Fighting greenwashing ... what do we really need?

A review of the legislative and regulatory framework
applicable to environmental impact
claims of financial products and concrete propositions to fight
greenwashing more efficiently

2° investing initiative

Executive Summary

With increasing client preferences for sustainable investment, it is little surprise to observe a concurrent increase in marketing claims by financial institutions relating to the environmental credentials of their financial products and services.

At the same time, the problem of greenwashing is fast climbing the policy and regulatory agenda. Apart from the consumer protection implications that greenwashing may entail, the issue also casts doubt on whether financial markets are genuinely responding to the changing profile of client preferences for sustainable investment. This distortion of market integrity may even undermine broader sustainable finance policy objectives.

Addressing greenwashing is a key focus for the European Commission and comes despite the raft of sustainable finance disclosure requirements introduced under the Sustainable Finance Disclosure Regulation (**SFDR**) and Taxonomy Regulation and voluntary ecolabels in the finance sector. This emerging body of sustainable finance disclosure requirements does little to assist environmental impact claims for financial products or services.

In the finance sector context, it is useful to distinguish environmental impact claims as a specific sub-category of broader environmental claims which refer to the practice of suggesting or otherwise creating the impression that a financial product or service has a real-economy impact which is positive for the environment (as opposed to broader statements in relation to environmental features which may be evident for a financial product or service).

This paper reviews the regulatory framework which is applicable to environmental impact claims in the finance sector and the extent to which this regulatory framework provides adequate governance of these claims. Several pieces of EU legislation (both finance sector specific regulation and consumer protection regulation) are potentially applicable, though none are sufficient to prevent greenwashing based on environmental impact claims.

While general finance rules are applicable to environmental impact claims in the finance sector, these rules are too general and high level to provide effective governance of environmental impact claims. And sustainable finance rules do not provide further assistance since they are not adapted to regulate environmental impact claims. Indeed, the current sustainable finance regulation does not integrate the concept of investor impact and consequently is not aligned with current academic theories of attribution differentiating investee company impact and investor impact. Even worse, market practices that use SFDR categories as marketing labels may create additional confusion and greater risk of greenwashing, especially when combined with environmental impact claims.

Moreover, consumer protection rules stemming from the Unfair Commercial Practices directive (**UCPD**) are also not sufficient to regulate environmental impact claims in the finance sector. Indeed, the absence of a definition of environmental impact of the investor and the lack of recognised tools and methodologies to evaluate the potential of impact prevent the efficient application of UCPD rules in the finance sector.

All these issues identified at EU level are compounded by variability of approach at Member State level. National rules applicable to environmental impact claims show a lack of harmonisation not only in the content of the rules but also in their core logic, creating legal uncertainty for financial institutions and unequal levels of protection for retail investors in Europe.

Further problems for effective governance of environmental impact claims are apparent when analysing regulatory oversight and enforcement and the legal framework for investor redress. Regulatory authorities and retail investors will be confronted with the fact that it is impossible to demonstrate an environmental impact claim is in breach of a clear set of regulatory provisions. Moreover, considering it is difficult (or near to impossible) to prove the loss caused by the misleading environmental impact claim, current investor redress mechanism cannot be efficient.

To address the problems in the current regulatory framework, this paper identifies recommendations which are conceived so that they refine and improve the focus of several initiatives and activities which are already apparent in the EU sustainable finance policy agenda:

- As a first step, the Commission should provide specific rules at EU level to regulate environmental claims in the finance sector with a focus on environmental impact claims.
- Further steps to integrate the notion of environmental impact in the finance sector are necessary. These include: (1) creating a category for impact-oriented products; and (2) developing methodologies and tools to evaluate the impact potential.
- Developing guidance for responsible environmental impact claims can assist financial institutions with regulatory compliance.
- Further research is required to identify suitable adaptations to the redress framework to ensure it is not a barrier to retail investors who want to take action against financial institutions in respect of misleading environmental impact claims.
- Finally, assessing supervisory activities and capabilities in relation to the current regulatory framework to analyse where it impedes the effective discharge of oversight responsibilities in relation to environmental impact claims should assist with enhancing market integrity.

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About

The 2° Investing Initiative (2DII) is an international, non-profit think tank working to align financial markets and regulations with the Paris Agreement goals.

Globally focused with offices in Paris, New York, Berlin, London and Brussels, 2DII coordinates some of the world's largest research projects on sustainable finance. Our team of finance, climate and risk experts develop research, tools, and policy insights to help financial institutions and regulators hasten and adapt to the energy transition.

In order to ensure our independence and the intellectual integrity of our work, we have a multi-stakeholder governance and funding structure, with representatives from a diverse array of financial institutions, governments and NGOs.

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Introduction

With increasing client preferences for sustainable investment, it is little surprise to observe a concurrent increase in marketing claims by financial institutions relating to the environmental credentials of their financial products and services. For sustainability minded retail investors, these environmental marketing claims are likely to impact the decision-making dynamics of whether to invest in financial products and services and will therefore be a key part of a financial institution's marketing strategy. Alongside the growth in environmental marketing claims, the problem of greenwashing is climbing the policy and regulatory agenda. Apart from the consumer protection implications that greenwashing may entail, the issue also casts doubt on whether financial markets are genuinely responding to the changing profile of client preferences for sustainable investment. This distortion of market integrity may even undermine broader sustainable finance policy objectives.

Addressing greenwashing is a key focus for the European Commission and comes despite the raft of sustainable finance disclosure requirements introduced under the Sustainable Finance Disclosure Regulation (**SFDR**) and Taxonomy Regulation[1] and voluntary ecolabels in the finance sector. However, this emerging body of sustainable finance disclosure requirements does little to assist environmental impact claims for financial products or services. Environmental impact claims are a specific sub-category of broader environmental claims and refer to the practice of suggesting or otherwise creating the impression that a financial product or service has a real-economy impact which is positive for the environment (as opposed to broader statements in relation to environmental features which may be evident for a financial product or service)[2]. 2DII research continues to provide empirical evidence that a significant proportion of clients are impact-oriented - therefore it is these environmental impact claims which are most important for these impact-oriented retail investors.

This paper is addressed to the legislator and regulators at EU level and may be of interest for national legislators and regulators. It reviews the regulatory framework which is applicable to environmental impact claims in the finance sector. It then reviews the extent to which this regulatory framework provides adequate governance of environmental impact claims in the finance sector and articulates recommendations for where improvements need to be made. This analysis covers regulation at EU level and that of six Member States: Spain, Germany, Belgium, Luxembourg, France and the Netherlands.[3]

- Section 1 summarises 2DII's most recent research on client preferences for sustainable investment with a specific focus on impact-oriented financial products. It then analyses the problems attendant to environmental impact claims in the finance sector and how these contribute to the increasing problem of greenwashing.[4]
- Section 2 provides a high-level summary of the regulatory framework that may apply to environmental impact claims in the finance sector. It analyses the finance sector specific regulation which requires communications to be fair, clear, and not misleading. It demonstrates the emerging body of sustainable finance rules is not adapted to regulate environmental impact claims. It then focusses on the application of consumer protection regulation in the finance sector context before analysing the variation in national implementation of these rules.
- Section 3 analyses how the current procedure for regulatory oversight and enforcement and investor redress is not effective in the context of environmental impact claims in the finance sector.
- Section 4 identifies recommendations to address the problems identified in this paper and ensure better market practice in relation to environmental impact claims in the finance sector.
- Section 5 sets out concluding remarks.

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[1] As well as the reporting requirements under the Non-Financial Reporting Directive shortly to be replaced by the Corporate Sustainability Reporting Directive.
[2] Impact claims can also refer to social impacts however in this report we only focus on environmental impact claims.
[3] These Member States are the focus countries for the LEVEL EEI project and were selected according to criteria defined for that project (including volume of savings, capacity to engage effectively in that jurisdiction etc.)
[4] Or more precisely *Impact washing*

Section 1

Greenwashing in the context of environmental impact claims

This section summarises 2DII's most recent research on client preferences for sustainable investment with a specific focus on impact-oriented financial products. It then analyses the problems attendant to environmental impact claims in the finance sector and how these contribute to the increasing problem of greenwashing.

1.1 Client preferences for impact-oriented financial products

A growing number of consumer surveys and behavioural finance experiments point to the increasing importance of sustainability considerations in client investment decisions.[5]

2DII's first research in this area involved a series of quantitative and qualitative surveys conducted in France and Germany and identified that 65% to 85% of retail clients say they want to invest more sustainably when they are asked.[6] But 'wanting to invest more sustainably' or 'being interested in sustainable investment' is a somewhat superficial analysis of the guiding sustainability motivations which retail clients have or what outcomes clients actually expect and why. Our research programme has sought to dig deeper into these granular details to understand how – if at all – these expectations intersect with the broad range of financial products available which integrate sustainability features in product design.

Our most recent research at the end of 2021 consisted of a survey in six European countries.[7] This was designed to increase the evidence base regarding household beliefs and preferences in relation to sustainable finance and reveal any variations in client preferences for sustainable investment and level of interest of European retail investor by country.

We asked a series of questions regarding the extent to which client investment decision making features one or more of the following financial/sustainability goals: (1) aligning investments and savings with values (*value alignment*); (2) achieving an impact in the real world (*achieving impact*); and (3) achieving maximum return for a certain level of risk (*maximising return*). This enabled us to generate a typology of seven profiles, either pure (focussing on one goal only) or mixed (incorporating two or three goals).

Select results from this research[8] are as follows:

- In all countries most participants fall in mixed profiles: from 50% in Denmark to 71% in Romania (60% on average).
- Overall, maximizing return is the most frequently cited sustainability/financial goal: from 62% in Ireland to 78% in Romania (68% on average).
- But just a small minority of participants *only* care about maximising returns (20% on average) leaving 80% having at least one sustainability goal.
- Value alignment is the second most cited goal: from 47% in Denmark to 75% in Romania (60% on average).
- Achieving impact is important for a significant fraction of participants: from 35% in Denmark and Estonia to 61% in Romania (46% on average i.e. almost half of all participants).

[5] See summary of third-party research in 2DII, 2020, A Large Majority of Retail Clients Want to Invest Sustainably
[6] 2DII, 2020, A Large Majority of Retail Clients Want to Invest Sustainably
[7] Denmark, Estonia, Germany, Greece, Ireland and Romania
[8] 2DII, 2022, What do your clients actually want?

These findings are broadly aligned with our previous research findings that 42% of retail investors want to have a positive environmental impact in the real economy through the way in which their money is invested.[9]

1.2 Exposition of an environmental impact claim in the finance sector

Our research reveals that most participants fall in mixed profiles which means that they have more than one financial/sustainability goal to balance. But the fact that nearly half of retail investors have a goal to achieve impact means that environmental impact claims associated with a financial product or service may influence their investment decisions.

While we are not aware of any formal legal or regulatory definition of an environmental claim, the following definition is taken from formal EU guidance on the topic:

'The expressions "environmental claims" or "green claims" refer to the practice of suggesting or otherwise creating the impression (in the context of a commercial communication, marketing or advertising) that a product or a service, is environmentally friendly (i.e. it has a positive impact on the environment) or is less damaging to the environment than competing goods or services. This may be due to, for example, its composition, the way it has been manufactured or produced, the way it can be disposed of and the reduction in energy or pollution which can be expected from its use.'[10]

The practice of providing environmental claims arose in the consumer goods sector and it is through this lens that much of the guidance and understanding has developed. However, in the finance sector context, it is useful to distinguish between environmental claims and *environmental impact claims*, which are a subset of environmental claims and refer to the specific practice of suggesting or otherwise creating the impression that a product or service has a real-economy impact which is positive for the environment (i.e. *environmental impact*).

There are several aspects which relate to why this distinction between environmental claims and environmental impact claims is useful in the finance sector context.

Environmental claims in the finance sector do not always relate to environmental impact

Many environmental marketing claims in the finance sector do not communicate information about environmental impact *per se*, but rather about various environmental features which a financial product might have.

An example of this is where the marketing claim relates to the thematic criteria which an investment fund adopts for its portfolio holdings. These thematic criteria may be constructed on a negative basis (e.g. avoiding investing in specific sectors) or a positive basis (e.g. focus on investing in predefined sectors). And while these marketing claims certainly feature in the investment decision making of sustainability minded retail investors, they do not explicitly communicate information on environmental impact.

Investor impact is not the same as investee company impact

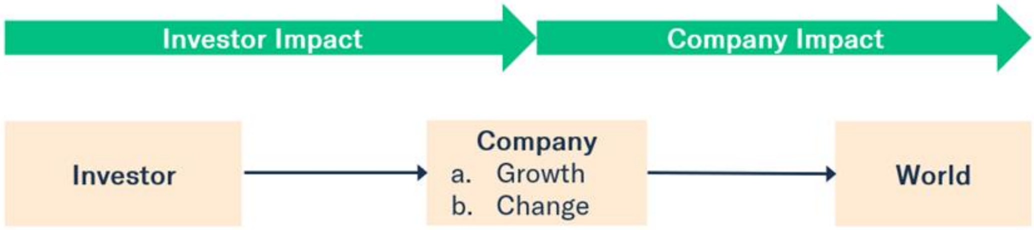
If we take the climate context as an example, *investor impact* can be defined as the change that the investor causes in the activities of real-economy actors (most often the investee company benefitting from the investment) that directly or indirectly reduces GHG emissions. Meanwhile *investee company impact* is the change that the company has caused in the real economy. Note that either investor impact or investee

[9] 2DII, 2020, A Large Majority of Retail Clients Want to Invest Sustainably
[10] Multi-stakeholder Dialogue on Environmental claims, 2016, Compliance Criteria on Environmental Claims: Multi-stakeholder advice to support the implementation/application of the Unfair Commercial Practices Directive 2005/29/EC

company impact can be positive (e.g. a reduction in emissions) or negative (e.g. an increase in emissions). In this paper, we refer to impact as meaning a positive impact.

Therefore, investor impact is not synonymous with investee company impact. In the climate context, investor impact is the extent to which the investor has caused the investee company to grow its green activities (e.g. a growth in green power production) or improve the quality of the investee company's activities (e.g. an increase in the energy efficiency of a plant).[11] But it is not legitimate for the investor to claim that its impact equates to all the positive investee company impact (the investor may have done nothing to bring about the investee company impact, or the investee company may have financing arrangements with multiple investors etc.).

Figure 1: A synthetic definition of investor impact (Kölbel et al., 2020)



Investor impact therefore designates a causal, demonstrable relationship between an investor's action and a real-world change (in the climate context a reduction in GHG emissions). Many factors (beyond the investor's actions) can affect investee company activities (e.g. consumer pressure, regulations, etc.). But assessing investor impact therefore requires being able to effectively identify which specific investee company activities are attributable to the actions of the investor.[12]

1.3 Difficulties demonstrating investor environmental impact

Because *investor impact* is not the same as *investee company impact,* this means that allocating environmental impact in the finance sector is a challenge.

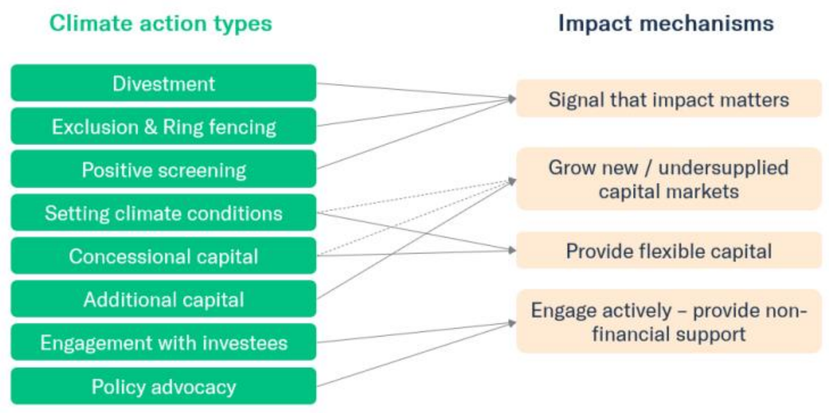
Investor impact can be delivered through implementing various *climate actions* that mobilize one or more different *impact mechanisms*.

[11] Kölbel et al., 2020, Can Sustainable Investing Save the World? Reviewing the Mechanisms of Investor Impact.
[12] Note that *investor impact* can refer to the financial institution impact or to retail investor impact (either through direct investment in investee companies or through an indirect investment with a financial institution intermediary). For the purpose of this paper, we do not propose to dig further into the distinction between financial institution and retail investor impact since the more crucial issue related to the distinction between investor impact (retail or institutional) and investee company impact.

Table 1: Classification of impact mechanisms

Active engagement	Engagement can include a wide spectrum of approaches - dialogue with companies, creation of industry standards, taking board seats and management support (often seen in private equity), that all contribute to the same goal: improving the sustainability performances of the targeted companies. The mechanism can be split into two main categories: provide non-financial support, and investee engagement. 2DII suggests extending this impact mechanism to policy advocacy, to capture the influence that investors can exert on policy makers.
Growing new or undersupplied capital markets	Investors can provide capital to new or previously overlooked opportunities, thus enabling their growth. This can for example involve offering capital at below-market rates.
Providing flexible capital	Investors can accept below-market, risk-adjusted financial returns when investing in impactful companies, thus lowering their cost of capital and enabling their growth.
Signalling that impact matters	Investors can choose not to invest in, or to favour, certain investments such that, if many investors did the same, it would ultimately impact the access to capital of high-carbon companies or send a nonmarket signal to society that impact matters – through nonmarket channels.

Figure 2: Overview of existing climate actions mapped to impact mechanisms



The causal chain from an investor implementing a climate action to the change that the company has caused in the real economy (e.g. GHG emissions reduction) consists of multiple steps. If an investor:

- implements a *climate action* (for example, engagement with investee companies in high carbon sectors);
- this can lead to an *output* as a direct consequence of the climate action (for example, a change in the WACC of targeted investee companies);
- this can in turn lead to an *outcome* in terms of growth or improvement in investee company activities (for example, a change in the investee company's capex plans and growth in production); and
- this can trigger an *impact* in the real economy (for example, a reduction of GHG emissions).

However, the causal change from an investor implementing a climate action to an impact in the real economy is subject to uncertainties. A climate action may not always result in an output[13] and similarly an output might

[13] For example, excluding high-carbon assets from a portfolio (the action) might not tangibly increase the cost of capital for the underlying high-carbon company (the unachieved output).

not translate into an outcome[14] and an outcome might not translate into an impact.[15] In short, implementing impact mechanisms does not mechanically lead to tangible impact, and demonstrating that impact mechanisms have been levered cannot be considered to be equivalent to demonstrating that an impact has been achieved.

Investigating investor impact is a nascent research field and as such numerous gaps and uncertainties remain about the effectiveness of different climate actions and impact mechanisms. A recent authoritative meta study on the topic[16] concluded that we do not have a consensus that any particular climate action or impact mechanism always has an impact under different conditions. However, while there may be no robust or measurable link between climate actions/impact mechanisms and real-world impact in all cases, there is an emerging understanding of the conditions in which different climate actions/impact mechanisms would be more or less likely to influence investee company behaviour and generate real world impact (i.e. impact potential). This work has led to the development of a framework for assessing the level of evidence of impact that can be attributed to different climate actions/impact mechanisms depending on the asset class concerned.[17]

For the line of enquiry of this paper – which relates to environmental impact claims of typical financial products and services – it is worth noting that regarding secondary markets and liquid financial assets (which are an essential part of the offer available to retail investors) the level of evidence identified is extremely low. Capital allocation approaches in secondary markets (green bonds, exclusions, positive screening etc.) are model based predictions at most while under certain conditions engagement activities have a higher (albeit non-decisive) level of evidence.[18]

Finally, impact evaluation requires a complex counterfactual analysis as impact is the additional effect on the world through an action. Beyond presenting the actions that have been deployed to achieve impact, demonstrating investor impact implies providing evidence of additional outcomes in the real economy. The highest level of proof of additionality cannot be achieved without running experimental[19] or quasi-experimental[20] scientific methods that compare actual achievements to a (virtual) counterfactual scenario where the investment would not have been made. Even if they are well-established and commonly used within the fields of public policy and philanthropy, those counterfactual impact evaluation techniques are still largely unfamiliar to financiers.

1.4 The negative effects of greenwashing

What has come to be a widespread and accepted term – greenwashing – also lacks a formal legal or regulatory definition. But it can be understood to describe the practice of making misleading claims about the environmental benefits of a product or of a company's policies more generally[21] or referring to circumstances where environmental claims are not true or cannot be verified.[22]

[14] For example, the increased cost of capital resulting from an exclusion policy (the output) might not trigger a change in the investee's activities (the unachieved outcome) due to a disproportion between the incentive to change and the cost of change.
[15] For example, an investee company implements a new green project because of a financial institution action (the outcome), but it fails due to competition.
[16] Kölbel et al., 2020, Can Sustainable Investing Save the World? Reviewing the Mechanisms of Investor Impact.
[17] Heeb, F., Kölbel, J., 2020, The investor's guide to impact
[18] 2DII, 2021, Sustainable finance and market integrity: promise only what you can deliver
[19] like randomized controlled trials or natural experiments
[20] For instance, difference-in-difference, propensity score matching and synthetic control methods
[21] EU Technical Expert Group on Sustainable Finance, 2019, Taxonomy Technical Report, p.14.
[22] Multi-stakeholder Dialogue on Environmental claims, 2016, Compliance Criteria on Environmental Claims: Multi-stakeholder advice to support the implementation/application of the Unfair Commercial Practices Directive 2005/29/EC

Various research identifies the harmful effects of greenwashing on market function. The research universally points to a significant detriment to consumers and organisations that adhere to the rules.[23] Greenwashing can increase consumer distrust – and eventually prevent the mobilisation of sustainability minded consumers – and create the conditions for unfair competition and free-riding behaviours.[24]

Through the package of policy proposals in the *Action Plan on Finance Sustainable Growth*, the Commission is seeking to leverage increased client preferences for sustainable investment in support of the objective to reorient capital towards sustainable investment and address the investment gap to achieve EU climate and energy targets. As the extent of the greenwashing problem becomes clearer, there are concerns that it can undermine these policy objectives in the Action Plan. Either through increasing distrust and loss of confidence by retail investors meaning they are discouraged against sustainable investment, or perhaps even more problematically, through greenwashing permitting market distortion so that the market is not responding to these client preferences for sustainable investment (i.e. mis-selling).

Many argue that the recent disclosure requirements under the Sustainable Finance Disclosure Regulation[25] (**SFDR**) and the Taxonomy Regulation[26] go some way to combat greenwashing through increased transparency and helping end-investors identify credible investment opportunities. However, as this paper will show, these disclosure requirements provide a limited framework unfit to regulate environmental claims – and provide no assistance at all in relation to environmental impact claims.

Last year's *Strategy for Financing the Transition to a Sustainable Economy* reveals that the Commission now has a specific focus on greenwashing. With the support of the European Supervisory Authorities, the Commission will assess whether supervisory powers, capabilities and obligations are fit for purpose. And based on this assessment and the monitoring of greenwashing risks by the ESAs, the Commission will consider steps to ensure a sufficient, consistent level of enforcement and supervision to address greenwashing.[27]

This focus on greenwashing is welcome – but the details of the precise activities to be undertaken remain scant. And as this paper will show, there are far more aspects to consider in order to address the greenwashing problem than is currently indicated in this strategy.

[23] European Social and Economic Committee, 2015, Opinion on 'Environmental, social and health claims in the single market'
[24] 2DII, 2021, Sustainable Finance and Market Integrity, p.13.
[25] Regulation (EU) 2019/2088 of the European Parliament and of the Council of 27 November 2019 on sustainability-related disclosures in the financial services sector
[26] Regulation (EU) 2020/852 of the European Parliament and of the Council of 18 June 2020 on the establishment of a framework to facilitate sustainable investment, and amending Regulation (EU) 2019/2088
[27] European Commission, 2021, Strategy for Financing the Transition to a Sustainable Economy

Section 2

Critical analysis of the relevant regulatory framework

This section provides a high-level summary of the regulatory framework that may apply to environmental impact claims in the finance sector. It analyses the finance sector specific regulation which requires communications to be fair, clear and not misleading. It demonstrates the emerging body of sustainable finance rules is not adapted to regulate environmental impact claims. It then focusses on the application of consumer protection regulation in the finance sector context before analysing the variation in national implementation of these rules.

2.1 A difficult mapping of applicable rules at EU level

Identifying the legal and regulatory framework applicable to environmental marketing claims of financial products is not straightforward.[28] Several pieces of EU legislation can apply to these claims though none of them are sufficient to prevent greenwashing based on environmental impact claims.

There are two main categories of regulation which are potentially applicable - finance sector specific regulation and consumer protection regulation. Moreover, within finance sector specific regulation, there are general rules applicable to all communications linked to financial products whereas other more recent rules relate specifically to sustainable finance.

Among the various frameworks, some contain compulsory rules (*hard law*, such as provisions in Directives and Regulations) whereas others are recommendations and principles (*soft law*, such as ESMA guidelines or other supervisory materials from regulators).

The table below identifies the European provisions analysed in this paper to assess if and how they regulate environmental impact claims in the finance sector.

Table 2: Regulatory provisions analysed for relevance to regulation of environmental impact claims in the finance sector

	Finance sector specific regulation		Consumer protection regulation
	General finance	Sustainable finance	
Hard law	MIFID II CBDF Regulation Prospectus Regulation	SFDR Taxonomy Regulation EU Green Bond Standard	UCPD Proposal of amendment to UCPD
Soft law	ESMA Guidelines on marketing communications		UCPD Guidance MDEC Principles

[28] The mapping includes only rules related to marketing claims, meaning that we exclude rules that only apply to regulatory documentation such as KIID, prospectus or annual reports and focus on provisions applying to all marketing material (brochures, sections of the website).

2.2 Study of EU finance sector specific regulation

The commentary below analyses the finance sector specific regulation articulated in Table 2 above to define the scope and identify where there are rules that could be used to fight greenwashing linked to environmental impact claims in the finance sector.

As illustrated in Table 2 above, a first distinction must be made between general finance rules and rules developed recently in relation to sustainable finance.

General finance rules are too high level

MIFID II[29] contains rules on all information, including marketing communications, addressed by an investment firm to clients or potential clients.[30] It states that the communication must be 'fair, clear and not misleading' both in its content and its presentation. It notably means that any marketing communication should 'be sufficient for and presented in a way that is likely to be understood by the average member of the group to whom it is directed, or by whom it is likely to be received.'[31] MIFID II thus provides a high-level principle and does not provide any further detail or criteria that could be used to assess whether an environmental impact claim made by an investment firm is fair, clear and not misleading.

The regulation on facilitating cross-border distribution of collective investment undertakings (**CBDF Regulation**)[32] sets a similar principle. This establishes uniform rules on the publication of national provisions concerning marketing requirements for collective investment undertakings and on marketing communications addressed to investors, as well as common principles concerning fees and charges levied on managers of collective investment undertakings in relation to their cross-border activities. According to the CBDF Regulation, marketing communications of collective investment undertakings must be:

- identifiable as marketing communications;
- describe the risks and rewards of purchasing units or shares of a fund in an equally prominent manner;
- contain fair, clear and not misleading information.[33]

ESMA guidelines on marketing communications under the CBDF Regulation[34] provide further precision related to information on sustainability-related aspects. The marketing claim should be consistent with the information included in the legal and regulatory documents and should be proportionate to the extent to which the investment strategy and product integrates sustainability-related characteristics or objectives.[35]

In addition, the Prospectus Regulation[36] applies to advertisement relating to offer of securities to the public or to an admission to trading on a regulated market. This regulation states that 'advertisements shall be clearly recognisable as such. The information contained in an advertisement shall not be inaccurate or misleading and shall be consistent with the information contained in the prospectus, where already published, or with the information required to be in the prospectus, where the prospectus is yet to be published.'[37] Here again the

[29] Directive 2014/65/EU of the European Parliament and of the Council of 15 May 2014 on markets in financial instruments and amending Directive 2002/92/EC and Directive 2011/61/EU (MiFID II)
[30] Art 24(3) MIFID II
[31] Art 44 Commission Delegated Regulation (EU) 2017/565 of 25 April 2016 supplementing Directive 2014/65/EU of the European Parliament and of the Council as regards organizational requirements and operating conditions for investment firms and defined terms for the purposes of that Directive
[32] Regulation (EU) 2019/1156 of 20 June 2019 on facilitating cross-border distribution of collective investment undertakings and amending Regulations (EU) No 345/2013, (EU) No 346/2013 and (EU) No 1286/2014
[33] Art 4 CBDF Regulation
[34] ESMA, 2021, Guidelines on marketing communication under the Regulation on cross-border distribution of funds
[35] Section 6.5 of ESMA Guidelines on marketing communications under the Regulation on cross-border distribution of funds
[36] Regulation (EU) 2017/1129 of the European Parliament and of the Council of 14 June 2017 on the prospectus to be published when securities are offered to the public or admitted to trading on a regulated market, and repealing Directive 2003/71/EC
[37] Art 22 Regulation (EU) 2017/1129

principle is high-level, and there is no further guidance on how to determine whether a marketing claim is misleading.

While the above high-level principles could be applicable to an environmental impact claim in the finance sector, considering the lack of detailed criteria, it is unclear how they would apply. The MIFID II principle stating that communication must be 'fair, clear and not misleading' must be transposed at national level. It is therefore up to national legislators and regulators to detail the criteria to consider a marketing claim as 'fair, clear and not misleading' (which may be based on the ESMA guidelines and other legal norms). This leaves room for the development of heterogenous rules at national level, especially regarding environmental impact claims[38] (see *Section 2.5 Lack of harmonisation at national level)*.

Sustainable finance rules are not adapted to environmental impact claims

The Commission has introduced three key sustainable finance legislation initiatives: the Sustainable Finance Disclosure Regulation[39] (**SFDR**), the Taxonomy Regulation[40] and the proposed EU Green Bond Standard (**EUGBS**).[41] These texts were not initially intended to regulate marketing claims; however, the industry has lately developed a practice to use certain regulatory classifications as marketing arguments, thus leading us to test the applicability of said regulations to environmental claims in general and environmental impact claims more specifically.

The SFDR is not adapted to regulate environmental impact claims

The SFDR sets out 'harmonised rules for financial market participants and financial advisers on transparency with regards to the integration of sustainability risks and the consideration of adverse sustainability impacts in their processes and the provision of sustainability-related information with respect to financial products.'[42]

The SFDR also categorises financial products according to the degree of sustainability related ambition for that product.

- Article 6 products do not pursue sustainable investment but may or may not integrate sustainability risk into the investment process. These are generally not marketed as having any sustainability credentials.
- Article 9 products (often referred to as dark green products) have sustainable investment as an objective and their underlying assets will always be in sustainable investment.
- Article 8 products sit between the other two categories and are those that promote environmental or social characteristics. They may or may not pursue sustainable investments and may invest in a wide range or underlying assets.

For each category of financial product, a level of compulsory disclosures is defined for pre-contractual documentation, periodic reports and the website.

Misuse of SFDR product categories as sustainability labels

The SFDR was initially not intended to provide *sustainability labels* or criteria for marketing claims related to sustainability. However, industry practice has developed to categorise products falling within Article 8 or Article

[38] In the absence of consensus on the definition of environmental impact of financial products.
[39] Regulation (EU) 2019/2088 of the European Parliament and of the Council of 27 November 2019 on sustainability-related disclosures in the financial services sector
[40] Regulation (EU) 2020/852 of the European Parliament and of the Council of 18 June 2020 on the establishment of a framework to facilitate sustainable investment, and amending Regulation (EU) 2019/2088
[41] Proposal for a Regulation on European green bonds COM/2021/391 final
[42] Art 1 SFDR

9 as 'light green' and 'dark green' product labels, respectively and use these regulatory categories as a marketing claim.

Examples of marketing claims using Articles 8 and 9 SFDR classifications are as follows:[43]

- 'The vast majority of strategies will be classified as Article 8. These are funds which form part of our Sustainability range, which has ESG integrated as standard, or the Sustainability Focused range, which has more specific targets, such as achieving a lower carbon footprint than the benchmark.'
- '90% of our AUMs are Article 8 or 9 (SFDR)'

These observations about current market practice demonstrate a significant risk of misunderstanding and misuse of SFDR provisions. Indeed, in the absence of clarification by the European legislator or regulator, a market practice appears to be evolving whereby SFDR disclosure provisions are viewed as defining criteria for marketing claims.[44]

This misuse of SFDR provisions is especially detrimental to transparency and fair marketing of sustainable products considering the lack of clarity in relation to the definitions of Article 8 and Article 9 of SFDR.[45]

Risk of greenwashing to impact-oriented clients created by SFDR

But predicating a marketing claim on the categorisation for SFDR purposes is even more problematic in the context of environmental impact claims. This is because the SFDR does not adhere to the distinction between investor impact and investee company impact (see *Section1.2 Exposition of an environmental impact claim in the finance sector*). There is no requirement for Article 8 and Article 9 products to reveal investor impact, therefore the SFDR is not adapted to apply to environmental impact claims.

Regarding Article 8, there is no regulatory criteria to specify eligible investment targets, investing styles, investing tools, strategies or methodologies to be employed. As a result, Article 8 products may apply various strategies (for example, screening and exclusion strategies[46]) many of which are unlikely to have an environmental impact.

Regarding Article 9, this refers to financial products which have 'sustainable investment' as an objective. Sustainable investment is then defined as 'an investment in an economic activity that contributes to an environmental objective as measured, for example, by key resource efficiency indicators on the use of energy, renewable energy, raw materials, water and land, on the production of waste, and greenhouse gas emissions, or on its impact on biodiversity and the circular economy, or an investment in an economic activity that contributes to a social objective …'[47]

Therefore, Article 9 products should not be considered to mechanically meet the definition of impact-oriented financial products either.[48][49] To develop the previous argumentation further (see *Section 1.2 Exposition of an environmental impact claim in the finance sector*), the (environmental) impact of an investor is the change that the investor causes in the real world that directly or indirectly influences GHG emissions[50]. Hence, for the

[43] 2DII research on limited sample for the purpose of this paper with key words 'article 9' and 'article 8', May 2022
[44] See Responsible Investor article: 'SFDR reclassifications raise "legitimate" greenwashing concerns, warns Morningstar'
[45] The ESAs were compelled to write to the Commission requesting clarification of the meaning of 'promotion' in the context of Article 8 products and the application of Article 9. While the Commission has responded to this request, that response has not shed much light on the topic.
[46] Annex to Commission Decision (c(2021) 4858 final)
[47] Art 2(17) SFDR
[48] As explained in 2DII, 2021, Does the SFDR help the impact-focused retail investor?
[49] Despite the confusion created by Recital 21 of SFDR implicitly referring to Article 9 as 'financial products which have as an objective a positive impact on the environment and society'.
[50] This impact can be positive (reduction of emissions) or negative (increase in emissions). In this paper, we refer to "impact" as meaning "positive impact".

investor to get credit for impact, it needs to have caused a change in the activities of its investees through its investments.

The drafting of Article 9 merely refers to 'investing in an economic activity that has a positive impact.' As such, it fails to consider what role the investor may have played in bringing about or increasing this positive impact. It fails to preserve the distinction between investor impact and investee company impact.

Moreover, it should be reminded that financial products have two ways to generate impact in the real economy, either by helping positive-impact companies to grow or by forcing negative-impact companies to change. Only the first pathway seems compatible with Article 9 definition of sustainable investments. Indeed, impact funds adopting a strategy of investing in negative impact companies (i.e., heavy carbon polluters) in order to change them from the inside through engagement may be de facto excluded from the scope of Article 9.

Article 9 products refer to what might generally be understood as thematic investment more likely to fit the goals of investors looking for value alignment rather than impact. And even though many financial institutions have understood the difference between investor impact and investee company impact, some still make the mistake of equating Article 9 products with impact products.

Information Box: Examples of marketing claims creating confusion between Article 9 products and impact products[51] [52]

'The investment funds that comply with Article 9 go even further: they show a willingness to have a real impact on the social or environmental spheres.'

'The third category includes impact products with a clearly identified sustainable development objective (so-called "Article 9" products).'

'Asset Manager is offering a new dark-green equity-based investment product for investors keen to make a simultaneous impact on the climate and society.'

'Asset Manager's Impact Investing range of strategies will be classified as Article 9. These include bespoke funds targeting climate change, renewable energy, the UN's Sustainable Development Goals and specific themes such as gender equality.'

On the contrary certain rightful asset managers avoid greenwashing by clearly differentiating regulatory categories of financial products and impact: 'An Article 9 is not an impact fund'.

In conclusion, the SFDR is not adapted to regulate environmental impact claims of financial products. Article 9 mixes products with a very low investor impact potential (e.g., thematic listed equity funds) and products with a significantly superior one (e.g., green infrastructure funds). Therefore, an emerging trend of equating Article 9 products with impact-oriented products creates significant risks of mis-selling non-impact financial products to impact-oriented clients.

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[51] 2DII research on limited sample for the purpose of this paper with key words 'article 9' and 'article 8' and 'impact', May 2022

[52] A recent study was led on 185 funds that claim to achieve an impact on the environment and/or society (mainly domiciled in Europe and in North America). 'The Impact of Impact Funds – A Global Analysis of Funds with Impact-Claim', Lisa Krombholz, Timo Busch and Johannes Metzler, April 2022. It shows that among the funds falling under the SFDR, 63% were assigned to Article 9 and 37% to Article 8. The paper further explains it 'reflects the widespread perception that Article 9 products are "impact products"' and indicates that 'the analysis suggests that only 37% of the funds assigned to Article 9 met the outlined impact requirements.

The Taxonomy Regulation is not applicable to environmental impact claims

The Taxonomy Regulation establishes the concept of 'environmentally sustainable investments.' For an economic activity to be environmentally sustainable under the Taxonomy Regulation, it must:

- contribute substantially to one or more of environmental objective[53];
- do no significant harm to any of the environmental objectives;
- be carried out in compliance with minimum social safeguards[54]; and
- comply with the technical screening criteria.[55]

Taxonomy compliant investments reflect economic activities that are environmentally sustainable but do not necessarily bring about positive change. For example, an environmentally sustainable investment can be neutral in terms of impact on the environment. This is a qualitatively different concept to that of bringing about a positive impact. In addition, while the Taxonomy Regulation provides a framework as to whether an economic activity can be classified as sustainable, it does not address the distinction between investor impact and investee company impact. Therefore, the Taxonomy Regulation is not applicable to environmental impact claims of financial products.

The EU Green Bond Standard is not applicable to environmental impact claims

The proposed EUGBS is envisaged to be implemented as a voluntary standard available to all issuers to help finance sustainable investments. It is intended to reduce the risk of greenwashing as financial institutions may only describe their product as an *EU Green Bond* where it complies with the EUGBS.[56]

To be able to claim that a product is an EU Green Bond, financial institutions must ensure the following four requirements are met:

- The funds raised by the bond should be allocated fully to projects aligned with the EU Taxonomy;
- There must be full transparency on how bond proceeds are allocated through detailed reporting requirements;
- All EU green bonds must be checked by an external reviewer to ensure compliance with the Regulation and that funded projects are aligned with the Taxonomy. Specific, limited flexibility is foreseen here for sovereign issuers;
- External reviewers providing services to issuers of EU green bonds must be registered with and supervised by the European Securities Markets Authority. This will ensure the quality and reliability of their services and reviews to protect investors and ensure market integrity. Specific, limited flexibility is foreseen here for sovereign issuers.'[57]

Green bonds would not necessarily be associated with increased volumes of climate-friendly activities (although green bonds can be used to action certain impact mechanisms).[58] Moreover, the information which would be available in relation to green bonds in compliance with the EUGBS is not directly relevant to the line of enquiry of this paper. Therefore investing in green bonds that comply with the EU GBS cannot be used by investment funds as sufficient evidence to back their environmental impact claims.[59]

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[53] The six environmental objectives are: climate change mitigation, climate change adaptation, sustainable use and protection of water and marine resources, transition to a circular economy, pollution prevention and control and protection and restoration of biodiversity and ecosystems.
[54] As articulated in Art 18 Taxonomy Regulation
[55] Art 3 Taxonomy Regulation
[56] As such the EUGBS is indirectly relevant to the line of enquiry of this paper as (where a financial product invests in green bonds) then financial institutions will base their own marketing claims on the EUGBS.
[57] Legislative train schedule, Establishment of an EU Green Bond Standard
[58] See 2DII, 2021, I've got the power! Really? for a detailed review of the impact potential of green bonds in supporting the energy transition.
[59] Retail clients are unlikely to invest directly in a green bond itself, but rather in a financial product which is itself invested in green bond(s) – therefore it is the environmental impact claims associated with the financial product which is relevant.

Information Box: The EU Ecolabel as a first step towards integrating the notion of investor impact

The EU Ecolabel technical criteria for financial products is currently being developed. The criteria would need to be adopted through a Commission Decision under the EU Ecolabel Regulation[60] and the working assumption is that this is expected by the end of 2022 with a view to being operational in 2023. However, this calendar is still uncertain – see below.

In the most recent draft of the technical criteria[61], Criterion 5 refers to measures taken to enhance investor impact. It refers to the concept of investor impact that is based on the academic literature.[62] Information on the measures that have been taken to enhance the impact of the financial product should be provided to retail clients along with the following disclaimer:

The EU Ecolabel is the official European Union label for environmental excellence aiming to capture the best products available on the Community market in terms of environmental performance. It is awarded to financial products that invest to a certain degree in environmentally sustainable economic activities as defined under the EU Taxonomy. However, the currently available methodologies and evidence do not allow to evaluate the environmental and social impacts of a particular fund.

The rational for including this disclaimer is that the EU Ecolabel does not carry out evaluation of environmental and/or social impacts and therefore not including a disclaimer could be misleading to the retail investors.

While the EU Ecolabel currently appears to be a means to (partially) integrate a better conception of investor impact into the regulatory framework, it is only a voluntary framework that will not apply to all financial products. Moreover, the ultimate outcome of the EU Ecolabel for financial products is currently on hold due to controversies in relation to the decision to classify nuclear and gas power as green activities under the Taxonomy Regulation.[63]

[60] Regulation EEC 880/92
[61] Joint Research Centre, 2021, Development of EU Ecolabel criteria for Retail Financial Products Technical Report 4.0: Draft proposal for the product scope and criteria
[62] As reviewed by Kölbel et al. 2020, Can Sustainable Investing Save the World? Reviewing the Mechanisms of Investor Impact, Organization & Environment
[63] Responsible Investor, 2022, Nuclear, gas status in EU green fund label uncertain as project put on hold

2.3 Study of EU consumer protection regulation

The commentary below analyses the consumer protection regulation articulated in Table 2 above to define the scope and identify where there are rules that could be used to fight greenwashing linked to environmental impact claims in the finance sector. The consumer protection regulation consists of the following:
The directive on unfair commercial practices[64] (**UCPD**) is the overarching EU legislation regulating unfair commercial practices between businesses and consumers. In addition, the Commission gathered a multi-stakeholder group on environmental claims[65] which provided recommendations in relation to how these general provisions apply in the context of environmental claims (the **MDEC Principles**).[66] The MDEC Principles are not legally binding, however they are key for the interpretation and application of UCPD rules.[67] They also inform the new Commission Notice on the interpretation and application of the Unfair Commercial Practices Directive (**UCPD Guidance**).[68] [69]

Information Box: Interplay between EU consumer protection regulation and finance sector specific regulation

Retail investment services are subject to the UCPD insofar as there are no relevant and applicable finance sector specific regulatory provisions (such as MiFID II). Indeed, the UCPD can be considered to work as a wider *safety net* to provisions provided by finance sector specific regulation. Where sector-specific EU law overlap with the provisions of the UCPD, the corresponding provisions of the sector-specific EU law prevails. The UCPD seeks to ensure that a common level of consumer protection against unfair commercial practices can be maintained in all sectors. Considering legislation specific to the finance sector only provides high-level rules, the safety net provided by UCPD proves useful.

UCPD rules applying to environmental impact claims

The UCPD prohibits unfair commercial practices[70] which include the following:

- *Misleading action*: A commercial practice shall be regarded as misleading if it contains false information or deceives or is likely to deceive the average consumer. The false information can notably relate to the main characteristics of the product (such as its benefits) or the extent of the trader's commitments.[71]
- *Misleading omission*: A commercial practice shall be regarded as misleading if it omits material information that the average consumer needs to take an informed decision. There can be an omission when the information is hidden but also when the information is provided in an unclear, unintelligible, or ambiguous manner.[72]

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[64] Directive 2005/29/EC of the European Parliament and of the Council of 11 May 2005 concerning unfair business-to-consumer commercial practices in the internal market and amending Council Directive 84/450/EEC, Directives 97/7/EC, 98/27/EC and 2002/65/EC of the European Parliament and of the Council and Regulation (EC) No 2006/2004 of the European Parliament and of the Council (Unfair Commercial Practices Directive). This was amended by Directive (EU) 2019/2161 of 27 November 2019 on better enforcement and modernisation of Union consumer protection rules.
[65] Composed of representatives of national authorities, European business and consumer organisations, and environmental NGOs
[66] Multi-stakeholder Dialogue on Environmental claims, 2016, Compliance Criteria on Environmental Claims: Multi-stakeholder advice to support the implementation/application of the Unfair Commercial Practices Directive 2005/29/EC
[67] Indeed, they are reflected in international standards and self-regulation, such as the ISO 14021- 2016 standard and the ICC Advertising and Marketing Communications Code.
[68] Commission Notice – Guidance on the interpretation and application of Directive 2005/29/EC of the European Parliament and of the Council concerning unfair business-to-consumer commercial practices in the internal market
[69] This Notice dated 17 December replaces the previous UCPD Guidance, the Commission Staff Working Document from 2016. The UCPD Guidance not only provides information on the application of UCPD principles to environmental claims but also details their articulation with other EU legislation.
[70] Art 5 UCPD
[71] Art 6 UCPD
[72] Art 7 UCPD

The UCPD Guidance and MDEC Principles provide detail on how to apply these rules to environmental claims. They are soft law and operate without prejudice to the 'national courts and authorities […] case-by-case assessment of whether a claim is misleading either in its content or in the way it is presented to consumers.'[73] Nevertheless they are the most relevant means to assess how national courts and authorities would likely determine whether an environmental claim is misleading.

As a reminder, '"environmental claims" and "green claims" refer to the practice of suggesting or otherwise creating the impression (in a commercial communication, marketing, or advertising) that a good or a service has a positive or no impact on the environment or is less damaging to the environment than competing goods or services. […] When such claims are not true or cannot be verified, this practice is often called "greenwashing".'[74] A claim can relate to all types of statements, information, symbols, logos, graphics and brand names, and their interplay with colours, on packaging, labelling, advertising, in all media (including websites).[75]

The MDEC Principles apply to environmental claims in general and are not specific to the finance sector. Table 3 below[76] summarises the main principles developed in the MDEC Principles to understand detailed criteria steaming from UCPD rules that can apply to environmental impact claims of financial products.

Table 3: Summary of the MDEC Principles

	MDEC Principle	MDEC Criteria
Content of the claim	'In order not to be misleading, environmental claims should reflect a verifiable environmental benefit or improvement and this should be communicated in a precise manner to consumers.' (Section 2.1).	Focus on the main environmental impacts Clarity on which aspects of the product the claim relates to Benefit beyond what is already considered as a common practice in the relevant market or required by law
Presentation of the claim	'Once the content of the claim has been established (section 2.1), it should be presented in a way that is accurate, clear, specific and unambiguous to ensure consumers are not misled about the intended meaning, and are thus able to make informed purchasing choices.' (Section 2.2)	Truthful wording as to the benefit achieved Clear scope and boundaries of the claim Avoidance of vague, ambiguous and broad claims
Substantiation of the claim	'In accordance with the UCPD, any claim or information in advertising and marketing (whether it is environmental or not) must be correct and not misleading. As such, claims should be based on robust, independent, verifiable and generally recognized evidence which takes into account the latest scientific findings and methods.' (Section 2.3)	Clear and robust evidence measured using the most appropriate scientific methods Avoidance of claims on future aspirations Availability to the public of information relevant to support the claim

[73] Disclaimer to MDEC Principles
[74] Section 4.1.1 UCPD Guidance. Please also refer to Section 1.2 Exposition of an environmental impact claim in the finance sector.
[75] It is interesting to note that the name of the financial product is also relevant when used for marketing purposes.
[76] Replicated from 2DII, 2021, Sustainable finance and market integrity: promise only what you can deliver

Table 4: Summary of claims to be especially avoided[77]

Practice to be avoided	Detailed explanation
Vague, ambiguous and broad "general environmental benefit" claims (MDEC, Section 2.2)	‘Examples (not exhaustive) of general environmental benefit claims could include: “environmentally friendly” […] “good for the environment”, “sustainable”, “green”, “carbon friendly”, “carbon neutral” […] “an ethically correct choice”.’ ‘In case traders choose to use general broad claims, they should be accompanied by clear and prominent qualifying language that limits the claim to a specific benefit or benefits.’ ‘The use of a general benefit claim (presented without further qualifications) may be justified […] if the life cycle assessment studies of the product have proven its excellent environmental performance. These studies should be made according to recognized or generally accepted methods applicable to the relevant product type and should be third-party verified. If such methods have not yet been developed in the relevant field, traders should refrain from using general benefit claims.’
Claims on scientifically uncertain environmental impacts (MDEC, Section 2.3)	‘If expert studies give rise to significant disagreement or doubt over environmental impacts, the trader should refrain from marketing the message altogether.’
Claims on future aspirations (MDEC, Section 2.3)	‘Traders should rather communicate about environmental achievements instead of aspirations of future environmental performance, which by definition are not eligible for substantiation by evidence. This does not prevent companies from communicating on future environmental efforts (via Corporate Social Responsibility reporting or also advertising) if they deem this necessary or useful. Nevertheless, in order to avoid the risk of being accused of greenwashing practices, companies should only do this when they have established a realistic plan with clear targets and timescales, involved relevant stakeholders and ensured third party monitoring of commitments.’

Additionally, the UCPD Guidance states that ‘the information provided to clients should be clear and understandable for the average consumer. The complexity and technical nature of the information should not be used to mislead consumers about the veracity of the green claim.’[78] Therefore, the complexity and technicity of measuring and attributing the environmental impact of financial product should not be used to mislead investors.

[77] Replicated from 2DII, 2021, Sustainable finance and market integrity: promise only what you can deliver
[78] Section 4.1.1.4. UCPD Guidance

Information Box: Introduction of rules specific to environmental claims in EU legislation

On 30 March 2022 the European Commission proposed amendments to the UCPD.[79]

These amendments notably aim at better regulating environmental claims in Europe and fight greenwashing practices through:

- Ensuring that consumers are not misled about environmental and social impacts of products.
- Ensuring that environmental claims related to future environmental performance always involve clear commitments.
- Prohibiting the use of sustainability labels not based on a certification scheme or established by public authorities.
- Prohibiting the use of generic environmental claims used in marketing towards consumers, where the excellent environmental performance of the product cannot be demonstrated in accordance with officially recognised eco-labelling.
- Prohibiting environmental claim about the entire product, when it actually concerns only a certain aspect of the product.

These amendments will improve legal certainty and should facilitate enforcement of rules preventing greenwashing. They do not however provide additional detail on how to apply the rules to environmental impact claims in the finance sector.

The UCPD (together with the UCPD Guidance and MDEC Principles) provides a more detailed and complete framework to regulate environmental impact claims in the finance sector than EU finance sector specific regulation. Nevertheless, the application of consumer protection rules to the reality and specificity of environmental impact claims in the finance sector reveals several barriers which prevent an effective protection of investors against misleading claims.

Barriers to effective application of consumer protection regulation to environmental impact claims in the finance sector

Two key obstacles prevent an effective and efficient application of UCPD rules and MDEC Principles to environmental impact claims in the finance sector: (1) the lack of definition of investor impact in the legislation and (2) the difficulties associated with substantiating investor impact. EU consumer protection regulation thus reveals insufficient to properly regulate this type of claims and should be completed by provisions tailored to the specificity of environmental impact claims of financial products. Such rules should be provided at the EU level to ensure harmonisation of practices.

Lack of definition of investor impact

The concept of environmental impact claims or ‘impact’ is an industry term and not yet a legal concept recognised under existing EU law. No EU law or regulation defines impact, impact investing or other related terms. As such, there are no specific requirements which directly apply to a statement by a financial institution to carry out impact investing or which purport to be an ‘impact product’, including in relation to how such products are marketed, promoted or distributed.

[79] Proposal for a Directive amending Directives 2005/29/EC and 2011/83/EU as regards empowering consumers for the green transition through better protection against unfair practices and better information. The new legislation can be expected by end-2023/ beginning 2024. However, the new rules must also be transposed into the national laws before taking effect (application 24 months after adoption at the latest).

Moreover, the current legal and regulatory framework is not consistent with the theories of attribution discussed in *Section 1.2 Exposition of an environmental impact claim in the finance sector*. Specifically, the current framework does not distinguish between investee company impact and investor impact.

Hence, in the absence of definition of 'impact' in the regulatory framework, it may be difficult to argue that a financial institution has made a misleading/prohibited impact claim about a financial product under the UCPD where the financial institution can demonstrate that the product exhibits some investee company impact, even where it cannot attribute any of this impact to the investment/purchase of the product itself (i.e. demonstrate investor impact).

Difficulties associated with substantiating investor impact

Financial institutions are required to substantiate their claims[80] and 'claims should be based on robust, independent, verifiable and generally recognized evidence which takes into account the latest scientific findings and methods.'[81] In this context there must be scientific evidence to support the claim.[82]

This requirement to substantiate claims proves particularly difficult to meet in the case of environmental impact claims in relation to (structural or practical) difficulties to demonstrate investor impact as explained in *Section 1.3 Difficulties demonstrating investor environmental impact*. As said previously, demonstrating that impact mechanisms have been implemented is not sufficient to demonstrate that actual impact has been achieved. And demonstrating that impact has been achieved requires to run a counterfactual impact evaluation based on scientific methods. Because impact attribution is never certain (due to the potential confounding effect of many external factors), the best way to demonstrate investor impact is to provide evidence of both the implementation of impact mechanisms and the achievement of additional outcomes.

2.4 Conclusion on the EU regulatory framework

General finance rules are applicable to environmental impact claims in the finance sector (MIFID II, CBDF Regulation and Prospectus Regulation), but these rules are too high level to provide effective governance of environmental impact claims.

Unfortunately, the sustainable finance rules do not provide further assistance in relation to the governance of environmental impact claims. The current sustainable finance regulation does not integrate the concept of investor impact. Therefore, it is not aligned with the theories of attribution differentiating investee company impact and investor impact. While the SFDR and the Taxonomy Regulation require that certain investments demonstrate a positive impact of the investee company (e.g. to be marketed as Article 9), there is no requirement to demonstrate the positive environmental impact of the investor (or the purchase of the financial product).

Therefore, current EU sustainable finance regulation is not adapted to regulate environmental impact claims. And an emerging trend of using SFDR categories as marketing labels create additional confusion and greater risk of greenwashing especially when combined with environmental impact claims.

In addition, the provisions of UCPD are not sufficient to regulate environmental impact claims in the finance sector. Indeed, the absence of a definition of investor impact and the difficulties to substantiate investor impact prevent the efficient application of UCPD rules in relation to environmental impact claims in the finance sector.

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[80] Art 12 UCPD
[81] Section 2.3 MDEC Principles
[82] MDEC Principles

While the EU Ecolabel currently appears to be a means to (partially) integrate a better conception of investor impact into the regulatory framework, it is only a voluntary framework that will not apply to all financial products. Moreover, the ultimate outcome of the EU Ecolabel for financial products is currently unsure due to controversies in relation to the decision to classify nuclear and gas power as green activities under the Taxonomy Regulation.

2.5 Lack of harmonisation at national level

Our analysis of national legislative and regulatory frameworks concerns Spain, Luxembourg, Germany, France, Belgium and Netherlands to provide an overview of the level of harmonisation at national level. As for the legal analysis at EU level, the following commentary distinguishes between finance sector specific regulation and consumer protection regulation.

Lack of integration of UCPD Guidance and MDEC Principles at national level

As a directive, the UCPD requires national implementing legislation in each Member State. All Member States covered in this paper have enacted national implementing legislation.[83] *Annex 1 Country specific rules* identifies the UCPD national implementing legislation in each Member State. Rules have been integrated either in competition law, consumer protection law, advertising law or economic law.

Although the UCPD appears to have been transposed in a harmonised way for the Member States covered by this paper, this does not necessarily ensure the harmonised *application* of the relevant rules and principles. Indeed, UCPD contains only high-level rules, and it is the MDEC Principles (and UCPD Guidance) which contains the most useful guidance about how to apply these rules and principles in the context of environmental claims. However, except as indicated below, most countries have not integrated the MDEC Principles into their national law.

Belgium has adopted its own guidance on environmental claims which is based on the UCPD Guidance and MDEC Principles, and various national guidance documents related to environmental claims.

France has not explicitly integrated the MDEC Principles into national law. However, the ARPP (French authority regulating advertisement) Sustainable Development Code[84] contains rules similar to certain MDEC Principles,[85] notably on the requirement to substantiate claims: ‘The advertiser must be able to support its sustainable development claims by means of evidence that is objective, reliable, truthful and verifiable at the time of advertising. For any message based on a scientific claim, the advertiser must be able to present the origin of the findings and methodology used for the calculation. Advertisements may not resort to demonstrations or scientific conclusions that do not conform to generally approved scientific findings.’

To our knowledge, Spain, Germany, Netherlands and Luxembourg have not integrated the MDEC Principles at national level. It is not compulsory for Member States to integrate the UCPD Guidance or MDEC Principles in their law, but considering the lack of detail of UCPD rules, the absence of transposition of UCPD Guidance and MDEC Principles leaves the responsibility for developing efficient rules against greenwashing to national bodies. As a result, there is a risk of heterogeneous regulation of environmental claims of financial products in the EU.

[83] For some Member States the transposition of 2019 amendments are still ongoing.
[84] ARPP Sustainable Development Code v3
[85] Such principles were not however expressed by AMF.

Limited comparability to finance sector specific regulation at national level

The UCPD allows Member States to set stricter rules in relation to financial services[86] and each Member State will have taken steps in relation to national implementation of the EU finance sector specific regulation. Table 5 below compares various national rules related to sustainability claims of financial products. It demonstrates that although EU level regulation seeks to provide a minimum level of harmonisation there are still significant differences between the national rulebooks which are potentially relevant to sustainability claims of financial products.

Table 5: Summary of national finance sector specific rules relevant to sustainable claims of financial products

Country	Summary of national rules relevant to sustainable claims of financial products
France	MIFID II rules on communication around financial products have been transposed in the Monetary and Financial Code.[87] The French authority of financial markets (**AMF**) adopted Doctrine DOC-2020-03 on information to be provided by collective investment schemes incorporating non-financial approaches. The Doctrine which is note legally binding sets out the following principle: 'the information sent to investors regarding consideration of non-financial characteristics should be proportionate to the actual consideration of these factors. Accordingly, only the approaches that are significantly engaging will be able to present non-financial criteria as a key aspect of product communication, e.g. in their name. Approaches based on a non-significant commitment may also adopt a "limited communication" proven that they comply with specific minimum standards.' The Doctrine also provides thresholds to determine whether the approach is based on significant commitments. Moreover, an advertisement by a financial institution is also subject to ARPP Recommendations. The ARPP Recommendations are the ethical rules applicable to advertising communication in France. The sustainable development recommendation (v3) has been in force since August 1, 2020, and applies to all products including the finance sector.
Netherlands	There are no finance-specific legal and regulatory requirements in respect of ESG. There are also no specific legal or regulatory rules on ESG marketing of products or services by a financial institution; marketing of ESG aspects is covered by the generic rules and regulations on marketing (e.g., article 24 of MiFID II). Specific rules on ESG aspects only relate to accountability and/or reporting on ESG matters by financial institutions.
Luxembourg	Specific finance sector rules only relate to the application of SFDR. The Commission de Surveillance du Secteur Financier (**CSSF**) requires market participants to submit an SFDR conformity confirmation letter for UCITS and AIFs. The confirmation letter requires sustainability claims made in pre-contract documentation to be underwritten by a statement which confirms the disclosures are accurate, clear and not misleading and that the remuneration policy and the risk management process have respectively been updated to be consistent with the integration of sustainability risks.

[86] Art 3(9) UCPD
[87] Art L 533-12 *Code Monétaire et Financier*

Belgium	In order to make a sustainability claim in relation to a financial product, the Belgian regulator (Financial Services and Markets Authority (**FSMA**)) has requested that financial institutions indicate the following on marketing documentation for such financial products: ● the sustainable selection criteria used for selecting investments; ● the methodology behind the sustainable selection criteria; ● the company responsible for assessing the sustainable selection criteria; and ● a reference to a webpage that provides more information about the inclusion of sustainability criteria in the investment objective.
Germany	The Federal Financial Supervisory Authority (**BaFin**) published their Draft Guidelines for Sustainable Investment Funds on 2 August 2021 to target misleading environmental claims. BaFin highlights that compliance with the transparency requirements of the SFDR alone is not sufficient for a fund to be described as 'sustainable' (whether in its name or otherwise) or to being marketed explicitly as a 'sustainable fund'. It then provides detailed criteria for a fund to qualify as sustainable investment fund.
Spain	The Comisión Nacional del Mercado de Valores (**CNMV**) has published criteria on the application of SFDR (the **Criteria**). The Criteria clarified that Collective Investment Schemes (**CIS**) that wish to qualify as an **ESG financial product**, may only include references to ESG elements in their commercial name only if the minimum percentage of investments in to achieve the environmental or social characteristics they promote exceeds 50%. In the case of general commercial communications for such products (outside the scope of their naming), references to ESG terms may be used provided that the communication content is aligned with the prospectus information in relation to ESG.

As illustrated in Table 5 above, it is difficult to compare the finance sector specific regulation between Member States. It is apparent that the rulebook at Member State level is quite different and what rules which do exist and are potentially relevant to sustainable claims of financial products are structured according to differing underlying logic. Certain jurisdictions have adopted rules related to the proportionality of the claim (see France), others focus on criteria to be considered as a sustainable fund and thus be allowed to make sustainable claims (see Germany) or on minimum information to be disclosed when making a sustainable claim (see Belgium) while others do not have any specific relevant provisions (Netherlands). All national finance sector specific regulation is similar on one point however in that no national regulation adheres to the notion of investor impact and the rulebook therefore suffers from the same problem as identified at EU level.

This heterogeneity of logic and approach at local level in relation to regulating environmental claims in the finance sector shows a lack of clear and sufficient guidance at EU level that is both detrimental for financial institutions and the level of protection of EU retail investors.[88]

[88] Differing rules on marketing according to each EU country oblige financial institution to have different marketing approaches and materials for each country of distribution. Moreover, considering local rules convey a different logic, the exercise creates legal uncertainty and risk for financial institutions. Heterogeneity of rules also creates inequalities in the level of protection of EU retail investors.

Information Box: Analysis of the practice in France, lack of compliance of environmental impact claims with UCPD rules and MDEC Compliance Criteria

In the second half of 2020, 2DII reviewed a sample of French funds marketed as having sustainability features and available to retail investors.[89] The objective was to identify trends in the use of impact claims that could not be substantiated i.e. claims in breach of UCPD rules and MDEC Principles. The analysis involved comparing the claims in marketing materials (brochure, website etc.) with available information on investment strategy and level of engagement in the regulatory documentation (KIID, prospectus). The database for the study included 521 French funds (representing USD 257 Billion AUM) with a sustainability-related focus and available to retail investors. The study showed that 68% of the funds were associated with environmental impact claims.

The analysis showed various ways in which environmental impact claims can be problematic in view of the MDEC Principles:

- Vague claims that are so broad in the benefit they refer to that no evidence could possibly support them on an objective basis. E.g. 'We aim at being responsible managers for our clients by ensuring that the way in which we invest assets creates societal positive impact and financial performance.'
- Unclear as to the aspect of the financial product that is supposed to generate the environmental impact. E.g. 'Green bonds give the investor certainty on the fact that its money will be beneficial on environmental terms.'
- Deceptive as they inaccurately link an investment in a fund to a specific environmental outcome in explicit terms which cannot rest on scientific evidence. E.g. 'Our sustainable funds have allowed us to realize this year: 430,000 tons of saved carbon emissions, which equates to 4 million trips from Berlin to Paris.'

This study showed that 12% of environmental claims were deceptive as they inaccurately linked an investment in a fund to a specific environmental outcome in explicit terms. 69% of environmental claims were unclear as to the aspect of the financial product that is supposed to generate environmental impact. 73% of environmental impact claims were too vague to be substantiated.[90] [91]

[89] 2DII, 2021, Sustainable Finance and Market Integrity: Promise only what you can deliver
[90] As for the previous research, 2DII was not able to find a single case where the impact claim could indisputably be deemed compatible with the MDEC Principles. This study has not been updated since 2020, however, considering legal framework has not evolved, it is most probable than wrongful practices have not disappeared. The fear of scandal could have however led certain financial institutions to be more caution about their impact claims (see development on Dekabank and DWS).
[91] A recent study analyzed 185 (so-called) impact funds based on an established classification scheme that outlines the requirements for factual impact investments. They found that only one third of the impact funds meet the outlined impact requirements. 'The Impact of Impact Funds – A Global Analysis of Funds With Impact-Claim', Lisa Krombholza, Timo Busch and Johannes Metzler, April 2022
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Section 3

Regulatory oversight and investor redress

This section analyses how the current procedure for regulatory oversight and enforcement and investor redress is not effective in the context of environmental impact claims in the finance sector.

While the previous section examined to what extent the regulatory framework governs the *content of an environmental impact claim* (or more broadly an environmental claim), this section analyses how the regulatory framework governs *what can happen in the event of an inaccurate or misleading environmental impact claim*. It focuses on two key aspects: (1) regulatory oversight and enforcement; and (2) investor redress. In the context of consumer distrust being a significant problem affecting the market for sustainable financial products[92] and an increasing awareness of the extent of greenwashing preventing sustainability minded consumers towards contributing to sustainability policy objectives (see *Section 1.4 The negative effects of greenwashing*), regulatory oversight and investor redress mechanisms are critical aspects to increasing retail investor trust and participation in financial markets.

Regulatory oversight and enforcement refer to the supervisory practices of financial regulators and other authorities to ensure market integrity and compliance with the regulatory framework. While there are many different regulatory tools which can be deployed to set supervisory expectations on a specific issue,[93] this section will focus on the extent to which regulators can take enforcement action in relation to a misleading environmental impact claim.

Investor redress refers to the enforcement of retail investor rights by demanding the cessation of an illegal activity or compensation for harm caused by misconduct.[94] As for regulatory oversight and enforcement, this section focuses on the extent to which investor redress is effective in the context of a misleading environmental impact claim.

3.1 Lack of comprehensive regulatory framework prevents efficient regulatory oversight and enforcement

Opportunities for regulatory oversight and enforcement

Where a financial institution makes an environmental claim which breaches the regulatory provisions articulated in the previous section of this paper then it may face regulatory action by different bodies.

Opportunities for action by financial regulators

In terms of finance sector specific regulation, the key sustainable finance regulations (e.g. SFDR, Taxonomy Regulation etc.) require that Member States provide competent authorities with all the supervisory and investigatory powers that are necessary for the exercise of their functions.[95] However, as demonstrated in the previous section, these sustainable finance regulations are of limited utility in the context of environmental impact claims.

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[92] 2DII, 2021, Sustainable Finance and Market Integrity, p.13.
[93] See our sister paper: 2DII, 2022, Integrating client preferences for sustainable investment into financial institution legal duties … still a way to go
[94] CFA Institute, 2015. Redress in Retail Investment Markets: International Perspectives and Best Practices. Note that investor redress does not refer to compensation of losses resulting from market risk or other risks borne by the investor legitimately.
[95] Art 14 SFDR and Art 21 Taxonomy Regulation

MiFID II similarly provides a general provision that competent authorities 'shall be given all supervisory powers, including investigatory powers and powers to impose remedies, necessary to fulfil their duties'[96] but also provides a very detailed list of the minimum supervisory powers which competent authorities must have.[97] MiFID II specifically requires that Member States enact rules to ensure that competent authorities may impose administrative sanctions.[98] The range of sanctions which Member States must allow for includes: (1) a public statement indicating the natural person or the legal entity responsible and the nature of the infringement; (2) an order requiring the natural person or legal entity responsible to cease the conduct constituting the infringement; and (c) pecuniary sanctions against both individuals and corporate entities.[99]

Opportunities for action by other regulators and notably competition regulators

In addition to action taken by financial regulators, financial institutions may face investigation and sanction by other regulators if their environmental claims breach the requirements under UCPD. Competition regulators often have jurisdiction over consumer protection legislation in relevant jurisdictions.

The UCPD is largely silent on the nature of sanctions which Member States may impose for breaches of the UCPD requirements, but Member States must impose penalties for infringements of the UCPD which are effective, proportionate and dissuasive.[100] Further, Member States must ensure that the court of an administrative authority has the necessary powers to enable them to order the cessation and/or prohibition of a practice which has been determined to be an unfair commercial practice.

In addition, it is worth noting that for both finance sector specific regulation and consumer protection regulation, while there is a variety of regulatory sanctions, the imposition of such sanctions mainly rely on national regulators' willingness to act. Indeed, enforcement by the regulator is unlikely to be an effective route of recourse for retail investors because they must complain to the regulator and then wait for the regulator to decide to take action.[101]

The problem for regulatory enforcement: it is impossible to demonstrate an environmental impact claim is in breach of a clear set of regulatory provisions

The main problem for effective regulatory oversight and enforcement do not stem from inadequate supervisory powers or ability to impose sanctions. These aspects of the regulatory toolkit continue to evolve alongside financial regulation generally so that regulators can take measures which are effective and dissuasive in relation to breaches of the regulation.[102]

Rather the problem for effective regulatory oversight and enforcement is that the regulatory framework does not provide effective governance in the context of environmental impact claims in the finance sector (as demonstrated in *Section 2 Critical analysis of the relevant regulatory framework*). There is an absence of specific legislation or regulation that addresses environmental impact claims in the finance sector, and the current legal and regulatory framework is not consistent with the distinction between investor impact and investee company impact.

This means that the regulatory framework is not sufficiently comprehensive to demonstrate an environmental impact claim is in breach of a clear set of regulatory provisions. In this context, regulatory action may fail

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[96] Art 69(1) MiFID II
[97] Art 69(2) MiFID II
[98] Art 70 MiFID II
[99] Art 70 MiFID II
[100] Art 13 UCPD
[101] While this is more likely in circumstances where many individuals raise a complain, the chance of success of such route remains uncertain.
[102] The scope of this paper does not include more holistic analysis as to whether regulators are furnished with all the necessary supervisory powers and ability to impose administrative sanctions which are necessary to ensure effective oversight.

regardless of the supervisory powers or ability to impose sanctions. Regulatory oversight and enforcement are simply not going to be possible when financial institutions are not in breach of a clear rule.

3.2 Obstacles to investor redress

Opportunities for legal claims by individual retail investors

In terms of judicial procedures, the court system functions as a tool of last recourse (e.g. when handling client complaints or alternative dispute resolution has not provided resolution). Retail investors can either bring individual actions or seek to be party to a collective action. The commentary below identifies the obstacles to a successful individual action before a national court in relation to a misleading environmental impact claim.

Opportunities for claims based on breaches of finance sector-specific regulation

None of the key finance regulations (MIFID II, SFDR, Taxonomy Regulation, EUGBS) contain specific requirements on Member States to provide a mechanism for individual retail investors to bring legal proceedings before a court.[103]

MiFID II requires Member States to set up complaints and redress procedures for out-of-court settlement of consumer disputes[104] and articulates various organisational requirements for keeping records etc. which can be used for handling client complaints.[105] These have not been examined in the scope of this paper which focuses on investor redress through judicial procedures (i.e. before a court).[106]

Opportunities for claims based on breaches of consumer protection regulation

The consumer protection regulation has a much more explicit focus on legal claims from consumers. Member States are required to put in place adequate and effective means to combat unfair commercial practices which ‘shall include legal provisions under which person or organisations regarded under national law as having a legitimate interest in combating [sic] unfair commercial practices … may: (a) take legal action against such unfair commercial practices; and/or (b) bring such unfair commercial practices before an administrative authority competent either to decide on complaints or to initiate appropriate legal proceedings.’[107]

A consumer which has purchased a financial product on the basis of an environmental impact claim from a financial institution would likely amount to a person having a legitimate interest in combatting unfair commercial practices and should therefore be able to seek redress under the legal rights of the UCPD.[108]

Other opportunities for claims

Notwithstanding all of the above, it is theoretically possible, that an individual retail investor might be able to bring a legal claim on a tortious basis (e.g. negligence). For example, such a legal claim might be possible where a financial institution has failed to carry out sufficient due diligence on the accuracy of an environmental impact claim. Similarly, this could give rise to a claim on the basis of misrepresentation. Additionally, the terms of an investment agreement may provide investors with grounds to bring a legal claim for breach of contract

[103] Moreover, as demonstrated in the previous section, sustainable finance regulations are of limited utility in the context of environmental impact claims.
[104] Art 75 MiFID II
[105] Art 16 MiFID II
[106] In addition, considering the high level of MIFID II rules, their utility for the line of enquiry of this paper, and notably for supporting legal claims by individual retail investors, is limited.
[107] Art 11 UCPD
[108] It should be noted that the UCPD also states that Member States may decide whether prior recourse to other established means of dealing with complaints is required before taking legal action. For example, a Member State may require that complaints against regulated firms are directed first via a financial ombudsman service, or an equivalent.

where an environmental impact claim is inaccurate (and replicated in the contract). However, these types of legal claims are very much in the theoretical realm at this stage in the absence of case law.[109]

The problems for successful legal claims by individual retail investors

Exposition of common legal and evidential obstacles to any legal claim in European jurisdictions[110]

The prospect of a retail investor successfully bringing legal action or seeking redress from a financial institution can arise in several ways but will always have to overcome certain legal and evidential obstacles. These include aspects such as causation (the loss suffered must be caused by the representation in the environmental claim), remoteness (the type of loss must be reasonably foreseeable) and quantum (assessing the value of the loss). In some instances, retail investors may have to establish a duty of care. Moreover, in most instances, retail investors will have to demonstrate that (a) it was reasonable to rely on the environmental impact claim, and/or (b) that the degree of reliance was justified.

The ability to bring such a legal claim will be highly fact-specific and practically/evidentially difficult, especially in the absence of case law. Moreover, passing these legal and evidential obstacles will be extremely difficult due to two critical conceptual problems.

Conceptual problem 1: It is impossible to demonstrate an environmental impact claim is in breach of a clear set of regulatory provisions

The first conceptual problem relates to the discussion above that the regulatory framework is not sufficiently comprehensive to demonstrate an environmental impact claim is in breach of a clear set of regulatory provisions. In this context, just as regulatory action may fail, so too may a legal claim from investors.

The concept of environmental impact claims is an industry term and not a legal concept recognised under existing EU law. As such, there are no specific requirements which directly apply to a statement by a financial institution to carry out impact investing or which purport to be an 'impact product', including in relation to how such products are marketed, promoted or distributed. Therefore, those terms are useful short hand to describe the intended impression a given statement is intended to make but they do not speak to whether they are made in a misleading manner, judged against legal tests/thresholds.

Conceptual problem 2: It is difficult (or impossible) to prove the loss caused by the misleading environmental impact claim

The second conceptual problem relates to the form which the redress takes. Generally, most investor redress claims are likely to be compensatory through seeking to recover lost monies or another form of damages. Other investor redress claims (albeit less common) may seek to rescind or end the contract/investment. This would lead to the return of invested sums as well as any applicable interest.

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[109] Financial institutions may also face legal claims for breach of client duties (although these legal claims are less directly relevant to misleading environmental impact claims). The MiFID II Amendments (Delegated Regulation (EU) 2021/1253) (which introduce a mandatory assessment of client *sustainability preferences* in the suitability assessment so that advisors must include questions on client sustainability preferences and any financial product recommendation must take account of sustainability preferences expressed by the client) will have a significant impact on the likelihood of individual retail investors bringing claims in relation to their sustainability preferences. The MiFID II Amendments require a financial institution to ensure client sustainability preferences are taken into account in the universe of products that are made available to the client. Where client sustainability preferences do not match the universe of investments available to the client then the financial institution must revisit the client's sustainability preference until such time as the sustainability preferences and the potential investments available do match. Where no match is possible the client cannot be sold or enter into relevant financial instruments or transactions. See our sister paper: 2DII, 2022, Integrating client preferences for sustainable investment into financial institution legal duties … still a way to go for further discussion.

[110] Such legal and evidential requirements may differ from one jurisdiction to another. Developments in this section aim at drawing a general view on legal and evidential requirements in Europe based on our sample of six countries.

By way of example: (a) in the context of an environmental claim that a financial product does not invest in coal, (b) which leads a retail investor to invest in the financial product, (c) but the financial product actually holds equities in a coal producer during the lifecycle of the product, the retail investor may try to bring an action on one of the following bases[111]:

- First, a retail investor may seek compensation on the basis that if the financial institution had ensured that the financial product followed the environmental claim (i.e. the financial product did not invest in coal) then the financial product would have achieved higher financial returns.
- Second, a retail investor may seek compensation on the basis that by investing in the coal producer, the financial institution has caused the retail investor to suffer a financial loss.
- Finally, a retail investor may seek compensation on the basis that the financial institution acted negligently in disregarding the retail investor's sustainability preferences by negligently investing in the coal producer (if the retail investor can establish a duty of care). If this led to the retail investor's investment being worth less than before the act of negligence occurred (i.e. it may not be possible to bring an action under negligence unless the financial product provides negative returns from the purchase date), it may seek compensation for the difference.

As illustrated above, the current legal framework does not provide opportunity for redress where an investor has not suffered a loss. And it is difficult to imagine how this loss could be considered outside the strict definition of personal financial loss (especially in the absence of case law or specific legal or regulatory provisions).

This means that, currently, a retail investor's legal claim against a financial institution because of a misleading environmental impact claim will not be successful unless that retail investor has suffered a financial loss. Proving the financial loss would be extremely difficult. [112]

Finally, in many cases there might not actually be any financial loss. The loss suffered by the retail investor may only be the lost opportunity to have a positive environmental impact (as initially promised by the marketing claim). But current legal redress framework does not cater for this type of loss. And if so, the question would remain on how to quantify and compensate it.

[111] Non-exhaustive basis
[112] Moreover, even where that retail investor has suffered a financial loss, this loss may not be commensurate to the environmental damage done by the retail investor's investment, which has been directed into an economic activity that they did not intend on the basis of the financial institution's environmental claim.

3.3 Lack of harmonisation at national level

As demonstrated above, the articulation of regulator supervisory powers and administrative sanctions is broadly drafted at EU level. Generally, the legislation is drafted so that supervision by competent authorities is proportionate and considers the nature, scale, complexity and diversity of entities and circumstances falling within scope of the legislation.

And while a minimum degree of harmonisation is apparent in relation to the supervisory powers and ability to impose sanctions,[113] there is still plenty of scope for variable oversight practices. *Annex 1* sets out further details on the national regulators at Member State level. It is possible to discern a divergence in relation to the extent to which sustainable finance, climate risk etc. is integrated into each national financial regulators' general oversight mandate and supervisory activities. We hypothesise that this divergence is more pronounced when looking at all Member States across the EU. Currently, while financial regulators in some Member States have taken active steps in relation to environmental claims within their supervisory mandate,[114] financial regulators in other Member States have remained largely silent. This divergence is likely to stem from a number of factors - while organisational mindset is likely to be a factor, so too are aspects such as organisational capacity, funding etc. Even for those Member States who have taken active steps, these steps still lack the required level of comprehensiveness to deal adequately with environmental impact claims themselves (as opposed to environmental claims more generally).

Investor redress is similar – while there may be a degree of harmonisation[115] ultimately each national legal system is different and will have a unique body of caselaw and jurisprudence.[116] And in addition to different national legal systems the collective mindset of retail investors may be very different. 2DII research into client preferences for sustainable investment has revealed subtle differences in prioritisation of sustainability issues and other aspects.[117] It would be interesting for further consumer research to focus on the extent to which retail clients are aware of their rights of redress or would be happy to use these rights of redress in a claim against a financial institution.

Any retail investor action relating to a misleading environmental impact claim is likely to focus first on the national regulatory framework. However, due to the problems identified in this paper (most notably, that the regulatory framework is not sufficiently comprehensive to demonstrate an environmental impact claim is in breach of a clear set of regulatory provisions) it is perhaps not surprising that there is very little by way of caselaw in this area. There are two well-known examples of financial institutions providing potentially misleading claims in an environmental context discussed in the following Information Boxes but neither of these examples have come before a court to date.

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[113] As evidenced through the articulation of supervisory powers and ability to impose sanctions in MiFID II and the general articulation of supervisory powers in SFDR and Taxonomy Regulation (for example).

[114] For example, as referred to in Annex 1, BaFin has taken action to protect investor from greenwashing through developing the *Guidelines for Sustainable Investment Funds* to target misleading environmental claims.

[115] For example, in relation to the MiFID II requirements for Member States to set up complaints and redress procedures for the out-of-court settlement of consumer disputes investment firms being subject to various organisational requirements for keeping records etc. which can be used for handling client complaints.

[116] Even if ultimately, the national jurisdiction is subordinate to the Court of Justice of the European Union which is responsible for ensuring EU law is interpreted and applied the same in every EU country.

[117] See 2DII, 2020, A large majority of retail clients want to invest sustainably. And 2DII, 2022, What do your client actually want?

Information Box: Case commentary on DekaBank

DekaBank in Germany released an Impact Calculator on the information page for the Deka-Sustainability Impact fund.[118] Potential investors could enter the investment sum to find out the potential environmental and social impacts of their investments.[119]

Baden-Wurttemberg Consumer Centre (**BWCC**), a consumer protection agency located in the German state of Baden-Wurttemberg, brought a case in the Frankfurt District Court claiming that the Impact Calculator is misleading to retail investors and seeking 'judicial clarification' on the impact claims DekaBank made about its Deka-Sustainability Impact fund. BWCC argued that while DekaBank's website says that the effects are achieved 'indirectly by investing in listed companies that match the investment objective of the fund,' this could mislead potential retail investors. Furthermore, the figures for the positive ecological impact are only based on an estimate and not all of the companies in the fund were taken into account. As a result, there is no evidence for the promised effects.[120]On the face of the information available about BWCC cause of action, it appears directly relevant to the line of enquiry of this paper.

Initially DekaBank said it would fight the case, with a spokesperson saying the legal claim was unfounded and citing various arguments in relation to the data being provided by service providers with decades of experience in reporting ESG and climate data and the presentation method having received an independent award. However, DekaBank subsequently removed the Impact Calculator and formally recognised the BWCC's claims. As a result, the court proceedings were terminated.

Information Box: Case commentary on DWS

German asset manager DWS is facing regulatory investigations over accusations that it made misleading statements about its use of sustainability criteria. There is currently a coordinated investigation by BaFin in Germany and the Securities and Exchange Commission (SEC) in USA.[121]

A former Group Sustainability Officer declared in the Wall Street Journal that DWS had exaggerated its ESG claims. She said that her revisions and objections regarding the volume of assets under ESG integration in the 2020 annual report were never included.

The annual report explained that DWS had €459 billion in what was termed integrated ESG assets. This is more than half of the total asset management of DWS but an internal assessment of ESG capabilities said that 'only a small fraction of the investment platform applies ESG integration.' The allegations are firmly rejected by DWS who has hired a law firm to assess all environmental allegations and not only the ones that are the subject of investigation.[122]

This example illustrates the multiple risks for a financial institution when faced with actions of this kind. When news of the investigation broken DWS's share price fell by 13.7% and if found to have exaggerated ESG claims then DWS could be order to re-label funds and offer financial compensation to misled clients or be condemned to fines. While the investigation is still ongoing, it may also raise questions in relation to third party advisory services with PwC both advising DWS on its net-zero neutrality strategy while investing greenwashing allegations.[123]

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[118] Citywire Selector, 2021, Deka fights lawsuit on misleading positioning of its impact equity fund
[119] Responsible Investor, 2021; DekaBank sued over 'misleading' fund impact calculator. The calculator gives five other metrics, including the amount of renewable energy produced and the amount of waste saved.
[120] Responsible Investor, 2021, DekaBank sued over 'misleading' fund impact calculator.
[121] Responsible Investor, 2021, UPDATED: BaFin and SEC investigate DWS over ESG allegations
[122] Bloomberg, 2021, Deutsche Bank's DWS orders fresh probe into greenwash claims.
[123] Natixis, 2021, Green-washing allegations are jolting the financial industry: heightened needs for cautiousness, integrity and guidance

Section 4

Recommendations

This section identifies recommendations to address the problems identified in this paper and ensure better market practice in relation to environmental impact claims in the finance sector.

There are several initiatives and activities which are apparent in the EU sustainable finance policy agenda which are relevant to the line of enquiry of this paper.

The *Strategy for Financing the Transition to a Sustainable Economy* takes up the mantle of the Commission's 2018 *Action Plan on Financing Sustainable Growth* in relation to developing a sustainable finance framework which reflects an evolved understanding of what is needed to meet EU sustainability goals and how the global context has changed. The Commission is currently developing the detail of the specific actions to be taken under this Strategy but has articulated the following areas of focus will be covered:

- *Addressing greenwashing:* With the support of the European Supervisory Authorities, the Commission will assess whether supervisory powers, capabilities and obligations are fit for purpose. Based on this assessment and the monitoring of greenwashing risks by the European Supervisory Authorities, the Commission will consider steps to ensure a sufficient, consistent level or enforcement and supervision to address greenwashing. Furthermore, the Commission will look to strengthen cooperation among all relevant public authorities, including Member States, the ECB, ESRB, the European Supervisory Authorities and the European Environment Agency, to work towards a common approach to monitor an orderly approach and ensure the double materiality perspective is consistently integrated across the EU financial system.

The *Strategy for Retail Investors* which is currently planned for the second quarter of 2022. While we are awaiting publication of this strategy to ascertain the precise actions and activities which will be included, the consultation which closed in August 2021[124] included various areas of focus:

- *Financial literacy:* Measures which the Commission can take to support and complement the financial education responsibilities of Member States to empower individuals to understand the risks and rewards surrounding retail investors, as well as the different options available.
- *Investor redress:* Examining aspects such as retail investor levels of knowledge in relation to redress procedures, effectiveness of existing out of court or alternative dispute resolution procedures at addressing consumer complaints relevant to retail investment and insurance-based investments, whether further efforts are needed to improve redress in the context of retail investment products and to what extent consumer redress is accessible to vulnerable consumers.

While these activities (either already articulated in relation to the *Strategy of Financing the Transition to a Sustainable Economy* or potentially indicated as an area of focus for the upcoming *Strategy for Retail Investors*) are highly relevant to the line of enquiry of this paper, there is no indication that the precise detail of these activities will extend to a specific focus on environmental impact claims of financial products.

In this context, the following recommendations are conceived so that they are either a standalone recommendation or so that the planned activities under each of the above strategies include a focus on their relevance to improving the regulatory framework which applies to environmental impact claims. In this regard, it would be highly beneficial to establish a body/working group at EU level to ensure coordination in the research activities and outputs.[125]

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[124] https://ec.europa.eu/info/law/better-regulation/have-your-say/initiatives/12755-Retail-Investment-Strategy/public-consultation_en

[125] 2DII intends to establish a working group built on the model of the EU Multi-Stakeholder Dialogue on Environmental Claims to address the issues identifies in this paper and identify clarifications and improvements needed to adapt the legal framework to the context of financial products as well as other measures to improve financial market practice in relation to environmental impact claims. These research outputs will be an invaluable starting point for the recommended body/working group at EU level.

4.1 Create an EU framework for environmental claims in the finance sector with a focus on environmental impact claims

The legal analysis in this paper reveals that it is difficult to map the legal rules applying to environmental impact claims in the finance sector and they are insufficient to provide effective governance.

At EU level, general finance rules which apply to marketing claims in the finance sector, such as MIFID II rules, are applicable to environmental impact claims, but these rules are too high level to provide effective governance of environmental impact claims.

Recent sustainable finance rules, such as those included in the SFDR or the Taxonomy Regulation, do not aim at regulating environmental impact claims of financial products. And an emerging trend of using SFDR categories (article 8 and article 9) as marketing labels create additional confusion and greater risk of greenwashing especially when combined with environmental impact claims. Indeed, SFDR does not adhere to the distinction between investor impact and investee company impact[126]. There is no requirement for Article 8 and Article 9 products to reveal investor impact[127], therefore the SFDR is not adapted to apply to environmental impact claims.

Furthermore, the provisions of UCPD are not sufficient for the finance sector context. While the consumer protection framework provides much more detailed guidance (in the form of the UCPD Guidance and MDEC Principles) about its application in the context of environmental claims, the absence of a definition of investor impact and the lack of recognised tools and methodologies to evidence investor impact (or impact potential) prevent the efficient application of UCPD rules in relation to environmental impact claims in the finance sector. The recent proposal to amend the UCPD[128] is a welcome initiative – but is likely to be insufficient to address the problems articulated in this paper. Indeed, it does not provide additional detail on how to apply the rules to environmental impact claims in the finance sector.

The lack of harmonisation of rules related to environmental claims at national level will also remain a problem. Indeed, the UCPD currently indicates that 'in relation to financial services […] Member States may impose requirements which are more restrictive or prescriptive.'[129] And furthermore, 'financial services and immovable property, by reason of their complexity and inherent serious risks, necessitate detailed requirements, including positive obligations on traders'. For this reason, in the field of financial services and immovable property, the UCPD is without prejudice to the right of Member States to go beyond its provisions to protect the economic interests of consumers.'[130]

We agree with the general principal that specific rules are required for the finance sector – and this need is particularly acute in the context of environmental impact claims in the finance sector. But the legal analysis in this paper reveals an urgent need for these rules at EU level rather than being written at Member State level. Finance specific rules at Member State level shows significant variability (in terms of areas of focus and underlying logic – see *Table 5: Summary of national finance sector specific rules related to sustainable claims*

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[126] See *Section 1.2 Exposition of an environmental impact claim in the finance sector* and *Section 2.2 Study of EU finance sector specific regulation.*

[127] Regarding Article 8, there is no regulatory criteria to specify eligible investment targets, investing styles, investing tools, strategies or methodologies to be employed. As a result, Article 8 products may apply various strategies (for example, screening and exclusion strategies) many of which are unlikely to have an environmental impact. The drafting of Article 9 merely refers to 'investing in an economic activity that has a positive impact.' As such, it fails to consider the causality angle i.e. what role the investor may have played in bringing about this positive impact. In addition, it fails to preserve the distinction between investor impact and investee company impact. Article 9 products refer to what might generally be understood as thematic investment more likely to fit the goals of investors looking for value alignment rather than impact. Despite the confusion created by Recital 21 of SFDR implicitly referring to article 9 as 'financial products which have as an objective a positive impact on the environment and society'.

[128] Proposal for a Directive amending Directives 2005/29/EC and 2011/83/EU

[129] Art 3(9) UCPD

[130] Recital 9 UCPD

of financial products thus resulting in legal uncertainty for financial institutions and unequal levels of protection for retail investors in EU.

To ensure a harmonised level of protection for retail investors against greenwashing, rules specific to environmental claims of financial products must be provided at EU level. This framework should particularly ensure the protection of retail investors against impact washing.

The Commission should provide specific rules at EU level to regulate environmental claims in the finance sector with a focus on environmental impact claims.

4.2 Create a category for impact-oriented financial products and provide methodologies and tools to evaluate the potential of impact

Alongside a framework at EU level for environmental claims (with a focus on environmental impact claims), further steps to integrate the notion of environmental impact in the finance sector are necessary. These include: (1) creating a category for impact-oriented financial products and (2) developing methodologies and tools to evaluate the impact potential at EU level.

Creating a category for impact-oriented financial products

There is a huge amount of uncertainty in relation to how impact-oriented financial products are accommodated (if at all) in the current approach to sustainable product classification. This uncertainty is apparent in terms of legal interpretation of the SFDR definitions of product categories, and it is also apparent in terms of market behaviour and how financial institutions are self-certifying their products according to SFDR.[131][132]The work on the EU Ecolabel is a first step towards integrating the notion of investor impact, however, it is only a voluntary framework that will not apply to all financial products. Moreover, the EU Ecolabel for financial products is currently on hold due to controversies surrounding whether to classify nuclear and gas power as green activities under the Taxonomy Regulation.

This uncertainty is detrimental to impact-oriented retail investors and financial institutions who are offering genuine impact-oriented financial products.

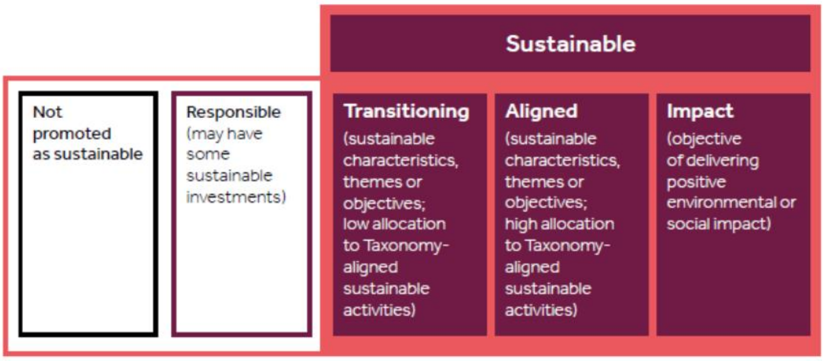
Improving the approach to sustainable product classification must create a separate category for impact-oriented financial products. This regulatory category should rely on a clear definition of the notion of impact distinguishing between investor impact and investee company impact.[133] *Furthermore criteria for this regulatory category should take into consideration the three pillars of impact: intentionality, additionality, and measurement.*[134] *Measurements should be done ex ante and ex post to assess if objectives have been achieved.*

[131] As referred to in this paper, a confusion has developed in the market between Article 9 financial products and impact-oriented financial products. For more detail refer to 2DII, 2021, Does the SFDR help the impact-focused retail investor?
[132] It is also now apparent in the definition of sustainability preferences of clients in MIFID II. Please refer to sister paper: 2DII, 2022, Integrating client preferences for sustainable investment into financial institution legal duties…still a way to go
[133] It can build on academic research as per Kölbel et al. (2020): 'The impact of an investor is the change that the investor has caused in the activities of the company benefiting from his investment. In the context of climate change mitigation, this change can either take the form of a growth in a "green" company' activities (e.g. a growth of its green power production) or of a change in the quality of a company's activities (e.g. an increase in the energy efficiency of a plant).'
[134] See F4T, 2021, Pledge for the development of Impact Finance: *'Impact Finance is an investment or financing strategy that aims to accelerate the just and sustainable transformation of the real economy, by providing evidence of its beneficial effects. It is based on the pillars of intentionality, additionality and impact measurement, to demonstrate:*
1. The joint search, over time, for an ecological and social performance and a financial return, while controlling the occurrence of negative externalities.

In this regard, 2DII's Climate Impact Management System (**CIMS**) provides a clear view on the notion of environmental impact of a financial product.[135] Another source of inspiration can be found in the work of the Paris Financial Centre Task force dedicated to Impact Finance launched in March 2021 by Finance for Tomorrow. The Paris Financial Centre Task force published a pledge for the development of Impact Finance in November 2021 that contains a definition of Impact Finance.[136] This option to create a specific category of impact-oriented products has already been proposed in the UK. The FCA has recently consulted on a proposed approach to a sustainable product classification and labelling system.[137] There are several aspects to the FCA's policy proposals which can serve as inspiration for improving the EU approach to sustainable product classification.

First, the proposed approach differentiates between *Impact* financial products (that aim to deliver positive environmental or social impact) and other types of sustainable financial products such as *Transitioning* and *Aligned* investment products (which can have varying degrees of sustainability). Second, the FCA is planning to develop detailed minimum criteria which are linked to tangible product features which determine how to categorise each financial product. For example, both *Sustainable-Transitioning* and *Sustainable-Aligned* are structured with underlying assets meeting sustainability criteria set out in the forthcoming UK Taxonomy, but the minimum proportion for *Sustainable-Aligned* is set at a higher level than for *Sustainable-Transitioning*.

Figure 2: FCA's proposed approach to sustainable product classification and labelling system



This proposed approach to sustainable product classification appears to offer significant scope for a framework which effectively articulates impact-oriented products as a separate category and is easier to use for both financial institutions and clients (e.g. simplification through ensuring the proportion invested in suitable underlying assets is included in the product classification criteria rather than clients choosing the minimum proportion to be invested in accordance with the criteria). Improving the approach to categorisation of sustainable financial products in a manner which accommodates impact-oriented financial products is a critical step to support the development of a framework at EU level for environmental claims (with a focus on environmental impact claims).[138]

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2. The adoption of a clear and transparent methodology describing the causal mechanisms through which the strategy contributes to the targeted environmental and social objectives, the relevant period of investment or financing, as well as the measurement methods – according to the concept of theory of change.
3. The achievement of environmental and social objectives aligned with frameworks of reference, in particular the Sustainable Development Goals, defined at the international, national and local levels.'

[135] 2DII, 2021, A Climate Impact Management System for Financial Institutions
[136] F4T, 2021, Pledge for the development of Impact Finance
[137] FCA, 2021, Discussion Paper (DP21/4) Sustainability Disclosure Requirements (SDR) and investment labels
[138] Furthermore, an approach to sustainable product classification which is predicated on tangible product features can enable clarification of the concept of sustainability preferences so that it can accommodate a better conception of client sustainability goals. In Switzerland, the Asset Management Association Switzerland (AMAS) and the Swiss Sustainable Finance (SSF) have recommended an approach to integrate sustainability across the asset management value chain including at entity level, product level and the point of sale or distribution level from the end-client perspective. Their recommendations include: (a) definitions of various sustainable investment approaches; (b)

Developing methodologies and tools to evaluate impact potential

Currently there is no tool or methodology recognised at EU level to substantiate environmental impact of financial products. We recommend the EU regulators to develop a framework to assist financial institutions in providing financial institutions with adequate methods to substantiate their environmental claims. As there is no mechanical and systematic link between climate actions/impact mechanisms and real-world impact, we recommend a two-step process to substantiate impact claims. The EU regulators should provide guidelines about how to i) present impact mechanisms deployed by financial products and ii) display evidence of achieved additional outcomes.

Regarding impact actions, there is an emerging understanding of the conditions in which different climate actions/impact mechanisms would be more or less likely to influence investee company behaviour and generate real world impact (i.e. impact potential). Several methodologies are being developed to evidence and evaluate the impact potential of a financial product.[139] 2DII's own work in this area builds on previous studies of investor impact by the Impact Management Project and University of Zurich to develop a Climate Impact Potential Assessment Grid.[140] This includes four criteria to assess the climate impact potential of a financial instrument:

- Signalling a commitment to the green energy transition;
- Servicing new or undersupplied markets;
- Providing flexible capital;
- Pressuring funded organisations to align their climate strategy with a 1.5°C scenario.[141]

Developing methodologies and tools to evaluate impact potential can support harmonisation of approaches and contribute to improved understanding of the mechanisms for investor impact. This empirical evidence can support both the work related to categorisation of sustainable financial products in a manner which accommodates impact-oriented financial products, as well as the work on substantiating environmental impact claims.[142]Regarding the demonstration of achieved investor impact, the EU regulators should also define the set of methods that can be used by financial institutions to back their impact claims and identify the minimum scientific level that is required. For financial institutions, there is a trade-off between accuracy and cost of impact evaluation methods that cannot be left unregulated.

The Commission should integrate the notion of environmental impact in the broader EU finance framework through (1) creating a category for impact-oriented financial products; and (2) developing methodologies and tools to evaluate the impact potential.

minimum criteria for implementation of each sustainable investment approach and related disclosures; and (c) a methodology for matching each sustainable investment approach to three main investor sustainability goals. See our sister paper *Integrating client preferences for sustainable investment into financial institution legal duties … still a way to go* for further discussion of this point.

[139] 2DII, 2021, Climate Impact Management System for Financial Institutions and F4T, Grid to evaluate the potential of contribution to the transition

[140] 2DII, 2021, I've Got the Power! Really? Assessing the Impact Potential of Financial Products Supporting the Energy Transition

[141] 2DII, 2021, I've Got the Power! Really? Assessing the Impact Potential of Financial Products Supporting the Energy Transition and F4T Grid to evaluate the potential of contribution to the transition (draft grid only currently available in French and applicable to investment funds)

[142] This action would fit in the EU initiative on substantiating green claims and the environmental performance of products & businesses**.** Indeed, as underlined by the EU: 'There is a proliferation of methods to measure and assess environmental impacts and a proliferation of labels and claims related to environmental information, which goes hand in hand with a proliferation of misleading environmental, including climate-related, claims.' Inception impact assessment on a legislative proposal on substantiating green claims, 20 July 2020

4.3 Establish guidance for responsible environmental impact claims in the finance sector

To assist financial institutions with regulatory compliance, clear guidance for responsible environmental impact claims must be developed. This guidance can build upon the methodologies and tools to evaluate potential of investor impact and foster a harmonized approach across all Member States.

A straw man of relevant criteria which should be included in this guidance for responsible environmental impact claims is below.

Make reality-based claims

Financial institutions should ensure that all information reported and documented is built around fact-based assumptions in order to limit misleading communication, in particular they should:

- Avoid ambiguous statements equating the deployment of a sustainable investment strategy (the means) with environmental impacts in the real economy (the ends). Clear differentiation between claims on intentions, actions or means, and outcomes is useful to ensure reality-based claims.
- Refrain from equating an evolution of the boundaries of their asset portfolio (e.g. divestment from an entity owning a coal-fired power plant) with environmental impacts in the real economy (e.g. closure of a coal-fired power plant replaced by renewables) as a direct consequence of their actions.
- Refrain from equating an increase in their allocation to certain financial assets (e.g. increase in green bond exposure, or assets under management in green funds) with an increase of investments in the real economy (e.g. increase in capital expenditure in green projects) as a consequence of their actions.

Moreover, claims should always use appropriate vocabulary. For example, avoid using inappropriate terms such as *financing*, which reflects a real cash flow, instead of *investment,* since it creates a confusion about the use of funds.

Substantiate claims (evidence-building)

Any institution that believes the deployment of an investment/lending approach (such as divestment from certain assets, the increase in allocation to other assets or the deployment of certain tools) will lead directly or indirectly to environmental impacts in the real economy should substantiate its claims by collecting evidence supporting the causal link between the financier's actions and the outcomes.

For this purpose, the institution should:

- Lay out each assumption made for the specific cause and the evidence available (ex-ante) to support the investment thesis.
- Collect further evidence (ex-post) and report how it supports—or contradicts—its thesis. This evidence-based approach aims to avoid any ambiguity between assumptions (i.e. divestment from coal mining companies prevents new coal projects from being financed) and facts and build evidence on an on-going basis to improve the investment thesis continuously.

Be transparent on additionality

An institution should refrain from suggesting that the environmental impacts of its investees and borrowers can automatically be credited to its investment/lending strategy and from reporting these impacts as if the financial institution itself was delivering them. A financier cannot automatically take credit for the investee's climate impact (i.e. low level and/or reductions of GHG emissions in the real economy) if there is no evidence that the financier's climate action was a key driver for the GHG emissions change. This involves refraining from suggesting that:

- The provision of financing to green activities brings a critical contribution to their development, if these activities do not face difficulties accessing finance in the first place;
- Its refusal to finance brown activities prevents the institution's access to finance, if the evidence suggests that the effect is fully offset by other finance sector players;
- Its strategy triggered the environmentally friendly practices of investees/borrowers if their decision were already made or have been primarily driven by other factors.

Be clear on the limits of the product

Investors should be clearly informed of the limits of the financial products. The use of disclaimers can be useful.

However, disclaimers should only be used to accompany fair, clear and not misleading communication complying with above principles and cannot be used to justify the use of unclear or ambiguous marketing claims. In other words, the retail investors should not have to read the content of the disclaimer to understand whether the financial products have a potential of positive impact on the environment.

Financial institutions should rely on solid marketing claims rather than over simplified and inaccurate ones in order to enhance trust and investment of retail investors in sustainable finance.

Constantly improve impact practices

The absence of scientific evidence on the effectiveness of various investment techniques in delivering real impact should not prevent leading financial institutions from implementing best practices and experimenting with new ones. Leading impact investors assess the effectiveness of their approach, acknowledge shortcomings, and learn from their mistakes to fine tune their investment thesis and approach.

Therefore, financial institutions should continue promoting their products with highest potential of positive impact as such.

Information Box: Next steps to advance the recommendations in this paper

To complement the theoretical review in this paper[143] 2DII is conducting an ongoing programme of interviews (with relevant stakeholders: EU and national policymakers, advertising SROs, financial institutions, competition and consumer protection authorities, judicial authorities, NGOs etc.). The purpose of this interview programme is to develop practical analysis of the specific challenges raised by the existing legal frameworks.

In addition, 2DII will be establishing a broad multi-stakeholder working group built on the model of the EU Multi-Stakeholder Dialogue on Environmental Claims. The goal of the working group is to develop further and advance the recommendations articulated in this paper. In particular: (1) assessing the clarifications and improvements needed to adapt the legal framework to the context of financial products; and (2) developing guidance for responsible environmental impact claims in the finance sector and integrating this guidance in existing rules and norms.

This working group will be coordinated by 2DII. The initiative will also be presented to the public and the sector through an inaugural public event, two workshops and a website.

[143] Together with the theoretical review in our sister paper: 2DII, 2022, Integrating client preferences for sustainable investment into financial institution legal duties … still a way to go

4.4 Review investor redress mechanism in the context of environmental impact claims

The existing avenues for investor redress may prevent a retail investor from making a successful legal claim in respect of misleading environmental claims generally (and environmental impact claims more specifically). The prospect of a retail investor successfully bringing legal action or seeking redress from a financial institution can arise in several ways but will always have to overcome certain legal and evidential obstacles (such as demonstrating causation between the breach and the loss, remoteness and quantum of the loss etc.). Passing these legal and evidential obstacles will be extremely difficult in the context of environmental impact claims due to two critical conceptual problems: (1) it is impossible to demonstrate an environmental impact claim is in breach of a clear set of regulatory provisions; and (2) it is difficult (or impossible) to prove the loss caused by the misleading environmental impact claim.

Currently, a retail investor's legal claim against a financial institution because of a misleading environmental impact claim will not be successful unless that retail investor has suffered a financial loss. Proving the financial loss would be extremely difficult.[144] Moreover, in many cases there might not actually be any financial loss. The loss suffered by the retail investor may only be the lost opportunity to have a positive environmental impact (as initially promised by the marketing claim).

As indicated at the start of this section, the Commission's 2021 consultation on what to include in the *Retail Investment Strategy* included a section on investor redress. And the response from ESMA's *Securities and Markets Stakeholder Group* reveals various problems associated with the current framework for investor redress in the EU.[145]

The focus on investor redress which is apparent in the consultation relates to the MiFID II complaint handling procedure and ADR/out of court procedures. This focus is necessary[146] and policy changes in response should advance the consumer protection agenda. But while there have been multiple changes to the regulatory framework which are intended to ensure client preferences for sustainable investment are considered by financial institutions, there has been limited or no consideration of what rights of redress clients should have in case of greenwashing or impact washing.

It appears key to review investor redress mechanism to ensure an efficient protection of retail investors against misleading environmental impact claims. Such review should focus on solving the two main obstacles highlighted previously: demonstrating an environmental impact claim is in breach of a clear set of regulatory provisions[147] and addressing the issue of loss in the context of misleading environmental impact claims.

In anticipation of the forthcoming Retail Investment Strategy, the Commission needs to ensure there is no barrier in the redress framework to retail investors who want to bring a claim against financial institutions in respect of misleading environmental impact claims

[144] Moreover, even where that retail investor has suffered a financial loss, this loss may not be commensurate to the environmental damage done by the retail investor's investment, which has been directed into an economic activity that they did not intend on the basis of the financial institution's environmental claim.
[145] ESMA Securities and Markets Stakeholder Group, 2021, SMSG response to the European Commission's consultation on the EU Strategy for Retail Investors
[146] In this regard, the feedback in the consultation response from the SMSG is useful for alerting to the generalised weaknesses in the redress framework.
[147] This demonstration does not seem possible without the creation of an EU framework for environmental claims in the finance sector with a focus on environmental impact claims and the creation of a category for impact-oriented financial products and development of methodologies and tools to evaluate the potential of impact.

It is also worth noting that the Commission's 2021 consultation on what to include in the *Retail Investment Strategy* also included a focus on financial literacy and the scope for Commission initiative to support financial education responsibilities of Member States. This was identified as an area with main scope for improvement by far more respondents (69% in total). There is also reference in the *Strategy for Financing a Transition to a Sustainable Economy* to the Commission working with the OECD and its International Network on Financial Education to improve citizens' financial literacy.[148]

The strategy articulates that increased financial literacy can have several benefits such as helping retail investors to improve their understanding of financial products, creating realistic expectations about risk and performance, increasing participation in financial markets and making investment decisions that are in line with their investment needs and objectives. However, what is missing from the materials available about improving financial literacy is a focus on sustainable finance literacy (i.e. an understanding of the various sustainability features which a financial product might have) or knowledge of investor redress mechanisms (to address the fact that retail investors are not sufficiently aware of how to enforce their rights).

The Commission work plan in relation to improving financial literacy must include provision for sustainable finance literacy and knowledge of investor redress mechanisms

4.5 Improve regulatory oversight of environmental impact claims

The lack of comprehensive regulatory framework prevents efficient regulatory oversight and enforcement. Indeed, it is not possible to have regulatory oversight and enforcement against misleading environmental impact claims if financial institutions are in compliance with a (albeit deficient) regulatory framework. Or alternatively, it is not possible to have regulatory oversight and enforcement against misleading environmental impact claims where the regulatory framework is not sophisticated or detailed enough to enable it.

But even despite these problems with the regulatory framework, there is still a concern that regulatory scrutiny of environmental impact claims – and broader environmental claims – is variable according to each Member State. And further that regulator capacity and expertise to effectively scrutinise the specific nature of environmental impact claims is lacking.

As set out previously, the Commission has revealed a focus on addressing greenwashing in last year's *Strategy for Financing the Transition to a Sustainable Economy*. With the support of the European Supervisory Authorities, the Commission will assess whether supervisory powers, capabilities and obligations are fit for purpose. Based on this assessment and the monitoring of greenwashing risks by the European Supervisory Authorities, the Commission will consider steps to ensure a sufficient, consistent level or enforcement and supervision to address greenwashing.

In addition, ESMA's *Sustainable Finance Roadmap 2022-2024*[149] identifies tackling greenwashing and promoting transparency as one of three priority areas for ESMA's sustainable finance work. The proposed follow up categories of activity to address this priority include:

- Organising case discussion focused on greenwashing issues among NCAs to establish a share understanding of key concepts;
- Providing guidance to the market and NCAs on how to apply various rules in the sustainable finance single rulebook;

[148] They will publish joint financial competence frameworks for adults and young people reflecting the skills and knowledge individuals need to support their financial wellbeing and to further access sustainable finance.
[149] ESMA; 2022, Sustainable Finance Roadmap 2022-2024

- Developing a common understanding of NCAs supervisory role in the area of sustainable finance and specifically on greenwashing;
- Contributing to further completing the EU single rulebook on sustainable finance while promoting its consistency with international initiatives; and
- Collecting and studying empirical evidence regarding the functioning of ESG markets and ESG products as well as cases of greenwashing to better understand current and developing market practices.

These initiatives are timely, and look set to be transformative in terms of activating regulatory oversight and harmonising practices. However as currently conceived, they look to enhance oversight of the regulatory framework as it currently stands. This means that there is a risk that this will do little to assist where the regulatory framework is deficient i.e. these activities will do little to assist with environmental impact claims which the regulatory framework cannot currently accommodate.

The focus on greenwashing in the Commission's Strategy for Financing the Transition to a Sustainable Economy and ESMA's Sustainable Finance Roadmap 2022-2024 must address the specific issue of supervision of environmental impact claims

In addition, the *Strategy for Financing the Transition to a Sustainable Economy* also refers to the Commission seeking to strengthen cooperation between all relevant public authorities in relation to monitoring an orderly approach and ensuring the double materiality perspective is consistently integrated. The authorities which are currently listed include Member States, the ECB, ESRB, the European Supervisory Authorities and the European Environment Agency – but what is clearly missing from this list is the competition authorities which provide oversight under the UCPD. Considering the regulatory uncertainty revealed in this paper – where an environmental impact claim may fall under the jurisdiction of different regulators who must ascertain compliance with different regulatory provisions – these competition authorities should also be included in the coordination process.

The Commission should ensure that competition authorities are included in the coordination process for public authorities envisioned for monitoring an orderly approach and ensuring the double materiality perspective is consistently integrated

Section 5

Conclusion

With increasing retail investor expectations for sustainable investment and a concurrent increase in marketing claims by financial institutions relating to the environmental credentials of their financial products and services, addressing the problem of greenwashing is a key priority to ensure financial markets are genuinely responding to the changing profile of retail investor expectations for sustainable investment. For those retail investors who are interested in having an impact through their investments (nearly half of all retail investors) the nature of environmental impact claims (as a sub-category of environmental claims) is a particularly complex issue. Several pieces of EU legislation can apply to these claims though the analysis in this paper reveals that none are sufficient to prevent greenwashing based on environmental impact claims (i.e., impact washing).

While general finance rules are applicable to environmental impact claims in the finance sector, these rules are too general and high level to provide effective governance of environmental impact claims. In addition, the sustainable finance rules do not provide further assistance since they are not adapted to regulate environmental impact claims. Indeed, the current sustainable finance regulation does not integrate the concept of investor impact and consequently is not aligned with the theories of attribution differentiating investee company impact and investor impact. Even worse, market practices that use SFDR categories as marketing labels may create additional confusion and greater risk of greenwashing, especially when combined with environmental impact claims. Furthermore, the provisions of UCPD are not sufficient to regulate environmental impact claims in the finance sector. Indeed, the absence of a definition of environmental impact of the investor and the lack of recognised tools and methodologies to evidence impact prevent the efficient application of UCPD rules in the finance sector. All these issues are compounded by variability of approach at Member State level. National rules applicable to environmental claims show a lack of harmonisation not only in the content of the rules but also in their core logic, creating legal uncertainty for financial institutions and unequal level of protection for retail investors in Europe.

Further problems for effective governance of environmental impact claims are apparent when analysing regulatory oversight and enforcement and the legal framework for investor redress. Regulatory authorities and retail investors will be confronted with the fact that it is impossible to demonstrate an environmental impact claim is in breach of a clear set of regulatory provisions. Moreover, considering it is difficult (or impossible) to prove the loss caused by the misleading environmental impact claim, current investor redress mechanism cannot be efficient.

At EU level, addressing greenwashing is a key aim for the Commission and the recommendations in this paper are conceived so that they refine and improve the focus of several initiatives and activities which are already apparent in the EU sustainable finance policy agenda:

- As a first step, the Commission should provide specific rules at EU level to regulate environmental claims with a focus on environmental impact claims.
- Further steps to integrate the notion of environmental impact in the finance sector are necessary. These include: (1) creating a category for impact-oriented products; and (2) developing methodologies and tools to evaluate the impact potential.
- Developing guidance for responsible environmental impact claims can assist financial institutions with regulatory compliance.
- Further research is required to identify suitable adaptations to the redress framework to ensure it is not a barrier to retail investors who want to take action against financial institutions in respect of misleading environmental impact claims.
- Finally, an assessment of supervisory activities and capabilities in relation to the current regulatory framework to analyse where it impedes the effective discharge of oversight responsibilities in relation to environmental impact claims should assist with enhancing market integrity.

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Legislation

International Level

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Minamata Convention on Mercury, United Nations, 2019

EU Level

Delegated Regulation (EU) 2017/565 of 25 April 2016 supplementing Directive 2014/65/EU of the European Parliament and of the Council as regards organizational requirements and operating conditions for investment firms and defined terms for the purposes of that Directive

Directive 2005/29/EC of the European Parliament and of the Council of 11 May 2005 concerning unfair business-to-consumer commercial practices in the internal market and amending Council Directive 84/450/EEC, Directives 97/7/EC, 98/27/EC and 2002/65/EC of the European Parliament and of the Council and Regulation (EC) No 2006/2004 of the European Parliament and of the Council ('Unfair Commercial Practices Directive') **(UCPD)**

Directive 2014/65/EU of the European Parliament and of the Council of 15 May 2014 on markets in financial instruments and amending Directive 2002/92/EC and Directive 2011/61/EU **(MiFID II)**

Directive 2014/95/EU of the European Parliament and of the Council of 22 October 2014 amending Directive 2013/34/EU as regards disclosure of non-financial and diversity information by certain large undertakings and groups **(NFDR)**

Directive (EU) 2019/2161 of the European Parliament and of the Council of 27 November 2019 amending Council Directive 93/13/EEC and Directives 98/6/EC, 2005/29/EC and 2011/83/EU of the European Parliament and of the Council as regards the better enforcement and modernisation of Union consumer protection rules

Regulation (EU) 2017/1129 of the European Parliament and of the Council of 14 June 2017 on the prospectus to be published when securities are offered to the public or admitted to trading on a regulated market, and repealing Directive 2003/71/EC

Regulation (EU) 2019/1156 of 20 June 2019 on facilitating cross-border distribution of collective investment undertakings and amending Regulations (EU) No 345/2013, (EU) No 346/2013 and (EU) No 1286/2014 **(CBDF)**

Regulation (EU) 2019/2088 of the European Parliament and of the Council of 27 November 2019 on sustainability-related disclosures in the financial services sector **(SFDR)**

Regulation (EU) 2020/852 of the European Parliament and of the Council of 18 June 2020 on the establishment of a framework to facilitate sustainable investment, and amending Regulation (EU) 2019/2088 **(Taxonomy Regulation)**

National Level

Belgium

Belgian Economic Law Code

France

Article L 533-12 French monetary and financial code

Article L 121-1 and the following of the Consumer Code

Article L 229-68 of the Environmental Code

French law n° 2019-486 (**Loi Pacte**)

French law n°2021-1104, Climate and resilience

Germany

Act against unfair Competition, Gesetz gegen den unlauteren Wettbewerb, (**UWG**)

German Investment Code, Kapitalanlagegesetzbuch, (**KAGB**)

German Securities Prospectus Act, Wertpapierprospektgesetz, (**WpPG**)

German Capital Investment Act, Vermögensanlagengesetz, (**VermAnlG**)

German Securities Acquisition Act, Wertpapierübernahmegestz, (**WpÜG**)

German Civil Code, Bürgerliches Gesetzbuch (**BGB**):

Draft Act on Corporate Due Diligence in Supply Chains, Lieferkettensorgfaltspflichtgesetz, (**LkSG** or **Supply Chain Act**).

Luxembourg

Luxembourg law of 29 April 2009 on unfair commercial practices

Law of 8 April 2011 introducing a Consumer Code

Luxembourg law of 25 November 2005 on Public Access to Environmental Information

Netherland

Dutch Civil Code

Spain

Unfair Competition Law 3/1991

Antitrust Law 15/2007 regarding unfair contractual terms

General Consumer and User Protection Law 1/2007

General Law on Advertising 34/1988

Retail Trade Law 7/1996

Law 11/2018 on non-financial disclosure and diversity information

Annex 1: Country specific rules

Spain

Finance specific legal and regulatory requirements

The Comisión Nacional del Mercado de Valores (**CNMV**) has published criteria on the application of SFDR (the **Criteria**).[150]

The Criteria clarified that Collective Investment Schemes (**CIS**) that wish to qualify as an "ESG financial product", may only include references to ESG elements in their commercial name only if the minimum percentage of investments in to achieve the environmental or social characteristics they promote exceeds 50%. Therefore, CIS in Spain must achieve this threshold of sustainable investments in order to make an environmental claim that they are an ESG financial product.

It is unclear from the Criteria what an underlying asset which achieves "environmental or social characteristics" is.

In the case of general commercial communications for such products (outside the scope of their naming), references to ESG terms may be used provided that the communication content is aligned with the prospectus information in relation to ESG. As such, CIS must only make environmental claims which are aligned with their investment objective, investment policy and/or investment process as set out in the relevant fund documentation.

Transposition of UCPD

Directive 2005/29/EC (**UCPD**) has been implemented in Spain by, amongst others, means of the following main Acts:

- Unfair Competition Law 3/1991;
- Antitrust Law 15/2007 regarding unfair contractual terms (Article 3);
- General Consumer and User Protection Law 1/2007;
- General Law on Advertising 34/1988; and
- Retail Trade Law 7/1996.

Adoption of MDEC guidance on environmental claims

We are not aware of the MDEC guidance being implemented in Spain.

Statements by local regulators in relation to environmental claims

We are not aware of any statements by local regulators in relation to the issuance of misleading environmental claims. However, there are statements in relation to the enhancement of supervision regarding sustainability practices more generally, in particular:

- **CNMV- Program of Activities 2022**: contains some declarations stating that the CNMV it will carry out a horizontal review regarding the implementation of ESG regulation within the financial institutions.[151]

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[150] The publication is only available in Spanish but can be found here: https://www.cnmv.es/docportal/Legislacion/FAQ/PyR_Sostenibilidad_pdtos_financieros.pdf
[151] https://www.cnmv.es/DocPortal/Publicaciones/PlanActividad/Plan_Actividades_2022.PDF

- **Bank of Spain- Strategic Plan 2024**: mentions that research priorities will focus, firstly, on analysing the sustainability information content being published in corporate reports. Secondly, they will deepen their knowledge of the market for "green" financial products. Thirdly, it will assess the extent to which public debt markets are taking sustainability factors into account.[152]

Grounds for retail action in relation to environmental claims

With regards to the transposition of the UCPD, the Spanish legislator decided to implement a combination of civil and administrative system for the punishment of the practices contained in this Directive. Typically, clients can bring a claim in courts based in civil liability: contractual and tort liability.

Given the public-legal interest pursued in repressing these practices, consumer authorities can also carry out an administrative sanctioning procedure which can be initiated by the authority or on the basis of a complaint. In this case, the decisions of these authorities are subject to review by the administrative courts.

In these legal acts, civil action initiated by clients (either individual or collective action) can include, among others: declaration of disloyalty; action of cessation of the unfair conduct or prohibition of its future repetition; action to remove the effects produced by the unfair conduct; action to rectify misleading, incorrect or false information; action for compensation for damages and losses caused by the unfair conduct, if the agent has acted with malice or negligence.

General Consumer and User Protection Law 1/2007 (also in line with UCPD) foresees the out of court system for resolving disputes between consumers and users and entrepreneurs known as the Consumer Arbitration System, provided that the dispute does not involve intoxication, injury or death or there are reasonable indications of a crime.

Finally, with regards to non-Financial Information published by companies, investors could seek misrepresentations (including that contained in the NFRD implemented in Spain through Law 11/2018 on non-financial disclosure and diversity information).

[152] https://www.bde.es/f/webbde/INF/MenuVertical/AnalisisEconomico/PRIORIDADES.pdf

Germany

Finance specific legal and regulatory requirements

Although not currently in force, the Federal Financial Supervisory Authority (**BaFin**) published their Draft Guidelines for Sustainable Investment Funds' on 2 August 2021 (the **Draft Guidelines**) to target misleading environmental claims. The consultation period for the Draft Guidelines closed on 6 September 2021 and the Draft Guidelines are expected to apply in the near future.

The Draft Guidelines apply only to public (retail) funds, while special funds for institutional investors remain subject to the European requirements for sustainability for the time being. They also apply to all public funds which either have a particular reference to sustainability in their name or are being distributed and marketed as primarily and explicitly sustainable.

The Draft Guidelines do not affect the obligations under the SFDR and the Taxonomy Regulation.

However, BaFin highlights that compliance with the transparency requirements of the SFDR alone is not sufficient for a fund to be described as 'sustainable' (whether in its name or otherwise) or to being marketed explicitly as a 'sustainable fund'. Instead, a relevant fund can only qualify as a sustainable investment fund, if it falls within one of the following categories:

- (a) maintains investment holdings of above a threshold level of "sustainable investments";
- (b) pursuit of a sustainable investment strategy; or
- (c) replication of a sustainable index.

An investment fund shall only be regarded as sustainable under category (a) above if its investment restrictions explicitly require that a minimum of at least 75% of the investments of the fund are invested in 'sustainable investments'. BaFin refers to Article 2(17) SFDR for a definition of 'sustainable investments' and additionally expects that certain minimum thresholds (e.g. minimum proportion of revenue generated from renewables) and certain negative screening criteria (e.g. no acquisition of fossil fuel electricity suppliers) are taken into consideration in order for an investment fund to make a claim to be 'sustainable'.

In addition, private equity funds and other public funds investing in financial instruments must comply with additional requirements. They are required to implement in their investment policy that their portfolio-companies:

- (a) make a material contribution to the environmental and social objectives of the Taxonomy Regulation;
- (b) the governance requirements of Art. 2(17) SFDR are realised; and
- (c) no significant harm is done to the environmental and social objectives of the Taxonomy Regulation.

BaFin provides explicit thresholds which automatically lead to the consequence that an investment and the corresponding fund no longer qualify as sustainable, and therefore prevent in-scope financial institution's making an environmental claim that it is sustainable. At portfolio-company level, the revenue must not be generated from:

- (a) more than 10% from energy production or other utilization of fossil fuels or nuclear power, (noting that natural gas is excluded);
- (b) more than 5% from mining of coal or oil;
- (c) any extension, exploration or services regarding tar sands and shale oil.

Real estate and other funds investing in physical assets are required to ensure in their investment policy that a material contribution to the environmental and social objectives of the Taxonomy Regulation is made at the portfolio-level is made whilst also complying with the 'do no significant harm' principle, in order for an FI to make an environmental claim that the fund is 'sustainable'.

This principle also applies funds which have a ‘sustainable investment strategy without fixed investment restrictions’ and to funds which replicate a sustainable index. These funds then qualify as ‘sustainable’ funds as well.

Finally, BaFin provides some examples of statements which do not comply with the requirements contained in the Draft Guidelines, for example: ‘The special funds (Sondervermögen) is composed of debt chosen on the basis of aspects of sustainability in a proportion of 75 %’ is considered as having an investment strategy too broad to be eligible to be described as ‘sustainable’. It does not fall into either of the other categories as it does not follow a sustainable index or invest in 75% of "sustainable investments" (as defined in SFDR).

Transposition of UCPD

UCPD has been transposed in German law by amending the Act against unfair Competition in 2008 and 2015 (*Gesetz gegen den unlauteren Wettbewerb*, **UWG**). The German legislator did not establish a separate legal framework for the protection of retail clients from unfair competition practices, but rather included the UCPD into its existing competition framework for market participants. Therefore, the UWG covers both business-to-business and business-to-consumer relationships.

The German legislator follows a principal-based approach and relies on general clauses with a broader scope. Importantly, there are no finance or ESG specific elements to UCPD's implementation in Germany (UWG).

In Germany, further specifications and interpretations compliant with UCPD are ensured by case law. As the EU requires full harmonisation of UCPD, there is no gold plating. Necessary imitations to the general clauses are ensured by German harmonised jurisdiction.

Adoption of MDEC guidance on environmental claims

There is no adoption of the MDEC guidance on environmental claims. Environmental claims are treated under the general rule of Section 5 UWG and the corresponding general case law on unfair commercial practices. Similarly, the German regulator for competition Bundeskartellamt has not referred to the MDEC.

Statements by local regulators in relation to environmental claims

BaFin issued a general statement that it intends to target greenwashing in its supervisory practice in the upcoming years (e.g. as a medium-term target to protect consumers from irritating marketing practices in relation with sustainability).[153]

Grounds for retail action in relation to environmental claims

Consumer claim under competition law

In order to implement inter alia Article 11a of UCPD (and Directive (EU) 2019/2161) into German law, the German legislator amends the UWG with effect of 28 May 2022. A newly introduced claim pursuant to Section 9 (2) UWG for damages caused by and limited to unfair commercial practices within the meaning of the UCPD. Competitors can also raise compensation claims under Section 9 (1) UWG and the consumer claim is by design and wording rather limited in its scope of application and is of less practical relevance.

General civil law claims

General civil law claims that could potentially be leveraged in this context include:

[153] Bafin Medium-term objectives

- Section 306 (1) German Investment Code (Kapitalanlagegesetzbuch, "**KAGB**") regarding UCITS-funds and if applicable Section 307 (3) for (semi-)professional investors regarding AIFs: If information in the sales prospectus that is material to the assessment of the shares or stock is incorrect or incomplete;
- Section 306 (2) KAGB: If information contained in the key investor information is misleading, incorrect or inconsistent with the relevant parts of the sales prospectus;
- Further product-specific liability provisions, such as Section 8 et seq. German Securities Prospectus Act (Wertpapierprospektgesetz, WpPG; the German complementation of Prospectus Regulation (EU) 2017/1129). Section 20 et seq. German Capital Investment Act (Vermögensanlagengesetz, VermAnlG), Section 12 German Securities Acquisition Act (Wertpapierübernahmegestz, WpÜG);
- Sections 280 (1), 311 (1) and (2) German Civil Code (Bürgerliches Gesetzbuch, **BGB**): If precontractual (disclosure/information) obligations are breached (e.g. by misleading ESG information), and the breach is both material and causal for the investor to enter into the transaction. (Note: This is the general rule for civil claims based on breach of precontractual (prudence) obligations.)
- Section 823 (2) BGB: This would be the case if ESG related disclosure obligations are considered as "protective laws"; this has not yet been decided by court and is highly debated.
- Section 826 BGB: If the investor is intentionally and immorally harmed. We consider a liability risk under this provision as low. Liability is more likely to be established by this if an entity (e.g. investment firm or credit institution) is purposefully using information that is misleading the investor that the financial product is taxonomy-compliant / SFDR-compliant.

There is still great legal uncertainty concerning consumer claims based on failed ESG disclosure obligations, as these obligations are new and subject to case law yet to come.

The German government agreed on the draft Act on Corporate Due Diligence in Supply Chains (Lieferkettensorgfaltspflichtgesetz, **LkSG** or **Supply Chain Act**). The LkSG generally enters into force as of 1 January 2023. This Supply Chain Act obliges large companies located in Germany to better fulfil their responsibility in the supply chain with regard to respect for internationally recognized human rights by implementing the core elements of human rights and environmental due diligence obligations. For example, affected companies have to consider potential infringements of environmental related international treaties such as Minamata Convention on Mercury, or Basel Convention to reduce the movements of hazardous waste. Companies subject to the LkSG are required to conduct appropriate human rights and environmental due diligence in their supply chains. However, the Act provides for a liability provision (the nature of which is not fully clear at this time) according to which "a breach of the obligations arising from this Act shall not give rise to civil liability. Any civil liability established independently of this Act shall be unaffected."

Belgium

Finance specific legal and regulatory requirements

In order to make a sustainability claim in relation to a financial product (including retail funds and structured products), the Belgian regulator (Financial Services and Markets Authority (**"FSMA"**)) has requested[154] that financial institutions indicate the following on marketing documentation for such financial products:

- the sustainable selection criteria used for selecting investments;
- the methodology behind the sustainable selection criteria;
- the company responsible for assessing the sustainable selection criteria; and
- a reference to a webpage that provides more information about the inclusion of sustainability criteria in the investment objective.

Transposition of UCPD

The UCPD is transposed in Belgian law by article I.8, article VI.38 and article VI.92 to article VI.103 of the Belgian Economic Law Code without any gold-plating provisions.

Directive (UE) 2019/2161 which amends the UCPD has not yet been transposed in Belgian law (legislative process is ongoing). The articles implementing the UCPD into Belgian law do not contain ESG specific elements.

Adoption of MDEC guidance on environmental claims

Belgium has adopted its own guidance on environmental claims which is based on the European Commission's guidance on the implementation of the Unfair Commercial Practices Directive 2005/29/EC, the multi-stakeholder group's guide to the implementation of the Unfair Commercial Practices Directive, and various national guidance documents related to environmental claims (e.g. the English and the French guidance).

Statements by local regulators in relation to environmental claims

We are not aware of any statements from the Belgian financial services regulator **(the FSMA)** and we are not aware of any enforcement action by the FSMA in relation to environmental claims.

The FSMA talks about greenwashing generally and the fact that information about a financial product should not be misleading in its 2020 annual report, but solely in the context of the SFDR and not in the context of the UCPD.

Grounds for retail action in relation to environmental claims

Based on article VI.38 of the Belgian Economic Law Code and general civil law, consumers which have been misled can ask for damages and for the reimbursement of part or all of the sums that they have paid. In certain cases, pursuant to article VI.38, judges may order a seller, when they estimate it proportionate, to reimburse in full a consumer without requesting that consumer to return the product.

[154] FMSA 2020 Annual Report, pp28-29, accessible here: https://www.fsma.be/fr/rapports-anuels/rapport-annuel-2020-version-pdf

Luxembourg

Finance specific legal and regulatory requirements

The Commission de Surveillance du Secteur Financier (**CSSF**) requires market participants to submit an SFDR conformity confirmation letter for UCITS and AIFs.

The confirmation letter requires sustainability claims made in pre-contract documentation to be underwritten by a statement which confirms the disclosures are accurate, clear and not misleading and that the remuneration policy and the risk management process have respectively been updated to be consistent with the integration of sustainability risks. From a practical perspective, the CSSF has adopted a lighter touch approach when reviewing the disclosure included in the pre-investment information for regulated AIFs, compared to the disclosure included in the prospectus of UCITS.

General administrative penalties may apply to FIs under relevant sectoral legislation for failure to comply with disclosure requirements under SFDR. Penalties for non-compliance include injunctive relief without proof of actual loss/damage or of intention/negligence on the part of the advertiser, publication of a finding of such unfair practices in the newspapers and fines (ranging between EUR 251-120,000). An FI may have a defence to such findings if they can show evidence to prove the factual accuracy of the sustainability claim.

Transposition of UCPD

The UCPD was transposed into Luxembourg law by the Luxembourg law of 29 April 2009 on unfair commercial practices.

However, this law was abolished (by the law of 8 April 2011 introducing a Consumer Code) and its provisions were included in Articles L. 121-1 to L. 122-8 and L 320-2 of a new Consumer Code. We are not aware of any gold-plating of the UCPD.

Adoption of MDEC guidance on environmental claims

As far as we are aware, the MDEC guidance has not been adopted in Luxembourg.

Statements by local regulators in relation to environmental claims

As far as we are aware, the local regulators have not made any statements of taken enforcement action in relation to misleading or false environmental claims.

Grounds for retail action in relation to environmental claims

On the basis of the Luxembourg law of 25 November 2005 on Public Access to Environmental Information, a retail client has the right to obtain access to environmental information held by or on behalf of public authorities.

In this context, in one of the most significant climate change related cases in Luxembourg to date, Greenpeace Luxembourg had in 2019 requested the Minister for Social Security supervising a public pension fund to obtain information on, among other things, the fund's compliance with the targets of the Paris Agreement.

So far, there are no general provisions on class actions and group litigation under Luxembourg law. However, there is a draft bill of law aiming to introduce a class action on consumer law.

France

The French rules applying to the environmental impact claims in the finance sector are scattered in different regulations and codes. The consumer protection regulation applies in a suppletive manner to financial regulations (i.e. if there are no financial regulations on the subject, we will look into commercial law). Moreover, the hard law does not currently take into consideration environmental claims in the finance sector. Thus, we need to refer to the soft law for such matter.

Finance specific legal and regulatory requirements

In relation to the communication of financial products, MIFID II (directive 2014/65/UE[155]) has been transposed in the French monetary and financial code at the article L 533-12[156]**: '**All information, including promotional communications, addressed to investors shall be accurate, clear and not misleading'*.* [157]

There are several finance-specific legal and regulatory requirements in respect to ESG, they are however not related to marketing claims, for example:

- Asset managers must specify in their annual report how criteria relating to compliance with social, environmental and governance objectives are considered in their investment policy.[158]
- In 2019, the French law n° 2019-486 (**Loi Pacte**) created the obligation to propose in life insurance products at least one unit labelled Greenfin, SRI, or Finansol. Moreover, every year the client must receive information concerning the policy for integrating environmental and social impacts into the management of the contract's euro fund, as well as the amounts invested in labelled funds.

Transposition of UCPD

Transposition of the directive 2005/29/EC[159] as known as UCPD in the Consumer Code at the article L 121-1 and the following[160]:

'Unfair commercial practices are prohibited.
A commercial practice is unfair if it is contrary to the requirements of professional diligence and materially distorts or is likely to distort the economic behaviour of the consumer who is reasonably well informed and reasonably observant and circumspect with regard to a good or service.
The unfairness of a commercial practice aimed at a particular category of consumers or group of consumers who are vulnerable by reason of mental or physical infirmity, age or credulity shall be assessed in the light of the average capacity of discernment of the category or group.'

Adoption of MDEC guidance on environmental claims

MDEC Compliance Criteria have not explicitly been integrated into French law. However, a Sustainable Development Code updated in 2020 by the Self-regulatory organization that oversees advertising practices in France (ARPP) contains principles similar to MDEC principles and criteria**[161].** It focuses on advertising

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[155] Directive 2014/65/EU of the European Parliament and of the Council of 15 May 2014 on markets in financial instruments and amending Directive 2002/92/EC and Directive 2011/61/EU
[156] Transposition order n° 2017-1107
[157] Also see article 314-6 of the general regulation of the French financial market authority
[158] L 533-22-1 et D 533-16-1 du code monétaire et financier
[159] Directive 2005/29/EC of the European Parliament and of the Council of 11 May 2005 concerning unfair business-to-consumer commercial practices in the internal market and amending Council Directive 84/450/EEC, Directives 97/7/EC, 98/27/EC and 2002/65/EC of the European Parliament and of the Council and Regulation (EC) No 2006/2004 of the European Parliament and of the Council
[160] Transposition order n°2016-301
[161] ARPP, 2020, Sustainability Code V3

practices and provides guidelines for ‘ecological argumentation, whether or not it refers to the concept of sustainable development’ among which:

‘2. Truthfulness of actions
2.1 Advertisements must not mislead the public about the actual actions of the advertiser or the properties of its products in terms of sustainable development.
2.2 The actions of advertisers and the properties of their products in this area should be significant before a claim can be made.
2.3 The advertiser must be able to support its sustainable development claims by means of evidence that is objective, reliable, truthful and verifiable at the time of advertising. For any message based on a scientific claim, the advertiser must be able to present the origin of the findings and methodology used for the calculation. Advertisements may not resort to demonstrations or scientific conclusions that do not conform to generally approved scientific findings (…).’

‘3. Proportionality of messages
3.1 The advertisement must accurately express the action of the advertiser or the properties of its products, in accordance with the available and communicable evidence. The reality of these actions or properties may be assessed in the light of the different pillars of sustainable development, the different types of impacts and the various stages of a product’s life cycle.
3.2 The advertising message must be commensurate with the scale of the advertiser’s action(s) in terms of sustainable development and the properties of the product(s) he is promoting.
3.3 In particular
a. The advertisement should not be presented in such a way as to imply that it relates to more pillars of sustainable development, more stages of a product’s life-cycle or more impacts than can be justified by the evidence (…)’

‘9. Complex systems
Some recognized systems may be based on highly technical argumentations or complex schemes, whose benefits in terms of sustainable development are indirect (e.g., systems known as “green electricity”, “carbon offset”, “socially responsible investments”, etc.).
When an advertisement refers to these types of systems:
9.1 It should take care not to mislead the public about the true scope of the mechanism.
9.2 If it uses simplified language for educational purposes it must provide the public with the necessary explanations, as per the conditions defined in article 3-4 of this Code.
9.3 The advantage of using systems to indirectly compensate the negative impact of a product or an activity should not be referred to in the ad as being a direct quality of the product or activity’.

The ARPP Sustainable Development Code is not specific to the finance sector.

Statements by local regulators in relation to environmental claims

AMF adopted a doctrine (position/recommendation) concerning the information to be provided by collective investment schemes incorporating extra-financial approaches.[162] This doctrine concerns managers and distributors of collective investments authorized for marketing in France to non-professional investors. It sets out the following principles:

- The information provided on the consideration of extra-financial criteria must be proportionate to the objective and the effective impact of the consideration of these extra-financial criteria in the management of collective investments.

[162] AMF DOC-2020-03

- Funds that take extra-financial criteria into account in their management without making them a significant commitment within the meaning of this doctrine will be able to include them in their communication without making them a central element.
- The logic of this doctrine is therefore to make a central environmental claim (which appears in the name, the DICI, the marketing documentation, and the prospectus) conditional on a significantly engaging investment strategy.

However, it should be noted that this doctrine does not deal with the subject of impact funds. The doctrine does not, therefore, specify the criteria for considering that an environmental impact claim is accurate, clear, and not misleading. *Ex-ante*, AMF has the power to decide, regarding its position, whether information to be provided by collective investment schemes incorporating extra-financial approaches is appropriate or not. *Ex post*, AMF has the power to decide whether an environmental claim in a commercial document is appropriate or not. To date, we are not aware of any use of these enforcement powers in relation to impact environmental claims.

A Practical Guide to Environmental Claims, published in 2012 by the National Consumer Center:

This publication presents different types of claims and provides guidance on how they should be used, around the following principles (not specific to the finance sector):

'What rules apply to environmental claims?
Any environmental claim must be explicit and precise so as not to mislead or generate doubt in consumers' mind. It must aim to inform consumers fairly about the environmental characteristics of the product or service. An environmental claim must be based on scientific evidence or accepted methods. Whatever the claim, it must focus on an environmental aspect that is significant in light of the impacts generated by the product. The benefit claimed by this claim should not also lead to pollution displacement, i.e. to create or aggravate other environmental impacts of the product, at any stage of its life cycle.'[163]

An Anti-greenwashing guide published in 2012 by the Agency for Ecological Transition (ADEME)

This publication provides self-assessment principles to avoid greenwashing, which is identified though nine criteria which cover aspects such as disproportionate promises, vague words, absence of evidence etc.[164] It is not specific to the finance sector.

A periodic report on "Advertising & environment", released in partnership by the ARPP and ADEME. The latest version has been published in 2020[165]

This report assesses a sample of advertisements and their compliance with applicable rules (especially against the self-regulatory principles set out in the Sustainability Code mentioned above). It is not specific to the finance sector. Importantly, this version notes that 'the poor results of this 10th review question the ability of actors to really promote, in accordance with ethical rules, products/services and mindsets compatible with the ecological transition and the fight against climate change. They push us more than ever to strengthen our vigilance with regard to brands and their agencies and to encourage all actions to raise awareness and support professionals, in education institutions, training centres and on a daily basis in companies and agencies. Compliance with ethical rules is a central element of advertising credibility, which must be consolidated'.

[163] Centre National de la Consommation, 2012, Guide pratique des allégations environnementales p.41
[164] ADEME, 2012, Guide Anti-Greenwashing
[165] ARPP, ADEME, 2020, Bilan 2019 Publicité & Environnement p.5

Grounds for retail action in relation to environmental claims

Grounds for action include breach of transposed rules of MIFID II and UCPD in the French Monetary Code and Consumer Code. AMF Doctrine can be used as an interpretative tool.

Moreover, new rules specific to environmental claims have been passed in France. The Climate and resilience law[166] creates new obligation and restriction notably in relation to green advertising. The law creates a section in the environmental code which is named "environmental claims". In this section, the article L 229-68 forbids to present a service or a product carbon neutral unless certain conditions are met:

'It is prohibited to state in an advertisement that a product or service is carbon neutral or to use any wording of equivalent meaning or scope unless the advertiser makes the following information readily available to the public:
'1° A greenhouse gas emissions balance sheet integrating the direct and indirect emissions of the product or service;
'2° The process by which the greenhouse gas emissions of the product or service are first avoided, then reduced and finally offset. The greenhouse gas emission reduction trajectory is described using quantified annual progress targets;
'3° The methods for offsetting residual greenhouse gas emissions that comply with minimum standards defined by decree.'

[166] Law n°2021-1104

Netherlands

Finance specific legal and regulatory requirements

There are no Dutch finance-specific legal and regulatory requirements in respect of ESG. There are also no specific legal or regulatory rules on ESG marketing of products or services by a financial institution; marketing of ESG aspects is covered by the generic rules and regulations on marketing (e.g., article 24 of MiFID II).

Specific Dutch rules on ESG aspects relate to accountability and/or reporting on ESG matters by financial institutions. For example:

- Dutch pension funds are required under the Dutch Pension Act to account for, in their board reports, the manner they take ESG matters into account in their investment policies. This requirement does not specifically aim at preventing greenwashing.
- Dutch institutional investors and asset managers (i.e., (re)insurance companies, pension funds, portfolio managers, alternative investment fund managers, management companies and self-managed collective investment undertakings) are required under the Dutch Act on financial supervision to publish their engagement policies on their websites, including a description of the manner oversight is performed in respect of portfolio companies, also in respect of non-financial performance and ecological effects. An engagement report must be published at least annually. This requirement does not specifically aim to prevent greenwashing.
- Institutional investors in Dutch listed companies that have voluntarily adhered to the Dutch Stewardship Code, must have a stewardship policy relating to their engagement with Dutch listed companies invested in. Stewardship includes (engagement on and monitoring of) environmental aspects. This requirement does not specifically aim to prevent greenwashing.

Transposition of UCPD

The UCPD has been implemented in line with the Directive. There is no gold-plating nor are there any specific additional rules in respect of financial services as allowed for by article 3(9) of the UCPD.[167]

Adoption of MDEC guidance on environmental claims

There has been no adoption of the MDEC guidance in the Netherlands. As far as we are aware, there is no reference to the MDEC guidance in Dutch rules and regulations and by Dutch regulators.

Statements by local regulators in relation to environmental claims

There have been statements by the Netherlands Authority for the Financial Markets (*Stichting Autoriteit Financiële Markten*) (**AFM**) in relation to ESG claims but there has not been enforcement action in this respect yet, at least no enforcement action has become public (it is possible that there is action that is still ongoing and that is not subject of public disclosure yet).

The AFM has issued guidance letters to the financial industry about properly dealing with the new EU regimes on ESG. These letters are informative in nature.

The AFM has performed an exploratory industry wide investigation into SFDR compliance by the funds industry in 2021. The outcome show that compliance is sub-standard in respect of transparency (often too generic) and in respect of sustainability (indicating the potential of greenwashing). While this is not yet to be classified as enforcement action by the AFM, enforcement action often starts with industry wide investigations

[167] Directive 2019/2161, also amending the UCPD, has not been implemented in the Netherlands yet. Implementation is expected for 28 May 2022.

that indicate non-compliance, following which the AFM targets specific parties which may result into enforcement action if individual non-compliance is established. It may therefore be expected that this exploratory investigation will be followed-up by further AFM action which may include enforcement action, also because the AFM has indicated that its 2022 priorities include taking on greenwashing.

Grounds for retail action in relation to environmental claims

The principal ESG rules and regulations (notably the SFDR and the Taxonomy Regulation) applicable in the Netherlands have a mandatory, public law character, meaning that they comprise of prohibitions and regulations to refrain from, or force certain action, which prohibitions and regulations can be enforced by the AFM only. As a result, direct action by retail clients cannot be based on these rules and regulations. Indirect action may however be brought by retail clients by addressing the AFM if non-compliance is discovered. However, it is at the AFM's discretion to follow-up on this or not.

Therefore, the principal grounds for clients to bring direct action for inaccurate environmental claims against a financial institution are based on Dutch civil law. The two main grounds for action are claims based on error or tort. This is based on the assumption that Dutch civil law applies to the relation between the parties, e.g., because the contract is subject to Dutch law or because the damage is suffered in the Netherlands:

- Error: A claim based on error requires that the contract would not have been entered into if the client was duly informed, the financial institution was required to inform the client and did not do so, or if both parties based themselves on incorrect information, unless the error shall be for the account of the client. A successful claim allows the client to (partially) nullify the contract which normally requires both parties to undo all performance under the contract (e.g., repay payments made).
- Tort: Dutch law provides for a general concept of tort and a specific section of tort which was implemented further to the UCPD. Tort requires damages being suffered as a result of an unlawful act. The unlawful act may be found in non-compliance with mandatory law, acting in violation of a particular right or acting in violation of unwritten law. The specific section of tort includes provisions on unfair practices towards retail clients that are deemed to be unlawful and are hence a basis for a claim for damages based on tort. Inaccurate and missing information can be misleading and hence unfair.