

Q A.1: Please provide your views on whether the above-mentioned core characteristics of greenwashing reflect your understanding of and/or experience with this phenomenon and whether you have anything to add/amend/remove.

The above-mentioned core characteristics reflect a large spectrum of the different forms greenwashing can take. Yet we feel several key aspects would need to be added to these characteristics.

We list a few of these characteristics below:

First of all, we consider the **diversity and opacity of ESG methodologies** as being a potential Greenwashing trigger:

- **Underlying methodologies:** Greenwashing can occur at the origin of the investment value chain through the underlying methodologies of ESG funds' portfolio management. Indeed, fund managers can select, analyse, and evaluate portfolio companies using internal or external ESG ratings. External ratings are often sourced from different rating agencies which themselves use different methodologies to measure and aggregate all environmental, social and governance issues.

Internal or external ratings are most often calculated using an arithmetic average that sums E, S and G ratings while allowing different weights to each of these aspects. Thus, the rated company can have a good overall rating, thanks to the excellent treatment of its employees, while harming the environment considerably. Therefore, some methodologies, such as arithmetic average, can hide negative impacts, which we consider to be methodology-prompted greenwashing.

These ratings are becoming structurally inherent to sustainable investing which is why we consider this characteristic to be a foundational aspect of Greenwashing in today's financial system. For instance, in commercial banks, decisions can be made at a credit committee level to refinance big oil companies solely based on their ESG rating. Similarly, fund managers can make investment decisions using ESG ratings only as an SRI filter.

→We would suggest using a geometrical average for these ratings. Even though the geometric mean is a less common measure of central tendency, it is more accurate than the arithmetic mean for percentage change and positively skewed data.

Also, geometric mean is a barycenter taking into account the product of the values of values; less sensitive than the arithmetic mean to high values, it gives a better estimate of the central tendency of the data. A geometric mean is more appropriate for series that are correlated, where the arithmetic mean is smoother.

- **Lack of transparency:** The lack of transparency of these underlying methodologies can lead to misinterpretations. We note that there is a strong divergence of ratings amongst ESG rating agencies [REDACTED] and a strong correlation factor between high ratings and capitalization size hence inducing a company-size bias which mostly benefits large capitalization companies [REDACTED]. Hence, doubt is cast on the reliability of these ratings and the fact that financial actors are making important investment decisions based on them is undermining the trust investors can place in ESG investing.
- **Defective integration and lack of methodology disclosure:** Besides ratings, we also consider the defective integration and lack of methodology disclosure on GHG emission scopes to be linked to Greenwashing. We consider that any company or portfolio manager communicating on GHG absolute

[REDACTED]

emissions, GHG emission intensity and GHG reduction targets must disclose with utmost transparency the calculation methodology and the scopes included and those excluded. This consideration can be extended to other ESG pillars. For instance, on the social pillar, a company disclosing good treatment of its employees in its direct activities but excluding employees working in the downstream and upstream indirect related activities, would lack methodological thoroughness which could lead to misinterpretation for investors. In this case, both the lack of methodological transparency and the failure to include scope 3 impacts should be considered as greenwashing.

→For any investment that may be labelled as responsible investing (i.e Articles 8 or 9), we would suggest adding a minimum requirement for each of the E, S or G ratings. We would also suggest a clear differentiation between each pillar: environment, social and governance in order to bring more transparency to the overall ESG-quality of an investment. We believe that the Environment rating should be related to actual physical requirements related to current and absolute CO2 emissions as well as company's emissions compared to its industry's goal for Paris-Agreement alignment. The emissions should be calculated using reliable methodologies (GHG Protocol or SBTi) encompassing scopes 1, 2 and 3.

Secondly, we identify several risks of Greenwashing drift caused by **the current structuring of listed markets and the current regulatory framework** as a potential Greenwashing trigger:

- **The impacts of passive investment on ESG investments** : Nowadays, with a large section of stock markets being put in motion by passive investing money flows, we see financial stability being affected through impacts on funds' liquidity and redemption risks, asset markets volatility and asset management's industry concentration [REDACTED]. Responding to investors' demand, the passive investment market has started to supplement its offer using investment strategies based on ESG ratings, labelling these ETF funds as "ESG trackers". These strategies further enhance the dependance of what can be considered as ESG-related investments to above-mentioned ESG ratings, hence leading to institutionalised greenwashing.

Over the years, ESG rating agencies and data providers have grown in scale and influence. Nowadays most ESG rating agencies are owned by some of the largest stock market data providers and most of them are US-based [REDACTED]. As a result, financial actors are working on the European regulatory framework with common data sources all coming from American institutions. This can work in such a way as to prejudice or undermine European sovereignty in building its own definition of responsible investing. We believe that data sources, as well as their nature, are paramount to build a model that represents the level of sustainability of a product. Since the EU and USA have different views on sustainable finance, we believe the need for agreed common data sources and methodologies within a multilateral frame (as WTO and OECD).

→Like methodologies, data sources can amplify, or trigger a greenwashing effect and contaminate the whole market. Indeed, without an official data repository of verified data and a methodological framework, unverified or biased data can be used and misused in all financial institutions and have an influence at all investment decision levels (screening, investment universe filtering, buying/selling decisions or credit allowances).

- **The asset-class blinkered view of the current regulatory framework:** Overall, looking at the regulatory landscape, we consider that it mainly corresponds to the characteristics of large capitalization companies in the listed stocks market. Thus, several asset classes are partially excluded or poorly tackled by existing regulations: private equity, small capitalizations, bonds market.

→We believe dedicated regulatory frameworks must be thought of distinctly. Greenwashing can take different forms depending on the asset class and harmonising regulation across asset classes without considering the complexity of each asset class would be a mistake.

- **Confusion on the SFDR directive:** Concerning the fifth core characteristic of greenwashing as it is defined in 1.1, our view is that SFDR is intended to be a disclosure regime, whilst the financial

market is using SFDR more as a labelling scheme, which gives rise to much confusion and can cause greenwashing [REDACTED]. Also, the 'comply or explain' aspect of the regulation can also lead to misinterpretation on the side of investors.

→We understand the need to be supportive of financial actors along their transition to the new regulatory framework and not to rush change. We are also aware that the European Commission is already working on a comprehensive assessment of SFDR to solve any remaining confusion. Still, we would advise regulators not to lower their expectations towards financial institutions: heeding constructive criticism or comments is useful, but we find it is important to keep a sufficient level of expectations regarding this matter.

More recommendations are shared at the end of this questionnaire, as a part of the answer to the question F10.

- **Potential greenwashing caused by the Taxonomy:** Beyond misleading claims due to deceiving or omitted information at the entity, product, or service levels, we identify risks of greenwashing at the regulatory level in the misunderstanding and mislabeling of what constitutes "Green", "Sustainable" or "Transitory" activities. For instance, the debated inclusion of gas in the Green Taxonomy may lead to transparent "greenwashing" as sustainability-related claims aligned with Taxonomy become incompatible with science-based targets.

Thirdly, we identify several risks of Greenwashing **emerging at the stage of branding, manufacturing, and reporting** on financial products:

- **Financial products name and description:** As stated in the introduction, Greenwashing can occur at any point of the cycle of financial products/services or value chain including at its very origin: the naming and branding of funds. We consider that the **use of words without normative content**, such as: "clean", "sustainable", "responsible", "green", etc. can mislead investors and thus induce greenwashing.

→ESMA has recently launched a consultation aiming at better regulating the naming of funds and the use of ESG-related or sustainability-related words in funds names. We believe this topic to be fundamental in the overall goal of undermining greenwashing and we heavily encourage the European regulation authorities to take a stand on this topic.

→We recommend that these statements be substantiated with strong Key Performance Indicators linked to the company's CO₂eq. emissions, or measured ESG provided benefits. Another recommendation would be the development of a normative content for those words. Several examples have emerged on the market: French law for the use of the terminology "carbon neutral" or the Swiss Federal Council working group on the circumstances under which a financial product or service can be labelled as 'sustainable'.

- **Use of benchmarks in funds reporting:** The use of benchmarking for carbon emissions in funds reporting can be a misleading piece of information for investors. Some portfolio managers compare the emissions of their fund's portfolio to the emissions of a stock market index, therefore giving the idea of a low-carbon alpha measure. We consider that the distribution of firms' carbon intensity is very skewed, making it easy for portfolio managers to exclude a small fraction of highly polluting firms to massively reduce the carbon footprint of their portfolio of corporate stocks hence outperforming their carbon index.

→ Regarding this issue, we would rather have funds using a benchmark that would be representative of the portfolio's sector allocation and that would be aligned to the Paris-Agreement objectives. Ideally, this sectoral benchmark would be calculated or supervised by a European regulatory instance or an independent body.

- **Use of portfolio temperatures in funds reporting:** To make investment decisions, sustainable investors may look at different information in an ESG fund, such as the fund's name, the fund's GHG

emissions and benchmark's emissions as well as annex data such as portfolio temperatures. Sustainability-linked information such as portfolio temperatures can also mislead investors in the sense that the concept of temperature increases should only be applied to the planet as a whole. The objective of 1,5°C is linked to a balance between emissions and absorptions of CO₂ on a global scale. A company stock on its own, and a sum of company stocks in the form of a portfolio cannot pretend to be representative of the planet as a whole and its complex balance of carbon emitters and carbon sinks. Displaying a portfolio temperature could lead investors to think that their investment would lead to the achievement of this planetary and collective temperature limit and can be considered a misleading claim.

→We would encourage the regulatory bodies to tackle this topic by closely monitoring the underlying methodologies in order to ensure the scientific reliability and usefulness of these portfolio temperatures.

- **Neutrality claim in a fund's description:** Similarly, we consider a neutrality claim at the scale of a product, a service, or a company, as being misleading: neutrality can only be achieved at the scale of the whole value chain. These claims are thus likely to create an optical illusion on the worldwide picture. Some companies can claim to eliminate their exposure to climate risks thanks to their activities while the rest of the world is still exposed. This kind of public statement distorts at best the reality and is at worst to be considered Greenwashing.

→We recommend strengthening the transparency of the scope and the perimeter and scopes included when such public statements are made. The idea is to accentuate visually and make it very clear to investors that the real beneficial impact of the company is in fact limited.

- **Key Performance Indicators:** KPIs used to measure and support the transition of a company, or its activities can be deliberately chosen to distort the reality of the ongoing transition. For instance, an economic intensity KPI (CO₂/€ or \$) for several sectors and actors can be reduced thanks to a turnover increase. Therefore, the company can very well emit more at the same time. Assuming a growth of 6% per year over 30 years, the turnover will be multiplied by 5.7. If we reduce carbon intensity by 78%, we emit at the same time 26% more carbon, which we consider Greenwashing. Another example of mis-used/defined KPI can be the use of absolute emission on a scope that is not material to the company's activities. For instance, an Oil and Gas company disclosing its scope 1, 2 and 3, but its scope 3 only include its employee business trips' emissions.

→These methodological inaccuracies are tolerable in a fund reporting statement. However, they can lead to serious greenwashing flaws when used in Sustainability-linked bonds as SPTs (Sustainability Performance Targets). We would suggest building a strict SPT framework that would avoid these methodological pitfalls in the bond market.

More broadly we consider that **perimeters, methodologies, incertitude, and risks linked to any strategies, products or services** may be linked to, hiding or triggering Greenwashing. Therefore, they must be more transparent to prevent Greenwashing. Indeed, we believe that despite all regulations emerging nowadays, there is still room for Greenwashing.