

The Consumer Voice in Europe

## GREENWASHING IN RETAIL FINANCIAL SERVICES

Findings and conclusions from BEUC member feedback to a consultation by the three European supervisory authorities



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## Why it matters to consumers

A growing number of consumers want to be sure that their savings don't trash the planet or harm its people. An equally fast-growing number of financial services providers are catering to this growing demand by offering investment- and other financial products that are marketed as 'green' or 'sustainable'. In far too many cases, however, the products do not live up to the promises. This mismatch between rhetoric and reality is called greenwashing, and it can mislead consumers into buying something they would not buy if they had accurate and accessible information.

## Summary

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Greenwashing is rife in retail financial services. The European Commission has recognised this, and in May 2022 it asked the European Banking Authority, the European Securities and Markets Authority and the European Insurance and Occupational Pensions Authority to look into the matter. In November 2022, the three supervisory authorities issued a joint call for evidence about greenwashing, with a deadline for January 2023.

BEUC welcomes this effort to better understand greenwashing in financial services, a growing problem that requires supervisory and legislative remedies to protect consumers from misleading product marketing.<sup>1</sup> We have compiled evidence of greenwashing practices from our member organisations across Europe. This paper provides an overview of BEUC's position.

Our members' input has shed light on the drivers and enablers of greenwashing. Regulatory shortcomings, insufficient standardisation, the use of relatively new and vague terms and the unavailability of reliable data facilitate greenwashing, especially in the investment funds industry. There is strong consumer demand for sustainable investments, but also a shortage of genuinely sustainable investment opportunities. All this creates incentives for, and the possibility of, greenwashing by sellers of investment products, many of which are not nearly as sustainable as claimed. The worst are investment products that promise a positive 'impact', without providing proof or being clear about what 'impact' means.

However, greenwashing is not restricted to false promises, but includes 'soft' techniques to influence consumers, like putting pictures of unspoilt nature on websites that market financial products. We also found that the net-zero pledges by many financial institutions, in particular banks and asset managers, are often rhetoric not matched by action.

The EU legislator bears responsibility for tackling the regulatory enablers of greenwashing. The Regulation on Sustainability-Related Financial Disclosures (SFDR) needs fixing urgently, through requiring that all investment products that claim sustainability exclude certain business activities and through other measures. The EU legislator should also introduce a regulation for an ESG benchmark label to improve the sustainability of investment products that track a benchmark index as well as a regulatory framework for ESG ratings to improve the sustainability data with which financial services providers have to work. They should also ban inducements in financial advice to improve competition in the sustainable investment industry.

Supervisory authorities should improve the reliability of marketing information for sustainable financial products through guidelines and recommendations, disallow or curtail the use of ill-defined or misleading terms like 'impact' and explore together with the consumer authorities whether the Unfair Commercial Practices Directive can be used to take action against misleading claims.

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<sup>1</sup> Greenwashing is not the only thing that prevents sustainability-minded financial services consumers from making the right choices. The scarcity of genuinely sustainable investment opportunities is at least equally important, but addressing it requires economic policy action that goes beyond the fight against greenwashing.

## Key findings from our members' input

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### Greenwashing drivers and enablers

Much of the greenwashing that our members observe in retail financial services can be explained by regulatory shortcomings and the frequent use of relatively new and vaguely defined terms.<sup>2</sup> This, combined with the mismatch between demand and supply for financial products with a positive sustainability impact, enables and encourages financial service providers to make exaggerated sustainability claims about their products. Finally, sustainable finance is not as powerful a tool as it is sometimes portrayed in political debate. Financial markets cannot replace economic policy in steering the economy away from harmful activity. Consumer investment will not transform the economy on its own, but that debate shapes consumers' expectations. This means they are targets for greenwashing and incentivising product manufacturers to overstate the sustainability quality of their products. These conditions, which make greenwashing possible in the first place and the drivers that make it a reality should be considered among the core features of greenwashing.

### Inadequate regulatory framework

A general driver/enabler of greenwashing is the vagueness of the legal and informational foundations of the market for sustainable financial products. This extends to the vagueness, insufficient standardisation, unreliability and sometimes sheer absence of sustainability-related information and ratings. The providers of retail investment products have to use this unreliable information against unclear legal criteria for sustainable financial products, especially in the case of products that are classified as Article 8 ('light-green') and Article 9 ('dark-green') products under the Sustainability-Related Financial Disclosures Regulation (SFDR). The latter make it possible to include in investment products securities from companies that buyers of those products would simply not expect to be there, for example, companies engaged in oil exploration in the Arctic, deforestation in the Amazon or severe labour rights violations in Qatar.

### 'Soft' greenwashing and the 'green feel'

In such an environment, the effectiveness of 'soft' forms of greenwashing should not be underestimated. By this we mean marketing, especially online, for allegedly sustainable financial products that is full of images and colours that create a 'green feel' around a product or the company that offers it. Vague terminology that evokes 'goodness', 'greenness' and sustainability, but does not make any clear promises that could be verified, is another means for creating the green feel. This would be less of a problem if there were clear and reliable rankings or product standards, but in their absence the green feel factors are likely to have a disproportionate influence on people's purchasing decisions.

### Investment products the worst greenwashers

The biggest culprit when it comes to greenwashing in retail financial services is the asset management/investment industry. There are examples of greenwashing in the banking and insurance industries, but they seem rare in comparison. Greenwashing in retail investment services mainly takes place at product level, especially in marketing materials, but also, to a lesser degree, in regulated information material (KIDs). This needs to be addressed urgently if the Capital Markets Union is to work for sustainability-minded retail investors.

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<sup>2</sup> This is not to say that outright, intentional malpractice does not play a role in greenwashing, but that it is impossible, from the outsider perspective of the consumer, to ascertain the role and scale of it.

## Beware investment products that promise 'impact'

Many retail investors do not only wish to avoid doing harm, they want to make a positive impact through their investment decisions.<sup>3</sup> There is no shortage of products that promise to do just that, but these promises are frequently questionable. In fact, the very notion of impact through financial investment is ill-defined, if not outright dubious. In what way can an investment fund that purchases company shares and bonds on the secondary market have a positive impact on the real world? Strong demand in combination with the absence of a clear definition creates a situation that is highly conducive to making unsubstantiated claims about alleged impacts.

## The SFDR is broken

As already mentioned, a particular problem that has been highlighted by Fair Finance Guide studies<sup>4</sup>, and most recently by a large-scale examination of sustainable investment products by a consortium of investigative journalists<sup>5</sup>, is that many Article 8 and 9 products include securities from companies engaged in highly controversial or clearly unsustainable business practices that the buyers of those products would simply not expect to be there. These studies do not suggest that laws have been systematically broken, so the law is itself the problem and therefore needs to be changed.

## Net-zero pledges are hot air

In recent years, many financial institutions, in particular banks and asset managers, have joined voluntary initiatives like the Principles for Responsible Banking<sup>6</sup> or the Glasgow Financial Alliance for Net Zero<sup>7</sup>. The former, for example, requires members to "align their business strategy to be consistent with and contribute to [...] society's goals, as expressed in [...] the Paris Climate Agreement". However, studies commissioned by our members and other civil society organisations<sup>8</sup> have found that financial institutions that subscribe to these initiatives continue to finance fossil fuel extraction and other unsustainable business activities.

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<sup>3</sup> For more about retail investors' preferences see <https://www.which.co.uk/news/article/is-ethical-investing-just-too-difficult-aIghk7i22xER>, <https://2degrees-investing.org/wp-content/uploads/2020/03/A-Large-Majority-of-Retail-Clients-Want-to-Invest-Sustainably-Final.pdf>, especially pp. 18-19, <https://2degrees-investing.org/wp-content/uploads/2020/03/Retail-Clients-Want-to-Vote-for-Paris-1.pdf>.

<sup>4</sup> <https://fairfinanceguide.se/media/497187/forests-on-fire-2021-09-21-low.pdf>, [https://fairfinanceguide.se/media/498008/rapport\\_svenska-banker-i-arktisk\\_30kt2022.pdf](https://fairfinanceguide.se/media/498008/rapport_svenska-banker-i-arktisk_30kt2022.pdf), [https://fairfinanceguide.se/media/498100/221122\\_banking\\_on\\_thin\\_ice\\_ii\\_final.pdf](https://fairfinanceguide.se/media/498100/221122_banking_on_thin_ice_ii_final.pdf), [https://fairfinanceguide.se/media/498080/ffi\\_qatar-report-2022\\_final.pdf](https://fairfinanceguide.se/media/498080/ffi_qatar-report-2022_final.pdf)

<sup>5</sup> <https://www.ftm.eu/green-investments>

<sup>6</sup> <https://www.unepfi.org/banking/bankingprinciples/>

<sup>7</sup> <https://www.gfanzero.com/>

<sup>8</sup> See, for example, <https://etiskbankguide.no/media/496891/case-banking-on-thin-ice-fossil-fuel-investments-february-2021.pdf> or <https://reclaimfinance.org/site/wp-content/uploads/2023/01/Throwing-fuel-on-the-fire-GFANZ-financing-of-fossil-fuel-expansion.pdf>.

## Recommendations

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### ESAs, and ESMA in particular, should crack down on misleading sustainability claims

A lot of greenwashing seems perfectly legal and merely exploits the vagueness of the legal and informational foundations of the market for sustainable financial products. Legislative action is urgently needed, especially a review of SFDR, but in the meantime the ESAs should use their powers to improve as much as possible the accuracy and reliability of marketing and pre-sale information for sustainable financial products through issuing guidelines and recommendations. The recent ESMA consultation on guidelines for fund names that contain ESG or sustainability-related terms<sup>9</sup> is a first step in the right direction because it proposes minimum requirements for funds that call themselves sustainable or use similar terminology.

ESMA should also consider disallowing or severely curtailing the use of ill-defined and strongly misleading terms in prospectuses, marketing and other pre-sale communication to consumers. This applies especially to the term 'impact'. ESMA should use the common supervisory action with national supervisory authorities that is scheduled for 2023<sup>10</sup> to examine impact claims that are not convincingly substantiated and to explore solutions. Finally, we suggest that the ESAs explore the option of working together with national consumer protection bodies (for example in the context of the Consumer Protection Cooperation Network) to take action against misleading green claims on the basis of the Unfair Commercial Practices Directive<sup>11</sup>.

### What should the EU legislator do?

#### Fix the SFDR

The frequency of greenwashing in the case of investment funds that are classified as 'green' or 'light green' reinforces the recommendation by BEUC and others in February 2022, to tighten the criteria for Article 8/9 products.<sup>12</sup>

- The do-no-significant-harm principle should be extended to Article 8.
- Article 8 and Article 9 should require exclusions, especially fossil fuels, and those for Article 9 products should be more far-reaching than for Article 8.
- Article 9 products should assess their sustainability impact against standardised criteria and disclose these impacts and how they are assessed in a standardised format. They should also have to comply with a minimum threshold for Taxonomy-compliant investments.
- Providers of Article 8 and Article 9 products should be required to engage with company boards and to disclose their engagement goals, although differentiated in accordance with the more or less ambitious nature of their products.

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<sup>9</sup> <https://www.esma.europa.eu/press-news/consultations/consultation-guidelines-funds%E2%80%99-names-using-esg-or-sustainability-related>

<sup>10</sup> See ESMA's work programme for 2023: <https://www.esma.europa.eu/press-news/esma-news/esma-work-programme-2023-focus-sustainability-technological-change-and>

<sup>11</sup> <https://eur-lex.europa.eu/legal-content/EN/TXT/?qid=1585324585932&uri=CELEX%3A02005L0029-20220528>

<sup>12</sup> [https://www.beuc.eu/sites/default/files/publications/beuc-x-2022-027\\_joint\\_recommendations\\_for\\_min\\_criteria\\_for\\_sustainable\\_investments\\_and\\_products\\_with\\_esg.pdf](https://www.beuc.eu/sites/default/files/publications/beuc-x-2022-027_joint_recommendations_for_min_criteria_for_sustainable_investments_and_products_with_esg.pdf)

### **Introduce a regulated ESG benchmark label**

The investment industry is not the only one to blame for investment products that fail consumers. *Passive funds* merely replicate an index provided by a third party, so if the portfolio of a passive fund that is marketed as somehow sustainable contains exposures to highly unsustainable business activities the benchmark administrator also carries some of the blame. It is regrettable that the European Commission appears to have decided not to follow yet ESMA's advice<sup>13</sup> to develop a legislative proposal for an EU ESG benchmark label. This could have given retail investors, as well as investment managers, more clarity when buying or putting together an ESG investment product that follows an ESG benchmark. We ask therefore the Commission to put forward a legislative proposal introducing such a label.

### **Introduce a regulatory framework for ESG ratings and providers**

Another well-known problem with investment funds that are marketed as sustainable is that the fund managers or benchmark providers who put together a portfolio must do so on the basis of data that is neither reliable nor comparable. Typically they use so-called ESG ratings from third parties that assess the sustainability performance of companies that issue shares or bonds. These services are not standardised at all, and as a result the ESG ratings for the same company can diverge widely, depending on the rating provider. A legal framework for ESG ratings that contains requirements for the rating providers and product requirements for the ratings themselves is sorely needed. The Commission mentions this option in its Renewed Sustainable Finance Strategy of 2021.<sup>14</sup> It should use it!<sup>15</sup>

### **The distribution of investment products must work for consumers, not financial advisers**

The way in which financial advice is provided in most of the EU is a part of the greenwashing problem. Financial products are distributed to consumers mostly through sales agents that are called 'financial advisers'. They often do not offer consumers the most suitable product(s) on the market, but only those of their contract partners in the industry. This means that consumers do not have access to other products and there is little to no competition for greater sustainability regardless of consumer preferences. This stunts the progress in product development which would otherwise be driven by such competition, leaves more credible sustainable products unknown to the consumer and pushes greenwashed products into the market. This is why the EU should ban inducements in financial advice-settings in its upcoming Retail Investment Package.

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<sup>13</sup> [https://www.esma.europa.eu/sites/default/files/library/esma81-393-502\\_esma\\_response\\_to\\_the\\_ec\\_consultation\\_on\\_the\\_bmr\\_review\\_2022.pdf](https://www.esma.europa.eu/sites/default/files/library/esma81-393-502_esma_response_to_the_ec_consultation_on_the_bmr_review_2022.pdf)

<sup>14</sup> <https://eur-lex.europa.eu/legal-content/EN/TXT/?uri=CELEX:52021DC0390>

<sup>15</sup> The European Securities and Markets Authority (ESMA) has already suggested this to the Commission: [https://www.esma.europa.eu/sites/default/files/library/esma30-379-423\\_esma\\_letter\\_to\\_ec\\_on\\_esg\\_ratings.pdf](https://www.esma.europa.eu/sites/default/files/library/esma30-379-423_esma_letter_to_ec_on_esg_ratings.pdf).

