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EU Financial Markets Watchdog Promises Action on Greenwashing

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The European Securities and Markets Authority ("ESMA") published its Sustainable Finance Roadmap on February 10, 2022, which outlines a regulatory roadmap for the 2022–2024 period (the "Roadmap"). The Roadmap is of significance to sponsors in the European Union ("EU") and outside the EU because of its focus on "implementation steps" necessary to eliminate greenwashing from the financial markets. ESMA, through the Roadmap, prioritises continued regulatory focus on creating more consistency and transparency around environmental, social and governance ("ESG") and climate claims and attributes of financial market participants (for example, in offering documents), while at the same time cracking down on practices that could be misleading to investors — a notable trend in the EU as well as the UK and U.S.[1]

The Roadmap begins by identifying key sustainable finance challenges in the EU, including:

- a "fast-evolving" regulatory framework that is leading to **inconsistency across regulatory requirements and complexity for investors**;
- diversity in the interpretation and application of sustainable finance legislation;
- **"growing demand for ESG investments not being matched by adequate transparency and comparability of the real sustainability impact of the financial products available"**; and
- the need for greater transparency on the reality of transition efforts by asset managers on the road to net zero.

To address these and other challenges, ESMA will take actions in three key priority areas:

1. tackling greenwashing and promoting transparency;

2. building national competent authorities' and ESMA's capacities; and
3. monitoring, assessing and analysing ESG markets and risks.

With respect to tackling greenwashing, ESMA notes that "[i]nvestigating the complex issue of greenwashing, getting to defining its fundamental features and taking coordinated action in multiple sectors . . . is key to deliver on ESMA's . . . mandate to secure investor protection." ESMA views greenwashing as intentional or unintentional market practices whereby the publicly disclosed sustainability profile, or the characteristics or objectives, of a fund — either by action or by omission — do not accurately reflect the underlying sustainability risks and impacts associated with that fund. Crucially, ESMA notes that "the causes of greenwashing may relate to multiple aspects of the functioning of the investment value chain, **sometimes affecting nodes of that chain long before a certain financial product reaches the final investor."** It therefore presents a broad view of sustainability claims and the risk management systems that underpin such statements, which could signal deeper scrutiny of manager's sustainability and ESG programs in the future as part of the enforcement mechanism for the Sustainable Finance Disclosure Regulation ("SFDR"). For example, regulators could ultimately seek to make EU investment funds responsible if an ESG claim is misleading due to inaccurate data provided by investee companies, which could have reverberations outside of the EU market.

The Roadmap also includes the following notable actions and insights:

- ESMA will assess greenwashing practices and develop a common understanding on greenwashing, including by analysing disclosures under Article 8 and 9 of the SFDR.
- When investigating greenwashing, ESMA will examine wrongful disclosure, mis-selling and the lack of clear labels *in addition to* the availability and quality of data. Data availability issues stem from difficulties in data gathering, partly due to insufficient granularity of the information being disclosed by companies. For EU companies, as the Corporate Sustainability Reporting Directive (which will oblige EU companies to disclose detailed ESG information) will not kick in until the 2024 reporting season at the earliest, investors and regulators will "have to cope with the current sub-optimal status of sustainability reporting . . . for some years."
- ESMA will contribute to the European Commission's planned work on **minimum sustainability criteria, or a combination of criteria**, for financial products that disclose under Article 8 of the SFDR.
- ESMA will work to clarify the Principal Adverse Impacts on sustainability factors ("PAIs" or "PASI") under the SFDR.
- ESMA will enhance its monitoring of developments in ESG markets and risks, in particular the EU carbon markets.

- Climate scenario analysis for investment funds is envisaged, including through bottom-up climate stress testing and a one-off stress test to assess the resilience of investment funds in line with the EU's Fit-for-55 package.

ESMA has promised to create a clear sustainable finance rulebook, accompanied by Q&As and Guidelines, which are to follow in due course. We will continue to monitor these and other EU regulatory developments related to ESG.

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1. We have previously written about ESG- and climate-focused regulatory initiatives in the U.S., UK, and EU. See, e.g., "EU and UK Regulatory Update for Fund Managers" (July 19, 2021); "Risk Alert: SEC's Examination Division Issues ESG Risk Alert for Investment Advisers" (April 19, 2021); and "Enforcement Task Force Announcement is Latest Sign of SEC Focus on ESG and Climate" (March 8, 2021).↩

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Suggested Reading

- 17 March 2022 Speaking Engagement Webinar: NFA 2022 Trends – Are You Prepared for NFA Exams?
- 03 March 2022 Sponsored Event PEI's Responsible Investment Forum: New York 2022
- 23 February 2022 Press Release Kirkland Advises TPG Rise and Element Markets on the Acquisition of Bluesource and the Merger of Bluesource with Element