

EDHEC-Risk Climate Impact Institute's Response to the European Supervisory Authorities' Call for Evidence on Greenwashing

October 2023



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Context

The demand for investments integrating Environmental, Social, and Governance (ESG) dimensions has increased significantly in the past decade and the assets that financial intermediaries claim to manage responsibly and sustainably have close to trebled, reportedly growing to represent a third of overall assets under management.¹

However, the industry-accepted definition of sustainable and responsible investing² is nothing if not inclusive. As incorporating ESG issues into investment management suffices to claim the responsible investment badge, the industry welcomes a dazzling array of strategies with heterogeneous objectives, sustainability ambitions, methodological implementations, and transparency levels (refer to Appendix). Furthermore, there remains considerable disagreement in respect of basic terminology across jurisdictions, voluntary standard setting bodies, and industry associations.³

Regulation of sustainability claims and appropriate disclosures⁴ would be required to protect investors against disorienting and misleading claims and facilitate matching of investment products with sustainability preferences. Beyond investor protection, such regulation could accompany the transition towards a (more) sustainable economy through better capital allocation and stewardship.⁵

For more than five years, the European Union has led the development of such regulation. In the wake of the aspirational⁶ and the legally binding⁷ sustainability and development commitments taken by the international community in 2015, the European Commission rapidly convened an expert group to develop a roadmap on sustainable finance⁸ and

1 - According to statistics compiled by the Global Sustainable Investment Alliance (GSIA 2013, 2021), professionally managed assets incorporating ESG dimensions into investment selection and/or management grew from USD13bn to USD35bn between the end of the 2011 and 2019 fiscal years (the figures are for the five regions covered consistently by the GSIA reports, i.e., Europe, USA, Canada, Australasia, and Japan). According to the latest GSIA report, 35.9% of total assets under management are sustainable investment. The GSIA is a collaboration of membership-based sustainable investment organisations currently representing North America (Responsible Investment Association Canada, US SIF), Europe (Eurosif), Japan (JSIF) and Australasia (Responsible Investment Association Australasia).

2 - The Global Sustainable Investment Alliance warns in its reports that "'sustainable investment' refers to a broad and inclusive definition of approaches to investment that include ESG factors in portfolio selection and management" and recognises that "there are distinctions and regional variations in its meaning and use, and related or interchangeable terms such as responsible investment and socially responsible investment."

PRI, the world's leading advocate of responsible investment characterises it as the consideration of ESG issues when making investment decisions and influencing companies or assets (PRI, 2023a). PRI is a voluntary investor initiative supported by the United Nations (it was launched in 2006 by UN Environment Programme Finance Initiative and the UN Global Compact).

3 - Evolving standards in terms of definitions can have a material impact on reported assets. Updates aligning industry practices with the stricter definitions being introduced in European legislation led to 13% fall in assets under management between 2018 and 2020 at a time when the rest of the world was reportedly reporting a 40% (GSIA, 2021).

4 - As things stand, the terminology is not standardised and of poor-quality, disclosures are heterogeneous, data are divergent, and labelling standards tend to be either excessively lax (creating room for misleading claims and competition issues) or excessively strict (leading to practical irrelevance).

5 - In particular where clear governmental signalling of and support for such transition exists.

6 - In September 2015, the UN General Assembly adopted the United Nations 2030 Agenda for Sustainable Development (i.e., development that meets the needs of the present generations without compromising the ability of future generations to meet their own needs). This agenda consists of seventeen Sustainable Development Goals (SDGs) and 169 associated targets, covering a wide range of social, economic, and environmental issues. The agenda is not legally binding; instead, member states are encouraged to integrate these goals and targets into their national plans and policies and make efforts to achieve them by 2030.

7 - In December 2015, 195 countries and the European Union adopted the Paris Agreement under the United Nations Framework Convention on Climate Change. The agreement is the first universal climate deal to organise the response to the threat of climate change by requiring parties to take greenhouse gas emissions mitigation action (to hold the global average temperature "to well below 2°C above pre-industrial levels" and pursue efforts to limit this increase to 1.5°C); to implement climate change adaptation action; and to align finance flows "with a pathway towards low greenhouse gas emissions and climate-resilient development." The wording of the Paris Agreement affirms the importance of sustainable development in the context of climate change action and implementation is intended to reflect "equity and the principle of common but differentiated responsibilities and respective capabilities, in the light of different national circumstances."

8 - Published at the beginning of 2018, the final report of the "High Level Expert Group" had a major influence on the architecture and contents of sustainable finance regulation in the European Union and beyond. Some of the priority actions identified by the expert group and that have led to legislation include: the development of a sustainability taxonomy starting with climate mitigation; the introduction of disclosures on corporates and financial institutions to increase transparency on climate and other sustainability risks; the integration of sustainability into the governance of financial institutions; and the establishment of a green bond standard. The group's recommendations also covered retail strategy where the key elements that have led to legislation were the integration of sustainability preferences into financial advice, the disclosure of investment sustainability impacts and processes, and minimum standards for sustainably denominated funds.

drew on its work to develop an Action Plan on Financing Sustainable Growth. Published in March 2018, the plan aimed to reorient capital flows towards sustainable investment, manage financial risks stemming from environmental challenges and social issues, and foster long-termism in economic activity (EC, 2018).

The implementation of the plan followed swiftly with the European Union putting in place three major elements of a sustainable financial framework, i.e., a classification of sustainable activities ("Taxonomy Regulation"), a sustainability disclosure framework for non-financial and financial companies (respectively the "Corporate Sustainability Reporting Directive" a.k.a. CSRD and "Sustainable Finance Disclosure Regulation" a.k.a. SFDR), and investment tools, including climate benchmarks, a green bond standard, and specific expectations and disclosures for financial products promoting environmental or social characteristics (SFDR Article 8 products) or with sustainable investment as objective (SFDR Article 9 products).

In a 2021 update to its sustainable finance strategy, the European Commission underlined that greenwashing – defined as "the use of marketing to portray an organisation's products, activities or policies as environmentally friendly when they are not" – could "generate reputational risks for the actors involved and trigger a loss of trust in sustainable finance products and the financial system" (EC, 2021) thus threatening the private-sector funding of the transition of the real economy towards sustainability.⁹

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The Commission claimed that the legislator had introduced an adequate framework of definitions, disclosures and tools to prevent greenwashing and underlined that the effectiveness of sustainable finance policies also depended on enforcement thus making clear its expectation that supervisors would need to play a key role in monitoring compliance with sustainable finance regulation, and use their powers to ensure that investors and consumers be protected against "unsubstantiated sustainability claims."

Taking a page from the European regulator, the International Organisation of Securities Commissions made five recommendations to securities regulators and policymakers in its November 2021 "Report on Sustainability-related Practices, Policies, Procedures, and Disclosures in Asset Management" (IOSCO, 2021):

- (1) to set expectations for asset managers in respect of the incorporation of material sustainability-related risks and opportunities; and of related disclosures;
- (2) to update regulatory requirements or guidance so as to improve product-level disclosure in respect of such risks and for sustainability-related products;
- (3) to have supervisory tools to monitor and assess compliance by asset managers (at entity and product levels) and address compliance breaches;
- (4) to encourage industry participants to develop common sustainable finance related terms and definitions, including in relation to ESG approaches;
- (5) to introduce or enhance financial and investor education initiatives relating to sustainability.¹⁰

9 - The term 'greenwashing' is mentioned in Regulation (EU) 2019/2089 introducing the EU Climate Benchmarks ("The establishment of EU Climate Transition Benchmarks and EU Paris-aligned Benchmarks, underpinned by a methodology linked to the commitments laid down in the Paris Agreement regarding carbon emissions, would contribute to increasing transparency and would help prevent greenwashing"), but the Regulation does not define it.

10 - This report followed upon the work of a Sustainability Task Force established in the wake of an IOSCO (2020) report that had concluded to the diversity of existing sustainability frameworks and standards, including in relation to sustainability-related disclosures; the lack of common definitions of sustainable activities; and the emergence of investor protection challenges, notably greenwashing (defined as "practices aimed to mislead investors or to give them a false impression about how well an investment is aligned with its sustainability goals"). In other workstreams, the taskforce explored issues of transparency and investor protection linked to issuers and ESG data providers.

Regulators and supervisors set their 2022 priorities accordingly and the year was marked by a flurry of position papers, consultations, and regulatory proposals – including in the United Kingdom and the United States.¹¹ 2022 was also the year when supervisors on both sides of the Atlantic took the first related enforcement actions.^{12, 13}

Early in the year, IOSCO (2022a) communicated that the focus of its own work plan would be on increasing transparency and mitigating greenwashing. At year end, it called on voluntary standard setting bodies and industry associations to adopt a set of "Good Sustainable Finance Practices" as a baseline to "counter the risk of greenwashing" and address related investor protection concerns (IOSCO, 2022b); the good practices intended for asset managers naturally paralleled the recommendations to regulators and policymakers in respect of asset management.¹⁴ Immediately after the release of this call for action, IOSCO (2022c) stressed that voluntary action was no longer sufficient and that governments and regulatory authorities had to take further action to build the foundations of "well-functioning sustainable finance markets."

In May, the European Commission approached the European Supervisory Authorities (ESAs) to request insights on greenwashing risks and occurrences in the financial sector and on the supervisory actions taken and challenges faced to address those risks. The Call for Evidence the ESAs conducted around the turn of 2023 was meant to gather insights on the "key features, drivers and risks associated with greenwashing" as well as examples of potential greenwashing practices (ESAs, 2022). This information added to the data sources upon which the ESAs relied to prepare their progress reports on greenwashing (out in May/June 2023; final reports are expected by the end of the first half of 2024).

In July 2023, the ESAs released the call for evidence contributions that respondents had authorised for publication. The contribution of EDHEC-Risk Climate Impact Institute as released by the European Securities and Markets Authority (ESMA) was redacted.¹⁵

11 - Inter alia, the United Kingdom Financial Conduct Authority conducted consultations (FCA, 2021 and 2022) and research (Gilchrist et al., 2022) to evolve its proposals on "Sustainability Disclosure Requirements (SDR) and investment labels"; the United States Securities and Exchange Commission put forward a proposal on enhanced disclosures about Environmental, Social, and Governance Investment Practices (SEC, 2022). In December 2022, the Federal Council of Switzerland produced a "Position on the Prevention of Greenwashing in the Financial Sector" (Federal Council, 2022) and required the Department of Finance to prepare implementation proposals by end September 2023 – we note that the Swiss Financial Market Supervisory Authority (FINMA) had produced guidance on "Preventing and Combating Greenwashing" but that these applied to funds only (FINMA, 2021). At the forefront of regulatory activity, the European Union adopted further Regulatory Technical Standards detailing Regulation (EU) 2019/2088 on sustainability related disclosures in the financial services sector ("SFDR") and Regulation (EU) 2020/852 on the establishment of a framework to facilitate sustainable investment ("Taxonomy Regulation") for application from 1 January 2023. The European Securities and Markets Authority produced a supervisory briefing at end May 2022 to promote convergence (among Member State competent authorities) in supervision of sustainability-related disclosures and sustainability integration; the ESMA (2022a) affirmed that this was meant "to increase transparency for investors as well as avoiding the practice of 'greenwashing'" (refer to paragraph 57 for examples of what may constitute greenwashing for the ESMA). The ESMA also consulted on funds' names using ESG or sustainability-related terms (ESMA, 2022b).

12 - On 23 May, the US Securities and Exchange Commission (SEC) disclosed that BNY Mellon Investment Adviser had paid USD1.5 million to settle charges of misstatements and omissions in relation to the integration of Environmental, Social, and Governance (ESG) considerations in investment decision making – the company had misleadingly represented or implied that all investments in certain funds had undergone an ESG quality review. On 31 May, prosecutors raided the offices of asset manager DWS and its parent Deutsche Bank in the context of an investigation of claims-brought forward by its inaugural Group Sustainability Officer after her dismissal—that the manager's sales prospectuses had grossly overstated the amount of assets under management for which it was considering ESG dimensions. Shares of the asset manager, which had already lost over a quarter of their value since the investigation had been made public, fell abruptly after the raids and the senior prosecutor's statement incriminating the company, the company's embattled Chief Executive Officer had to step down. His successor continues to deny wrongdoing accusations but has admitted that marketing had been exuberant and needed to be toned down. On 22 November, the SEC disclosed that Goldman Sachs Asset Management had been fined USD4 million for failing to follow its policies and procedures in relation to two funds and a managed account marketed as ESG investments.

13 - On 28 February 2023, The Australian Securities and Investments Commission launched its first court action for alleged greenwashing (against Mercer Superannuation (Australia) Limited conduct in respect of allegedly misleading statements about the sustainable nature and characteristics of some of its superannuation investment options).

14 - Naturally, asset managers are not expected to develop supervisory tools; instead, IOSCO calls on the industry to develop guidance on ESG data due diligence.

15 - The ESAs had reserved the right not to publish responses assessed to be of an offensive or defamatory nature, not related to the topic of the survey, or that included confidential information. Our contribution was apparently redacted due to misplaced concerns about fair use of potentially copyrighted work. Indeed, the only redacted parts are references and brief excerpts from referenced resources.

In the rest of this document, we present our original contribution of January 2023, including the parts that were redacted.

Questionnaire

Answers to questions common to the three European Supervisory

1. Possible features of greenwashing

The ESAs represent that greenwashing—which in the context of the Call for Evidence is to be understood in reference to any sustainability-related matter and not simply in respect of environmental matters—can be analysed through four main dimensions:

I. **The role market participants may play** in greenwashing: "trigger" i.e. source, spreader and receiver.

II. **The actual topics on which the claims are made**, which they group into three broad categories:

a. "Claims about an entity's governance and remuneration around sustainability and about an entity or a product's dedicated resources to sustainability matters;

b. claims about sustainability strategy, objectives, characteristics or qualifications of a product, an entity, or a service; and

c. claims about sustainability-related metrics based on historical data or future targets."

III. **The misleading qualities of the claim**, e.g., selective disclosure or hidden trade-off; exaggerated claims and/or unfulfilled promises; omission or lack of disclosure; vagueness or ambiguity or lack of clarity; poor advice; etc.

IV. **The location of the claim**: "The channels through which the claims are communicated to other actors across the sustainable value chain (e.g. regulatory documents, ratings/benchmarks/labels, product information, marketing materials) or the various stages of the product lifecycle in which they occur (e.g. product delivery, product manufacturing)."

1.1 Core features of greenwashing

The ESAs make a number of assertions about the core characteristics of greenwashing, According to their tentative characterisation:

1. Greenwashing may arise:

- either **by omission of (sustainability-related) information that consumers or investors would need to take an informed decision** ("including but not limited to partial, selective, unclear, unintelligible, inconsistent, vague, oversimplistic, ambiguous or untimely information, unsubstantiated statements");

- or **by commission, i.e.**, through misleading communications due **to the actual provision of (sustainability-related) decision-relevant information that is false, deceives or is likely to deceive consumers or investors** ("including but not limited to mislabelling, misclassification, mis-targeted marketing");

2. It can occur at different levels:

- **at entity level** ("e.g., in relation to an entity's sustainability strategy or performance"), and/or

- **at product level** ("e.g., in relation to products' sustainability characteristics or performance"), and/or

- **at service level** ("including advice and payment services (e.g., in relation to the integration of sustainability related preferences to the provision of financial advice)").

3. **Greenwashing can be either intentional or unintentional** ("e.g., resulting from negligence or from misinterpretation of the sustainable finance regulatory framework requirement").

4. **Greenwashing can occur "at any point where sustainability-related statements, declarations or communications are made" and thus at any stage of product/service provision lifecycle** ("e.g., manufacturing, delivery, marketing, sales, monitoring") **and throughout the investment value chain** ("e.g., issuer, benchmark/rating provider, investment firms, etc.").

5. **Greenwashing may occur not only in respect of EU mandated sustainable finance disclosures**, e.g., SFDR disclosure requirements, **but also as a result of non-compliance with general principles** (featured in EU financial legislation), **including the requirement to provide information that is fair, clear and not misleading**. As such it may occur in relation to entities that are not currently in the scope of the EU sustainable finance legislation, e.g., ESG rating agencies.

6. **The source or "trigger" of greenwashing can be the entity to which the sustainability communications relate, the entity responsible for the product, or a third party**, e.g., a third-party verifier).

The ESAs also represent that if not addressed, greenwashing will undermine trust in sustainable finance "markets and policies, regardless of whether immediate damage to individual consumers or investors (in particular through mis-selling) or the gain of an unfair competitive advantage has been ascertained."

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Q A.1: Please provide your views on whether the above-mentioned core characteristics of greenwashing reflect your understanding of and/or experience with this phenomenon and whether you have anything to add/amend /remove.

The proposed core characteristics are a reasonable description of greenwashing.

One may nevertheless note that:

- Greenwashing concerns/perceptions may arise when an entity promotes its adherence to sustainability regulation at product or entity level in a manner that appears inconsistent or disproportionate with its perceived/actual sustainability performance at entity level, e.g., a service provider may prominently market/display its sustainability-regulation compliant products/services to benefit from the legitimacy conferred by sustainability while achieving a less than stellar sustainability performance - more broadly, **the regulator needs to recognise the disinformation potential of communication around compliance and pre-empt to the extent possible the strategic exploitation of sustainability-regulation compliance by entities.**
- **Labels pertaining to processes have potential to mislead in a context where outcomes are expected**, whether this is the intention of the label-awarding entity, the label awardee, or a party that is communicating in relation to the label/a label awardee.

Process standards require entities to implement performance measurement and monitoring systems—which it is hoped will lead to performance improvement; however, they **do not impose performance level standards and may strategically be used to manage expectations of performance / reinforce organisational legitimacy in the realm of sustainability** (while the entity legitimacy is enhanced, label adoption is only performative/symbolic; performance gains may remain unaffected by the adoption or the added legitimacy may be used to allow for performance progress to slow down or reverse course). For illustration of the issue in the context of environmental certification and empirical evidence based on actual performance rather than perceptions of performance, refer to Heras-Saizarbitoria et al. (2020). More generally, **regulation focusing on performance governance rather than performance transparency is inherently dangerous in that it can be exploited to mislead about performance; it also tends to be encouraged by market incumbents, even in the absence of intellectual property or trade secret concerns, as it erects costly barriers to entry.**

- While the ESAs seem to be aware of the limits of third-party voluntary labels and certifications and their potential for abetting greenwashing due to insufficient stringency, they do not appear to question the potential for greenwashing offered by labels and classifications that originate with or are adopted by the regulator – the existing labels for sustainable investment under the EU Benchmark Regulation are one example (see Ducoulombier, 2020, and Amenc et al., 2022) – this is particularly worrying as sponsorship of such labels and classifications by regulators disincentivise investor due diligence and may create moral hazard.

- Likewise, the ESAs seem to pay insufficient attention to the greenwashing risks involved with the use and reporting of information that is not fit-for-purpose whether this originates from data (Ducoulombier, 2021) or their management (Ducoulombier and Liu, 2021), including for compliance with regulatory standards.

Q A.2: Do you have or use a specific definition of greenwashing as part of your activities? If so, please share this definition.

We are comfortable with a generalised definition based on Lyon and Montgomery (2015),¹⁶ i.e., communication (positive or negative) that misleads or may mislead a party into holding (adopting, maintaining, restoring) overly positive perceptions or beliefs about the environmental characteristics / performance of a technology / process / practice, product / service / activity, policy / programme / plan / project / action, or of a legal person or organisation (including de facto organisations of legal persons, for-profit or not-for-profit organisations, private-sector or public-sector organisations, government administrations at any level including supranational).

As misleading communication is facilitated by the lack of precise definitions, our preference is to reserve the use of greenwashing and social washing, respectively, to environmental and social matters, respectively. **We prefer the use of sustainability-washing to refer to misleading communication pertaining to environment and/or social characteristics/performance.**

¹⁶ - These authors note: « In view of the wide range of communications that may be considered greenwash, we argue that the literature needs to begin to think in terms of "varieties of greenwash." In both the popular and the scholarly press, the word greenwash is used to cover any communication that misleads people into adopting overly positive beliefs about an organization's environmental performance, practices, or products. We believe it makes sense to stick with this broad use of the word, and to focus scholarly attention on the various ways in which greenwash occurs.»

We also note that perceptions of sustainability-washing may arise in the absence of actual sustainability washing and lead to wrongful accusations; this particular disconnect will be facilitated by definitional ambiguity, asymmetric information (including insufficient education) and lack of trust (which absent, lax, or ill-designed regulation and enforcement can reinforce).

We also observe that accusations of greenwashing may be levied strategically by various parties to manage their legitimacy and reputation or affect the legitimacy and reputation of the accused and that it is possible that some of these allegations be unsubstantiated or even knowingly false.

1.2 Dimensions of greenwashing

1.2.1. The potential roles market participants can play in greenwashing

The ESAs write: "Market participants could potentially play three main different roles (trigger, spreader, receiver) in any given occurrence of greenwashing. For instance, a corporate issuer can trigger greenwashing by understating its carbon emissions. This misleading claim could be communicated to both investment managers, ESG data providers and/or other market participants some of whom might continue to spread the misleading claim to the end investors/consumers, who will be the receiver of greenwashing."

Q A.3.1: Do you agree that market participants could be involved in three different ways in greenwashing, as described above?

Yes

1.2.2. The topics of sustainability-related claims

For the ESAs, another dimension of greenwashing is the topic of the sustainability-related claim. They identify three such topics:

Topic 1: Claims about an entity's governance and remuneration around ESG and about an entity or product's dedicated resources to sustainability matters:

- i. Board and senior management's role in sustainability
- ii. ESG corporate resources and expertise

Topic 2: Claims about the sustainability strategy, objectives, characteristics or qualifications of a product, an entity, or a service:

- i. ESG strategy, objectives, characteristics
- ii. Sustainability management policies
- iii. ESG qualifications / labels / certificates
- iv. Engagement with stakeholders

Topic 3: Claims about sustainability-related metrics based on historical data or future targets:

- i. ESG performance to date (including metrics for impact claims)
- ii. Pledges about future ESG performance (ESG targets, including net-zero commitments; transition plan, taxonomy alignment plans)

Q A.4: Please indicate the degree to which you consider each topic described above, as prone to the occurrence of greenwashing. Please provide a score from 1 to 5 (where 1 = very low occurrence ; 2 = low occurrence ; 3 = neutral ; 4 = high occurrence ; 5 = very high occurrence).

| | 1 | 2 | 3 | 4 | 5 | Dont know |
|---|---|---|---|---|---|-----------|
| Board and senior management's role in sustainability (Topic 1, i) | | | | • | | |
| ESG corporate resources and expertise (Topic 1, ii) | | | | • | | |
| ESG strategy, objectives, characteristics (Topic 2, i) | | | | | • | |
| Sustainability management policies (Topic 2, ii) | | | | • | | |
| ESG qualifications / labels / certificates (Topic 2, iii) | | | | | • | |
| Engagement with stakeholders (Topic 2, iv) | | | | | • | |
| ESG performance to date (including metrics for impact claims) (Topic 3, i) | | | | | • | |
| Pledges about future ESG performance (ESG targets, including net-zero commitments; transition plan, taxonomy alignment plans (Topic 3,ii) | | | | | • | |

Q A.4.1: Please specify the underlying drivers of greenwashing in relation to the topics you scored higher.

Lack of standardisation of definitions and required/authorised disclosures/claims pertaining to objectives, strategies, implementation processes and (positive/negative) sustainability characteristics/performance create room for sustainability-washing.

We draw attention to the specific risks of sustainability-washing (that could be created by certain choices and/or design flaws with respect to classifications/labels and related definition and/or endorsement of approaches and metrics supporting compliance with portfolio construction or disclosure obligations (T2i, iii, iv and 3i, ii).

These arise from disconnect/inconsistence between the objectives/characteristics promoted—including as per classification/label—and what may be achieved given the manner in which sustainability considerations are integrated in the investment/product design process, including as a result of eligibility criteria, key performance indicators (KPIs) and/or other disclosures defined by the standard setter (Ducoulombier, 2020).

For illustration with respect to T2i+iii, Rec. 6 of Delegated Regulation 2020/1818 ("DR") explains that the DR aims to ensure that the EU Climate Benchmarks «provide a realistic image of the real economy (...) to make the objectives of the Paris Agreement attainable» and that this is achieved by way of sector exposure control. However, constraints at Art. 3 are insufficiently granular and allow the decarbonisation requirements (especially the compression of greenhouse gas («GHG») intensity («intensity»), set forth at Art. 7, 9 and 11) to be met by divestment of high climate impact issuers irrespective of their importance for the transition.

In addition, Art. 12(1g) applying to EU Paris-Aligned Benchmarks excludes companies whose majority revenues are from high intensity electricity generation with no consideration for their revenues from low intensity electricity generation, their related capex, or transition plans (all the while letting more diversified companies with higher intensity off the hook); this removes companies responsible for c.30pc of renewable energy generation (Christiansen, 2022). «Pulling the plug» on electric utilities may not be consistent with benchmark objectives (or the massive electrification required by the transition).

A less obvious, yet fundamental, DR flaw lies with defining intensity mitigation requirements at portfolio-level without regard for how portfolio construction may incentivise decarbonisation in the real economy. This is despite the first recital of the DR citing Paris Agreement Art. 2-1c which targets "Making finance flows consistent with a pathway towards low GHG emissions and climate-resilient development." However, popular portfolio construction approaches-determining constituent weights based on composite signals of climate and financial performance or using an optimiser to meet portfolio-level climate and financial KPIs/constraints-cannot lead to consistent capital allocation providing clear signals and incentives to issuers to improve climate performance. Whether envisaged in a cross-sectional (i.e., relative to peers) or time-series (i.e., relative to self) manner, these approaches cannot produce such signals and incentives.

Other DR flaws (topic 3i) arise from defining intensity relative to enterprise value, which introduces capital market volatility and «significantly weakens the link between intensity and real-world decarbonisation" (Ducoulombier and Liu, 2021) and from mandating use of data unfit for the purpose of comparing intensity across issuers (Ducoulombier, 2021).

Transparent and predictable capital allocation in respect of climate performance can make finance flows consistent with necessary climate action and send strong, unambiguous, and actionable signals to stakeholders. The DR fails to do either and powerfully incentivises sustainability-washing.

Major risk would arise from accepting any investor impact channel as effective absent solid theoretical justification and empirical validation; engagement comes with particularly high sustainability-washing risks.

Falsifiability and transparency are key both for data and investor impact.

Q A.5: For the same list of topics listed in the previous question, please provide a score from 1 to 5 on the potential harm/impact of a misleading claim made on that topic (where 1 = very low impact ; 2 = low impact ; 3 = neutral ; 4 = high impact ; 5 = very high impact).

| | 1 | 2 | 3 | 4 | 5 | Dont know |
|---|---|---|---|---|---|-----------|
| Board and senior management's role in sustainability (Topic 1, i) | | | • | | | |
| ESG corporate resources and expertise (Topic 1, ii) | | | • | | | |
| ESG strategy, objectives, characteristics (Topic 2, i) | | | | • | | |
| Sustainability management policies (Topic 2, ii) | | | | • | | |
| ESG qualifications / labels / certificates (Topic 2, iii) | | | | | • | |
| Engagement with stakeholders (Topic 2, iv) | | | | • | | |
| ESG performance to date (including metrics for impact claims) (Topic 3, i) | | | | • | | |
| Pledges about future ESG performance (ESG targets, including net-zero commitments; transition plan, taxonomy alignment plans (Topic 3,ii) | | | | • | | |

Q A.5.1: Please explain what types of impacts or harm and their consequences you anticipate as a result of greenwashing practices.

14

Misleading claims of any sort about investment objectives, characteristics, and performance may harm investors.

When accusations of sustainability washing are levied, the reputation and legitimacy of the accused (and other parties affected by association) may be harmed, including when the accusation is false (admittedly the parties making and spreading the accusations may also be harmed, notably in cases when the accused is in a position to convincingly establish the falsity of the accusation and the intention to harm when it exists - note however that certain accusations may be hard or costly to disprove or even non falsifiable - also note that establishing the falsity of an accusation may not only be costly but may also fail to fully restore the reputation and legitimacy of the accused and/or those parties that were affected by association).

Accusations and instances of sustainability washing may also harm trust in (sustainable finance) markets, products, services as observed by the ESAs.

Centrally, sustainability washing may also:

- (i) **reduce the efficiency of financial markets and harm their allocational efficiency** thus eventually (unfairly) affecting markets for real products and services (as the terms and conditions of access to capital by producers are modified);
- (ii) **reduce the value of sustainable investments and the impact of sustainable investors on the real economy.** Indeed, whether the sustainability features of investments pertain to issues that are currently financially material or provide nonpecuniary benefits

to (a significant class of sustainable) investors, sustainability washing will lead to:

- (a) **financial asset mispricing** (unfairly advantaging sustainable-washing companies and parties with remuneration linked to these assets, e.g., senior managers; exposing bona-fide investors to the risks of losses if/when information/expectations are corrected);
- (b) **under-optimal allocation, whereby capital will not flow in the right quantities to "the right" issuers** (including financial intermediaries), e.g., the schedule of funding of climate change mitigation and/or adaptation projects will be different from what would be observed in the absence of misleading communications; and
- (c) **reduction of overall sustainability-related investment** (assuming sustainability-washing is assumed or identified and contributes to increasing the uncertainty about the quality of sustainability information) - **indeed the uncertainty affecting the information results in a risk premium to be paid by (all) issuers and thus a higher cost of capital and, other things equal, reduced investment – this 'uncertainty tax' reduces the positive impact that may accrue to issuers as a result of their sustainability disclosures (whether investors incorporate these disclosures because they pertain to issues that they deem financially material or affect their non-pecuniary preferences).** Avramov et al. (2022) show how disagreement about sustainability information theoretically "leads to higher effective risk aversion, higher market premium, and lower demand for stocks" and "affects the systematic risk exposure of individual stocks; they provide empirical evidence using ESG rating divergence. De Angelis et al. (2023) focus modelling on climate action and sustainable investment and establish that "heightened uncertainty (...) alleviates green investors' pressure on the cost of capital of companies and pushes them to increase their emissions." The authors note that "green investors can increase their impact by pushing companies to enhance disclosure on environmental issues, thereby reducing uncertainty about future environmental externalities."

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Q A.6: In addition to the three topics and eight sub-topics above, do you identify any additional topics which would be relevant to potential greenwashing issues?

- a) Yes
- b) No

Q A.6.1: If yes, please provide below more information on your unsustainability-washing including, if possible, a short example.

We wish to underline the considerable risks pertaining to the use of data that are not fit for purpose (and misuse of data producing derivative data/metrics that are not fit for purpose) in relation to Topics 2+3.

Where data are used that are not fit for purpose or in a manner that is not fit for the strategy, objectives, characteristics or management policies, then derived claims about the sustainability strategy, objectives, characteristics or management policies may become misleading.

Where ESG qualifications / labels / certificates («distinctions») (are allowed to) depend on strategy, objectives, characteristics, or sustainability management policies that allow (or organise) the use of data that are not fit for purpose or allow (or organise) the use of data in a manner that is unfit for purpose, these ESG distinctions may lose their purpose and even produce counterproductive effects.

Indeed, these distinctions may fail to discriminate between products/services that properly integrate sustainability information and those that do not; encourage the use of data or data usages that are unfit for purpose, or even disallow the use of data (usages) that are fit for purpose.

The issue is particularly perverse when these distinctions carry the weight of the regulatory and/or supervisory authorities, e.g., when their use is regulated and/or supervised, the hallmarks of the regulator/supervisors disincentivise investor due diligence and create moral hazard.

Selected illustrations include:

(A) encouragement of cross-sectional usage of Scope 3 emissions for asset selection, including

(i) through the criteria to be met to label indices as EU CTB/PAB as per Commission Delegated Regulation (EU) 2020/1818 («DR»); and

(ii) indirectly by requirements found in other EU law to disclose sustainability metrics whose computation requires averaging portfolio-constituent-level Scope 3 emissions.

In adopting a fast phase-in schedule for Scope 3 emissions for the DR, the European Commission ("EC") disregarded clear warnings about data limitations by multiple practitioners, including by some with ties to data providers, e.g., SPDJI (2019). In a damning assessment, Scientific Beta (2020) documents that the EC technical expert group has acknowledged that Scope 3 emissions would not be fit for the purpose of stock selection "for the foreseeable future" and observes «We would find it unacceptable that a tool that is part and parcel of the European Commission action plan to support the reorientation of capital flows towards a more sustainable economy (so cynically) disregard the efforts made by companies in the mitigation of their (...) emissions. (...) mandating the construction of EU Climate Benchmarks upon unreliable data constitutes institutionalisation of illegitimate claims about the climate impact of these Benchmarks.»

In the academic literature, Ducoulombier (2021) discusses Scope 3 emissions data limitations and workarounds; he advises (business-as-usual and impact-motivated) investors to treat the integration of value chain considerations into portfolio construction with extreme caution lest they encourage greenwashing. Taking a financial materiality angle, Cheema-Fox et al. (2021) provide empirical illustration of value destruction from adding estimated Scope 3 emissions to the numerator of the traditional carbon intensity metric (endorsed by the TCFD, 2017, and defended by a majority of the respondents to the draft DR consultation). Hall et al. (2023) put forward an alternative measure of supply chain climate risks that is found to be more suitable and of higher quality than Scope 3 emissions data.

(B) injection of capital market volatility into carbon intensity measurement weakening the link to underlying corporate emissions and producing metric volatility that rewards an issuer's stock market performance over its decarbonisation performance, notably through the use of Enterprise Value Including Cash ("EVIC") as the denominator for the computation of GHG intensity in the DR. The obvious sustainability-washing implications for impact-motivated investors are described in Ducoulombier and Liu (2021).

1.2.3 The way in which a claim can be misleading

Q A.8: On a scale from 1 (i.e. "not at all relevant") to 5 ("very relevant"), please indicate the extent to which you find each of the misleading qualities of a sustainability-related claim listed below relevant to greenwashing practices.

| | 1 | 2 | 3 | 4 | 5 | Dont know |
|--|---|---|---|---|---|-----------|
| Selective disclosure or hidden trade-off (cherry-picking positive information and/or omitting relevant negative information) | | | | • | | |
| Empty claims (exaggerated claims and/or failure to deliver on such claims) | | | | | • | |
| Omission or lack of disclosure | | | | • | | |
| Vagueness or ambiguity or lack of clarity | | | | • | | |
| Inconsistency across various disclosures and communications (marketing, regulatory, website, etc.) | | | | • | | |
| Lack of fair and meaningful comparisons, thresholds, scenarios and/or underlying assumptions | | | | | • | |
| No proof (unsubstantiated) | | | | | • | |
| Misleading / suggestive non-textual imagery and sounds (including the use of specific colours like green) | | | | • | | |
| Irrelevance | | | | • | | |
| Outdated information | | | | • | | |
| Misleading / suggestive use of ESG-related terminology (naming-related greenwashing) | | | | • | | |
| Outright lie (falsehood) | | | | • | | |

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Q A.8.1: Please provide further comments to the identified misleading qualities of communication in the context of greenwashing. In particular, should any of the qualities be added, amended or deleted from the list and if so, why?

The classification put forward by TerraChoice Environmental Marketing («TEM») is often cited. «The Six Sins of Greenwashing» (TEM, 2007) are:

1. Hidden Trade-off (focus on an unreasonably narrow set of attributes without attention to other important issues - which is facilitated by omission or lack of disclosure in relation to these other issue);
2. No Proof (claim that cannot be substantiated by easily accessible supporting information or by a reliable third-party certification);
3. Vagueness (poorly defined or broad claim that can be used to mislead);
4. Irrelevance (unimportant or unhelpful; e.g., performance in line with legal or industry

standards is presented as exclusive or innovative);

5. Lesser of Two Evils (possibly true in respect of the product but distracting from the impacts of its category as a whole);

6. Fibbing (false claims, including outright lies).

Another sin is added (TEM, 2009):

7. Worshiping False Labels (exploiting demand for third-party certification by advertising a fake label or third-party endorsement).

Responsible marketing/advertising guides, such as that issued by the French Agency for Ecological Transition (ADEME, 2012) also identify the possibility of:

- Exaggerated Claims (other than those falling under Hidden Trade-offs);
- Insufficient Information (the claim appears relevant in all likelihood, but it is hard to understand why or how or where further information may be found);
- Overly suggestive use of imagery (misleading about the importance of environmental benefits of the product/service/initiative);
- Irrelevant prominence (sustainability is mentioned or illustrated, including with actual examples of CSR actions, but this has no connection to the product or service being advertised).

Lyon and Montgomery (2015) survey the academic work studying greenwash and produce the following classification for the variety of misleading environmental communication described in the literature:

- Selective Disclosure;
- Empty Green Claims/Policies («Cheap Talk»);
- Dubious Certifications/Labels;
- Co-Opted NGO Endorsements/Partnerships;
- Ineffective Public Voluntary Programs;
- Misleading Narrative/Discourse; and
- Misleading Visual Imagery.

Based on this recension from practitioner and academic literature, we find the proposed list to be adequate.

As must be obvious by now, we are primarily concerned by the risk of regulators increasing sustainability washing through the promotion of ESG qualifications / labels / certificates («ESG distinctions») that cannot or are unlikely deliver on their sustainability promises and their greenwashing prevention pretentions (assuming they do not actively promote sustainability-washing as in the case of DR 2020/1818). Failure may arise from design flaws and /or lack of enforcement action; a modest and principles-based approach may be preferable to an all-encompassing and detailed approach. Regulators must be fully aware of the potential for gold-standard sustainability-washing offered by ESG distinctions arising in or endorsed by regulatory/government authorities and of their condoning or enforcing the use of sustainability investment management approaches, metrics, or data

that are unfit for purpose (and may be insufficiently effective, ineffective, or even counterproductive).

Our concerns about metrics and data have probably been made sufficiently clear in our previous comments which have also touched on the possibility of a disconnect between strategy objectives and asset-level decisions which would undermine the potential impact of sustainability approaches based on capital allocation.

In this regard, we wish to stress that the sustainability investment industry preference for and belief in the effectiveness of engagement is decades old and predate any serious investigation. What is new is the representation that the scientific evidence distinctively favours engagement over capital allocation as an investor impact channel. This cannot be supported by a dispassionate look at theoretical and empirical evidence.

1.2.4 Which communication channel

The ESAs consider that another dimension of greenwashing is represented by the channels through which sustainability-related claims are communicated.

Q A.9: Regarding the above dimension and the list of channels through which misleading claims can be communicated to other segments of the sustainable value chain, please indicate the likelihood that a given channel serves to communicate misleading sustainability claims made at entity level and/or at product/service level. Please score each channel from 1 (rather unlikely) to 5 (very likely):

| | 1 | 2 | 3 | 4 | 5 | Dont know |
|---|---|---|---|---|---|-----------|
| a) Regulatory documents (including Key Investor Documents or Key Information Documents, Prospectuses, Financial Statements, Management Reports, Non-Financial Statements, Benchmark Statements and methodology documents, insurance-product information documents, pension benefit statements, etc.) and/or any mandatory disclosures | | | • | | | |
| b) ratings (ESG ratings and/or other ESG data products) | | | | | • | |
| c) Benchmarks | | | | | • | |
| d) Labels | | | | | • | |
| e) Product information (including internal classifications, and internal target market, product testing and distribution strategy related documentation) | | | • | | | |
| f) Intermediary/advice information | | | | • | | |
| g) Marketing materials (including website, social media, advertising) | | | | • | | |
| h) Voluntary reporting, falling outside previous categories as reported on a voluntary basis | | | | | • | |
| i) Other (please specify) | | | | | | • |

Q A.9.1: Please indicate below if you have any comments regarding the communication channels of potentially misleading sustainability-related claims?

We trust we have provided sufficient information in respect of c) and d).

As for b), **we trust that the intrinsic divergence of ESG ratings is now better understood. In respect of ESG data in general, we consider it key that authorities avoid mandating the use of data that are not fit for purpose and that they contribute to improving the quality of investor disclosures by imposing reporting obligations upon issuers before requiring that investor / their service providers report on the performance of issuers, especially if they consider that the use of estimated data should be avoided.**

We suspect that political pressure has led the European Commission to err in this respect in relation to DR 2020 / 1818 and the SFDR and hope better practices will prevail going forward.

In respect of ESG data, authorities should also consider the competition and wealth transfer implications of imposing disclosures that require the purchase of data from commercial providers and make bona fide efforts to promote the provision of truly open-source data; this may require protecting the independence of rulemaking from undue influence by the ESG data industry, e.g., over technical committees. While seeking industry input to inform legislation makes sense; rulemaking should not be outsourced to the industry.

With respect to b) and h), we wish to underline that while audit and independent assurance of sustainability reporting provides credibility to sustainability claims, current practices facilitate sustainability-washing and will need to be reformed; regulatory and enforcement authorities can incentivise such reform by clarifying expectations and affirming that scrutiny of the field will increase.

Soonawalla et al. (2022) observe that non-financial assurance has developed «as an analogy of financial auditing, copying its processes, logics and methods» and that «a) stakeholder exclusion due to firm and management centricity, b) issue exclusion (...) due to conservatism in practice and measurement, and c) a limited audit scope due to methodological and professional constraints» makes it ill-adapted to the needs for «problem-oriented, impact-focussed and inclusive approaches to sustainability measurement.»

Carmichael et al. (2023) consider that, in its current form, auditing and assurance «often creates doubt and confusion in an already highly disorganized space» and warns that «Reporting that claims to verify sustainability practices but undermines, rather than affirms, those practices is ultimately just a form of greenwashing.» The authors' investigations point to misleading statements, obfuscation, and diversion as common sustainability-washing strategies. Sustainability assurance reports were found to be

excessively short and engagements were «frequently» of the limited (vs. reasonable) assurance type (misleading statements). Ascertaining what information was within the scope of the assurance engagement was difficult (obfuscation). Finally, disclosures left out relevant information which had the authors wonder about the extent to which «omissions were intended to distract from an unwanted story line» (diversion). The authors suggest that: (1) assurers should «better outline how sustainability assurance is different from financial auditing» and develop «much more stringent, standardized, and rigorous processes around these requirements to achieve a credible audit practice for sustainability information»; (2) companies could aid the credibility of sustainability assurance by providing more complete and consistent information.

Q A.10: For each of the stages of product lifecycle and with regard to the business model and management, please indicate the likelihood of the occurrence of greenwashing. Please provide scores ranging from 1 (rather unlikely) to 5 (very likely):

| | 1 | 2 | 3 | 4 | 5 | Dont know |
|---|---|---|---|---|---|-----------|
| a) Product manufacturing | | | | | • | |
| b) Product delivery - marketing: advertisements, non- regulatory information | | | | | • | |
| c) Product delivery - regulatory disclosure | | | | | • | |
| d) Product delivery - regulatory channels | | | | | • | |
| e) Product delivery - sales: information asymmetry (this includes under or over emphasis of certain product features) | | | | | • | |
| f) Product delivery - sales: misseling due to misleading information/disclosure | | | | | • | |
| g) Product delivery - sales: misseling due to unsuitable product | | | | | • | |
| h) Product delivery - sales: incentives at point of sale | | | • | | | |
| i) Product management - product monitoring, product review, ongoing product disclosure | | | | | • | |
| j) Business model at entity level - value chain, group structure, innovation/ digitilization, out sourcing | | | • | | | |
| k) Business management at entity level - culture, governance arrangements, systems and processes | | | | | • | |

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2. Examples of potential greenwashing practices

This section of the survey relates to the collection of examples of potential greenwashing practices that respondents may have encountered

Q A.12: Are you able to identify and characterize at least one example of potential greenwashing practice?

Yes

Q A.12.2: (If yes) if you have, briefly describe this example of potential greenwashing practice, including the potentially misleading sustainability-related claims identified, a short description of the product, service or entity (as applicable) and of the claim. Please also provide information on how you identified / found out about this case.

The faulty design of Commission Delegated Regulation (EU) 2020/1818 ("DR") actively encourages the provision of index strategies that fail to deliver on each of the main objectives of the DR (i.e., i) allow a significant level of comparability of methodologies while leaving an important level of flexibility; ii) provide investors with an appropriate tool that is aligned with their investment strategy; iii) increase transparency on investors' impact, specifically with regard to climate change and the energy transition; and iv) de-incentivise greenwashing).

Details of design faults were publicly shared with the European Commission by various stakeholders as the DR was being drafted - see inter alia, the contributions of thinktank 2DII (2020) and index provider Scientific Beta (Amenc and Ducoulombier, 2019, 2020a, 2020b; Ducoulombier, 2020) - but most of this useful feedback was ignored prompting some contributors to document persisting issues through academic publications: Ducoulombier (2021) details the unsuitability of Scope 3 emissions data for cross-sectional comparisons supporting portfolio construction; Ducoulombier and Liu (2021) explain how the adoption of a greenhouse gas intensity metric with Enterprise Value Including Cash as denominator introduces capital market volatility into measurement, which significantly weakens the link between carbon intensity and real-world decarbonisation and produces metric volatility that rewards an issuer's market performance over its decarbonisation performance;

Amenc, Goltz and Liu (2022) show that popular portfolio construction mechanisms (encouraged by the DR) exhibit attractive climate metrics at the portfolio level but do little to reallocate capital in a manner that would incentivise companies to contribute to the climate transition (investor impact objective). The authors observe that typical approaches tilting capitalisation weights by climate metrics or optimising a portfolio-level climate metric subject to market-benchmark tracking error constraints produce «Closet Business-As-Usual Investing» and «boil down to greenwashing.» The most damning finding of the authors is that the evolution of constituent weights over time in such strategies cannot send consistent signals to firms.

While coming late to the party, the world's two key end-investor net-zero investment standardisation initiatives have criticised DR design flaws.

The Paris Aligned Investment Initiative ("PAII") notably takes exception to the excessive benchmark relative carbon intensity reductions at onset and blanket exclusion of high carbon-intensity issuers: «The PAII wants to incentivize allocation of capital to assets whose emissions are declining over time and to climate solutions. However, it considers this may be more effectively achieved by maintaining investment in assets, where there

is an opportunity to maximise real world impacts by driving reductions in companies that need to transition through stewardship and engagement, rather than initially excluding issuers from a benchmark to achieve an immediate ambitious emissions reduction target.» Observing that benchmarks are «a critical tool that supports investors in implementing strategic asset allocation and translates investor objectives to asset managers», the UN-convened Net Zero Asset Owner Alliance calls for the development of Net-Zero-Aligned Benchmarks as «efficient and practical tools for integrating decarbonisation objectives into the investment process and for supporting net-zero portfolio alignment» and specifically puts forward ten guiding principles that are supposed to address «some shortcomings» of the DR (UNEP FI and PRI, 2022).

Q A.12.3: Please indicate if you consider this as an example of potential entity-level or product/service-level greenwashing practice

Product / service level

Q A.12.4: In case of product / service level example, what was the asset class/ type of financial product in question?

Funds, such as UCITS funds and AIFs (excluding ETFs), ETFs, Private Equity funds or other funds (e.g. Hedge Funds, ELTIFs); Benchmarks, such as PAB and CTB Climate Benchmarks, other climate benchmarks or ESG benchmarks

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Q A.12.5: Please indicate the sectors by which this example of potential greenwashing practice was triggered:

ESG data and rating providers

Benchmark administrators

Investment services providers

Investment managers

Other (please specify): The responsibility of the regulator as trigger should be underlined as the regulation intrinsically encourages greenwashing.

Q A.12.6: According to you, was the entity triggering this potential greenwashing practice acting:

Intentionally

Q A.12.7: If applicable, please indicate the stakeholders which acted, intentionally or non-intentionally,

Benchmark administrators

Investment services providers

Investment managers

Occupational pension schemes providers

Pension funds

Q A.12.8: Please indicate the stakeholders which were the receivers of this example of potential greenwashing practice

Insurance undertakings
Insurance intermediaries
Occupational pension schemes providers
Pension funds
Retail investors/Consumers
General public

Q A.12.9: Please identify the most relevant topic(s) in this example of potential greenwashing practice:

- a) Board and senior management's role in sustainability (Topic 1, i)
- b) ESG corporate resources and expertise (Topic 1, ii)
- c) ESG strategy, objectives, characteristics (Topic 2, i)
- d) Sustainability management policies (Topic 2, ii)
- e) ESG qualifications / labels / certificates (Topic 2, iii)
- f) Engagement with stakeholders (Topic 2, iv)
- g) ESG performance to date (including metrics for impact claims) (Topic 3, i)
- h) Pledges about future ESG performance (ESG targets, including net-zero commitments; transition plan, taxonomy alignment plans) (Topic 3, ii)

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Q A.12.10: Please identify the most relevant misleading characteristics of communication in this example of potential greenwashing practice

- a) Selective disclosure or hidden trade-off
- b) Empty claims (exaggerated claims and/or failure to deliver on claims)
- c) Omission or lack of disclosure
- d) Vagueness or ambiguity or lack of clarity
- e) Inconsistency across various disclosures and communications (marketing, regulatory, website, etc)
- f) Lack of fair and meaningful comparisons, thresholds and/or underlying assumptionsg)
- No proof (unsubstantiated)
- g) Misleading / suggestive non-textual image and/or sounds
- h) Irrelevance
- i) Outdated information
- j) Misleading / suggestive use of ESG-related terminology (naming-related greenwashing)
- k) Outright lie (false)
- l) Other (please specify)

Q A.12.11: Please identify the communication channels through which this example of potential greenwashing practice have been communicated

- a) Regulatory documents (including Key Investor Documents or Key Information Documents, Prospectuses, Financial statements, Management Reports, Non-Financial Statements,

- Benchmark statements and methodology documents, insurance-product information documents, pension benefit statements, etc.) and/or any mandatory disclosures
- b) Ratings (ESG ratings and/or other ESG data products)
 - c) Benchmarks
 - d) Labels
 - e) Product information (including internal classifications, and internal target market, product testing and distribution strategy related documentation)
 - f) Intermediary/advice information
 - g) Marketing materials (including website, social media, advertising)
 - h) Voluntary reporting, falling outside previous categories as reported on a voluntary basis

Q A.12.12: Please indicate below if the potential greenwashing practice relates to a stage of the product lifecycle or to business model/management:

- a) Product manufacturing
- b) Product delivery – marketing: advertisements, non-regulatory information
- c) Product delivery – regulatory disclosure
- d) Product delivery – distribution channels
- e) Product delivery – sales: information asymmetry (this includes under or over emphasis of certain product features)
- f) Product delivery – sales: misselling due to misleading information/disclosure
- g) Product delivery – sales: misselling due to unsuitable product
- h) Product delivery – sales: incentives at point of sale
- i) Product management – product monitoring, product review, ongoing product disclosure
- j) Business model at entity level – value chain, group structure, innovation/digitalization, outsourcing
- k) Business management at entity level – culture, governance arrangements, systems and processes)
- l) Not enough information to determine this
- m) Other (please specify)

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Q A.12.13: Is the example of the potential greenwashing practice related to any of the following situations?

- a) Mis-selling (i.e., transaction or investment decisions not actually reflecting the actual preferences of the consumer or investor)
- b) Misclassification
- c) Mis-labelling
- d) Naming
- e) Market-abuse (typically consists of insider dealing, unlawful disclosure of inside information and market manipulation)

Q A.12.13.1: If yes, please explain in further details how:

The product sold does not deliver upon its stated objectives and thus cannot reflect the preferences of the investor. The product is correctly labelled but the label itself allows greenwashing. The naming is misleading as it derives from labels (EU CTB/PAB) that refer to objectives that need not be delivered given the design faults of the regulation.

Q A.12.14: Is this example of potential greenwashing practice the result of a lack of compliance with current EU or national sustainable finance legislation requirements?

No

Q A.12.15: Does this example of potential greenwashing practice relate to a third country entity providing financial services in the EU?

No

Q A.12.16: Please include references/links to supporting materials substantiating this example of potential greenwashing practice.

Greenwashing through ill-design of regulation – EU Climate Benchmarks

2DII

- EU Climate Benchmarks Factsheet - Technical analysis of key elements of the climate benchmark standards and potential solutions, May 2020, <https://2degrees-investing.org/wp-content/uploads/2020/05/2DII-Climate-Benchmarks-Report.pdf>

PAII

- Net Zero Investment Framework Implementation Guide, April 2021

UN-NZAOA

- Development and Uptake of Net-Zero Aligned Benchmarks: A call to action for asset owners and index providers, November 2022.

Scientific Beta

White Papers

- Unsustainable Proposals: A critical appraisal of the TEG Final Report on climate benchmarks and benchmarks' ESG disclosures and remedial proposals, February 2020.
- A Critical Appraisal of Recent EU Regulatory Developments Pertaining to Climate Indices and Sustainability Disclosures for Passive Investment, October 2020.
- Financing the Energy Transition – What is the Role of Fossil Fuels Divestment?, November 2022.

Responses to consultations and public communication with DG FISMA

- Response to the European Commission Call for Feedback on the Draft Delegated Act pertaining to Sustainability Disclosures in the Benchmark Statement, 5 May 2020.

- Response to the European Commission Call for Feedback on the Draft Delegated Act pertaining to EU Climate Benchmarks, 5 May 2020.
- Letter to DG FISMA in relation to the Call for Feedback on Draft Delegated Acts supplementing Regulation (EU) 2016/1011 as regards minimum standards for EU Climate Transition Benchmarks and EU Paris-aligned Benchmarks and as regards the explanation in the benchmark statement of how environmental, social and governance factors are reflected in each benchmark provided and published, 4 May 2020.
- Response to the TEG Call for Feedback on Interim report on Climate Benchmarks and Benchmark ESG Disclosures (summary), 31 July 2019.

Peer-reviewed articles

- Carbon Intensity Bumps on the Way to Net Zero, Frédéric Ducoulombier and Victor Liu, *The Journal of Impact and ESG Investing* Spring 2021.
- Understanding the Importance of Scope 3 Emissions and the Implications of Data Limitations, Frédéric Ducoulombier, *The Journal of Impact and ESG Investing* Summer 2021.
- Doing Good or Feeling Good? Detecting Greenwashing in Climate Investing, Noël Amenc, Felix Goltz and Victor Liu, *The Journal of Impact and ESG Investing* Summer 2022

Questions and Answers specific to the European Securities and Markets Authority

3. Understanding the drivers and the scale of greenwashing risks

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Question F.1. Which, of the elements listed below, do you consider to be the main driver(s) of greenwashing risks?

- a) New / innovative ESG products in rapidly evolving ESG markets
- b) Entry of new participants such as issuers of ESG products, ESG rating or data providers, etc.
- c) Lack of ESG expertise and skills of market participants
- d) A rapidly evolving regulatory framework
- e) Differing interpretations of the regulatory framework
- f) Desire to exaggerate the sustainability profile at entity/product or service level
- g) Competition (wanting to be better than a comparable issuer/product)
- h) Lack of reliable data
- i) Mismatch between retail investors' expectations and market participants' ability to deliver real-world impact

The development of sustainable investment and disclosure regulation in the European Union has outpaced the regulator's abilities and sometimes the ability of the industry to comply with the rules despite reasonable if not best efforts. See A4.1./A6.1. in respect of DR 2020/1818. See Ducoulombier (2020) on how DR 2020/1817 goes beyond or even reinterprets Regulations (EU) 2019/2089 and (EU) 2016/1011. The drafting of Regulation (EU) 2019/2088 allowing for divergent interpretations remains an issue to this date.

Question F.2. As stated before, this CfE uses the term greenwashing broadly, covering sustainability-related claims relating to all aspects of the ESG spectrum. While the sustainable finance legislation gives more prominence to environmental aspects, we would like to understand which aspects of the ESG spectrum may be more prone to greenwashing risks, at this stage

| | 1 = very low occurrence | 2 = low occurrence | 3 = medium occurrence | 4 = high occurrence | 5 = very high occurrence |
|--------------------------|-------------------------|--------------------|-----------------------|---------------------|--------------------------|
| a) Environmental aspects | | | | | • |
| b) Social aspects | | | | • | |
| c) Governance aspects | | | • | | |

Question F.8. Which industry initiative(s) do you see as instrumental in tackling greenwashing?

We consider that initiatives standardising definitions and processes can play an instrumental role in improving the relevance of disclosure, reducing the leeway for greenwashing, and improving the potential for investor impact. However, standardisation initiatives are not immune to capture by interest groups or bona fide design flaws. In matters pertaining to net-zero investment, the work of the PAII and the UN NZAOA shows considerably more depth and relevance than that displayed by the regulator in 2020 / 1818.

More fundamentally, establishing (environmental) sustainability definitions in a manner consistent with planetary boundaries (as understood by science) is a prerequisite to avoid greenwashing and greenwashing (the Sustainable Development Goals may be used as a norm to anchor sustainability definitions that may not be related to planetary boundaries). To make an understatement, the definition of sustainability given by the International Sustainability Standards Board (in its release of 14 December 2022) does little to clarify the subject matter and combat greenwashing: "Sustainability will be described (...) as the ability for a company to sustainably maintain resources and relationships with and manage its dependencies and impacts within its whole business ecosystem over the short, medium and long term."

Question F.9. Which do you think are the market mechanisms that can help mitigate greenwashing risks (e.g. reputational issues) and how do you believe supervisors can help in this respect?

See answer to Question F.10.

Question F.10. Beyond what is already being done, what could policymakers and regulators do to alleviate greenwashing risks?

The obvious priority for policy makers should be to correct market failures created by externalities and retire anti-sustainability policies (e.g., direct and indirect subsidies to fossil fuel production/consumption). Regulatory action pertaining to the mitigation of sustainability washing should be focused on promoting publicity, transparency and comparability of sustainable investment goals, processes, impact channels, and performance – the task is considerable. Beyond that a modest approach that has the regulator require that providers demonstrate the fitness for purpose of their approaches may be superior to an approach where the regulator attempts to define granular technical criteria for products (with high risks of unintended, including, counterproductive, consequences).

Appendix

As explained in Ducoulombier (2019): "Responsible investing has traditionally been concerned with the imposition of ethical standards on investment and the promotion of a progressive ESG agenda – through engagement, divestment, and investment in relation to the ESG performance of companies in the investment universe (and, more modestly in terms of capital deployed, through targeted investment in ventures with clear environmental or social purposes). While responsible investing was initially motivated by deontological ("dissociate from harm") or consequentialist ethical concerns ("do no harm" and "do good"), some of its promoters attempted to increase its marketability by contending that it could produce superior risk-adjusted financial rewards ("do well"), at least in the long-term, to try and address the fiduciary concerns of investors showing interest in a progressive ESG agenda but lacking a clear investment mandate ("do good and do well") and to appeal to business-as-usual investors ("do well by doing good").

In 2005, to remove a roadblock that was hampering the incorporation of ESG considerations into mainstream investment, the United Nations Environment Programme Finance Initiative (UNEP FI) commissioned the law firm Freshfields Bruckhaus Deringer to determine whether it was "voluntarily permitted, legally required or hampered by law and regulation." The firm concluded that the practice was "clearly permissible and is arguably required in all jurisdictions" where its objective was to "more reliably predict financial performance", that it was arguably required in the presence of a consensus amongst the beneficiaries and that it was permissible as a tiebreaker when faced with options that are equally attractive from a financial standpoint (Freshfields Bruckhaus Deringer, 2005, hereafter "the Freshfields report").

The Freshfields report was celebrated as a turning point in the debate on fiduciary duty and ESG investment and for this reason was generally welcomed by proponents of responsible investment. However, it did not put an end to that debate in the institutional investment industry and it should not have been a cause for celebration for proponents of traditional responsible investment since accepting its conclusions clearly makes the pursuit of a progressive ESG agenda contingent on financial considerations in most cases. In the absence of a progressive ESG investment mandate, these conclusions externalise ethical agency to governments and society at large (to use a concept discussed by Welker and Wood, 2011). With respect to the Freshfields report, there is basis to adopt the view of Sandberg (2011) and consider that its conclusions mean that, absent a progressive mandate, Socially Responsible Investing (SRI) "could only be reactive and never truly proactive" and that ESG concerns could only be taken into account once the desirability of doing so "has become widely recognised in society." While we would argue that uncertainty about the impact of ESG issues and the general fiduciary standard of prudence provide some leeway for progressive ESG investment strategies supported by a resilience justification, the conclusions of the Freshfields report have been used to promote business-case ESG incorporation and reshape the responsible investing industry.

Today, responsible investing as defined by PRI, the largest ESG-focused organisation in the investment management industry, no longer requires a progressive ESG agenda or even a positive ESG impact, and the amoral incorporation of ESG information into standard investment decision making ("do well with ESG data"), which is promoted negatively as

a fiduciary obligation for any investor (evidently where such data concern issues with potential financial materiality, as underlined by the Freshfields report) and positively as a way to improve risk management and return generation, is sufficient to claim the responsible investing badge. Naturally, hosting ESG regressive investment strategies under the banner of responsible investing is fraught with reputational risk for the entire industry and in this regard, it is interesting to remark that "mistrust and concerns about greenwashing" is cited ahead of lack of advice, performance concerns or risk management issues as the main hindrance to the adoption of responsible investing (Eurosif, 2018)."

In support of this analysis, one may remark that PRI signatories commit to adopt and implement the Principles for Responsible Investment, *where consistent with their fiduciary responsibilities* and that the origins of the PRI are clearly linked to the idea that ESG issues may have financial materiality [In the words of the UN Global Compact (UNGC, 2023), the six principles "reflect the view that ESG issues can affect the performance of investment portfolios and therefore must be given appropriate consideration by investors if they are to fulfil their fiduciary (or equivalent) duty." Past PRI literature explained that the PRI had been "established as a framework to help institutional investors achieve better long-term returns through better analysis of ESG in the investment process and the exercise of responsible ownership practices" (see for example UNEP FI and PRI, 2008) or claimed that the end-goal of responsible investment was "to better manage risk and generate sustainable, long-term returns" (see for example PRI, 2019). The PRI (2023a) contends that by implementing these principles, signatories contribute to developing a *more sustainable global financial system* (our emphasis).] The Signatories' commitment points to the conclusions of Sandberg (2011) about the reactive nature of responsible investment established on financial materiality (the document requires signatories to opine on the belief that applying the principles will not only improve their "ability to meet commitments to beneficiaries" but also "better align (...) investment activities with the broader interests of society." (PRI, 2023b)).

However, the PRI is attempting a reinvention. Its updated definition of sustainable investment recognises the diversity of responsible investors: "Some focus exclusively on financial returns and consider ESG issues that could impact these. Others aim to generate financial returns and to achieve positive outcomes for people and the planet, while avoiding negative ones." (PRI, 2023b) Furthermore, its latest strategic blueprint (PRI, 2017) ambitions "to bring responsible investors together to work towards sustainable markets that contribute to a more prosperous world for all" and includes a section titled "Enable Real-World Impact Aligned with the SDGs."

This shift towards real-world impact of investment has been characterised by some stakeholders as a major change of orientation that should have been approved by a formal vote of signatories – we concur with this analysis.

The PRI has adapted to the pushback by representing that impact feeds back into financial risks; it has identified its 2021-2024 strategy theme as "Building a bridge between financial risk and real-world outcomes" and explains that: "Increasingly, our signatories

are recognising that the real-world sustainability outcomes they contribute to shaping through their investment activities will feed back into the financial risks they face. For this reason, Building a bridge between financial risk, opportunities and real-world outcomes is a key element of this strategy. In the coming three years, the PRI will help signatories understand what this looks like in practice, how to integrate and how to measure outcomes, while remaining grounded in fiduciary duty and the broader role of investors in society." (PRI, 2021).

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About EDHEC-Risk
Climate Impact Institute

Exploring double materiality – studying the impact of climate-change related risks on finance and the effects of finance on climate change mitigation and adaptation

Institutional Context

Established in France in 1906, EDHEC Business School now operates from campuses in Lille, Nice, Paris, London, and Singapore. With more than 110 nationalities represented in its student body, some 50,000 alumni in 130 countries, and learning partnerships with 290 institutions worldwide, it truly is international. The school has a reputation for excellence and is ranked in the top 10 of European business schools (Financial Times, 2021).

For more than 20 years, EDHEC Business School has been pursuing an ambitious research policy that combines academic excellence with practical relevance. Spearheaded by EDHEC-Risk Institute, its aim is to make EDHEC Business School a key academic institution of reference for decision makers in those areas where it excels in expertise and research results. This goal has been delivered by expanding academic research in these areas and highlighting their practical implications and applications to decision makers. This approach has been complemented by strategic partnerships and business ventures to accelerate the transfer of scientific innovation to the industry and generate financial benefits for the School and its constituencies.

In the Fall of 2022, EDHEC-Risk Institute became EDHEC-Risk Climate Impact Institute (EDHEC-Risk Climate). This transition reflects the importance assigned by the School to sustainability issues and builds on the foundations laid by EDHEC-Risk Institute research programmes exploring the relationships between climate change and finance.

Mission and Ambitions

EDHEC-Risk Climate's mission is to help private and public decision makers manage climate-related financial risks and make the best use of financial tools to support the transition to low-emission and climate-resilient economies.

Building upon the expertise and industry reputation developed by EDHEC-Risk Institute, EDHEC-Risk Climate's central ambition is to become the leading academic reference point helping long-term investors manage the risk and investment implications of climate change and adaptation and mitigation policies.

EDHEC-Risk Climate also aims to play a central role in helping financial supervisors and policy makers assess climate-related risks in the financial system and provide them with financial tools to mitigate those risks and optimise the contribution of finance to climate change mitigation and adaptation.

The delivery of these ambitions is centred around two long-term research programmes and a policy advocacy function.

The research programmes respectively look at the Implications of Climate Change on Asset Pricing and Investment Management and the Impact of Finance on Climate Change Mitigation and Adaptation.

The Institute also supports the integration of climate issues into the research agenda of the School's other financial research centres and into the product offering of the School's business ventures. In particular, it helps leading infrastructure research centre EDHECinfra build capacity on sectoral alignment and transition plans.



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