Just in Time

EBA Progress Report on Greenwashing Monitoring and Supervision

Jul 2023

iason ESSENTIAL SERVICES FOR FINANCIAL INSTITUTIONS

Executive Summary

- **Climate change** and the need to transition to a more sustainable economy have become one of the most pressing global issues and a top priority on the **EU policy agenda**.
- Related to this, the **demand for and supply of sustainable products** has also increased by providing financing for the green transition by banks and other financial institutions.
- One of the side effects of this change is the phenomenon of **greenwashing**, which, can impact the transition by reducing investor confidence, generating reputational and financial risks for the institutions involved, and affecting the overall credibility of sustainable finance policies and products.
- In May 2022, the European Supervisory Authorities (**ESAs**) received a request from the European Commission for each ESA to provide input on the phenomenon of greenwashing.
- The **EBA's progress report** is a document that considers the following points: a high-level understanding of the greenwashing phenomenon with its main characteristics, most relevant types, associated risks, monitoring tools, and gaps and inconsistencies in the current legislative framework.

At a Glance

Keywords: Greenwashing

01

Defining and Understanding Greenwashing

A Common High-level Understanding of Greenwashing Covering the Three ESAs Remits

Characterizing Greenwashing

Greenwashing Trends and Examples in the EU Banking Sector

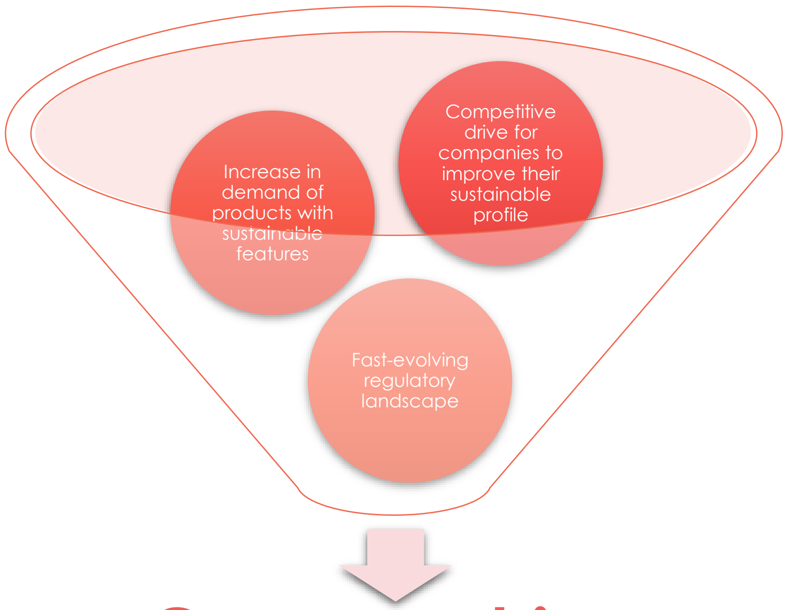
Defining and Understanding Greenwashing 1/3

A Common High-level Understanding of Greenwashing Covering the Three ESAs Remits

The **ESAs** understand **greenwashing** as **a practice whereby sustainability-related** statements, declarations**, actions, or communications do not clearly and fairly reflect the underlying sustainability profile** of an entity, a financial product, or financial services. This practice may be **misleading to consumers**, **investors**, or other **market participants**.

ESAs have identified several core characteristics that help understand the potential scope of greenwashing:

How can communication be misleading?	Information can be missing, false or deceiving. For example, mislabeling, misclassification mistargeted marketing or inconsistent information.
How can actions be misleading?	Not considering clients' sustainability preferences or identifying clients within the perimeter of products with no sustainability features.
No matter the awareness...	… greenwashing can happen intentionally or unintentionally. Rather, negligence, lack of appropriateness and responsibilities constitute aggravating factors.



Greenwashing

But what is it precisely?

Greenwashing can occur at different:

- **stages of the business cycle** of a financial product or service;
- **degrees of regulation**: either general principles or more specific sustainable finance legislation;
- **levels**: entity, financial product, financial service in relation to sustainability-related preferences, performances and strategies.

Defining and Understanding Greenwashing 2/3

Characterising Greenwashing

Just in Time

Drivers

- Greenwashing can be driven by various factors. In particular, it can be induced by **competition** in the market, **regulatory requirements**, NGOs and media scrutiny, **imperfect information** or by the entity itself.

The potential roles market participants

- In greenwashing, market participants can be **triggers** (initiating greenwashing), **spreaders** (facilitating it), or **receivers** (buying products marketed as sustainable but aren't).
- Some suggest additional roles like facilitators, verifiers, gapers, and whistleblowers in greenwashing.

Stakeholders' opinions

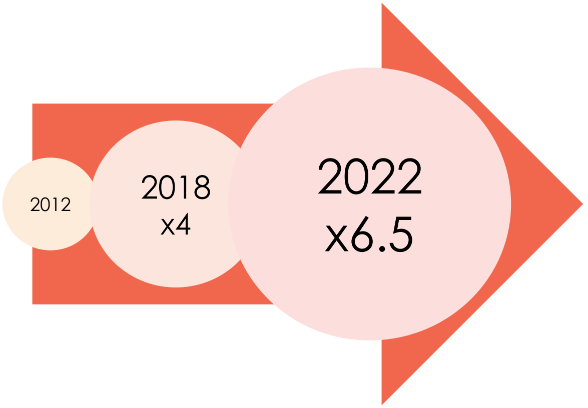
- Stakeholders perceive future **ESG performance** pledges as highly prone to greenwashing, with significant **potential harm**.
- Selective disclosure, misleading terminology, lies, and empty claims are common forms of misleading sustainability-related claims.
- **Marketing materials** are the most likely channel for communication of misleading claims.
- Greenwashing is most likely to occur during product delivery stages, particularly in marketing and sales.

iason

Defining and Understanding Greenwashing 3/3

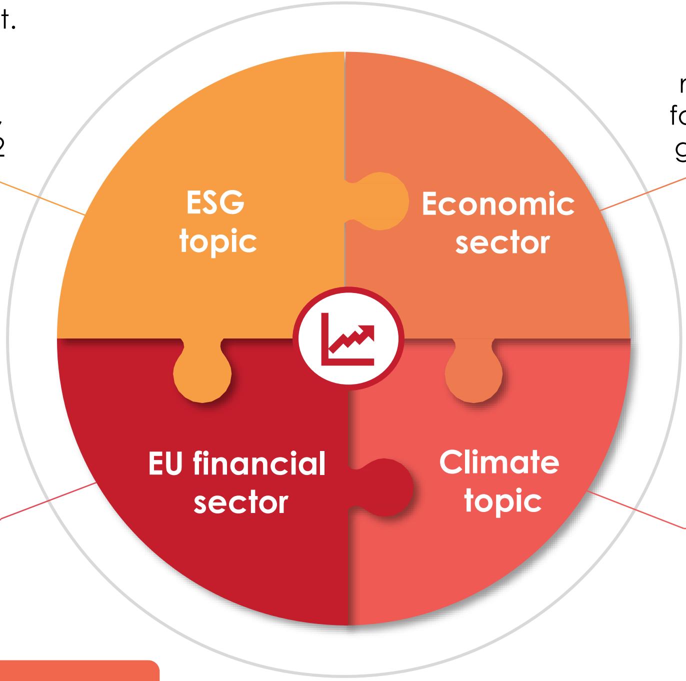
Greenwashing Trends and Examples in the EU Banking Sector

Recently, the total number of alleged cases of misleading communication reported by stakeholders has risen significantly



Environmental and social topics are the most prominent. Climate related topics now account for ca. 30% of alleged greenwashing case, against ca. 15% back in 2012

Alleged greenwashing cases n the EU financial sector (including EU banks) have also increased significantly in the most recent years, with around 206 cases reported in 2022 against 40 in 2018



Greenwashing has been mostly concentrated around six activities: oil, gas and utilities, mining, industrial construction, food and beverage, household goods and the financial sector

Climate change, impact on landscape and biodiversity and impact on local communities are the three most common topics subject to greenwashing claims in the EU financial sector

KEY CONCLUSIONS

Potential cases of greenwashing across all sectors and regions (particularly, across EU companies and banks**) have increased recently** due to the rising accountability of climate action, especially after the signature of the Paris Agreement in 2015. Consequently, **sustainability-related legislation has grown** rapidly since 2018, with the EU Taxonomy and the SFDR. However, it is still not clear whether these trends can be explained by changes in company's conduct or by the fact that greenwashing gets more scrutiny nowadays.

The analysis of the examples of greenwashing reported by the paper report that **EU banks are** increasingly **being blamed for positioning themselves as sustainability-oriented** through advertising and communication, **but still engaging in businesses or practices that could contradict the sustainability objectives** they communicate. These alleged greenwashing cases emerge at entity level because they are generally reported by external stakeholders accessing to publicly available information.

02

Greenwashing Risk and Adverse Impact

Greenwashing-Related Financial Risks and Transmission Channels

Scale, Prevalence and Adverse Impact

Greenwashing Risk and Adverse Impact 1/2

Greenwashing-related Financial Risks and Transmission Channels

Reputational risk

- Initiatives that contribute to the deterioration of the institution's reputation.
- Legal actions due to alleged greenwashing.
- Difficulties in attracting and retaining customers, employees, business partners and investors.

Operational risk

- Losses related to liability claims arising from the sale of products that do not meet established standards or stated ecological credentials.
- Litigation cases against institutions due to a misalignment between their internal environmental or social policies and some of their activities.

Strategic and business risk

- Reductions in earnings or loss of confidence with the institution by investors, depositors or interbank market participants.
- Loss of income resulting from conduct failure and fines.

Liquidity and funding risk

- Reduced access to market funding or less favorable market access conditions motivated by reputational damage leading ultimately to the withdrawal of funding provided to the institution by investors.
- Reduced ability to issue green bonds due to a lack of confidence as a result of reputational damage.

Credit risk

- Impact on the institution's counterparties (e.g., in the case of greenwashing-related litigation) could cause a weakening of creditworthiness and affect their ability to honor their commitments to the institution.

Market risk

- Losses due to a drop in the market price of green-labelled financial instruments owned by an institution if these instruments are at some point not regarded as green.
- Higher volatility in the market price of financial instruments issued by entities affected by greenwashing controversies.

Greenwashing Risk and Adverse Impact 2/2

Scale, Prevalence and Adverse Impact

For **credit institutions**, more than half of the Cas consider greenwashing of low relevance at present, but it is expected to increase in the future.

For **investment companies**, the opinions of Cas and stakeholders are differentiated, but a slight increase in the future relevance of greenwashing is expected.

For **payment service providers**, the relevance of greenwashing is considered low at present by more than half of the relevant CAs and is expected to remain so in the future.

Purchase and investment decisions based on misleading information can lead to a **loss of trust and discourage** for users from participating in sustainable finance and jeopardize the green transition.

This loss of confidence in financial markets **reducing the willingness to finance the transition** can cause **misallocation of capital**.

03

Addressing Greenwashing: State of Play

The EU Legislative Framework

Market Practices

Supervisory Tools and Practices

Summary and Way Forward

Addressing Greenwashing: State of Play 1/5

The EU Legislative Framework

Consumer protection: regulating (environmental) claims in marketing and communication

The purpose is to address greenwashing by regulating communication and marketing to **avoid misleading the end-customer**.

UCPD (Unfair Commercial Practices Directive): **green claims must be truthful**, not contain false information and be presented in a clear and unambiguous manner, **so that consumers are not misled**.

MiFID II (Markets in Financial Instruments Directive): communication must be **fair**, **clear** and not misleading both in its content and its presentation. **CAs shall be given** all **supervisory powers** and investigatory powers.

The EU legislative framework addresses greenwashing though two categories of concerns

A fast-evolving array of sustainable finance regulation

The purpose is to **improve disclosure** on how to identify green initiatives to **reduce the need of interpretation** and **improve data reliability** and comparability.

Other requirements in terms of enhancing data transparency and comparability of products and activities with environmental features are also provided by:

- Regulation on Sustainability-Related Disclosure in Financial Sector (**SFDR**)
- Capital Requirement Regulation (**CRR**)
- Corporate Sustainability Reporting Directive (**CRSD**)

RESULTS

- The **EBA notes** that disclosure obligations contribute to address, prevent and even reduce the occurrence of greenwashing.
- The banking package (**CRR/CRD**) introduce new obligations for institutions to manage **ESG risks.**
- Regulatory initiatives encourage the creation of new products with an eye on environmental sustainability, such as green bonds.
- Climate-related information and risk metrics allow investors to better form an opinion.

Stake holders still need to face two **challenges**: lack of available and reliable data and ambiguity of sustainable standards and requirements. Plus, stakeholder perceive the **gap** of an absent definition of transition finance and of benchmarks for transition-aligned trajectories – this under-developed framework may lead to unharmonized practices. Challenges and gaps jeopardize the effectiveness of the actions undertaken.

Addressing Greenwashing: State of Play 2/5

Market Practices

Entity level

- Prudent communication.
- Internal control mechanisms.
- Building sound ESG data management.
- Managing greenwashing at a consolidated level.
- Putting in place overarching climate strategies and transition plans and restructuring business practices.
- Codes of conduct and remuneration policies for sales staff that aim at mitigating the risk of mis-selling of green financial products.
- Specific committees to review and assess any new sustainable product, activity and service from the perspectives of risks, permanent controls, legal and compliance to ensure that all requirements (including on advertising and marketing) as well as internal procedures are met.

Institutions' tools and processes

Market and other stakeholders' initiatives

Product or service level

- Applying market guidance and/or standards that contribute to anchor definitions and criteria.
- Establishing a clear list of eligible projects and activities for sustainability lending/finance.
- External reviews and third parties verification.
- Product approval processes, have rigorous internal standards and criteria for products and services labeled as sustainable.

Beyond the tools deployed by individual institutions, some market or other stakeholders' initiatives may contribute to mitigate greenwashing.

- Market guidance aimed at ensuring comparable product design can contribute to anchor definitions and criteria and support market integrity.
- Guidance and frameworks provided by industry bodies often aim at addressing investors or stakeholders' concerns about greenwashing.

Addressing Greenwashing: State of Play 3/5

Supervisory Tools and Practices 1/2

Just in Time

Mandates

The majority of CAs believe that their mandate allows them to address greenwashing issues indirectly and to the extent that it is related to their core mandate.

- Consumer protection authorities: it is associated with irregular or unfair business practices that harm the fairness and transparency of the financial products market.
- Banking supervisory authority is considered to the extent that it indirectly leads to prudential and conduct risks and affects the safety and soundness of lending institutions and/or financial stability.

Supervisory practices

This activity includes :

- Assessing the compliance of institutions with certain requirements relevant to greenwashing.
- Participation in ESMA's joint supervisory action.
- Supervision of green mortgage/loan products, from a conduct perspective.
- Development of internal guidelines or supervisory expectations regarding greenwashing.
- Surveying institutions with specific questions related to greenwashing.
- Examine institutions' practices in the area of climate and environmental risk management.

Limits:

- **Resources** available to address greenwashing or greenwashing-related financial risks are relatively scarce at the moment.
- The **data** and **information** available is only partly sufficient to identify, address and monitor greenwashing risks.
- Most CAs have not received information from or cooperated with other authorities.

Addressing Greenwashing: State of Play 4/5

Supervisory Tools and Practices 2/2

Level 3 requirements have been or may be used in the future by supervisors to improve the mitigation and supervision of greenwashing or related financial risks.

EBA Guidelines on loan origination and monitoring (LOG):	The EBA Guidelines on product oversight and governance arrangements for retail banking products (POG Guidelines):	Guidelines on the supervisory review and evaluation process (SREP):
Include minimum requirements for institutions wishing to engage in environmentally sustainable activities, including the preparation of a list of projects, activities that the institution considers eligible for environmentally sustainable lending. The process by which institutions assess that proceeds from environmentally sustainable credit facilities are used for environmentally sustainable activities.	The guidelines aim to address certain conduct risks by providing a framework for responsible product design and distribution by manufacturers and distributors for retail banking products. Several CAs expressed the view that these Guidelines would be helpful going forward, given that they provide a tool to mitigate the risk of greenwashing at all stages from product manufacturing to distribution.	Contain several provisions that may be relevant to assessing financial risks related to greenwashing. CAs have not yet reflected in the in their SREP evaluations assessments information and outcomes related to greenwashing coming from other supervisory activities.

Addressing Greenwashing: State of Play 5/5

Summary and Way Forward

Just in Time

The overview of existing or planned regulation shows that several elements may already or probably will contribute to address greenwashing. Several measures are still in the early stages of implementation, while others are being updated or developed, suggesting that benefits of these frameworks are not fully visible yet.

NOW…

The EBA notes that **certain communication and marketing rules** (e.g., UCPD, MiFID) already aim at tackling misleading statements and **may allow to prevent or sanction greenwashing** practices.

The **EBA is** however **not in position to state the effectiveness of these rules** to combat greenwashing at this point, also considering its limited mandate on these regulations

The **EU sustainable finance regulatory is still stated to be under development** and has not yet fully entered into application.

Nevertheless, **many potential sources of greenwashing are already being covered by EU regulatory mitigant**. For example, at product level, EU Taxonomy addresses green loans and mortgages, while EU Green Bond Standards treats green and sustainability linked-bonds; at entity level disclosure frameworks (Taxonomy, Pillar 3 CSRD) cover claims on sustainability characteristics and net-zero claims.

… AND WAY FORWARD

More **experience** will be needed to assess the effectiveness and shortcomings of the regulatory frameworks to address greenwashing and to clarify the need for any further measures.

The EBA will pursue its assessment as it prepares its final report on greenwashing, its related risks and the implementation of sustainable finance. Meanwhile, it takes note of the **views expressed by stakeholders** on the right way forward…

Stakeholders' views:

- **Caution** against regulatory activities that may increase complexity
- **Mitigations of gaps and challenges**, through higher transparency on the methodologies behind ESG rating and data, more reliable labeling of sustainable products and higher availability of data
- Enhancement of **international alignment** and comparability
- Controversial opinions on the need of new rules and stricter supervision

iason

Our Services & Solutions

iason is an International company that provides its clients with **highly specialized consultancy** the fields of **finance** and **risk management**

Strategy

Strategic advisory on the design of advanced frameworks and solutions to fulfil both **business and regulatory needs**

Methodology & Governance

Implementation of the designed solutions **in bank departments**

Technology

Design, development and implementation of **advanced software solutions** for **modelling, forecasting, calculating metrics** and **integrating risks**

KEEP IN TOUCH

iason

ESSENTIAL SERVICES FOR FINANCIAL INSTITUTIONS

Company Profile

Iason is an international firm that consults Financial Institutions on Risk Management. Iason integrates deep industry knowledge with specialised expertise in Market, Liquidity, Funding, Credit and Counterparty Risk, in Organisational Set-Up and in Strategic Planning.

Tommaso Casagrande

This document was prepared in collaboration with Michele Penza and Alessandro Ghisoni who at the time were working for Iason Consulting.

www.iasonltd.com