OPSG

OCCUPATIONAL PENSIONS STAKEHOLDER GROUP

Advice on

EIOPA’s technical advice on greenwashing risks and supervision of sustainable finance policies

EIOPA-OPSG-23-07

14 March 2023

eiopa

European Insurance and Occupational Pensions Authority

CfA on Greenwashing – Request for input to the OPSG

Background

On 23 May 2022, EIOPA and the other European Supervisory Authorities (ESMA and EBA), received a Call for Advice (CfA) on Greenwashing from the European Commission. This CfA requests each ESA, separately but in a coordinated manner, to provide input on (i) definition, cases and risks of greenwashing, (2) the supervision of greenwashing and relevant sustainable finance requirements, (3) proposals to improve the regulatory framework. Two deliverables are foreseen in the CfA:

- A progress report expected by May 2023, and
- A final report expected by May 2024.

As presented during the September 2022 OPSG meeting, EIOPA would like to seek the OPSG's input in order to inform its work on the CfA on greenwashing. This request for input will complement the stakeholders' input collected in the context of the Call for evidence to stakeholders due to end on 16 January 2023.

Therefore, EIOPA sent a request for input to the OPSG with a deadline **by 13 March 2023 COB**. This with a view of seeking more pension specific inputs and of receiving the OPSG's views as a group rather than Members' specific inputs, which EIOPA highly welcomes via the Call for Evidence.

Understanding what is greenwashing

1. Please outline below what the OPSG understands greenwashing to be in the pension sector - ideally this would be a common understanding that suits all members of the OPSG, and this understanding would be captured in one to two paragraphs maximum. (It should cover some or all elements presented in Annex 1 to this document):

We can generally consider that greenwashing in this context consists of two clear components: **misleading intentionally** or **misleading through negligence.** The first category consists of knowingly misrepresenting the sustainability-related characteristics of a particular investment or product with the intention to mislead. The second refers to situations of gross negligence where claims are made without taking reasonable steps to ensure the veracity of the 'sustainability' claim. The fact that there is no common definition of sustainable investment in the context of a rapidly evolving legislative framework cannot justify treating the issue with negligence.

Greenwashing can occur when the information provided about the product/portfolio/company is **overstating** the incorporation of sustainability risks assessment in the decision process (i.e., for financial products that state to incorporate sustainability risks through an exclusionary approach, but without estimating sustainability risks on the rest of the portfolio). It will be noted that in the specific case of IORPs, where one does not promote (i.e., advertise) its sustainability approach AND if there are only mandatory memberships in the respective IORP AND if there are no investment options for the beneficiaries to decide, greenwashing cannot occur by definition and that no further extensive reporting or data requirements are needed (this is, of course, only valid for the case mentioned above).

Greenwashing can occur either at entity level, at product level or at service level, including advice and payment services. When considering greenwashing the structure of IORPs should be given full consideration, particularly when IORPs invest their assets through mandates with asset managers and are therefore outsourcing investment activities. Also, some IORPs being insurance based, the employer chooses the funds for the pension scheme. This is the case in Malta, for instance, as there are no DB schemes being set up. In this case greenwashing can also occur and so these schemes do not fall under the type of IORPS described above.

Occurrence of greenwashing

2. What should pension providers do in order to ensure that their sustainability-related claims do not lead to greenwashing? In particular, inputs are sought on measures which pension providers could put in place to prevent greenwashing spreading from other sectors, such as asset managers, ESG data providers, investee companies, bond issuers – into the pensions sectors. Please explain how pension providers should cope with their responsibilities when relying on third-party providers? Please elaborate on challenges faced by pension providers to avoid making claims leading to greenwashing and the measures to address those challenges.

When pension products adopt a fund of funds structure: An important rule is to consider sustainability targets and metrics at the **whole portfolio level (on a look through basis)**. As an example, and as per the SFDR regulation, this means that a fund comprised of only article 8 funds should avoid relying solely on the fact that the underlying funds are article 8 to consider the fund in fund itself is article 8. Typically, a pensions product that has investments in funds from different product providers/asset managers is subject to those funds having their own/different definitions of what is a sustainable investment, different indicators and targets, and different exclusion policies. This can make it very difficult to have a comprehensive portfolio view on sustainability related characteristics. Therefore, and in reference to the concept of intentionality laid down in question 1, to avoid greenwashing risks, it should be important for pension providers to define first their own **sustainability policy**, indicators and targets **precisely and independently** and make sure they are incorporated in the investment process of the pension product (whole portfolio and look through basis regardless of the investment vehicles). For IORPs, this could mean for instance, the alignment between the ORA and SIPP, in as much as the ORA as a relatively new requirement can lead to clear evidence of how potential ESG/green/sustainability claims, are enacted in the risk policy.

- Stemming from the above, a rigorous **due diligence process** should be put in place for the selection of third-party funds in the portfolio and as well as for any delegation of the portfolio management to asset managers.

- **Exclusionary policies should not be qualified as sustainability policies** unless if following stricter criteria than solely screening out very controversial businesses like weapons and tobacco (this would rather be about good governance).

- Special attention should be brought to renamed/rebranded funds which, in the absence of sufficient ”green” investments are an alternative to setting up a new ESG fund without much effort.

- Furthermore, the individual answer to the questions, if a concrete economic activity is sustainable or not, sometimes depends on individual ethical principles, values and own subjective convictions of the person judging on this issue and not

solely on regulatory matters (EU taxonomy). So, not always pure objective criteria can be applied. Recent past has shown several examples underpinning this fact. This all forces pension providers to rely (at least to a certain extent) on their own interpretation of these concepts, which may vary across providers and differ from clarifications that can be brought by regulators over time.

Finally, pension providers should have a **stewardship and engagement policy in place (already as part of SRD II requirements)**, and be able to ensure that the partners they delegate investment functions to have such policy, to be able to trigger changes in their investee companies. Engagement (actively participating to general meetings of investee companies, voting and/or initiating or supporting relevant resolutions) can be an effective strategy for creating positive change, leading to measurable improvements in ESG impact. In fact, systematic review of the empirical evidence for shareholder engagement documents scientific consensus on the effectiveness of this strategy (with other green investment strategies like "exclusion" (disengagement) being less effective/having less evidence for impact potential). In order to plan for an effective alignment of stewardship and engagement policies between IORPs and their investment managers, IORPs should focus on the selection strategy for their service providers.

3. What should pension supervisors do in order to ensure that pensions providers' and advisors' sustainability-related claims do not lead to greenwashing? Please also elaborate on aspects such as which data supervisors should collect, which tool should they use, and challenges thereof, and in relation to aspects which should be monitored in the advice when choosing investment options (either for the single saver or for the employer depending on whether it is a OP DB or DC) in the accumulation phase.

- As greenwashing relates to vague definitions of sustainability, it seems to the OPSG of the outmost importance that the current regulations (such as the EU taxonomy, SFDR, MIFID II) be harmonized, so as to guarantee that, within the EU legislations and supervisory activities, the definition of sustainability is clear. At that point regulators should monitor very closely what pension providers/advisers use for the **definition of sustainable investments**, and how they ensure that the investments **do no significant harm** environmental objectives. Because of the lack of data available directly from investee companies, specifically on certain themes such as biodiversity, the use of proxies can lead to low quality indicators being used across the industry. As much as possible, reported data should be used but if this data doesn't exist/isn't reported yet, there should be more guidance provided from regulators on minimum standards for proxies and transparency on how they are calculated.

- More precisely, leveraging official indicators to compare private sector definitions could prove useful. For example, comparing % of sustainable investments to taxonomy alignment. Another important information to collect is the pension provider's/adviser's policies in place to avoid investments that do significant harm to climate and nature. There should be precise indicators, target and risk assessments part of those policies - to be then compared with sustainability related claims.

- On sustainability risks: **scenario analysis and stress tests** are tools available that can provide information relevant for assessing sustainability risks (this can help inform advice as well, depending on the nature of the end investor, investment horizon, risk profile, preferences) and while they themselves rely on many assumptions, those tools enable some form of quantitative assessment that supervisors can collect regarding the financial risks of different investment options in relation to climate/nature.

- On data sources: supervisors can be instrumental for ensuring the ESG data that is made available and used is regulated, available at a low cost (or free) and in a standardised format.

4. Do you see similar risks of greenwashing in both the occupational and personal pensions sectors?

The main difference is that in the case of personal pension sector the individual is directly responsible for investment decision (which provider/fund to select?). Depending on the individual's financial literacy, it is possible that greenwashing risks are higher versus occupational sector that has an additional layer involving social partners. On the other hand where the employer sets up an IORP for his employees via an insurance wrap, the employer is also exposed to possible greenwashing.

5. Do you believe the risk of greenwashing in the occupational pension sector is minimized by the role which social partners can play in negotiating pensions agreements and/or by sitting on the board of IORPs? Do you believe social partners should have a role in promoting the sustainability of pension funds and in monitoring that greenwashing cases do not occur?

Yes, see above.

In addition, by creating a label or sitting in follow up committees sustainability investments can be promoted. In France, trade unions (CFDT, CFTC, CGE-CFC and CGT) were the first to promote

socially responsible investments by creating a label (CIES Comité intersyndical d'épargne salariale) in 2002, way before other ESG labels. The website : http://www.ci-es.org/les-fonds-labellises/

The example of France could be scaled or a European approach (EU label) could be used to guide investors and beneficiaries.

6. Do you think that for pension schemes there are risks that scheme members do not understand whether the pension schemes have / do not have sustainability features? What should pension consumers/scheme members do to protect themselves against potential greenwashing? How could the authorities help consumers/scheme members dealing with greenwashing risks?

See all of the above and below. One additional aspect: With social partners playing a role e.g. in the supervisory board of an IORP or in a General Meeting, beneficiaries are directly represented in the steering of the IORP in some countries and can by these mechanisms express their ESG preferences against the management of the IORP.

Authorities can help consumers/scheme members dealing with greenwashing by promoting a simple reporting standard on sustainability. Currently the SFDR framework provide the templates for such a disclosure in pre-contractual documents, periodic reporting and PAIs. SFDR represents a significant step forward in tackling greenwashing however its effectiveness could be further strengthened if the current reporting were more user friendly. The current SFDR reporting standards are not easy to read and understand, and too long (in some MS a situation in which the annexes for products art.8/9 would be longer that the main document of the scheme may occur). The simplification of the aforementioned templates would help members/beneficiaries to better understand the sustainability features of the pension product, helping them to protect against the risk of greenwashing in a more effective way. Consumer testing could be beneficial in showing the possible simplifications to implement.

7. Various pension providers have recently made voluntary net zero commitments. In your view, are these commitments prone to potential greenwashing? if possible, provide examples of how greenwashing could emerge from these commitments.

A lot of confusion can arise from the interpretation of net zero and carbon neutrality for instance. Offsetting alone can hardly lead to concrete emission reductions which the Net Zero pledge supports. Both terms are simplifications which are currently used by people who

lack understanding of the science behind. It is therefore important to have more information and more transparency of these concepts in order to facilitate investors' ability to discern the goodness of both such strategies, without forgetting that there are companies' whose reality because of the industry they are in or their product, will have a longer way to go in their transition. Those efforts should be supported and not undermined.

Achieving Net Zero in the context of portfolio management and investment hasn't so far reached consensus in terms of best practices. The Science Based Target Initiative is currently working on the first global science-based Net Zero standard for financial institutions, to be published later this year.

To achieve meaningful carbon emissions reduction of a portfolio, it has to correspond to a carbon reduction in the real economy. Otherwise, the carbon reduction of a portfolio is a result of optimization and shifting capital from one place to another (aka paper decarbonization).

In other words, NZ commitments must be forward-looking and leverage indicators that are more complex than just historical/backward looking emissions. Typically, in some cases an investment in a renewable energy company can appear more carbon intensive than the rest of the universe and be excluded from a portfolio.
Lastly, in the context of pension funds that are pursuing NZ targets, it is often the case that a form of glide path is applied, increasing the allocation to fixed income and more particularly government bonds through time as pensioners get closer to retirement. In this case, as we tend to exclude government bonds from portfolios emissions calculations, the share of the portfolio based on which emissions are calculated and NZ targets are set, mechanically decreases through time. Very clear explanations should be provided regarding the aggregation methodologies used for such cases where allocations to ineligible assets increase over time.

ESG reports should include strict guidelines and methodology on plans related to zero emissions, i.e., if a company/institution declares such a goal, it should present in great detail the methods to achieve it. Otherwise, such action can be considered as greenwashing for companies.

8. For occupation pension schemes in the accumulation phase: in your view how does potential greenwashing occur in the implementation of the investment policy? How can the board significantly prevent greenwashing in view of its fiduciary role? Do you believe the role of

preventing greenwashing mostly sit within the Board of IORPs or should employer(s) also be accountable?

The investment policy cannot give up its own features (efficiency of the selected assets, a desired risk/return profile) but must add the sustainability features to the other profiles of the policy. Green washing can occur, as illustrated above, from a number of sources, including KPIs not being clearly defined, not transparent, thresholds or targets too low, and non-uniform assessment of sustainability over different assets, without a portfolio view. However, the first risk relates to a lack of consistency over the different applicable regulations. A clarification and creation of a consistent EU framework is again a prerequisite for avoiding greenwashing.

For the Board to avoid greenwashing, not only the details of the sustainability internal policy (KPIs) and its implementation must be clearly described and transmitted to it, but, before that, accurate induction and training on sustainability must be offered to the Board, so as to make sure that it is literate, well informed and well aware of the possible unreliability of counterparty claims (counterparty risk) when there is delegation, possible overstating of sustainability, poor data quality and lack of consistency among different regulations. The Board needs to take accountability for the sustainability commitments of the IORP all along the value chain and needs to take ownership of the management of the same. Board members should undergo regular training and updates on the evolutions around the management of ESG in the IORP.

The employer should also bear responsibility for ensuring an appropriate oversight of the reputational risks linked to greenwashing, as part of the entity responsibilities foreseen as part of the SFDR.

Regular training of the Board is fundamental in preventing greenwashing practices.

9. In your view can there be greenwashing in the decumulation phase? If so at what point in time – i.e., when advice is sought on possible pay-out options or only in relation to specific pay-out options?

Normally, in the decumulation phase an IORP should have no reasonable interest to do greenwashing. Nevertheless members or beneficiaries should always be informed even during the decumulation phase, if there are any changes of the investment policy of their IORP with regard to ESG criteria. Obviously pay-outs are always closely linked to the ongoing investments of the IORPs.

Regulation:

10. Please identify shortcoming (mishaps, inconsistencies, conflicting concepts or definitions, gaps, etc.) in the EU sustainable finance regulatory framework that might lead to greenwashing in the pensions sector or that might prevent the adequate mitigation of greenwashing in the pensions sector.

The sustainable finance regulatory framework is a great progress towards a greener financial system, but it also creates challenges that can lead to certain shortcomings due to the suboptimal sequencing of directives. For example, the timeline gap in the application of different regulations, namely SFDR, taxonomy regulation, CSRD creates a real data gap for investors to disclose information that is non-existent. This means that while the original goal is to foster transparency and adoption of standards, the use of proxies that lack transparency and the application of varying definitions across the industry are starting to become the norm.

Across regulations, the definition of what is sustainable can be confusing. Namely Sustainable investment that pursues environmental objectives in SFDR versus environmentally sustainable activities in the Taxonomy regulation. It is unclear how a sustainable investment can be environmentally unsustainable. Similarly, the concepts of DNSH vary between the taxonomy and SFDR. One definition across directives is clearly needed.

Another issue is simply coverage. Given the diversification benefits for pension providers to get exposures to international assets, a lot of the international companies that make up portfolios will not even fall under the scope of CSRD. Thus, investors will need to request this information from non-European companies to avoid using proxies and exposure to assets which are not as green as assumed. CDP is a platform that is used for such requests.

Another issue relates to financial market participants' strong dependencies on large index providers, on which an increasingly large number of products are built (namely passive products and ETFs, which AuMs are also steadily increasing through time). Given the new EU sustainable finance regulations, a lot of products and portfolios depend on how large index provider define sustainability, or Paris alignment and so on. For example, an ETF-only pension product will somehow need to rely on available investment vehicles in order to implement its sustainability policy. If the pension provider considers that a revenue threshold of maximum 5% from fossil fuels should be applied to comply with its exclusion policy but that the index provider has defined this threshold to be 10%, and

that most of the ETFs available are tracking this index, the pension provider can't implement its policy. To tailor an index that aligns with the own investment policy is very costly for the pension provider.

Regarding IORPs, it should be taken into account that in some countries many IORPs are relatively small and may be too small to really get into a direct dialogue with issuers and to have a real impact on them or to carry out extensive analyses on their own. Forcing them to do so would make occupational pensions more expensive and hence less attractive for employers and employees. Hence, it is crucial to find a right balance to support sustainable investing and reporting on the one side and to limit inadequate burdens for IORPs on the other side, if we do not want to weaken the occupational pensions landscape.

It is an important monopoly risk for the financial sector - that the definition of sustainable investments converges towards one that has been set by for profit index providers.

<u>Annex I – Based on the ESAs Joint Call for evidence launched in November 2022:</u>

Potential core characteristics of greenwashing[1]:

1. Similarly with the communication of other **misleading** claims there are several ways in which sustainability-related statements, declarations, actions, omissions or communications may be misleading. On the one hand, communications can be misleading due to the omission of information that consumers or investors would need to take an informed transactional or investment decision (including but not limited to partial, selective, unclear, unintelligible, inconsistent, vague, oversimplistic, ambiguous or untimely information, unsubstantiated statements). On the other hand, communications can be misleading **due to the actual provision of information,** relevant to an informed transactional or investment decision, that is false, deceives or is likely to deceive consumers or investors (including but not limited to mislabelling, misclassification, mis-targeted marketing);

2. Greenwashing can occur either at **entity level** (e.g. in relation to an entity's sustainability strategy or performance), at **product level** (e.g. in relation to products' sustainability characteristics or performance) or at **service level** including advice and payment services (e.g. in relation to the integration of sustainability-related preferences to the provision of financial advice).

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

4. Greenwashing can occur at any point where sustainability-related statements, declarations or communications are made, including **at different stages of the cycle of financial products/services** (e.g. manufacturing, delivery, marketing, sales, monitoring) **or of the investment value chain** (e.g. issuer, benchmark/rating provider, investment firms, etc.).

5. Greenwashing may occur in **specific disclosures required by the EU sustainable finance regulatory framework** (e.g. SFDR Article 9 product-level disclosure requirements). Greenwashing may also occur as a result of **non-compliance with general principles** – as featured either in general EU financial legislation or more specifically in EU sustainable finance legislation (e.g. the requirement to provide information that is fair, clear and not misleading). In that context, greenwashing may occur in relation to **entities that are currently outside of the remit of the EU sustainable finance legislation** as it currently stands (e.g. ESG ratings).

[1] As noted in the ESAs Joint Call for evidence, this should not be understood as the current view of EIOPA nor of the ESAs.

6. Greenwashing **can be triggered by the entity to which the sustainability communications relate** or by the entity responsible for the product, **or it can be triggered by third parties** (e.g., ESG rating providers or third-party verifiers).

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