association of the
luxembourg fund industry

Luxembourg, 10 January 2023

Targeted response to the ESAs call for evidence on better understanding greenwashing

Introduction

The Association of the Luxembourg Fund Industry (ALFI) represents the face and voice of the Luxembourg asset management and investment fund community. The Association is committed to the development of the Luxembourg fund industry by striving to create new business opportunities, and through the exchange of information and knowledge.

Created in 1988, the Association today represents over 1,500 Luxembourg domiciled investment funds, asset management companies and a wide range of business that serve the sector. These include depositary banks, fund administrators, transfer agents, distributors, legal firms, consultants, tax advisory firms, auditors and accountants, specialised IT and communication companies. Luxembourg is the largest fund domicile in Europe and a worldwide leader in cross-border distribution of funds. Luxembourg domiciled investment funds are distributed in more than 70 countries around the world.

We thank the ESAs for the opportunity to participate in this call for evidence (CfE) on better understanding greenwashing.

Response to selected parts of the Questionnaire

C. <u>ESAs common section of the CfE</u>

1 Possible features of greenwashing

1.1 Core features or greenwashing

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.

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Prior editorial remark: We responded to specific questions only in order to convey the messages that are most important to our Members. For other questions we therefore either referenced our responses or answered with “Don’t know” / “NA”.

Concerning the features of greenwashing, we refer to our responses under Q A.2 regarding the definition of greenwashing and the element of intent that we consider as crucial, and to the list with main drivers of greenwashing under Q F.1. Based on the considerations stated therein, the following should **not** be considered as intentional greenwashing (non-exhaustive):

c) Lack of ESG expertise and skills of market participants. We believe that these aspects should be dealt with by existing regulatory measures and the sectorial regulatory framework.

e) Differing interpretations of the regulatory framework. The piecemeal implementation of SFDR and other incomplete aspects of the sustainable finance (SF) framework have caused significant legal uncertainty, necessarily resulting in differing/changing interpretations of the legal text. It is quite difficult to address greenwashing in a proper way as long as key definitions are still missing (e.g. sustainable investments/promotion of ESG characteristics). Before envisaging any additional legislative initiative relating to greenwashing, it is essential to see how the existing framework can be clarified. Diverging interpretations at national level should be avoided as these can create confusion/inequality/mis-interpretation/mistrust in the EU SF sector.

h) Lack of reliable data. The requirement to disclose data under SFDR but at the same time not yet having the regulatory framework in place (i.e. the staggered application dates in Art. 8 TR DA and the CSRD) to ensure that reliable data is available has been one of the most serious shortcomings of the EU SF framework. Ref. is also made to the speech of Ms Ross on 31 May 2022 stating that "In an ideal world, the disclosures required for financial market participants [FMPs] and financial products would have followed a comprehensive corporate transparency regime. […] Despite these challenges, we need to move ahead urgently with what we have."

i) Mismatch between retail investors' expectations and market participants' ability to deliver real-world impact. As acknowledged by Ms Ross in her speech, "the disclosures to investors in the SFDR are complex by nature and difficult for especially retail investors to understand". We also received the feedback by some Members that features of funds disclosing under art. 8/9 SFDR/impact funds are often not well understood. In this context, the influence of media should not be underestimated. Financial literacy will help to improve retail investors' understanding of the nature and main features of financial products and to create realistic expectations about the performance (ref. is made to the ALFI response to the EC RIS consultation). Transparency on methodologies, ESG scoring, data sources etc. also fosters better understanding and is at the same time a major tool to avoid greenwashing.

j) *Other*

- Incomplete/incorrect information reported in good faith
  FMPs should not be treated as greenwashers where they rely in good faith on ESG data obtained from direct investments/third parties, provided appropriate due diligence was carried out on such investments/data providers.

- Issues linked to timing
  In the context of the EU Green Deal and the long-term nature of transition to net zero, circumstances will change, new technologies and types of data be developed. Transition also necessarily means that many companies today are "brown" or not as "green" yet and transition plans will be amended over time, KPIs added/modified/removed, etc. FMPs adapting their investment strategies/processes/disclosures/reporting based on the information available at a certain point in time is clearly not greenwashing, but reacting to new circumstances.

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

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Ref. to our answers to Q A.1 and QF.1., we would like to address our considerations reg. a specific definition of greenwashing based on discussions within the respective ALFI working group.

First, we stress that greenwashing is subjectively interpretable and entails many challenges, both for investors (reg. in particular their risks of being subject to fraudulent activities and eventually mis-investing) and the financial industry (reg. in particular their litigation and reputational risks). Most importantly, any definition of "greenwashing" should be clear and provide legal certainty for the benefit of all stakeholders.

We are therefore of the view that the main characteristic of greenwashing should be intent. Recital 11 TR (cf. also recital 16 SFDR RTS) provides some guidance and supports the notion of intent being a key aspect (emphasis added):

"greenwashing refers to the practice of gaining an unfair competitive advantage by marketing a financial product as environmentally friendly, when in fact basic environmental standards have not been met."

The "practice of gaining an unfair competitive advantage" implies an intentional action/omission to receive such an advantage. The "marketing" of a product also contains an intentional aspect in line with general investor protection rules.

Greenwashing extends of course to S and G aspects, despite the quote only referencing the existing environmental Taxonomy.

The notion of "mis-representation" (used by the FCA/IOSCO) is also an important criterion relating to intent. In its final Recommendations of Nov. 2021, IOSCO states "[…] the term greenwashing" refers to the practice of misrepresenting sustainability-related practices or the sustainability-related features of investment products. In the 'race to promote their green credentials,' some asset managers may misleadingly label products as sustainable without meaningful changes in the underlying investment strategies or shareholder practices." Mis-representation to promote green credentials includes the aspect of intent as well.

Linking greenwashing to intent is of paramount importance given the risk of regulatory sanctions (which should be envisaged only in case of intent) and civil litigation. Documented evidence from the time of investment should be required to prove greenwashing.

Furthermore, the definition of greenwashing should not lead to a too broad interpretation. Otherwise, FMPs may not further develop ESG/sustainable products fearing to fall under the definition and potential reputational damage (i.e. so-called green bleaching). Then the objective to re-orient private capital flows to sustainable investments may be undermined.

Ref. to point 1.1, 6) in the CP on which market participant can trigger greenwashing, given that greenwashing is business misconduct per se, it is in our view important to clarify who is responsible for which contribution to greenwashing, instead of using the different roles (trigger/receiver/spreader) detached from these considerations (e.g. in case of wrong information by the investee company, the spreader can also be the receiver).

Moreover, it should be kept in mind that there are already legislations/GL such as SFDR, TR, CSRD, ESMA marketing GL, that address (also) greenwashing risks, via disclosure requirements and adoption of standards/common criteria. It is important that the existing framework is fit for purpose. In view of that, we believe it is ultimately the responsibility of the legislator to provide a clear definition which is well embedded into the existing regulatory framework. This would also serve a harmonization of this term on EU and international level.

As a final consideration it can be questioned whether it is the right time to review greenwashing, while a consultation on fund names was launched and the EC has announced an assessment of SFDR and new workstreams on SFDR/TR implementation, or whether the outcome of these initiatives should not be awaited first.

F. <u>ESMA section of the CfE</u>

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

[multiple answers possible]

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

j) Other, please specify below

Question F.1.j. You selected "j) Other", please specify:

100 character(s) maximum

Should **not** be greenwashing:

*c);e);h);i);*j) Incompl. info reported in good faith; timing issues

Please elaborate briefly on the answer to question F.1

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Given that we believe "intent" must be key to any greenwashing, the said points listed above (i.e. c); e); h); i), j)) should **not** constitute greenwashing. We refer to our answer under Q A.1.