PRI RESPONSE

FCA GUIDANCE ON THE ANTI-GREENWASHING RULE CONSULTATION

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An investor initiative in partnership with UNEP Finance Initiative and UN Global Compact

ABOUT THE PRI

The Principles for Responsible Investment (PRI) works with its international network of signatories to put the six Principles for Responsible Investment into practice. Its goals are to understand the investment implications of environmental, social and governance (ESG) issues and to support signatories in integrating these issues into investment and ownership decisions. The PRI acts in the long-term interests of its signatories, of the financial markets and economies in which they operate and ultimately of the environment and society as a whole.

The six Principles for Responsible Investment are a voluntary and aspirational set of investment principles that offer a range of possible actions for incorporating ESG issues into investment practice. The Principles were developed by investors, for investors. In implementing them, signatories contribute to developing a more sustainable global financial system.

The PRI develops policy analysis and recommendations based on signatory views and evidence-based policy research. The PRI welcomes the opportunity to respond to the Financial Conduct Authority's (FCA) call for feedback on the proposed anti-greenwashing rule guidance, as part of a package of measures in the Sustainability Disclosure Requirements (SDR) and investment labels regime.

ABOUT THIS CONSULTATION

The FCA are seeking feedback on their proposed anti-greenwashing guidance, as part of a package of measures in the SDR and investment labels Policy Statement. The anti-greenwashing rule seeks to ensure that sustainability-related claims made by authorised firms about their products and services are fair, clear and not misleading, and are consistent with the sustainability characteristics of the product or service. The wider SDR and investment regime is designed to increase transparency and trust in sustainable investing and intends to protect consumers from greenwashing so they can make informed decisions that are aligned with their sustainability preferences.

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PRI Principles for Responsible Investment

KEY RECOMMENDATIONS

The PRI welcomes efforts by the FCA to reduce greenwashing and ensure savers and investors are confident in the services advertised and provided by investment and fund managers. As the first measure to be implemented in the Policy Statement, the anti-greenwashing rule will set the foundation for the wider SDR and investment labels regime. The creation of an anti-greenwashing rule should set a regulatory framework to combat the risk of disconnect between claims made by certain issuers and their actual environmental and/or social impact.

The PRI's key recommendations to the FCA are set out below.

- Ensure **coherence with global regulatory approaches** to greenwashing where feasible, drawing on the International Organization of Securities Commissions' (IOSCO) recent guidance, Supervisory Practices to Address Greenwashing. Global regulatory alignment on overcoming greenwashing will benefit UK and global investors looking to operate in the UK.
- The lack of consistency and transparency in terminology used to describe funds and their impact remains a concern. We recommend that the FCA complement the anti-greenwashing guidance with **additional guidance aimed at harmonising terminology** for the financial ecosystem, drawing on the joint work by the PRI, the Global Sustainable Investment Alliance (GSIA) and the CFA Institute on Definitions for Responsible Investment Approaches.
- Strengthen guidance on **stewardship practices**, setting a minimum baseline of stewardship considerations. Overstating the influence of company engagement can happen intentionally and unintentionally, leaving stewardship claims susceptible to greenwashing.
- **Internal capacity building** on sustainable finance concepts through education initiatives can proactively help protect against greenwashing and sustainability-related risks. The FCA should promote investor education to help understandings of disclosed sustainability information, through signposting education, training, and information.
- Set out a clear **monitoring approach** detailing how potential greenwashing claims and the use of labels will be monitored, and how breaches will be handled.
- **Provide stronger examples to illustrate claims that are likely to be false or misleading and cases of good practice**. Examples should take into account genuine cases where greenwashing is a high-risk, such as through forward-looking net zero claims, unintentional incidents, and within stewardship claims. The examples could also show a more **holistic scenario,** with potential actions taken to remedy the greenwashing, or factors considered when taking enforcement action for a breached rule.

More broadly, it is crucial that wider sustainable finance policies and standards, such as corporate disclosures, taxonomies, and ESG ratings, continue to develop in a coordinated manner. This will tackle greenwashing more comprehensively, which is key to ensuring investors have the information and tools needed to substantiate sustainability claims, rather than just guidance.

DETAILED RESPONSE

Question 1: does the proposed guidance clarify the anti-greenwashing rule? If not, what more could we do to provide clarity?

The development and completion of standards and policies to promote further clarity, transparency, and accountability will be essential to addressing greenwashing risks. Overall, the PRI agrees with the premise of the anti-greenwashing rule. Asset owners and their advisers need to be empowered to challenge investment managers on practice, to uncover greenwashing and to trigger changes in practice across ESG integration and engagement.

We support the actions proposed by the FCA to address greenwashing risks, notably:

- the scope of the rule, applicable to all FCA regulated firms and all communications about financial products or services which refer to sustainability characteristics; and
- the intention of the rule, to protect consumers from greenwashing so they can make informed decisions that are aligned with their sustainability preferences.

However, the guidance could benefit from further elaboration on:

- how **interoperability** will be sought to align global regulatory regimes and avoid market fragmentation;
- harmonising **terminology** to best ensure consistency and clarity;
- further details on what constitutes a credible standard of **stewardship**; and
- the FCA's **monitoring and review** approach.

Interoperability

Financial markets are increasingly interconnected, with asset owners and managers working across multiple jurisdictions. Having to conform to multiple different standards creates higher costs and operational complexities for firms, which in turn leaves less resource for working with companies to steer them towards net zero.[1]

A global framework is needed to prevent fragmentation, provide greater comparability and transparency, as well as reduce the complexity of sustainability disclosure requirements.[2] **Adopting IOSCO's recommendations in Supervisory Practices to Address Greenwashing across jurisdictions** would help to promote regulatory coherence for investors and ensure that regulators have the necessary framework for cooperation.

Currently, regulators are pursuing different approaches. The PRI have conducted a review of trends in ESG reporting requirements for investors, which found that many jurisdictions are looking at tackling

[1] House of Commons Environmental Audit Committee, The financial sector and the UK's net zero transition. First Report of Session 2023-24.
[2] Chitra Silva Lokuwaduge and Keshara De Silva, "ESG Risk Disclosure and the Risk of Greenwashing." *Australasian Accounting Business and Finance Journal* 16 (2022)

greenwashing but adopting different approaches in doing so. These approaches can be categorised as ‘medium-regulation jurisdictions’ and ‘high-regulation jurisdictions.’ In practice, product-level disclosure requirements tend to vary across jurisdictions on different types of “sustainable products,” meaning investors cannot effectively compare these.

IOSCO’s mapping of regulatory authorities approaches to greenwashing across the globe is a useful starting point for distinguishing between the different types of legal and regulatory frameworks at play. The FCA should **ensure that the anti-greenwashing rule covers entity-level practices, policies, procedures and disclosures relating to material sustainability-related risks and opportunities and product-level disclosure of sustainability-related products**. This aligns with most jurisdictions supervisory tools and mechanisms to address greenwashing.

More broadly, to support the creation of a system of globally comparable and decision-useful information for investors, and support effective sequencing of the UK’s disclosure framework, the UK government should endorse the International Sustainability Standards Board (ISSB) Standards (IFRS S1 and IFRS S2) and transpose them into UK regulatory requirements as soon as practicable.

Guidance on terminology

We recommend that the FCA complement the anti-greenwashing guidance with additional guidance aimed at harmonising terminology for the global financial ecosystem.

Disclosures should allow for meaningful assessments of how an investment meets or contributes to sustainability objectives. Precise and clear definitions of responsible investment approaches enable end investors to understand the nature of an investment strategy’s objectives and how they will be achieved. Additionally, consistent definitions can encourage greater global policy alignment across jurisdictions.

Imprecise and inconsistent definitions cause confusion for retail investors seeking specific funds and could lead to fund managers or advisers downplaying their ESG consideration practices for fear of misstatement. These issues, combined with the wide applicability of the anti-greenwashing rule could make the implementation of the anti-greenwashing rule difficult.

As highlighted in the FCA’s SDR Policy Statement, the PRI, the GSIA and the CFA Institute have been working on an initiative looking at Definitions for Responsible Investment Approaches. It aims to unify the industry around a set of common definitions, so that users and preparers of information can communicate effectively with harmonised, well understood language. The paper describes the concepts that define each responsible investment approach, rather than criteria for product labelling or categorisation. This could form a basis for the FCA’s work in providing further clarity in the anti-greenwashing guidance, ensuring that terminology applied in the UK is interoperable.

Stewardship

In addition to the ongoing wider work on building a regulatory framework for effective stewardship, there is scope within both the anti-greenwashing rule and the labelling regime for more guidance on what constitutes **a credible stewardship strategy** at product-level to bring alignment with sustainability goals over a certain time frame. The lack of clear standards and transparency on stewardship best practice may make the regime particularly vulnerable to greenwashing. For example, claims about engagement with investee companies could be misleading without stewardship prescription.

The recent greenwashing guidance published by the Australian Securities and Investments Commission (ASIC) is a leading example of regulatory guidance on possible ways that funds could misrepresent the fund's investment and objectives, which may, in turn, mislead investors into purchasing funds that appear to be focused on ESG factors or sustainability. ASIC provide additional regulatory guidance on stewardship investment approaches:

"If you have adopted a stewardship investment approach to achieve your sustainability-related targets, you should:

- *explain to investors the rationale for engaging with particular companies to influence changes in their corporate behaviour*
- *provide regular updates on your progress with those companies, including stewardship activities and outcomes, such as voting and engagement activities."*[3]

Setting a **minimum baseline** for how sustainability-related considerations are taken into account, and incorporated into investment decisions and stewardship activities in the wider SDR regime could remedy greenwashing and stewardship concerns in the FCA's Guiding Principles. Within the anti-greenwashing itself, an example of cases of good practice or claims that are likely to be false or misleading could be useful. We elaborate on changes to the proposed examples in our response to Question 2.

Monitoring and review

A further area of divergence across regulators is the monitoring and enforcement approaches, with some adopting stronger sanctions such as specific infringement notices (Australian Securities and Investments Commission (ASIC) Australia), financial penalties (US Securities and Exchange Commission (SEC)), or orders for business improvements (Financial Services Authority (FSA) Japan).[4]

The FCA have not indicated how they would monitor the application of the anti-greenwashing rule in the guidance or in the examples given, or which steps may be taken in the case of a breach. This could reduce the overarching transparency and accountability mechanism of the rule and destabilise the flow of high-quality decision-useful data across the investment chain.

The FCA have a dual role of both setting clear regulatory requirements *and* monitoring whether requirements are being followed, taking swift enforcement action and potential sanctions if these are breached.[5] As the European Securities and Markets Authority (ESMA) have cited, the combination of

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[3] Australian Securities and Investments Commission (ASIC) How to avoid greenwashing when offering or promoting sustainability related products, 2022.
[4] IOSCO, Supervisory Practices to Address Greenwashing (2023).
[5] IOSCO, Supervisory Practices to Address Greenwashing (2023).

greenwashing monitoring tools at product and entity level should further help to build a comprehensive assessment of greenwashing-driven financial risks.[6]

Without a clear monitoring and review process in place, there is a risk that the FCA's principles-based approach could fail to adequately prevent greenwashing and lose its credibility. However, through conscientious monitoring, the FCA could proactively review the guidance in light of changing market dynamics to ensure it is up to date for the audience. Investors highlighted that findings from the FCA's monitoring could be communicated back to the financial sector, with clear direction of focus on how the rule has been interpreted by industry.

The Australian Competition & Consumer Commission (ACCC) have similarly adopted a principles-based approach but have complemented it by setting out factors that are considered when determining whether to take enforcement action once a breach is identified. To this end, we recommend that the FCA **set out how the anti-greenwashing rule will be monitored as well as next steps taken where a breach occurs**.

The monitoring and review process should capture the nuance for investors to **faithfully describe their investment processes**, with sufficient information available to retail investors. This is particularly key given that the wider sustainable finance tools have not developed at the same pace as the anti-greenwashing rule.

Whilst there is no evidence at this stage that increased scrutiny surrounding greenwashing is reducing demand (institutional or retail) for sustainability-themed products, there is a risk that insufficient clarity, transparency, and accountability may inhibit the UK's ability to align markets with sustainability goals. Therefore, we encourage the FCA to **monitor and update guidance** regularly.

Furthermore, the examples in the guidance only show single, static instances. It would be helpful if the FCA provided clarity on how the firms could take **proactive steps to improve their practices** and no longer be at risk of breaching the rule. Within the examples given, we recommend that the FCA add next **steps on enforcement measures** if the firm did not re-evaluate claims that were found to be greenwashing. We further expand our feedback on the examples in the following question.

Application of the rules

More broadly, investors raised a need for clarity in the SDR Policy Statement on the application of the anti-greenwashing rule. Specifically, on the different expectations on institutional and retail investors, particularly on what does and does not apply to retail investors and what might apply in institutional cases.

As well as this, the rule applies to all "products and services" that make sustainability-related claims, yet investors may interpret "services" differently. For example, the application of the rule to cross-cutting services like responsible investment across all investment strategies could do with further clarification. Given that the guidance is still in consultation and investors need clarity that cross-cutting

[6] European Securities and Markets Authority (ESMA) Progress Report on Greenwashing (2023).

services *are* captured in the rule, there is a concern that the timeframe could be too tight considering the substantial work required with responsible investment writ large in scope.

Question 2: do you have any comments on the proposed guidance including the examples given?

The PRI is supportive of a specific anti-greenwashing rule in the FCA's SDR Policy Statement. This will reduce the reliance on the investment labels alone to tackle greenwashing. Further, the wider applicability of the anti-greenwashing rule will permeate more of the market and set a stronger precedent. The FCA have gone into sufficient detail and clarity on the guidance itself, however the examples could be improved. At this stage, they do not serve the purpose of helping firms understand what the guidance means in practice.

The FCA's examples

The seven examples offer realistic scenarios and intentional cases of greenwashing. However, they do not give a holistic enough picture to offer enough guidance on the anti-greenwashing rule. Given that the anti-greenwashing rule is applicable to all FCA regulated firms, we recommend the following to improve the examples.

- Many financial institutions have net zero commitments and transition plans, which rely on forward-looking data on how firms are intending to meet those commitments. Forward-looking information is a high-risk area for greenwashing, as it relies heavily on judgements and projections. Further, climate target-setting and portfolio alignment methodologies are inherently complex. We recommend that the FCA **provide examples of how forward-looking claims can be misleading and result in greenwashing**.
- The FCA's examples only offer instances where greenwashing occurs or is at risk of occurring. By comparison, the ACCC guidance on making environment claims offers examples of good practice. A focus on **positive reinforcement of the rule**, rather than only negative examples, would be beneficial. The FCA should bring to life **examples of good practice**, to set a standard for firms to follow. This could bring further clarity to the rule and lessen the burden of regulatory enforcement.
- To better exemplify how claims of the influence of stewardship can be a high risk of greenwashing, the FCA should provide an example of an **overstated stewardship claim**, detailing why it is misleading, and clarify the FCA's stewardship expectations as set out in the Policy Statement.[7]
- The examples themselves could benefit from more signposting to direct users of the guidance to the specific breach. Rather than titling the examples numerically, **the FCA should signal *'claims***

[7] ASIC guidance on overstating the degree of influence one could reasonably have through company engagement offers a clear example of this from a regulatory body.

that are likely to be false or misleading'* and *'cases of good practice.'[8] To offer even further clarity, the FCA could pinpoint in the title which element of the rule the example breaches.

Overall, the guidance should be consistent with the development of the wider sustainable financial ecosystem for the industry to coalesce around. As a valuable policy steer, we recommend that the FCA also offer guidance on:

- greater internal **capacity building** on sustainability considerations; and
- developing a regime for **ESG Data and Ratings Providers.**

Capacity building

We recommend that the FCA complement the proposed guidance by promoting **financial and investor education initiatives.** These are essential tools at regulators' disposal to support sustainable finance and proactively protect against greenwashing risks.

As IOSCO have noted, education initiatives can enhance the ability of retail investors to understand the disclosed information and ask appropriate questions to enable them to make better financial decisions.[9] Furthermore, promoting capacity building can create an internal 'sustainability positive culture' within organisations, which can enhance firms' sustainability strategy and risk appetite to pursue sustainability goals.[10]

In some cases, greenwashing can occur unintentionally due to a lack of internal capacity to understand the environmental and/or social impact of a fund. As Morningstar Sustainalytics have highlighted, investment funds have often led with marketing surrounding the way a fund has been invested, which may not be aligned with the genuine sustainability profile of a fund.[11]

An additional consideration is that whilst greenwashing can occur at any stage of the investment chain, many financial education initiatives have been focused on asset managers rather than ESG ratings and data product providers.[12] A key challenge for asset managers in adjusting their practices for the anti-greenwashing rule is the availability, quality, and relevance of data, as highlighted in PRI's Investor Data Needs Framework. ESMA's diagnosis of data challenges also points out that sequencing issues have led to difficulties in assessing data needed by financial market participants and that scrutiny of information can require significant human resources.[13] This has subsequently exacerbated a reliance on ESG data and ratings providers.

Future regime for ESG Ratings Providers

Misuse of the FCA's labelling regime by investors and data providers with limited ESG literacy can undermine the entire SDR and investment labels regime. Many firms also rely on third party data

[8] Following ACCC's Making Environmental Claims: A guide for business (2023)
[9] IOSCO, Supervisory Practices to Address Greenwashing (2023).
[10] Deloitte, Blog: FCA's new anti-greenwashing rule – clear fair and not misleading is complicated when it comes to sustainability-related claims. (2023)
[11] Morningstar Sustainalytics, Seeing Through Green: A Guide to Greenwashing Risks for Asset Managers (2023).
[12] IOSCO, Supervisory Practices to Address Greenwashing (2023).
[13] ESMA, Progress Report on Greenwashing (2023).

providers to make sustainability claims. Therefore, we recommend that the FCA work with HM Treasury on the **scope of a future regulatory regime for ESG ratings providers** and integrate the final recommendations within the anti-greenwashing guidance and wider SDR regime. This should focus on improving transparency by both ESG data and rating providers on their methodologies and data processes, by developing minimum quality and transparency standards. A further consideration is ensuring appropriate governance arrangements are in place to prevent conflicts of interest and ensure the independence and integrity of their research and offering.

Future regulation should be consistent with the International Capital Market Association's (ICMA) voluntary Code of Conduct for ESG ratings and data providers to promote international consistency. As an industry-led threshold, there is huge value in the FCA using ICMA's voluntary Code of Conduct as a baseline.

Question 3: do you agree that the guidance should come into force on 31 May 2024?

As the FCA have noted, a staggered implementation timeline to address potential harm as early as possible, while acknowledging that firms of all types and sizes need to operationalise the requirements is useful. With the anti-greenwashing guidance coming into force ahead of the sustainability labels, naming and marketing rules, and disclosure rules, the rule will set a good foundation for markets to integrate the latter tools more easily.

Evidence shows that the removal of greenwashing opportunities under mandated reporting encourages firms to make changes to improve environmental performance.[14] With staggered implementation, firms should have sufficient time to develop internal processes of assurance and comply with the regime.

As the SDR Policy Statement is the start of a regime that will expand over time, it is also important to view its implementation to all FCA regulated firms and all communications about the sustainability characteristics of products or services as part of **an iterative process**.

We recommend that entity-level reporting requirements be aligned with IFRS Sustainability Disclosure Standards at pace following entry into force of SDR. A speedy adoption of ISSB-aligned entity-level reporting requirements under SDR would limit the risk of duplicative reporting by firms subject to both rules and create an end-to-end reporting system between issuers and SDR-regulated firms. In this regard, the FCA should publish a **timeline for adoption of ISSB requirements** under SDR. This would provide clarity to firms concerned with prioritising resources and the double burden of reporting requirements.

More broadly, appropriate sequencing of disclosure requirements will be essential to ensure investors are able to access decisions-useful information. Clarity on how the ISSB Standards, scope 3 GHG emissions, a sustainable taxonomy, and outputs from the Transition Plan Taskforce (TPT) will be brought into the SDR regime would also be highly valuable.

[14] Jody Grewal, Gordon Richardson, Jingjing Wang, "The Effect of Mandatory Carbon Reporting on Greenwashing." (2022)

The PRI has experience of contributing to public policy on sustainable finance and responsible investment across multiple markets and stands ready to support the work of the FCA further to eradicate greenwashing and support the wider SDR regime in the UK.

Please send any questions or comments to policy@unpri.org.

More information on www.unpri.org