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The crackdown on greenwashing

Why it matters and managing your organization's risk

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As more products are being labeled "green" or "sustainable," there has been a rise in exaggerated, misleading or unsubstantiated claims — and financial services regulators are taking notice. In the UK, the Financial Conduct Authority (FCA) has given a clear signal that it plans to clamp down on greenwashing.[1] Other stakeholders are also watching.

It's a given that organizations should not be greenwashing. Consumers need to understand what they're buying and be able to trust that products have the sustainable characteristics they claim to.

Regulators have a clear mandate to build trust in financial markets. But more than this, trust is imperative to sustainability and the environmental, social and governance (ESG) agenda. Engaging in greenwashing can erode trust and make it difficult or impossible for consumers to take an organization's ESG messages at face value.

There have always been regulatory and legal requirements to not mislead or misrepresent a product or service's credentials. But the ESG agenda has ushered in an era of hyper-transparency and invites scrutiny from a significantly wider spectrum of stakeholders.

The fines courts around the world are imposing for greenwashing are starting to mount, but we believe this is just the beginning. The commercial and reputational damage that comes with being accused of greenwashing, or being perceived as greenwashing, is usually a much greater cost.

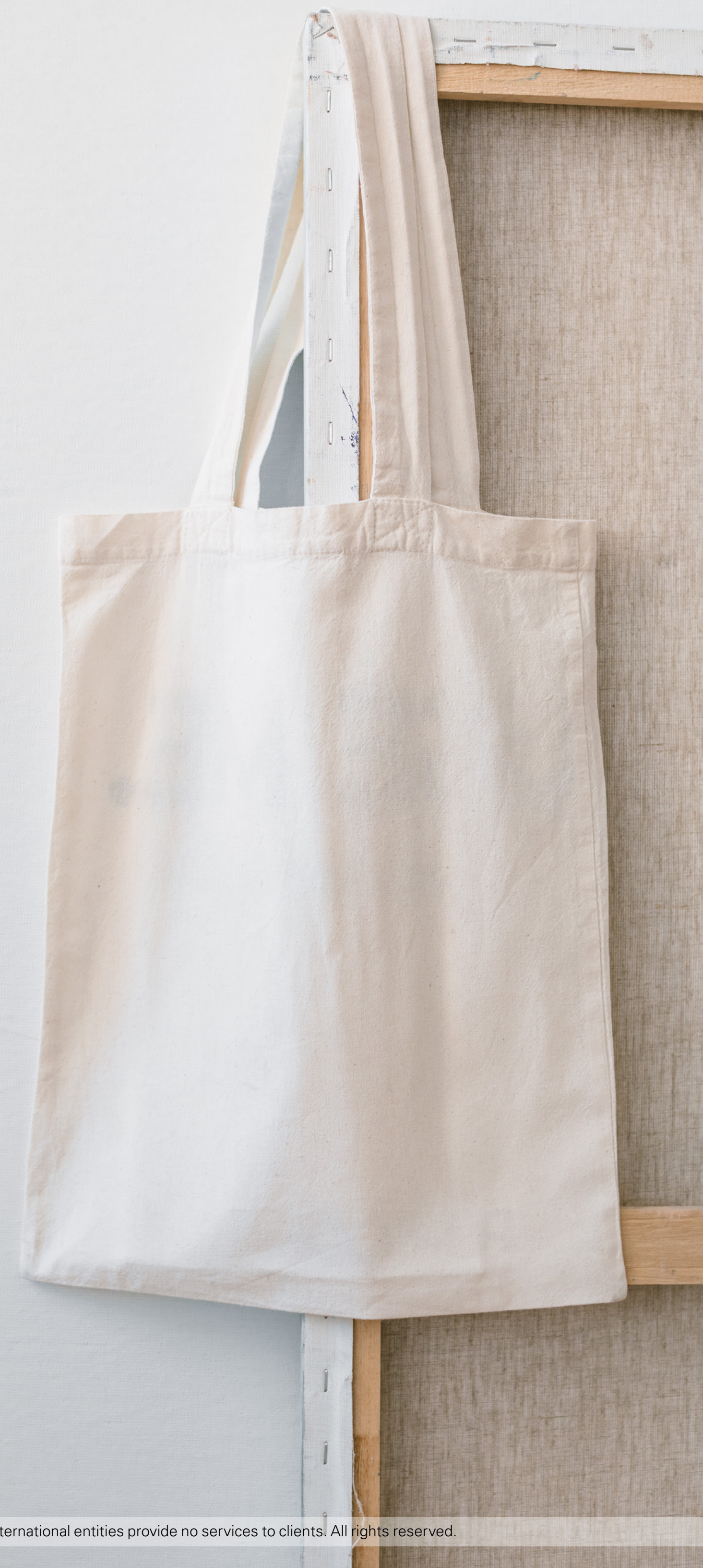
In the past year, KPMG professionals have come together to support clients in identifying where risks may lie and the steps they can take to help mitigate them. This paper details what we have learned, shares examples of organizations that have been challenged on what they sell and what they do, and includes six steps organizations can take.

Confronting greenwashing risk

Organizations face mounting pressure to act on environmental and social issues. If businesses make dishonest or unjustifiable performance claims — whether to give the illusion they're tackling climate change, or to attempt to secure competitive advantage — it's likely they'll be accused of greenwashing.

Greenwashing matters to consumers. According to KPMG in the UK research, sustainability is the third most important consideration when consumers buy products or services.[2] It's not surprising that companies are anxious to stress their green credentials.

What is
greenwashing?
implies any dishonest practices used by businesses to represent themselves as more sustainable either by giving a false impression or providing misleading information as to the sustainability of a product/service.



Indeed, the financial services sector has built an entire industry on such demands: the market for ESG-centric products has grown at a compound annual rate of 27 percent over the past six years.[3] And financial services businesses are hardly alone in seeing opportunity in ESG — sustainability is now a marketing strategy in almost every industry.

The concept of sustainability has broadened considerably in recent times. ESG spans many issues: climate change mitigation, diversity and inclusion, supply chain practices, corporate accountability, and more. Organizations are keen to put a positive spin on their activities across all these areas.

Scrutiny of such spin continues to become more exacting — and in our view the standards to which organizations are held are also increasing. Legislators and regulators are determined to hold companies to account on their claims, along with parties from campaign groups and trade unions to consumers and employers.

One of the primary reasons to avoid greenwashing is not to avoid scandal, damaging though this would be. Rather, the challenge for organizations is to make genuine positive change and embed ESG practices in everything they do.

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What are the risks of greenwashing?

Companies engaged in greenwashing face many different types of risk that could cost them financially, damage their reputation and prevent them from realizing opportunities.

Legal threats mount

Greenwashing is misrepresentation. It can lead to legal claims including misrepresentation and fraudulent misrepresentation, and possibly breach of contract. Some claims have also alleged breach of duty which may give rise to a claim in negligence.

One growing danger businesses may face is litigation from consumers or pressure from groups concerned they're engaged in greenwashing. Anti-greenwashing campaigners are becoming more organized and working closely with specialist legal advisers to pursue cases on the grounds of deception or fraud.

In November 2022, for example, a European retailer was sued in the US for allegedly "misleadingly, illegally, and deceptively" seeking to capitalize on consumers' desire to buy greener products, with plaintiffs accusing the company of misrepresenting its products as more sustainable, despite being made mostly of polyester or recycled plastic.[4] Elsewhere in the US, brands spanning across industries such as grocery, food and beverage and airlines, face class actions with similar claims.[5]

In Europe, such cases have been less common, though there are signs campaigners may be focusing on litigation. For example, a German consumer protection agency in Baden-Württemberg, has brought a similar claim against a large German bank.[6]

The UK, meanwhile, recently experienced its first greenwashing case against a UK bank. Lawyers are also becoming increasingly concerned about the potential for class actions brought by company shareholders seeking compensation for losses resulting from inaccurate statements. Section 90 of the *Financial Services and Markets Act 2000* provides recourse for investors in the event of "untrue or misleading" statements. This could include greenwashing.

Regulations increase — as do the penalties

Financial services regulators across multiple markets are taking increasingly tough action on greenwashing claims. In the US, the Securities and Exchange Commission (SEC) fined a large US bank's investment adviser US$1.5 million following "misstatements and omissions" about its ESG approach to managing funds.[7] That fine was followed by a US$4 million penalty imposed on a US-based global investment banking, securities and investment management firm over similar failings.[8] In Europe, a large German bank's asset management firm is also facing regulatory action.[9]

The penalties in such cases are set to increase. The European Securities and Markets Authority (ESMA) is looking at how to introduce a new regime to counter greenwashing.[10] In the UK, the FCA is pursuing new rules to strengthen its ability to take action on greenwashing.[11]

It's important to not assume that financial services businesses are the only organizations facing greenwashing compliance or regulatory risk. With non-financial services regulators entering the fray, a much broader scope of businesses now face potential issues and almost every organization could be subject to scrutiny.

In June 2022, the UK's Advertising Standards Authority (ASA) launched new guidance on potentially misleading claims about environmental and social responsibility. Even before publishing its advice, the ASA had intervened more than 15 times following complaints from consumers and other groups.[12]

The UK's Competition and Markets Authority (CMA) has also taken steps to protect consumers from misleading environmental claims and greenwashing with its Green Claims Code, introduced in September 2021.[13] Many competition watchdogs across Europe are taking a similar approach.

> Consumers say they're ready and willing to
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> whose behaviors they believe are unfriendly to the environment.

Reputational risk grows

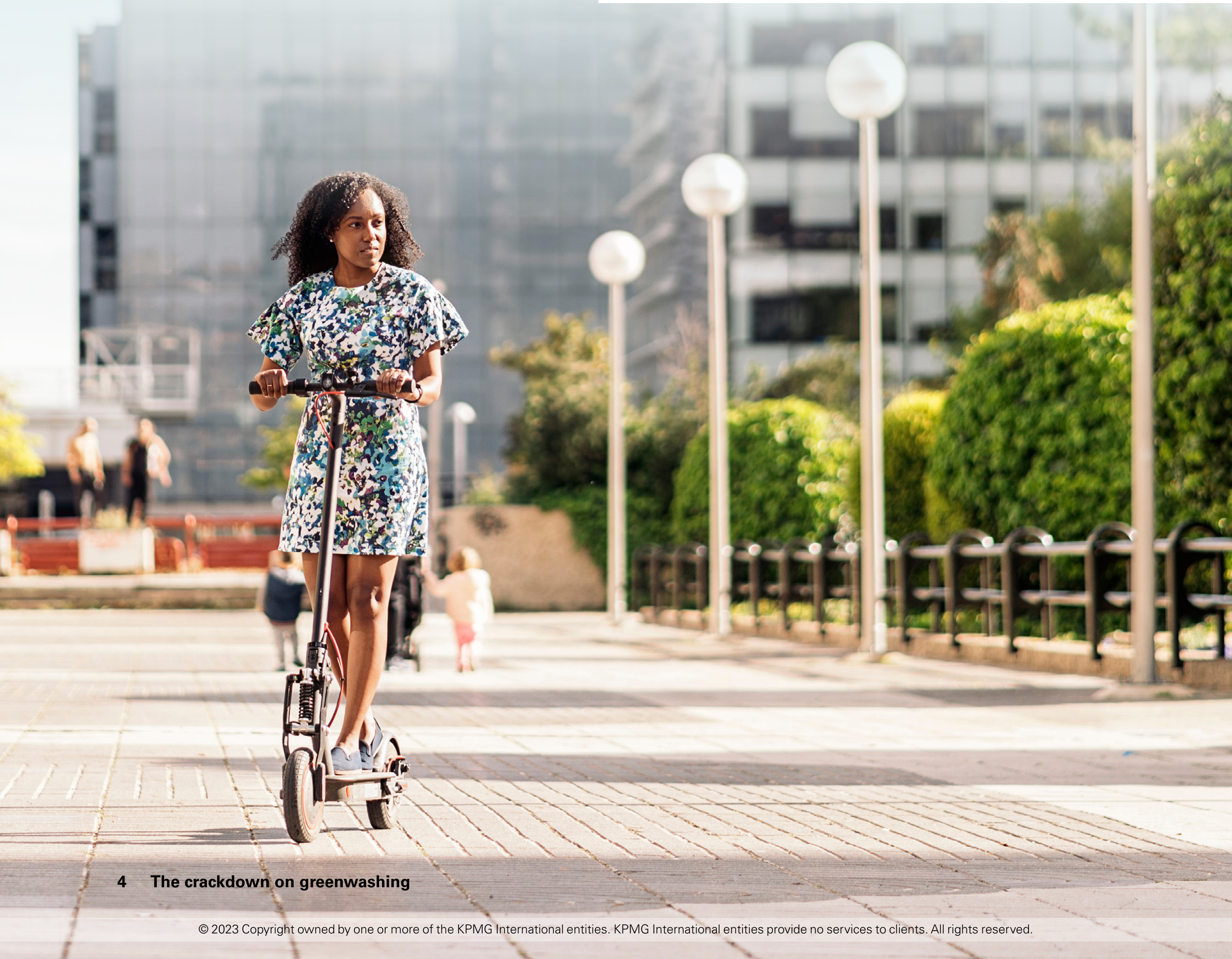
As sustainability issues become more important to consumers, employees, investors and suppliers, the reputational risk to businesses caught up in greenwashing scandals is anticipated to increase.

Environmental campaigners are increasingly adept at using social media to ensure that stories about greenwashing reach a large audience.

It's difficult to put a number on the reputational risk of greenwashing, but that number is only expected to go up. Consumers say they're ready and willing to boycott brands whose behaviors they believe are unfriendly to the environment.[14] Investors are taking their stakes elsewhere.[15] Employees want to work for organizations that are open and transparent about ESG efforts.[16]

The opportunity cost multiplies

Managing greenwashing risk carefully can help both minimize the chance of a legal, regulatory or reputational hit, and increase opportunity. Investors, borrowers and policyholders are increasingly looking for support from organizations with strong ESG records as they focus on how to finance their own decarbonization plans.



Six ways you can effectively manage greenwashing risk

Since the 2015 Paris Climate Accords, banks have loaned US$4.6 trillion to the fossil fuel industry.[17] This may be good business, but can those same banks claim to be net zero while continuing to build or invest in new fossil fuels?

For most organizations, greenwashing risk is almost impossible to eradicate entirely. Even if taking a highly conservative approach, eschewing any claims about environmental performance for fear of facing accusations of greenwashing, organizations can likely still expect to face scrutiny and be held to account for the commitments made in public statements, decarbonization pledges and sustainability policies.

"Green hushing" — avoiding public comment on issues such as climate change targets — is on the rise.[18] Organizations including the United Nations (UN) are pushing back on this. The UN recently called for all organizations to make public declarations of how they will move toward net zero.[19]

Organizations should take a strategic approach to face greenwashing risk. These six recommendations can help you get started.

1 Understand your greenwashing risk

Such an approach begins with acknowledging that greenwashing risk may exist in different places throughout an organization, including:

- Through the organization's environmental impact and policies in areas such as diversity and inclusion and corporate governance.
- Through the products and services the organization sells, where sustainability claims may not stand up to scrutiny.
- Through links to suppliers and consumers that may want to secure arrangements that go against the organization's stated ESG aims.

These different levels of exposure apply in varying degrees to most organizations, but the financial services sector is particularly vulnerable to product level and relationship or transaction level risk.

For example, asset managers' ESG funds that make bold sustainability claims are increasingly in the firing line of regulators under regimes such as the Sustainable Finance Disclosure Regulation (SFDR) and the EU Taxonomy. In the banking sector, firms lending to organizations in industries perceived as poorly performing on key ESG issues has led to multiple claims of greenwashing, as discussed previously. Lenders can quickly get caught up in other organizations' scandals.

New risks are emerging in the sector, particularly as financiers and advisers become more involved in supporting clients with carbon emissions costs.

In Singapore, a state-backed investment group is facing criticism over how one of its portfolio companies sold two coal-fired power stations as it seeks to stay within emissions targets agreed with its sustainability-linked bond holders. Critics say the company has retained control of the plants, selling them in name only to access cheaper sustainability linked funding.[20]

Organizations should keep in mind the importance of identifying potential greenwashing risk exposure throughout their operations and professional relationships. There are several challenges involved in undertaking this work.

a) The lack of common definitions.

Terms such as sustainability, green and ESG are loosely defined at best. There's room for confusion even in the financial services sector, where regulators have introduced new regimes to standardize terminology and definitions. Change and debate happens relatively quickly across the sustainability space, meaning organizations regularly face shifting goalposts.

b) The lack of data.

Organizations need reliable data to identify greenwashing risk, particularly where third parties are involved. Yet ESG data remains patchy and out of date, and its quality varies hugely around the world. While the ESG ratings industry continues to grow, using its services has not always been enough to protect organizations from greenwashing accusations.

c) Increased demand for sustainable products.

Industries are trying to meet rising demand for more sustainable products and services. Responding to that demand while maintaining the ability to identify greenwashing risk can be challenging.

2 Agree on your appetite for risk

Armed with a better understanding of where greenwashing risk resides, individuals in your organization can begin to have conversations about the level of risk you are prepared to accept.

Given that no organization is perfect, to what extent should you temper your public statements on sustainability given what else may be going on in the organization?

No organization will want to fall foul of sector regulations or leave itself vulnerable to legal threat. But with reputational risk in mind, perception matters. Though behaviors and actions may be technically compliant, there's still the possibility to leave your organization open to criticism.

Most organizations already face some degree of greenwashing risk in relation to previous operations or previously sold products and services. Reviewing your risk appetite on a regular basis provides an opportunity to reduce this risk going forward, particularly as your organization strives to meet its sustainability targets.

3 Create a governance structure for risk

In our view, organizations cannot manage — let alone reduce — exposure to greenwashing risk without a robust and comprehensive plan. This approach is unlikely to be effective unless it's coordinated across the organization. Where risk remains stuck in siloes, vulnerability will likely increase.

Organizations can explore making a paradigm shift, focusing on creating a purpose- and values-driven culture. Creating structures that ensure organizations can apply common standards consistently is key, as is updating existing risk management procedures and controls to include sustainability criteria. Ensuring that public statements on sustainability are accurate and can be supported with reliable and up-to-date evidence is crucial as well.

Developing a bespoke sustainability policy for your organization may be a useful way to move forward and can help determine who the arbiter of best practice should be. The task of identifying and managing greenwashing risk can be embedded in roles such as product development, sales and marketing, as well as in control functions. Developing a policy can help with the consideration of issues, including greenwashing risk, and provide a framework that can be applied across multiple functions.

Third-party support may also prove invaluable. Independent audit and assurance work may give organizations clarity and confidence in their stances on sustainability and can provide the necessary data to properly evidence sustainability claims.

Sustainability policies and governance practices need support from the organization's senior leadership and will likely not gain traction without it. We believe that C-suite and board-level engagement will be crucial to an organization's success.

4 Educate the entire organization

Sustainability is a comparatively new discipline, meaning it's important that organizations equip staff with the knowledge required. Upskilling the whole organization on the basics of ESG and greenwashing risk can provide stronger foundations on which to build a more robust approach.

The board should also take part in such upskilling programs. Greenwashing risk represents a threat to entire organizations and can also leave individual leaders vulnerable to personal risk or even legal/regulatory sanctions.

5 Harness new technologies

In some organizations, the focus on greenwashing prevention is confined to process discussions. New technologies, including artificial intelligence (AI), natural language processing (NPL), machine learning (ML) and predictive analytics, could add increased speed and intelligence to greenwashing approaches.

For example, the KPMG IMPACT ESG IQ platform can help facilitate smarter decision making and improve risk mitigation and support for regulatory compliance and reporting. Additionally, the AI platform KPMG Ignite uses machine learning capabilities to help evaluate commercial documentation, identify green clauses and validate use of proceeds.

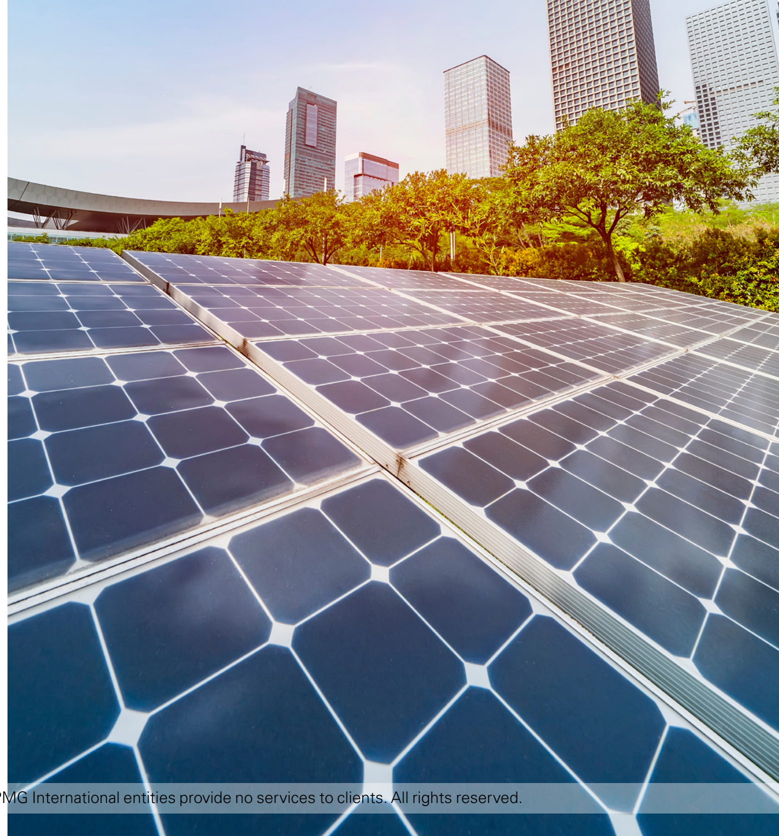
6 Prepare for incidents

Even if your organization is risk focused, you shouldn't assume there will never be some form of greenwashing crisis. Organizations may face accusations and criticisms that may be seen as unfair but will still need addressing. It's also possible to overlook greenwashing risk.

Therefore, crisis management plans should be put in place and answer questions, including: Who will take the lead on your organization's response in the event of a crisis? What resources will they have at their disposal? How will the organization respond?

Organizations that have spent time identifying risk and building structures to manage are generally better equipped to deal with a crisis over those that have not.

> Ensuring that **public statements** on sustainability are accurate and can be supported with reliable and up-to-date evidence is crucial.



An action plan for change

With a broad range of risks, it's important for organizations to act on greenwashing. As a starting point, consider focusing on:

- **Education:** Ensure that everyone in the organization, from the board down, understands what greenwashing risk is and how they could be exposed.
- **Regulations:** Review existing regulations and how they apply to greenwashing risk, staying on top of a fast-moving regulatory environment.
- **Risk identification:** Map where greenwashing exposures may lie in the organization.
- **Governance:** Agree on the organization's risk comfort level and build cross-functional structures to help ensure this level is not exceeded.
- **Policy and practices:** Develop a sustainability policy that takes greenwashing risk into account and build new risk management procedures and controls.
- **Communicate with confidence:** Agree on a process for speaking publicly on ESG, with all claims supported by clear, accurate and up-to-date evidence.

Confront greenwashing risk and embrace opportunity

Greenwashing risk represents a potential threat to organizations, and one that can possibly destroy significant shareholder value. Organizations would do well to consider how to manage and mitigate their greenwashing vulnerabilities.

In our view, doing nothing is not an option. Education, governance and communicating with confidence are all steps that can help reduce an organization's greenwashing risk. If you can make that cultural shift, you can expect your shareholders, consumers, other stakeholders — and the planet — to thank you.

How can we help

KPMG professionals assist clients in fulfilling their purpose and achieving their ESG goals. We can work with you to enhance trust, mitigate risk and help unlock new value as you build a resilient business for a more sustainable future. KPMG firms' ESG services seek to go beyond strategy as a key part of a client's ESG transformation, reporting and assurance needs. With access to industry-leading experience, data-driven technology and global alliances, you can turn insight into opportunity for your business, your people and the planet.

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