GREENWASHING

Paint it green

Despite its best efforts, EU regulators have yet to successfully tackle greenwashing in the investment world. Lynn Strongin Dodds **investigates**

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Greenwashing is not a new problem in the investment world but one that has come to the fore as the number of sustainable strategies have mushroomed over the past few years. European regulators have issued several edicts and proposals to tackle misleading claims, but it is not an easy fix and could take many years to solve the problems.

Ironically, combating greenwashing was one of the main objectives of the European Union's swathe of legislation under its Sustainable Finance Action Plan of March 2018.

Fast forward to today and the regulatory landscape has become more complicated to navigate and accommodate. As a result, the European Commission tasked three European Supervisory Authorities – the European Insurance and Occupational Pensions Authority (EIOPA), the European Banking Authority (EBA) and the European Securities and Markets Authority (ESMA) – to provide a sustainable finance progress report card for their respective domains.

The results were published last summer with EIOPA finding that "greenwashing can manifest as part of a broader set of conduct risks at all stages of the insurance and pensions lifecycle". For pensions, this means through scheme design, delivery and management. The concern was that consumers could be deceived into purchasing products not aligned with their preferences.

The trade group's fears were also highlighted in its EU-wide Eurobarometer survey conducted in June 2022, which showed that 62 per cent of EU consumers did not trust the sustainability claims made by insurance undertakings or distributors.

EIOPA did not mention any concrete examples of greenwashing in its section of the progress report though but instead said that the sector was tainted by cases emerging from other industries. As Invesco head of UK government relations and public policy, Graham Hook, notes: "EIOPA published a useful report in 2023 that did not identify any major cases in these sectors. It did observe that there had been cases in other areas, and this may have had an impact on investors and consumers. It can lead to a general perception of greenwashing, which is aligned with the report's conclusions."

An issue for pensions?

PensionsEurope policy and communications officer, Gabrielle Kolm, also explains that greenwashing is less of an issue for pension funds because they are not selling products so there is no concept of mis-selling. "However, when it comes to pension funds as clients or buyers there is a lack of comparability because of the data gaps," she adds. "The industry is moving towards more standardised and uniform disclosures."

Law firm RPC partner, Rachael Healey, echoes these sentiments. "One of the points of difference is who is to blame – pension investors tend to invest via someone else," she adds. "This means the fault rests with those that have picked the funds or made the investments if they have invested in something different to what they promised or represented – it's a failure of due diligence."

Healey also believes strides have been made over the past couple of years thanks to ESMA's consultation paper in 2022, which introduced preliminary guidelines on the wording of asset fund names. "The paper was clearly enough to make certain asset managers think twice about labelling their funds as sustainable," she says. "The issue has improved in the past year and funds are now more conscious than ever about labelling themselves as 'sustainable' to avoid criticism and regulatory scrutiny."

There is of course more work to be done and in the wake of the progress report, the three ESAs are currently delving further into their individual markets. Despite the differences they do share common obstacles, such as establishing and managing supervisory frameworks, as well as addressing and monitoring greenwashing risks, particularly the development of accurate data and methodologies. Their recommendations, including possible regulatory framework changes will be published in a final greenwashing report in May.

Defining greenwashing

The ESAs have already taken an important first step by crafting a much-needed working definition of greenwashing. Many market participants hope that the new description will help investors and consumers separate truth from false statements.

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The ESAs decided greenwashing is "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."

As for EIOPA, its particular consultation closes in mid-March and focuses on four key planks. These comprise sustainability claims made by a provider have to be accurate, precise, and consistent with the provider's overall profile and business model, or the profile of its product. In addition, claims should be current, with any changes disclosed in a timely manner and with a clear rationale. Last but not least, they need to be substantiated with clear reasoning and facts and made accessible by the targeted stakeholders.

EIOPA also compiled examples of good and bad practices for each principle in order to make the proposed principles more tangible and to demonstrate how greenwashing can occur in practice.

"EIOPA hopes that when the report is finalised it will help establish a common set of principles that can guide the industry," says Hook.

The next path?

There are growing fears that the upcoming elections could see the European Union take a sharp right turn, scuppering ambitious climate change policies over the next five years. A report by think tank European Council on Foreign Relations, which combined polling of all 27 EU members with modelling of how national parties performed in past European parliament elections, shows radical right parties are on course to finish first in nine countries.

Meanwhile, projected second or third place finishes in another nine countries, could, for the first time, produce a majority right wing coalition in the parliament of Christian Democrats, conservatives and radical right MEPs.

The other concern is that there is not enough emphasis on education and dialogue between all parties, which will only worsen if the bloc changes political guard. As Morningstar global head of sustainability research, Hortense Bioy, says: "EIOPA's consultation will have a positive effect on disclosures and the need to use the right language. The challenges are to understand what the end investor wants and ensuring the right product is being delivered."

This may explain why some institutions would prefer to have something along the lines of the proposed Green Claims Directive as the first line of defence. It will require companies to substantiate and verify their environmental claims and labels. Common phrases such as 'net zero', 'carbon neutral' and 'eco-friendly' would be prohibited in advertisements, social media posts or on packaging unless they were sufficiently substantiated and verified.

"We see the directive as the first step against greenwashing because it demands that environmental claims be based on science, not subjective values," says Varma senior vice president, sustainability and communication, Hanna Kaskela. "In our own operations, the directive has been manifested in a more critical attitude towards overall responsibility communication, which is somewhat separate from actual marketing communication."