

Outline

- ▶ What is greenwashing and why it is important?
- ▶ Macro dimension: The economic consequences of GW for the EU orderly climate transition envisaged in the EU Climate Law
- ▶ Micro dimension: Implications for the firm. Abundant Literature on the importance of accurate disclosure in limiting greenwashing

What is greenwashing and why it is a concern?

- ▶ A practice where sustainability-related statements, declarations, actions, or communications do not clearly and fairly reflect the underlying sustainability profile of an entity, a financial product, or financial services (*ESAs common understanding*)

What is greenwashing and why it is a concern?

- ▶ The risk of greenwashing has grown significantly in the past years and expected to remain high (EU): unintended?
 - **methodological limitations** (i.e. uncertainty regarding the transition paths to Net Zero 2050)
 - the **rapid regulatory developments** ... which coexisted with insufficient progress on the regulation of due diligence process requirements including "third-party verifiers"
 - **lack of knowledge and experience of market participants**

What is greenwashing and why it is a concern?

▶ Macroeconomic dimension

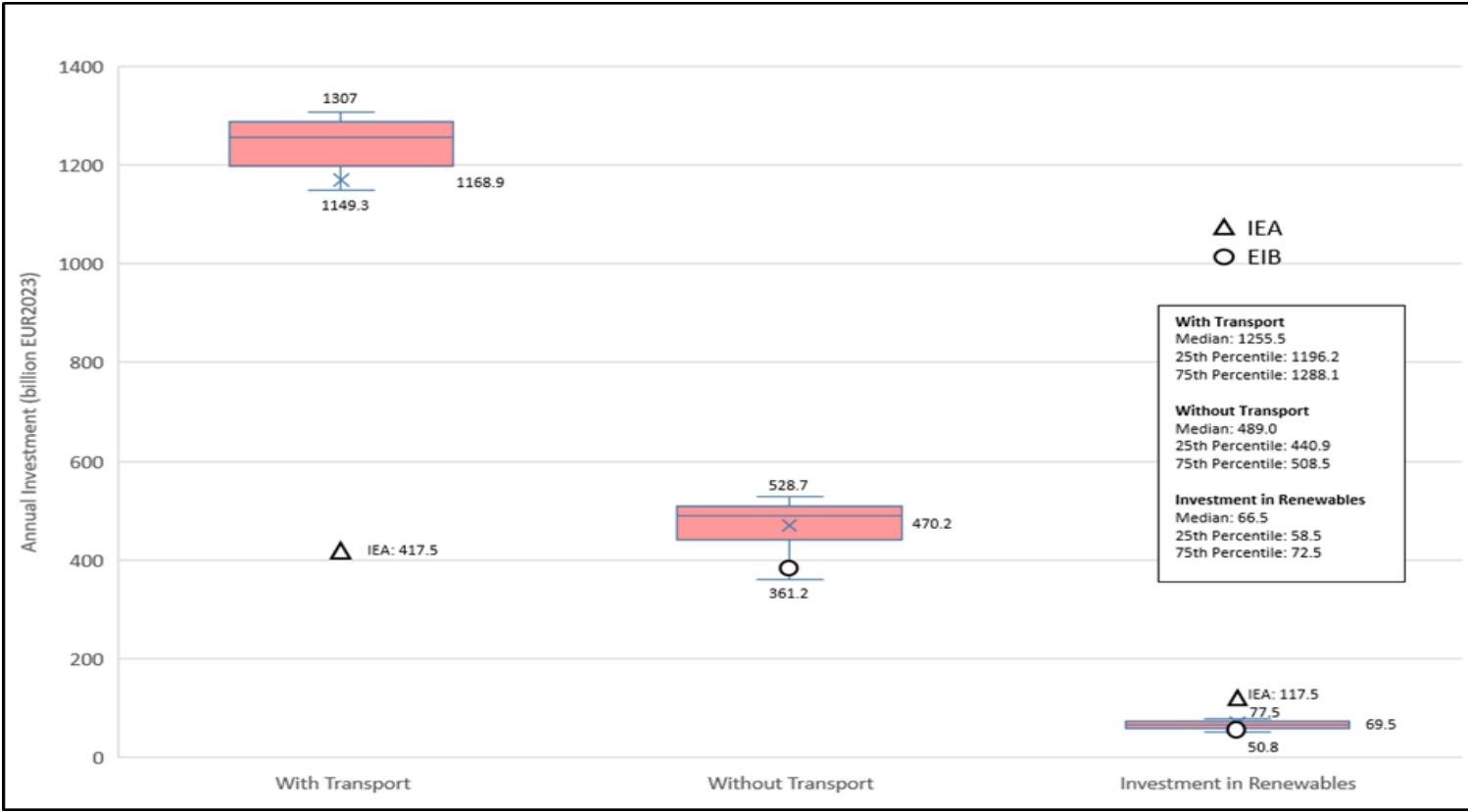
- Greenwashing stands as an obstacle to the collective endeavor of Net Zero emissions
- With IMPLICATIONS FOR THE EU ECONOMY AT LARGE

▶ Microeconomic dimension

- IMPLICATIONS FOR THE FIRM: Litigation AND reputational risks
 - Consumer protection/business conduct
 - Safety and soundness/prudential

Large investment push required for the orderly transition to a low carbon economy in line with the ECL

Average annual energy public and private investment needs (mitigation) in the EU (2020-30) (billion EUR 2023/yr)

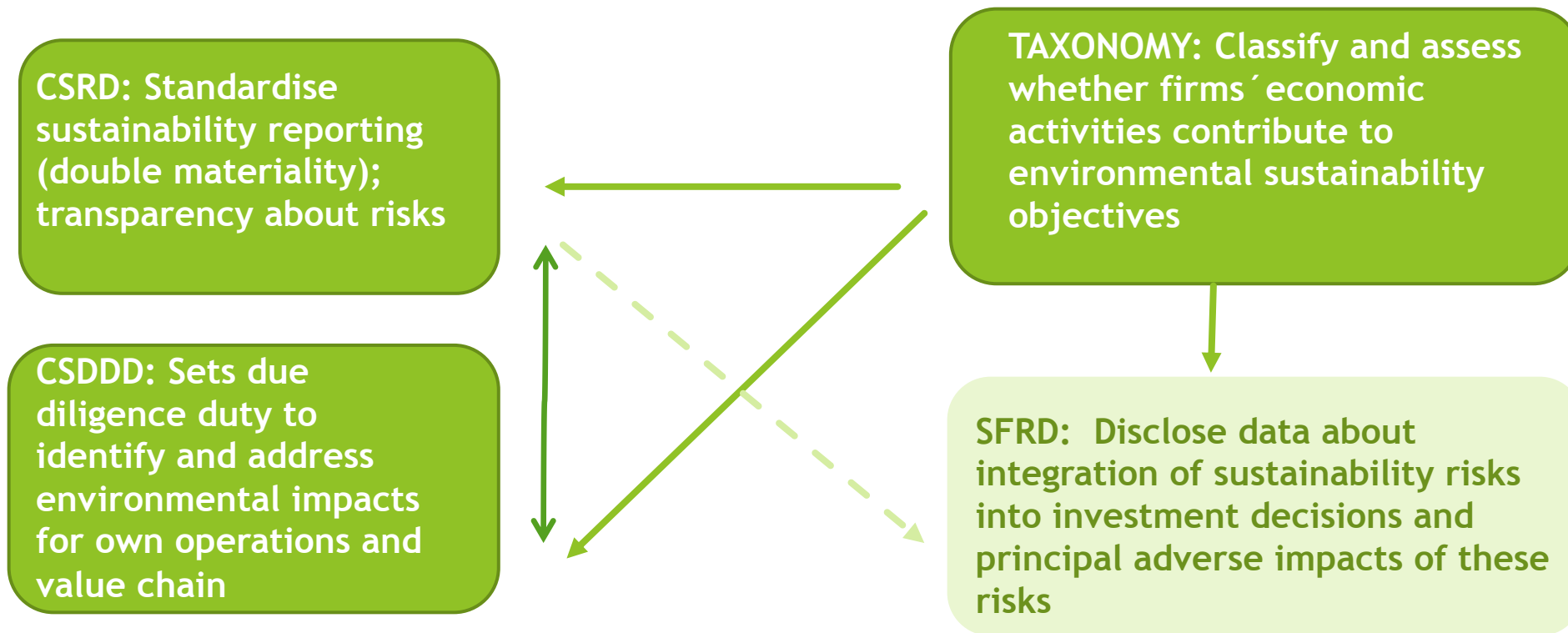


Sources: EC, EIB and IEA estimates. The lack of consistency of assumptions across models, supporting models and a lack of clarity of the breakdown of the output figures make comparability difficult. EU Commission estimates based on SWD (2021) 621 final and SWD (2020) 176 final. Investments without transport includes: power grid, boilers, new fuels production and distribution (i.e. green hydrogen) and energy efficiency measures.

Micro economic dimension → implications of GW for the firm → Literature review

- ▶ What are the economic consequences of GW?
 - Market penalizes greenwashing behavior, lowering the re-issuance probability and making it costlier for greenwashing firms to re-issue
 - Reputational risks from lawsuits → Larger market premiums
- ▶ What are the relevant regulatory components of the sustainable finance framework
 - Common definition of what is “environmentally sustainable” → Taxonomy } Chryssa
 - Ensure a high level of transparency and credible 3er party verification } Chryssa
 - Harmonizing criteria and labels for certain sustainable investments } Gabor
- Relevant elements of regulatory design → content of corporate sustainability disclosure
 - New regulatory tool: Transition Plans → Agnieszka
 - Third party verifiers as a mechanism to reduce info asymmetries

Literature review



The EU Taxonomy (Regulation (EU) 2020/852)

- ▶ It is designed to institute a market transparency tool, enabling a common language for “environmental sustainability” and defining “green investments” in the EU (economic activities) ... Not fully developed as yet
 - [Lucarelli et al. \(2023\)](#) the staggered development causes firms to postpone investments in response to the regulatory uncertainty.
- ▶ It addresses the shortcomings of the widely used ESG ratings ([Chen et al., 2021](#); [Berg et al., 2022](#))
- ▶ Art. 8(2)(b) of the Taxonomy Regulation requires corporates to disclose the proportion of capital expenditure (CapEx) and operating expenditure related to sustainable activities (OpEx) → Reference in Transition Plans (TPs)
- ▶ Implementation challenge: Limitations in access to good quality data

EU disclosure and reporting requirements

Corporate Sustainability Reporting Directive (CSRD) Directive (EU) 2022/2464

- ▶ Double Materiality is linked to the EU Taxonomy
- ▶ Sustainability is a European public good
- ▶ Report publicly on “implementing actions and related financial and investment plans” in line with the ECL and, where relevant, the exposures to coal, oil and gas-related activities.
- ▶ Transition plans include the value chain, upstream and downstream (Scope 3 emissions) → Comparability issue
 - Although Science Based Target initiative (SBTi) Corporate Net-Zero Standard are recognised subject to criticism including for the excessive use of Carbon Capture and Underground Storage (CCUS), [Trexler and Schendler \(2015\)](#), [Chan et al. \(2016\)](#), [Robiou du Pont et al \(2024\)](#) challenge the claim that corporate emissions targets of the SBTi are aligned with the Paris Agreement
- ▶ Separate sustainable reporting in the management report and consolidated financial statements and reports.
- ▶ Breaches of reporting is sanctioned under national law → Uneven playing field

EU disclosure and reporting requirements

Corporate Sustainability Due Diligence Directive (CSDDD) Directive (EU) 2024/1760

- ▶ CSRD and CSDDD have **different scope**. CSDDD is narrower. Size will be the only factor to determine the application of CSDDD, new criteria not aligned with the definition of large undertakings in CSRD (larger corporates). SMEs not within the scope, only indirectly as contractors of large corporations
- ▶ Both upstream and downstream activities are encompassed, but downstream is restricted to business partners conducting activities for or on behalf of the company
- ▶ Financial institutions, the obligation is limited to the upstream value chain (Art. 3 CSDDD)
- ▶ Obligations of means, i.e. best effort to mitigate companies' environmental impact
- ▶ If companies report annual transition plans under the CSRD, they are deemed to be in compliance with CSDDD TPs
- ▶ Companies may use independent third-party verifiers
- ▶ Harmonised administrative penalties range from “name and shame” (for at least 5 years (Art. 27(5)) up to 5% of the corporate net worldwide turnover (Art. 27 para. (3) and (4)) and public statements for failure to comply with a pecuniary penalty decision (Art. 27(3)(b)).
- ▶ Novelty: Civil compensation under national law if company breaches obligation intentionally or negligently if: the obligation is aimed to protect the natural or legal person, the person suffers a damage, and there is causal link between the failure to comply and the damage caused

EU disclosure and reporting requirements

CRD6/CRR3, (Directive (EU) 2024/1619 and Regulation (EU) 2024/1623)

- ▶ Pillar 2: non-public transition plans assessed during SREP (Art. 76(2) CRD6)
 - Art. 8 of the Taxonomy Regulation requires large companies to disclose the proportion of turnover, capital expenditure (CapEx) and operating expenditure (OpEx) related to sustainable activities, and this allows banks to evaluate the alignment of their loan portfolios with the Taxonomy.* The KPI banks disclose is the Green Asset Ratio (GAR).
- ▶ Pillar 3: Banks admitted to trading in a regulated market are obliged to disclose information on ESG physical and transition risks biannually (Article 449a CRR3)
 - The Net Zero Emissions by 2050 climate risk scenario (NZE2050) of the International Energy Agency (IEA) is prescribed. The IEA provides scenarios at global level and some specific metrics at European level. Institutions are to measure the distance from the IEA scenario benchmarks at global level and, where the specific European level metrics are available, at European level
- ▶ Facilitated emissions linked to funding activities where banks play an advisory role which is off-balance sheet
- ▶ Impetus is expected internationally on climate related disclosures (BCBS, 2023 and FSB, 2023)
- ▶ Harmonised sanctions for breaches of the CRD6 including periodic penalty payments (up to 5% of annual turnover for legal persons) and *cease and desist orders*, name and shame (Art. 67(2) CRD6)

Outline

- ▶ What is greenwashing and why it is important?
- ▶ Macro dimension: Large investment push required to meet the objectives of the EU Climate Law (ECL): the importance of accurate reporting
- ▶ Micro dimension: Literature review
- ▶ The nexus of disclosure requirements for corporates and banks in the EU
- ▶ Next steps going forward

Conclusions: Next steps going forward

- ▶ The EU has an ambitious regulatory framework for corporate disclosure *cum* deterrence: high sanctions for breaches of obligations
- ▶ The success of the regulatory framework will heavily rely on its credible implementation, including penalties, that will contribute to anchoring the expectations of economic agents
 - Need of full development of the EU taxonomy framework
 - Coordination across national competent authorities for the implementation of CSDR and CSDD will be necessary
 - The scope of application of both directives should ideally overlap (CSRD and the CSDDD) even if transitional periods are envisaged
 - Mandatory transition plans for climate mitigation should be science based and same scenario provider
 - The definition of an international/EU scenario provider (i.e. IEA, NGFS) would facilitate their comparability and reliability as it has been done in the case of banks' reporting
 - Targets for financed emissions by banks should cover facilitated emissions (off-balance sheet)
 - Any potential future regulation of greenwashing should be based on the existing sustainability disclosure framework (CSRD, CSDDD, CRD6/CRR3 on ESG risks for banks)