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

July 18, 2023

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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.

Taking the Temperature: 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.

Report Makes Recommendations for Financial Institutions to Advance Climate-Action Initiatives

July 18, 2023

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In a report published in June 2023, the Columbia Center on Sustainable Investment (CCSI) claims that many financial institutions' climate strategies are not currently aligned with global climate goals under the Paris Agreement. The report, entitled **"Finance For Zero: Redefining Financial-Sector Action to Achieve Global Climate Goals,"** also states that the financial sector's climate commitments are sometimes overstated or misrepresented due to a reliance on misaligned targets or metrics.

The report focuses on three types of financial institutions: asset owners, asset managers, and banks. The report highlights that these financial institutions, along with other market participants like insurance companies and rating agencies, have important roles in achieving climate goals. The CCSI acknowledges that the absence of a clear public policy framework presents challenges to the sector but makes several key recommendations:

1. *Clear, Transparent Communications*

The report emphasizes that financial institutions should "be clear and unambiguous about their climate commitments, and use robust and relevant targets, metrics, and methodologies that are aligned with their goals." For example, the report states that the Glasgow Financial Alliance for Net Zero stated that "over $130 trillion of private capital is committed to transforming the economy for net zero" but that this figure does not reflect new capital allocated to climate goals but rather "is the sum of assets under management or controlled by the member financial institutions." The report calls on financial institutions to release clear communications regarding climate-related pledges, particularly "whether their goal is to contribute to climate action or to mitigate risk and how business strategies will be aligned to achieve those goals."

2. *Stop Anti-Climate-Action Lobbying*

The CCSI urges financial institutions to cease anti-climate-action lobbying and focus on "how new finance is being directed and whether new finance is contributing to and not undermining a rapid and just transition." The **report highlighted** that an assessment of the lobbying positions of 80 financial institutions showed that, "both directly and through industry associations, many [financial institutions] are more 'obstructive' than 'supportive' of climate policy."

3. *Adopt Strong Climate-Related Governance*

The report recommends that financial institutions employ strong corporate governance embedding climate commitments at both board level as well as in day-to-day management. “Having in place clear internal oversight structures and mandates, incentives, and monitoring and review processes is necessary to ensure climate commitments are taken seriously by all the internal stakeholders who need to prioritize meeting them,” the report noted.

4. *Contribute to Filling Gaps in Metrics and Methodologies*

The CCSI highlights that current practices for calculating carbon emissions are inconsistent and in many cases lead to underreporting. Under the frameworks based on the GHG Protocol (the most widely used greenhouse gas accounting standards), companies are “not required to disclose how they calculated their emissions estimates,” such as the “type of research they did to rigorously prepare for their disclosures.” Different scenarios are used by companies using the science-based targets (SBTs) benchmarks, which leads to more inconsistency. CCSI highlighted that “there should be more alignment and consensus among [financial institutions] on what scenarios to use (in particular, when it comes to carbon budget and probability).”

Taking the Temperature: The CCSI report identifies that to stay on track for the Paris Agreement’s 1.5°C goal, there is a need for a significant increase in non-fossil fuel investments. The report echoes the concerns of certain climate-focused investor groups, which have been taking increasingly interventionist steps to scrutinize and influence the transition approaches of major financial institutions. In February, a group of investors representing over $1.5 trillion AUM urged five major European banks to stop financing new oil and gas fields by the end of this year. In March this year, a French bank was sued over its fossil fuel financing strategies. A report published by the London School of Economics’ Grantham Institute on trends in climate litigation identified actions focused on the financial sector as one of the key categories of emerging ‘strategic’ litigation.

Reports Highlight UK Private Sector Preference for Mandatory ESG Reporting

July 18, 2023

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UK regulators, specifically the Institute of Chartered Accountants of Scotland (ICAS) and the Financial Reporting Council (FRC), recently released reports regarding the demand for mandatory environmental, social, and governance reporting in the United Kingdom.

On June 20, 2023, **ICAS reported** that its survey of over 500 UK companies revealed strong support for mandatory reporting of ESG matters and a preference for EU-style impact reporting. The **FRC's June 2023 report** about Audit Committee Chairs (ACC) views on ESG reporting, on the other hand, highlighted concerns regarding inconsistent ESG reporting guidelines and the potential burden of ESG reporting.

ICAS Survey Findings

The ICAS survey of senior managers from 581 UK companies indicated a significant level of support for mandatory reporting of ESG matters. Approximately 45% of respondents favored reporting on both the financial impact on the company of ESG factors and the broader impact of the company on external sustainability considerations. In contrast, only 17% supported financial reporting alone, suggesting a developing consensus among UK companies that ESG considerations should be integrated into their reporting frameworks to provide stakeholders with a comprehensive view of their operations. By aligning with the EU's requirements regarding impact reporting, UK companies can promote consistency and comparability in ESG reporting across borders. The desire to follow the EU's lead reflects concerns about falling behind international and European counterparts in terms of ESG reporting standards.

FRC's ACC Feedback

The FRC's report highlighted concerns expressed by audit committee chairs at 40 large UK companies. These chairs pointed out inconsistencies in existing ESG reporting guidelines, emphasizing the need for clearer and more standardized frameworks. While acknowledging the importance of ESG reporting, the chairs also cautioned against imposing excessive burdens on companies as a result of the reporting requirements. The FRC also observed that a broad definition of ESG creates challenges for companies, as it encompasses a wide range of factors, suggesting potential reporting benefits in refining and clarifying the scope of ESG reporting to facilitate more effective compliance and reporting practices.

To address the concerns raised by ACCs, the report recommends that the UK government and regulatory bodies take the following actions:

- Collaborate with industry stakeholders: Engage with companies, industry associations, and experts to develop comprehensive and harmonized ESG reporting guidelines. This collaborative approach would collect the perspectives of relevant parties, leading to more effective reporting frameworks.
- Provide guidance and support: Establish a mechanism to assist companies in implementing ESG reporting, particularly in developing the necessary skills and talent within their organizations. Offering guidance and support would help alleviate concerns regarding the current lack of expertise in reporting on sustainability matters.
- Streamline reporting requirements: Work towards simplifying and standardizing ESG reporting guidelines to avoid unnecessary complexities and burdens on companies. Clarify the definition of ESG and develop clear reporting frameworks that enable companies to identify and report on material ESG factors.
- Consider broader audit reform: The report advocates continuously assessing and enhancing the overall audit ecosystem to ensure the integrity and reliability of ESG reporting.

Taking the Temperature: The ICAS and FRC reports highlight surprisingly strong corporate support for mandatory ESG reporting in the UK and the preference for following the EU's lead in this area, recognizing the value of aligning reporting practices with international standards to enhance transparency and comparability. The need to address the challenges posed by current guidelines necessitate collaborative efforts from regulatory bodies, companies, and industry stakeholders. By implementing the recommended actions, the UK can align its reporting practices with international standards, enhance transparency, and facilitate informed decision-making for stakeholders in ESG matters.

As we reported previously, there is a strong call for the UK Government to accelerate its ESG efforts, but the UK has been falling behind with delays to the introduction of sustainability disclosure requirements and no clear timeline for the UK’s green taxonomy. In fact, the CEO of ICAS warned that “[s]hort-term investor pressure and a lack of skills and talent to be able to report on sustainability means that the UK is at a real risk of falling behind our international and European counterparts in implementing [ESG] policies and addressing climate change.” He added that “[s]ustainability reporting needs to be on par with the level of detail and scrutiny given to financial reporting. But without the mandate from government, it is hard to see how this will happen.”

2023 Analysis Of Climate Litigation Shows Continuing Upward Trend

July 18, 2023

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In its 2023 snapshot report (the Climate Litigation Report), the London School of Economics' Grantham Institute found that climate litigation continues to grow, with 190 new cases filed in the last 12 months, including cases filed in new jurisdictions Bulgaria, China, Finland, Romania, Russia, Thailand and Turkey. Although the Grantham Institute found that climate litigation remains on the rise, it also stated that overall rate of growth appears to be slowing in part due to a continuing decline in cases filed in the U.S.

Outside the U.S., over 90% of cases filed in the last 12 months have been brought by non-governmental organizations, individuals, or both acting together, some of which are cited below. The survey found a 16% reduction from previous years in the number of non-U.S. cases being brought against governments.

The Grantham Institute also reported that the nature of such litigation, is changing with litigants filing so-called 'strategic' cases. Strategic cases are described as those with the aim of "influencing the broader debate around decision-making with climate change relevance." The Institute identified eight types of strategies:

- 'Government framework': These cases focus on a government's response to climate change and may include challenging a claimed lack of ambition in climate policies or a failure to implement policies or legislation, or both. An example can be seen in ClientEarth's challenge to the UK government's Department for Business, Energy and Industrial Strategy on the grounds that its net zero strategy was inadequate. The UK's High Court held that the strategy breached the Climate Change Act and needed to be strengthened. Government framework cases also encompass rights-based actions whereby a plaintiff invokes his or her human or constitutional rights. Recent examples include ***Held v Montana*** and ***Greenpeace Italy et al. v ENI S.p.A.***, which we have discussed previously.
- 'Corporate framework': Similar to 'government framework' cases described above, corporations' climate policies are claimed to be inadequate. Many such cases often overlap with other strategies in this list. Examples include ***Greenpeace Italy et al. v ENI S.p.A.***; ***Notre Affaire à Tous and others v BNP Paribas*** and ***ClientEarth v Shell Board of Directors***.

- ‘Integrating climate considerations’: Cases seeking to compel or encourage government or corporations to integrate climate considerations, standards or principles into a particular decision.
- ‘Turning off the taps’: Preventing the financing of projects or initiatives which, when completed, would result in a high level of greenhouse gas emissions. In February, for instance, several climate groups **filed a lawsuit** against a French-based financial institution criticizing the bank for failing to “require” its clients in the fossil fuel industry “to immediately stop developing new fossil fuel projects and engage in a progressive exit from the sector.”
- ‘Failure to adapt’: Cases against a government or company for failing to adapt to climate change, such as by failing to adapt property to physical risks or failing to consider transition risks.
- ‘Polluter pays’: Cases seeking compensation from defendants based on their alleged contribution to climate change.
- ‘Climate-washing’: Cases challenging inaccurate statements made by governments or companies in relation to climate change or transition to net-zero. Recently, for example, Klima Allianz, a Switzerland-based climate action group, filed a case against the International Federation of Football Association (FIFA) alleging that FIFA’s claims that the 2022 Qatar World Cup was “climate-neutral” constituted greenwashing. This **follows a finding** by the Swiss advertising regulator against FIFA on the same claim.
- ‘Personal responsibility’: Seeking to bring climate issues to the top of the agenda among public and private decision makers by attributing personal responsibility on senior officers for failing to adequately manage climate risks. Although ultimately unsuccessful, **such an action** was brought by ClientEarth against the directors of an oil major for allegedly violating directors’ duties in connection with climate risk management.

In addition to “traditional” litigation, the Grantham Institute observes that actions seeking advisory opinions are increasingly being filed too, with three such matters filed before the International Tribunal on the Law of the Sea, the Inter-American Court of Human Rights and the International Court of Justice. Advisory opinions are not binding but may hold persuasive authority. They also bear a significantly lower cost than litigation and may therefore be sought more frequently.

Other future trends identified by the Grantham Institute include litigation arising out of biodiversity impacts; extreme weather events; the release of short-lived climate pollutants such as methane; suits seeking increased ocean protection by governments and corporations; and international litigation between states over fossil fuel production and use.

Taking the Temperature: As cited above, we have frequently commented on the rising trend of climate litigation, which the extensive survey underpinning the Climate Litigation Report confirms. The Grantham Institute aims to evaluate the overall effectiveness of climate litigation. Notably, the Report finds that of the relevant proportion of cases which result in judicial outcomes, over half have rendered decisions in favor of climate action. While this may serve as encouragement and further incentive for potential claimants, it does not tell the whole story. A significant driver of climate-related litigation is the publicity that these cases inevitably generate. Climate-activist

shareholder groups and NGOs are fully aware of the reputational impact that such actions have on major companies and seek to leverage the platform that litigation in open court provides. Such litigants are not necessarily driven by the same objectives as commercial parties. We expect this trend to continue and companies, particularly in high-emitting sectors, will have to develop strategies for dealing with such interest groups.

EFRAG Seeks Input on Draft Response to ISSB’s Proposed Internationalization of Accounting Standards

July 18, 2023

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On June 2, 2023, the European Financial Reporting Advisory Group (EFRAG) **issued a draft letter** requesting comments on the International Sustainability Standards Board’s (ISSB) proposal to improve the international applicability of the Sustainability Accounting Standards Board’s Standards and Taxonomy.

The proposed enhancements are intended to ensure that entities can apply the SASB Standards regardless of the jurisdiction in which they operate or the type of generally accepted accounting principles they use. The ISSB released the **“Exposure Draft Methodology for Enhancing the International Applicability of the SASB Standards and SASB Standards Taxonomy Updates”** on May 9, 2023 with a 90-day comment period ending August 9, 2023.

In the Draft Letter, EFRAG generally agreed that the proposed methodology would improve the international applicability of the SASB standards. However, it suggested two further potential improvements:

1. EFRAG recommends maintaining the comparability of SASB standards when adopting generalized jurisdictional references. Internationally applicable regulations should be relied upon as much as possible. But, because jurisdictionally bound references may differ between jurisdictions, comparability between undertakings reporting can be affected. When this is the case, priority should be given to comparability at jurisdictional level instead of international level.
2. When relying on internationally applicable references, a key consideration is whether these references have been ratified because international references do not become applicable automatically in all jurisdictions. International applicability may differ across countries as well over time. EFRAG recommends that the ISSB create and make available on its website mappings that show all internationally applicable references used and which countries have ratified these references.

EFRAG also requested that the ISSB develop a gap analysis between the SASB standards and sustainability reporting frameworks developed more recently or which are in the process of being developed. The results of this gap analysis would then serve as a basis for updates to the SASB standards.

Taking the Temperature: Internationalization of ISSB's standards as a part of harmonizing globally various sustainability reporting frameworks makes sense, particularly when it comes to taxonomy; an effort to align definitions and labels will ensure that meaningful comparisons can be made, as we have discussed previously in relation to the European Commission, in Canada and in Asia.

We have also commented frequently on the challenges surrounding climate-related disclosures, including challenges due to a lack of consensus on appropriate disclosures and a lack of quality data on which to base disclosures, and ISSB's efforts to systematize and implement, climate-related reporting globally in response to demand from investors. Amid a proliferation of guidance, the SASB Standards represent a comprehensive resource addressing industry-specific disclosures across a range of sustainability matters. As we reported in November, the ISSB indicated that companies will be required to consider SASB Standards to meet its general sustainability requirements.