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ESMA Stakeholder Group Warns Against "Green-Bleaching"

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In a **response** to a call for evidence on greenwashing by the European Securities and Markets Authority (ESMA), the Securities and Markets Stakeholder Group (SMSG) emphasized the importance for EU authorities to ensure that any new rules published on greenwashing also guard against "green-bleaching." Green-bleaching is a term coined to describe financial market participants choosing not to claim ESG features of their products in order to avoid extra regulation and potential legal risks. The stakeholder group, which provides opinions on the technical aspects of regulation, suggests that adequate guidance on legally permissible representations may help in reducing this problem.

SMSG opened its response with the suggestion that the term "greenwashing" is itself limited and that "ESG-washing" would be more appropriate as it would capture the social and governance aspects of ESG. The response goes on to posit that the lack of a regulatory and European-wide definition of "impact investing" risks a mismatch of investor, regulator and financial firm expectations. SMSG recommends that providers of "impact" products "clearly explain their strategy and efforts to reinforce the ESG dynamic that is sought, to distinguish them from strategies that are 'only' based on meeting some ESG criteria." Overall, according to SMSG, ESMA should introduce definitions for key terms such as "green," "ESG," "sustainable," and "impact investing" in order to help reduce greenwashing and green-bleaching.

In its second recommendation, the SMSG encourages ESMA to identify potential gaps in the current regulatory framework prior to introducing new legislative requirements and advises the European Supervisory Authorities to first provide a list of practices that would violate existing regulations and amount to greenwashing. SMSG also observes that regulators need to adopt a flexible approach, and that unintentional mistakes or changes in data reported due to additional availability of data or the enhancement of calculation methodologies should be treated differently than grossly negligent or intentional misrepresentations.

SMSG's response also recommends further clarification of what qualifies for Article 8 and Article 9 fund classification under the Sustainable Finance Disclosure Regulation (SFDR). An

Article 8 fund under the SDFR is defined as a "Fund which promotes, among other characteristics, environmental or social characteristics . . . provided that the companies in which the investments are made follow good governance practices," and an Article 9 fund as one which "has sustainable investment as its objective or a reduction in carbon emissions as its objective." As we have **discussed**, following ESMA's issuance of draft guidelines as part of a consultation on funds' names using ESG or sustainability-related terms, a number of large asset managers announced downgrades to ESG funds from Article 9–the highest sustainability classification under the Sustainable Finance Disclosure Regulation—to the broader, and less restrictive, Article 8. The asset managers include Amundi, BlackRock, DWS, HSBC AM, Axa, Invesco, NN Investment Partners, Pimco, Neuberger Berman, Robeco, and Deka.

Taking the Temperature: Greenwashing and green-bleaching have received significant regulatory and media attention, relatively more so than other climate-related phenomena. To name just a few examples, the UK's Competition Markets Authority just announced an investigation into the "accuracy of 'green' claims made about household essentials;" the Australian Securities and Investment Commission recently issued several greenwashing fines against regulated entities; and the Swiss Federal Council published a position paper on the prevention of greenwashing in the financial sector.

But we agree with SMSG that alleged greenwashing does not necessarily reflect intent to mislead, but rather could be the product of multiple other causes, including lack of agreement on what constitutes a sustainable product or business (taxonomical issues), poor quality or inconsistent data and/or assessment tools or lack of clear regulatory guidance. The SMSG response also is interesting for its recognition that very few, if any, climate-related matters exist in isolation. Instead, it refers to the ESG "ecosystem" supporting sustainable finance, which includes primary and secondary financial markets and derivatives. According to SMSG, "the ESG finance ecosystem should support the evolving nature of the ESG transition. In this respect, ESMA should provide clear guidance with respect to different ESG strategies. As not all ESG actors and projects are already 'dark green,' for instance, the ESG finance ecosystem should also encourage companies to adopt a greener (transition) agenda."

Finally, we have discussed the challenges associated with the ESG ratings landscape, including how consumers of such information can make sense of divergent scores that, at times, purport to encompass all of an issuer's ESG characteristics. That issue was not lost on SMSG, which (in our view correctly) pointed out that "methodological choices are presently not always sufficiently disclosed," and "investors may not be in a position where they can make truly informed decisions, making it necessary for them to compare several ESG ratings and conduct their own research in parallel, often using raw ESG data." As SMSG observed, the market would benefit from improved "availability, integrity, and transparency of ESG ratings."