim was made. It is reasonable to believe that a sustainability claim was correct when it was made, but that it has become incorrect in hindsight with the discovery of new information, such as new scientific evidence. In other words, concepts and notions of what is sustainable may develop over time, because of new science-based data and insights. Needless to say, any sustainability claim should be updated when such new information becomes available, otherwise, such a claim may be susceptible to greenwashing.

In addition, we highlight the need to ensure a risk-based approach based on best efforts. For example, given the lack of standardized disclosures from issuers, asset managers must undertake their own due diligence or rely on third-party data providers to collect relevant data and assess a company's sustainability profile. This can again evolve over time because of future disclosures of new KPIs or information by the company.

3. *Responding to regulatory uncertainty should not be confused with instances of greenwashing*

The EU Sustainable Finance regulatory framework remains at an early stage of its development with regulatory uncertainty on multiple key aspects and legal concepts leading to different interpretations. This cannot be directly considered as intentional greenwashing practices. Situations similar to sustainability claims being discovered as inaccurate in hindsight can occur. Additionally, sustainability claims and disclosures based on legal interpretations made in good faith can become invalid when the underlying legal clarification changes or is being added (e.g. through a regulator, a legislator, or a court). Adjustments based on such new interpretations should not be considered instances of greenwashing if market players were simply complying with existing regulations and there was no intention to mislead consumers and investors. For example, regulators (often through Q&As) interpret with hindsight sustainable finance legislation such as the SFDR, whilst

FMPs have already been forced to follow their own interpretations in their absence. We believe that such market interpretations preceding the clarifications cannot be considered greenwashing unless such FMP intentionally misuses the legal uncertainty by following an unsubstantiated interpretation.

We are also concerned about the **reference to "non-compliance with general principles**" which is not clearly defined in the call for evidence paper. It is of the utmost importance at this stage not to increase the level of complexity and create more uncertainty. We would question whether this reference to non-compliance is useful or even needed. We would instead strongly emphasize that the clear condition for greenwashing is that a product is marketed as a sustainable product and that greenwashing should be linked to the intentional misselling of a product.

4. *Interpretations of sustainability and other associated terms (e.g. DNSH) can genuinely vary*

In addition to factual correctness, sustainability includes many environmental and social aspects with varying views on how they should relate to each other. For example, there may be competing views of acceptable trade-offs between sustainability objectives, and particular thresholds or normative practices could be challenged. In this case, facts on positive and negative impacts may be correct but the claim of sustainability could be challenged based on different viewpoints. This should also be distinguished from greenwashing when there was no intention to mislead and there is high transparency on the methodology used (such as website and pre-contractual disclosures).

It is on this premise that we wish to highlight another point – that the difference in understanding or considering what a sustainable investment product should look like versus the reality should not be dubbed as greenwashing. Indeed, greenwashing can also be quite subjective and what constitutes an act of greenwashing may differ between individuals. For example, it has been dubbed as greenwashing because there are Article 9 products that have exposure to fossil fuels and consumers do not expect these products to have such exposure when there is no explicit regulatory requirement to completely ban these activities from Article 9 products. Given the subjective nature of greenwashing, any regulation that addresses greenwashing should not deal in absolutes (i.e. "funds that hold assets in companies in the energy or mining sectors must be greenwashing"), but rather provide for accurate disclosure and description of processes.

In this context, we also wish to emphasise that the lack of definitions and homogeneity are creating a significant mismatch between authority's and civil society's expectations and market participants' ability to invest in a "green/sustainable" economy. In particular, in a (non-sustainable) current state of the real economy, one of the key roles of the sustainable finance framework is to guide capital toward transition and support companies' transformation. The partial and heterogeneous existing definition of a "sustainable investment" is nevertheless triggering a lack of recognition of **transition-oriented investment strategies** as sustainable investment strategies and, as a result, a misperception of Greenwashing. We developed this argument later in question F1.

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

As stated in our previous answer to A.1, we advocate for the **two main components** (i) knowingly misrepresenting sustainability-related practices of features of a product, (ii) with the intention to mislead or induce the receiver of the sustainability claim, applying cumulatively. This is broadly aligned with the already existing concept of misselling, misrepresentation, and the attempt to gain an unfair competitive advantage at the core. Nonetheless, where there is no intention to mislead or induce the receiver of

the sustainability claim, there may still be greenwashing in the case of gross negligence[3] of the financial market participants making the claim.

At the same time, when addressing the issue of clearly defining greenwashing, it is important to note, that greenwashing risks are to a large extent being incorporated into the product governance process and the risk and compliance assessments that are already taking place. As already mentioned above, this follows from already existing provisions in the relevant marketing and disclosure legislation. We would strongly encourage ESMA to take into account the **existing definitions based on the EU frameworks**, and **international organizations**, and focus on **practices from the different stakeholders** instead of increasing complexity by introducing a whole new definition detached from the legislative framework already in place.

In addition, we would like to point out that greenwashing does not only occur among FMPs, but it can also occur in the overall economy, or in society more widely. In particular, potentially, all private and public entities (e.g. including States) can be part of the scope. For instance, when a State does not comply in practice with its public commitments taken earlier in the context of some COP agreements, it might potentially be qualified as greenwashing.

As mentioned in A.1, we would like to emphasise once more the importance of recognising that significant areas of regulation and supervision of financial institutions already address a number of aspects of greenwashing. Therefore, any gaps in the current regulation should first be identified before moving to possible new legislative requirements. New guidance around greenwashing should complement and supplement only where necessary and proportionate to fill identified gaps or weaknesses in existing frameworks. They should also aim for a consistent and harmonised approach on both European and international levels.

Question 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?

☐ Yes

☒ 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

While we understand the concepts of a trigger, spreader, and receiver as proposed by ESMA, we would

3 Gross negligence: person/entity may have committed their actions deliberately but did not necessarily intend to cause harm/greenwash. It is more than mere carelessness or failure to act, it is behaviour likely to lead to foreseeable harm

like to make the following observations:

1. ***Entities making sustainability claims are responsible for transparency and substantiation of claims***

There needs to be more clarity regarding the responsibility for greenwashing along the greenwashing "value chain". For this to be possible, sustainability claims must be clear, transparent, substantiated, and specific. However, the entity making the claim may also base its claim on incorrect information that originates from a third party, such as ESG data vendors. Unless prima facie, such information is incorrect – in which case such information must be rectified –, the entity making the claim should be able to rely on such third-party information.

Given the immense reputational risk involved, it is important to further clarify what the roles of "spreader" and "receiver" mean. It also begs the question whether a FMP should be concerned about trusting the information they receive from data providers and investee companies. If FMPs are not allowed to trust the data of their counterparties, each company will end up running its own independent checks on data which will prove to be a costly burden. The most effective approach would be to state each stakeholder's own responsibility for the accuracy and quality of their data, regardless of whom this data is being disclosed to within the investment chain. It should be entirely clear that a FMP indirectly involved in such a greenwashing occurrence is not responsible for misleading claims being made by investee companies in their financial statements or for inaccurate ESG data provided by ESG data and/or rating providers. Expectations for each stakeholder should be clear so that responsibility can be appropriately determined.

2. ***The role of entities setting sustainability criteria should not be forgotten***

We agree that FMPs, including asset managers, can take on the role of the trigger, spreader, and receiver in any given occurrence of greenwashing. However, we would like to emphasize that unclear standards can also contribute to inaccurate or challenged sustainability claims. Therefore, the role and responsibility of regulators, standard setters, criteria developers, and possibly also accountants and auditors should not be forgotten or underestimated as sustainable finance policies continue to grow in number and scope.

So far, there have been instances where new sustainable finance frameworks are still relatively vague and have led to different implementation approaches being used by market participants and supervisors. In this context, we would like to highlight the importance of proceeding in the right order: starting by setting clear definitions/parameters and expectations, before reviewing greenwashing. In our view, the risk related to an unorderly approach could hamper the development of ESG/sustainability and could ultimately have the potential to undermine the objective to re-orient private financing to sustainable investments and to fund the transition to a more sustainable economy.

F. ESMA section of the CfE

Question F.1: Which of the elements listed below, do you consider to be the main driver(s) of greenwashing risks?

☒ a) New / innovative ESG products in rapidly evolving ESG markets

☐ b) Entry of new participants such as issuers of ESG products, ESG rating or data providers, etc.

☒ c) Lack of ESG expertise and skills of market participants

☐ d) A rapidly evolving regulatory framework

☐ e) Differing interpretations of the regulatory framework

☒ f) Desire to exaggerate the sustainability profile at entity/product or service level

☒ g) Competition (wanting to be better than a comparable issuer/product)

☐ h) Lack of reliable data

☐ i) Mismatch between retail investors' expectations and market participants' ability to deliver real-world impact

☐ j) Other, please specify below

Please provide a short explanation of your answer: [multiple answers allowed]

Greenwashing risks are driven by the following elements:

i) Desire to exaggerate the sustainability profile at entity/product or service level

ii) Competition

iii) Lack of ESG expertise and skills of market participants (as could lead to 'competency washing')

iv) New/innovative ESG products in rapidly evolving ESG markets (as this is closely associated with competition)

The below elements are causing 'perceived' greenwashing, but we do not believe they should be classified as greenwashing:

i) A rapidly evolving regulatory framework

ii) Different interpretations of the regulatory framework

iii) Lack of reliable data

iv) Financial literacy

v) Mismatch between retail investors' expectations and market participants' ability to deliver real-world impact.

Lack of regulatory clarity

A key challenge for asset managers is that ESG standards and definitions are lacking or, if they exist, are subject to interpretation. For instance, sustainable investments have been broadly defined under SFDR. However, questions of interpretation around sustainable investments have been raised by the ESAs almost two years after the effective date of SFDR and are still under consideration with the European Commission. Interpretation of this concept is of particular importance for the qualification of

Article 9 SFDR investment funds, which according to the legislator may only consist of sustainable investments, as well as Article 8 products making commitments to sustainable investments.

The lack of unequivocal interpretation also applies to the concept of do not significant harm (DNSH), which - like sustainable investments - has been loosely defined and therefore has been applied by FMPs differently. The concept is also highly confusing for retail investors given scientific evidence that only the absence of human activity comes without negative impacts.

Since SFDR came into force, FMPs based on their good faith representation have developed their own framework to determine whether an investment can be classified as sustainable or not under SFDR and have implemented processes to apply the DNSH tests. As such, to define sustainable investment, some asset managers have i) chosen to rely on the positive contribution to Sustainable Development Goals, or ii) chosen to exclude companies active in certain sectors/activities and iii) taken the approach to use today's exposure or have supplemented this by a forward-looking approach. This has to date, according to the letter of SFDR not been ruled out. As mentioned previously transparency is key in that context where clarity and legal certainty are still missing in many aspects.

Financial literacy

It is of utmost importance to increase sustainable finance education of investors in order to enable them to fully understand disclosures from FMPs and to make informed investment decisions. We believe this is crucial for us to recognise our responsibility to help close the gap between retail investors' expectations and market participants' ability to deliver real-world impact.

For example, several Article 9 products were criticised for their holdings in weapons manufacturers. The claims were made based on a subjective view that defense stocks should not be considered sustainable. However, while the PAIs do include controversial weapons as an indicator, the broader defense sector is not a PAI indicator and therefore there is no rationale from a regulatory point of view to find that investments in the defense sector should automatically be considered breaching the DNSH criteria. Furthermore, if the fund clearly discloses its methodology and exposure to the specific industry, the information provided is clear, fair, and not misleading so it should not be counted as greenwashing.

This example highlights a discrepancy between what end investors (particularly retail investors) expect to find in products labeled as sustainable and the strategy of the products marketed. However, MiFID ESG preference delegated acts were adopted precisely to address those discrepancies and make sure that retail investors can effectively invest in products that are in line with their expectations. Just because expectations differ from the investment strategies of the products available does not mean that those products are actually engaged in greenwashing practices.

At the same time, there are limits to the expertise we can require from investors to navigate through the growing range of sustainable funds. The way in which the legislation has been drafted does not help either in their search for a better understanding (being confronted with concepts such as "taxonomy", DNSH and PAIs). To gain a fuller understanding of the companies they invest in and to inspire consumer confidence, the importance of simple and understandable language intended for investors cannot be overestimated. While it is important to educate investors, it is equally crucial to speak "their" language instead of imposing regulatory language (including any sophisticated definition of greenwashing). As EFAMA, we are fully committed to working closely with regulators to build trust in the market for sustainable investments and to ensure there is clarity and consistency in the way our industry describes sustainable and responsible investment products to clients.

Rapidly evolving regulatory framework

The rules of the game are changing rapidly while expectations from the investors, the public, and the regulators evolve at the same time, creating regulatory uncertainty even for responsible actors. To avoid potentially restricting positive initiatives for the evolution of the economy and the planet, we believe that this uncertainty should be recognised by the different market players, including the public. Restricting potential investments in view of too much fear of greenwashing (e.g. through a very broad definition of greenwashing) might lead to counterproductive effects as responsible actors might turn away from crucial issues to help solve environmental and social issues.

Against this background, we believe it is important that the regulatory framework supports the **transition** that will allow for the inclusion of activities that cannot meet all currently required sustainability criteria. For example, the taxonomy framework is a very powerful tool, but only depicts the situation of a company today. We believe a forward-looking approach would be more appropriate instead of making investment decisions purely based on past data. The activities aligned with the green taxonomy represent at best less than 10% of the investment universe, whereby the listed economy is around 5% on average, with a very high discrepancy from one sector to another and from one data provider to another. Meaning that today, the economy is not green or sustainable at all.

However, if the interpretation of the ecosystem is that only taxonomy-aligned companies deserve to be called sustainable investments, then we will miss the opportunity to transfer capital to companies in transition or required to transition. Requiring only investing in "already aligned" issuers would therefore lose the notion of "transition" and miss out on the capital reallocation initially targeted by the action plan on financing sustainable growth.

We believe it is essential to consider activities whose transition takes place over a longer period and to provide appropriate support to enable them to rethink their organization and operations and/or operationalize the transformations already decided. Too restrictive requirements which do not allow for gradual implementation might lead to insufficient availability on the market of compliant financial products, running counter to an increase and a reorientation of capital towards sustainable finance.

The industry considers it their responsibility to engage with as many corporates and issuers as possible to support their transition so that the impact on the global economy, and ultimately on the planet, is greater and more efficient. While focusing investments on issuers that have reached all their sustainability goals is important, we believe it is at least equally important to encourage issuers that have demonstrated their ambitions to reach these goals and to provide the support they need to transition their business models to more sustainable practices. In a transitional economy, we need actors to take responsibility to be involved in this transition. We also need to find an effective levy of action to develop and stimulate this transition and encourage change. The most important concern of the public is that **the expected promise is not deceiving.** We believe that this is crucial to achieving the EU's ambitions of channeling flows to sustainable propositions. This emphasizes once more the importance of the ESAs to provide stability and certainty to the greenwashing definition, but also to ensure that there are no retroactive effects when they decide to clarify, modify or change their doctrines or rules.

Lack of reliable data

A significant challenge when it comes to claims of greenwashing is the lack of reliable data and standards in the market, which means that asset managers may be complying with rules and requirements in good faith but can still be criticised for greenwashing because the data is inconsistent

across the market.

For example, certain SFDR Article 9 funds were claimed to be non-compliant with the regulations because they are investing in firms that have UN Global Compact violations and controversies. Nevertheless, there is no objective standard as to what constitutes a UN Global Compact violation and the response from data providers is hugely inconsistent. When comparing Sustainalytics and MSCI data, we see that Sustainalytics currently flags 212 issuers as being non-compliant with the UNGC, while MSCI only flags 33 issuers. However, only 8 of those issuers are common to both lists. Therefore, asset managers could legitimately be investing in issuers based on the MSCI list that would flag as non-compliant by Sustainalytics and vice-versa.

Moreover, if the data issued by issuers is inaccurate or untrue, this could have adverse effects on the products or services of our members. While product manufacturers have the liability and burden to disclose information on extra-financial criteria, the issuers of the data do not have to disclose themselves in a harmonised manner, causing major discrepancies and risks. As long as the data is not completely defined and harmonised there will still be some room for perceived greenwashing to arise but we do not believe these should be classified as greenwashing provided that the FMP was transparent regarding limitations in data.

While the recently adopted CSRD will play a pivotal role in delivering accurate and meaningful data on non-financial matters, the framework is still a work in progress and will only deliver in full in 2029.

Consideration of greenwashing risks by financial market participants and issuers

Question F.7 Does your organisation perceive greenwashing as a potential source of risk?

☐ a) Yes and we have started developing a structured approach to tackling the issue

☐ b) Yes, but we have not yet developed a structured approach to the issue.

☐ c) No

☒ d) Other

Question F.7.d. If you selected “other”, please specify:

As a trade association, EFAMA did not develop a structured approach to tackle the issue of greenwashing. However, the industry clearly perceives greenwashing as a potential source of risk, and our members have started developing a structural approach to tackle the issue. We emphasize that greenwashing is a risk for the financial sector as a whole and may be detrimental to the confidence of investors and other stakeholders in sustainable investing.

Question F.7.1 what category of related risks do you anticipate could result from greenwashing issues?

☒ **a)** Financial risks

☒ **b)** Reputational risks

☒ **c)** Legal risks

☒ **d)** Risk that investors lose confidence and trust in "ESG/Sustainable" products and that the initial objective of attracting investors towards these products is missed.

Question F.8: Do you know of any industry initiative that could be instrumental in tackling greenwashing?

Question F.9: Which do you think are the market mechanisms that can help mitigate greenwashing risks (e.g. reputational issues) and how do you believe supervisors can help in this respect?

Question F.10: What could policymakers and regulators do more to alleviate greenwashing risks?

We consider that regulation is a good way to mitigate the extra financial risk, as it tends to provide a more secure environment. We encourage this approach, both at the international level and at the European level to ensure a better harmonisation of domestic regulations and the development of a level playing field. As such, we believe the European Commission and the ESMA must use the **existing rules and tools** at their disposal to address greenwashing challenges, ensure successful implementation and pave the way for further actions to come. As a starting point, many long-standing laws and regulations, referring explicitly to "misleading", "false" and "deceptive" practices already go a long way in addressing greenwashing risks and apply to financial institutions and their offerings. In addition, important steps have been taken to address greenwashing by adopting sustainable finance-related policies and legislation that are specific to financial products and services. We would encourage the ESAs to take the existing frameworks into account. Finally, any deliberation by ESMA on greenwashing should be based on an understanding that greenwashing is subject to two components: (i) knowingly misrepresenting sustainability-related practices or features of a product and (ii) with the intention to mislead or induce the receiver of the sustainability claim.

When greenwashing occurs we believe the entity responsible for triggering greenwashing holds the most responsibility. However, for investors to understand the financial products they buy, **sustainability claims** must be **clear, transparent, substantiated, and specific.** Sustainability is such a broad concept that it leaves great room for interpretation; therefore, by being specific you reduce the risk of (mis)interpretation. This is something both industry and policymakers can help improve. The main challenge is that looking beyond the claim is time-intensive and many investors spend insufficient time on this. Therefore, the responsibility to ensure sustainability claims are valid should lie with the entity making the claim and if the incorrect information originates from a third party, this should also be clearly communicated when correcting sustainability claims.

Supervisors and regulators can additionally support by providing guidance on the implementation when regulatory requirements are unclear. They can also help mitigate the reputational risks by clearly acknowledging the difficult situation, both related to regulatory uncertainty and data availability. This can be done both by helping in the communication efforts of explaining these nuances and uncertainties to the public, as well as by ensuring workable timelines for implementing new guidance and RTSs and acknowledging best efforts. In any event, the rules set forth and the interpretation thereof should be as simple as possible, unambiguous, and based on full transparency.

Also, the importance of **consistency** among policymakers and regulators cannot be overestimated, not only in setting their local regulations but also – in the EU case – in interpreting, in the same way, the EU regulatory provisions (as otherwise, it is very difficult for cross-border EU players to have a manageable and consistent approach at EU-wide level).

We would once more like to emphasize that unclear standards can also contribute to inaccurate or

challenged sustainability claims. Therefore, the role and responsibility of **regulators, standard setters, criteria developers, possibly accountants & auditors (and even the media**) should not be forgotten or underestimated. A similarly harmonised implementation of regulations and definitions, more focus on outcomes, and mandatory third-party verification are essential to effectively alleviate greenwashing risks.