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European Financial Regulators Define Greenwashing, Outline Risks and Propose Mitigation Approaches



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In [progress reports](#) to the European Commission (“EC”) published on June 1, 2023, the European Banking Authority (“EBA”), European Insurance and Occupational Pensions Authority (“EIOPA”) and European Securities and Markets Authority (“ESMA”) have articulated a common, high-level definition of greenwashing and outlined greenwashing risks, impacts, proposed mitigation efforts and challenges for their respective industries (“the Progress Reports”).

The Progress Reports are a culmination of a process commenced in May 2022 during which the EC had requested that the European supervisory authorities (“ESAs”) provide input on greenwashing risks in the financial sector and the supervision of sustainable finance policies, including a common understanding regarding, and the most relevant types of, greenwashing; risks that greenwashing pose to entities, investors and consumers in various financial sectors; supervisory practices, experiences and capacities, including tools to monitor greenwashing; and issues related to the current legislative framework. As we [reported previously](#), the ESAs, in turn, issued a Call for Evidence to stakeholders, including financial institutions, retail investors, consumer associations, non-governmental organizations and academia, seeking information on greenwashing, soliciting their greenwashing-related views, examples and data.

The ESAs have jointly agreed upon a cross-sector definition of greenwashing: “a practice where 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.” The Progress Reports also detail the individual findings of the ESAs related to their respective banking, insurance and pensions, and financial markets industries as to how greenwashing occurs, and its impact, supervisory challenges and regulatory implications.

EBA

The [EBA's Progress Report](#) primarily focuses on the banking sector, with some information on investment firms and more limited feedback from payment service providers. The report identifies that an increased public attention to climate change has led to banking entities being held more accountable for their environmental policies, climate impact and disclosures, and “a clear increase in the total number of potential cases of greenwashing across all sectors.” The EBA observes that it is unclear whether the trend is driven primarily by companies engaging in more greenwashing or is attributable to increased scrutiny by stakeholders. Pledges about future environmental, social and governance performance are considered to be the most prone to greenwashing, followed by ESG strategies and objectives, and ESG labels and certificates. The report indicates that member state competent authorities and stakeholders estimate that the highest risk related to greenwashing is reputational damage, followed by operational, strategic and business risks for banks and investment firms. Liquidity and funding risks are perceived to be low. Challenges to mitigating greenwashing include lack of adequate data and methodologies, and the absence of a fully developed sustainable finance regulatory framework.

EIOPA

According to [EIOPA's Progress Report](#), greenwashing has a substantial impact on both consumers and insurers. Unsubstantiated sustainability claims can mislead consumers into buying insurance and pension products that are not aligned with their preferences. The impact on insurance providers includes increased public mistrust, as well as reputational and financial damage when instances of greenwashing are made public. The EIOPA report notes that greenwashing can occur to varying degrees across all stages of the insurance and pensions lifecycles.

The report also acknowledges that EIOPA and member state competent authorities recognize that addressing greenwashing in the marketplace requires integrating it into supervisory activities, but identifies supervisory challenges including limited expertise on sustainable finance requirements and lack of methodologies, data and tools to assess greenwashing in the insurance and pensions sectors.

ESMA

The [ESMA's progress report](#) focuses on four sectors – issuers, investment managers, benchmark providers and investment services providers – and identifies the specific areas in which each is most susceptible to greenwashing. Overall, the report concludes that market participants across the sustainable investment value chain face challenges in implementing the necessary governance processes and tools to support sustainability disclosures and transition efforts. These challenges include difficulty in producing and accessing relevant, high-quality sustainability data and keeping up with a fast-moving regulatory framework. To mitigate greenwashing risks, market participants must ensure that claims are substantiated, communication on sustainability is balanced and labelling schemes for financial products are well-designed and reliable.

The ESAs anticipate issuing their final reports in May 2024.

Conclusion

The lack of an accepted definition of greenwashing has been an ongoing concern for regulators and industry. The ESAs' consensus on a high-level understanding of greenwashing likely will help promote consistent efforts to address greenwashing in the financial industry across the European Union, but is by no means the last word on how greenwashing is defined. We have [previously reported](#) on definitions put forth by other groups, including the UN High-Level Expert Group on the Net Zero Emissions Commitments of Non-State Entities, which proposed a broad greenwashing definition. [As we noted](#) in March, the EC proposed the Green Claims Directive to combat greenwashing and misleading environmental claims. The proposal must be approved by the European Parliament and the Council, but currently there is no date set for entry into force.

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