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**Key messages by BVI[1] in the context of the ESAs' call for evidence on better understanding greenwashing**

1. On definition of greenwashing:

   - **We do not subscribe to the view that greenwashing can happen unintentionally**. In particular, **accidental misinterpretation of regulatory requirements should not be considered as resulting in greenwashing**. The current regulatory framework, in particular the SFDR regime and MiFID/IDD provisions on sustainability preferences, encompasses many concepts and provisions that still leave room for interpretation. This pertains also to the disclosure requirements in the standardised ESG annexes and the standardised PAI statement under SFDR. The understanding based on clarifications by the ESAs/the EU Commission or market standards improves only gradually. In these circumstances, we do not deem it appropriate to treat potential misinterpretations of regulatory requirements (that will become evident at a certain point of time but may not have been obvious before) as greenwashing.

   - When monitoring greenwashing claims raised by some stakeholders and the press, it often seems that greenwashing is being understood in the sense of not meeting certain quality standards of sustainability. This is in our view a misconception of greenwashing. Given that there is no universal understanding of sustainable investments or investment strategies promoting environmental or social characteristics, nor any other minimum standard of sustainability, no common level of ambition must be expected. We deem it very important to make a clarifying statement in this regard in the upcoming ESA report in order to objectivise the debates about greenwashing in the public media. **Sustainability claims should be rather assessed against the specific features of individual products** as disclosed in the pre-contractual documents and reported over time in periodic reports. This assessment will soon be facilitated by implementation of standardised ESG annexes under SFDR.

2. On problems with the availability of ESG data:

   - Fund management companies struggle with ensuring sufficient quality of disclosures based on ESG information obtained from third parties (commercial vendors), but not yet reported by companies; this pertains to the use of ESG KPIs for risk assessment and investment due diligence, but represents also a huge problem in the context of forthcoming reporting obligations (i.e. in relation to PAI reporting at the entity level under SFDR due by mid-2023).

   - A **significant proportion of ESG data sourced from third parties is being approximated or estimated based on partially non-transparent methodologies**. For asset managers as users of ESG data it is very difficult to establish which KPIs/data elements are credible and to which extent.

[1] BVI represents the interests of the German fund industry at national and international level. The association promotes sensible regulation of the fund business as well as fair competition vis-à-vis policy makers and regulators. Asset managers act as trustees in the sole interest of the investor and are subject to strict regulation. Funds match funding investors and the capital demands of companies and governments, thus fulfilling an important macro-economic function. BVI's 114 members manage assets of some EUR 4 trillion for retail investors, insurance companies, pension and retirement schemes, banks, churches and foundations. With a share of 28%, Germany represents the largest fund market in the EU. BVI's ID number in the EU Transparency Register is 96816064173-47. For more information, please visit www.bvi.de/en.

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- The **assessment of ESG controversies** (i.e. alleged events or practices with likely negative environmental, social or governance impacts) and their **implications for ESG ratings/scores of issuers can also significantly vary** across data providers. While an apparent controversy can be taken into account by some providers as reported on the spot, other will have processes in place that involve further investigations or an opportunity to react for the involved issuers. Asset managers that currently have to refer to external data providers in the absence of directly reported company data thus face significant difficulties as to which assessment they can eventually rely on.

- The decision on which/how many data vendors to contract with depends on many factors (i.e. covered investment universe, technical interoperability, costs) and should be subject to a strategic determination by the fund management company. Likewise, asset managers must retain the discretion to either use the external ESG rating or to make their own evaluation based on a proprietary methodology and additional data sources, as long as such selection of methods is based on a pre-defined process and thus avoids cherry picking. In any case, **presuming that data sources and methodologies are being appropriately disclosed pursuant to Art. 10 SFDR, the consequential ESG assessment must not be considered greenwashing**.

3. On greenwashing risk arising in the distribution chain:

   In the current regulatory environment, it can happen that due to diverging interpretations of relevant regulatory concepts at the product level, greenwashing risk becomes relevant in the distribution channels when advisers attempt to compare sustainability features of products in order to make recommendations to their clients. In this regard, the following greenwashing risks may arise:

- **Providers may be tempted to apply rather lax criteria for sustainable investments in order to be able to commit to high proportions and potentially, to qualify for the Article 9 status under SFDR:** Indeed, the lack of clarity about the qualitative approach to sustainable investments (how to establish a positive contribution to an environmental or social objective/how to assess the "do no significant harm" requirement by applying principal adverse impact indicators) as well as about their calculation at the portfolio level (based on the proportion of sustainable activities or on the evaluation of the entire investee company) might set wrong incentives as regards the level of ambition. This applies even more in view of the regulatory expectation for Article 9 products to make "only sustainable investments" which implies a high minimum commitment to be made in the upcoming ESG annexes to sales prospectuses. Nonetheless, the recent wave of reclassifications of products that have been initially assigned to Article 9 SFDR (cf. the BVI sustainability snapshot for the German market and the Morningstar market review, both for Q3 2022) demonstrates that **many fund providers prefer to take a rather cautious approach in order to avoid greenwashing claims** in case they were not able to meet the required level of sustainable investments after the pending clarification of definitions to be expected soon from the EU Commission.

- **Distributors might pick products or investment solutions that match a client's preferences in terms of minimum proportion of sustainable investments without being able to understand the underlying approaches or to compare the methodical level of ambition:** Due to the highly diverging approaches applied by product manufacturers for assessing sustainable investments, distributors are currently unable to directly compare commitments in terms of proportion of sustainable investments across products, but must refer to the underlying

concepts applied at the product level. Against this background, matching of products with certain levels of sustainable investments with the corresponding preferences of investors is quite a challenging exercise that entails the risk of improper communication by the adviser and misapprehension by the client.

4. On further evolvement of the EU regulatory frameworks in order to tackle greenwashing risk:

   The following evolvement of the sustainable finance regulations could help alleviating greenwashing risk concerns:

   - **Introducing transparency and conduct of business rules for ESG research and rating:** For a long time, we have been advocating for voluntary transparency and conflict of interest standards for ESG rating and research providers. Such market-driven initiative would have been helpful in order to enhance the understanding of methodologies and data sources as well as potential associated shortcomings. Unfortunately, there is so far neither a common industry code nor sufficient level of disclosure on the part of individual providers. Therefore, we see the case for regulatory intervention that should focus on transparency rules and accountability requirements as follows:
     - Increased transparency should involve disclosure requirements for internal methodologies and processes as well as proprietary ESG rating frameworks;
     - There should be disclosure on data sources, data collection processes, how missing data are dealt with, and the methodology for estimation and their data quality controls (in particular if raw data has been third-party audited by the company or not);
     - Providers should have robust operational and control processes in place to ensure a continuous service and provide sufficient detailed information on such processes.

   - **Aligning the understanding of key concepts of sustainable finance by principle-based guidance**: There is a blatant need for further clarification of concepts underlying sustainability-related product features that are relevant in terms of sustainability preferences of clients. This applies in particular to the concept of sustainable investments for which currently there is no clear level of ambition nor a uniform rule for calculation. We look forward to the answers to corresponding questions put forward by the ESAs to the EU Commission that will hopefully provide principle-based guidance to the level of ambition that needs to be observed and clarify the conditions under which sustainable investments can be forward-looking in order to facilitate sustainable transition. Transition-oriented ESG strategies are indeed key to fostering sustainable progress in the entire economy and thus to achieving the objectives of the EU Green Deal. However, the acknowledgment of such strategies as integral elements of sustainable finance needs to be deepened especially on the side of supervisors and investors.

   - **Streamlining supervisory expectations for products that are marketed as sustainable to investors:** Linked to this topic is the overarching issue of clear and commensurate communication on sustainability-related concepts. ESMA is currently consulting a first set of supervisory guidance on the use of ESG and similar terms that relates, however, only to fund names. Moreover, the consultation is very much focused on imposing certain minimum thresholds without attempting to clarify the underlying concepts. In view of the persisting uncertainties especially about the standards for sustainable investment mentioned above, this does not seem the right way forward. We are generally more in favour of principle-based requirements that would ensure credibility of ESG investment approaches and responsible

communication to investors and will certainly explain our ideas in more detail in our reply to the ESMA consultation.

- **Enhancing investors' understanding of sustainability issues:** Ultimately, the risk of greenwashing cannot be tackled without investors being able to understand the various strategies and concepts offered by products with sustainability features. Investors and distributors currently struggle with new regulatory concepts of "Taxonomy-aligned", "sustainable investments" or "consideration of principal adverse impacts" and have difficulties to relate these aspects to their individual preferences. In order to facilitate truly informed investment decisions on sustainability matters, there is an urgent need to effectively enhance investors' understanding that should be the focus of any future regulatory initiatives on sustainability-related disclosures. In this context, the German Sustainable Finance Advisory Committee has recently published an open letter with the suggestion for introducing a colour-based ESG scale that would illustrate the sustainability profile of a product in a simple, easy to understand manner on the basis of existing regulations, but condensing it into one single figure. Such a simplified approach to communicating on sustainability matters should in our view focus on sustainability-related product features, not on the extent of sustainability risk that might be associated with underlying investments. It could be well worth considering in order to enhance comprehensibility for retail investors.