EUSFiL

Jean Monnet Centre of Excellence on Sustainable Finance and Law

EUSFiL Research Working Paper Series

2022 no. 3

Antonio Davola

The promise and perils of sustainable disclosure for retail investors. Does the SFRD framework tackle, or rather promote, product greenwashing?

May 2022

© Antonio Davola 2022. All rights reserved.
Short sections of text, not to exceed two paragraphs, may be quoted without explicit permission provided that full credit, including © notice, is given to the source.

www.eusfil.eu/working-papers

With the support of the Erasmus+ Programme of the European Union

EUSFiL Research Working Paper Series

EUSFiL Research Working Paper Series are a project of the Jean Monnet Centre of Excellence on European Union Sustainable Finance and Law. All studies in the EUSFiL Research Working Paper Series have followed a rigorous process of academic evaluation performed by EUSFiL Editorial Board.

Working Papers present an author's provisional findings, which, upon further consideration and revision, are likely to be republished in an academic journal.

The opinions expressed in EUSFiL Research Working Papers are the authors' and do not represent official positions of the EUSFiL Center or University involved in the project.

EUSFiL project has been funded with support from the European Commission. The Research Working Paper Series reflects the views only of the author, and the European Commission cannot be held responsible for any use which may be made of the information contained therein.

Editor in Chief

Michele Siri, University of Genoa

Editorial Board

K. Alexander, University of Zurich
V. Colaert, KU Leuven University
G. Ferrarini, University of Genoa
P. Schwizer, SDA Bocconi School of Management
A. Sciarrone Alibrandi, Catholic University of the Sacred Heart
B. Sjåfjell, University of Oslo

Editorial Assistants

Matteo Gargantini, University of Utrecht
Eugenia Macchiavello, University of Genoa
Shanshan Zhu, University of Genoa

With the support of the Erasmus+ Programme of the European Union

© 2020 EUSFiL. All rights reserved.

THE PROMISE AND PERILS OF SUSTAINABLE DISCLOSURE FOR RETAIL INVESTORS. DOES THE SFRD FRAMEWORK TACKLE, OR RATHER PROMOTE, PRODUCT GREENWASHING?

ANTONIO DAVOLA*

Abstract

Within the European Commission Action Plan on Sustainable Finance, a significant effort was made to introduce sustainability-related disclosure rules on investments.

These duties – structured both as pre-contractual and ongoing disclosures – are regulated by the Sustainable Finance Disclosure Regulation (SFDR) and, in part, by the Taxonomy Regulation (TR). They are supposed to reduce information asymmetry between end-investors and financial market participants, favoring aware investment decisions considering sustainability risks and adverse impacts. The SFDR entered into force in March 2021, while the TR will operate from 2022 – with some aspects delayed to 2023 - onwards.

Amongst the declared goals of these interventions, contrast of financial greenwashing is pivotal: greenwashing is detrimental both for investors' decision-making and for the market, diverting resources towards fictious sustainable investments. Therefore, a primary regulatory concern is to allow end-investors to efficiently compare investment opportunities and have a clear perception of their sustainability.

To supplement the provisions on disclosure of sustainable investments, European Supervisory Authorities (ESAs) have been mandated to draft a set of Regulatory Technical Standards (RTS). Due to the Covid-19 pandemic, though RTSs' implementation has been delayed and currently RTS are not expected to come into force until January 2022. With the Final Draft published in February 2021, RTS have now been submitted to the European Commission for endorsement, which should be accomplished within three months: the European Commission could endorse the RTS in part only, or with amendments, but if it makes amendments, it must resubmit them to the ESAs. If endorsed, the European Commission must put them to the European Parliament and Council, who may formally object to the drafts. Only if there are no objections, then the RTS will enter into force on the specified

* Assistant Professor, University of Bari "Aldo Moro". Ph.D. (Sant'Anna School), LL.M. (YLS), Postdoctoral Fellow (Luiss), Marie Curie Research Fellow, University of Amsterdam, Fair Personalization Project. Email: a.davola@uva.nl. This paper was concluded in October 2021.

date. For all these reasons, there could well be further substantive changes and delays before the RTS become effective.

In the meanwhile, the SFDR will nevertheless operate: according to the European commission, the application of the SFDR is not conditional on the presence of RTS, given the self-sufficiency of general principles of sustainability-related disclosures. In this context, the RTS are relevant both in assessing the compliance burden which will apply later, and for the insight they give into the ESA's views on some of the known unknowns concerning the primary legislation already on the statute book. This insight is provided mainly through some of the recitals to the draft RTS.

This approach seems disputable since, in absence of stringent harmonizing standards, financial market participants might opportunistically exploit the principles set by the SFDR: while being apparently compliant with the Regulation, they could engage in strategies that, profiting on the framing of information and cognitive overload, have detrimental effects on investors' decision-making. In addition, even the definite regime (as soon as RTS are approved), as it is currently shaped, raises significant concerns in terms of effectiveness in tackling greenwashing.

Against this background paper investigates whether the current provisional regime, and the expected final one, can promote the goals related to investors' protection and sustainability by means of rules on product disclosure duties or if, on the contrary, it might end up being counterproductive, favoring misleading practices related to greenwashing.

SUMMARY: 1. Greenwashing as an intrinsic corollary of sustainability in markets; 2. Greenwashing in Financial Markets; 3. Greenwashing at product level, and non-financial disclosure as a regulatory tool to empower retail investors; 4. The product level disclosure framework set in the SFDR and in the TR; 5. Preliminary considerations regarding the disclosure regime at product level, and the uncertainty it unfolds; 6. Shortcomings in the product level disclosure regimes; 6.1. Intertemporal drawbacks; 6.2. Structural drawbacks; 7. Concluding remarks.

1. Greenwashing as an intrinsic corollary of sustainability in markets.

In recent years, sustainability has arisen as a central driver for market development, and a powerful tool for marketing and communication strategy of firms.

As a result of the increasing awareness for environmental and social concerns related to sustainable development, consumers' interest has been shifting towards social causes, with the subsequent pursuit of products and brands that align with their values: nowadays, consumers declare to be willing to change their shopping habits to reduce environmental impact, and support the crescent industrial

interest for the use of clean energy resources, indirectly fostering the adoption of green technology and sustainability-based products and processes in the market.[1]

Notably, consumers' interest does not relate exclusively to the environmental impact arising from uncontrolled industrial development and mass consumption, but rather embraces a wider set of issues that considers social sustainability as well: promotion of gender equality, reduction of wealth disparity, contrast to extreme poverty and systemic unemployment in developing countries currently represent major declared drivers for consumption as well.[2]

Even if, on the one hand, consumers' top concerns in purchasing seem to be still performance and price – and, therefore, a stringent relationship between declared attitude and actual willingness to pay is not always to be found[3] - on the other one it is nonetheless undeniable that the traditional value-driven decision-making is being integrated with purpose-driven considerations, and that consumers are increasingly willing to select brands and allocate expenditures based on how well they align with their personal values.

Considering the centrality that the debate over sustainability has reached in the market, it is not surprising that spillover effects are present as well: in particular, as sustainability emerged as an essential reputational component for products and services, firms began competing on promoting environmental and social initiatives. In the 'Eco-mark Era'[4] green branding, advertising environmentally friendly products and services, and touting sustainable business practices constitute a pervasive and profitable strategies.

With marketing communication stressing how offered products minimize adverse social and environmental impact over their lifecycle, comes the risks of companies' exaggerating (or even feigning) their 'environmental credentials' to attract consumers and to increase market power. In the absence of detailed positive rules on the appraisal of sustainability-related claims – and considering that consumers are usually devoid of the resources to verify marketers' environmental assertions[5] – ensuring the reliability of information has become a pivotal precondition to empower consumers to make informed choices. Accordingly, the European Green Deal[6] states that "companies making 'green claims' should substantiate these against a standard methodology to assess their impact on the environment" and that it is essential for companies and financial institutions to increase their disclosure on climate and environmental data so that counterparties are fully informed about the sustainability of their choices and to prevent so-called 'greenwashing" phenomena'.[7]

---

[1] Cfr. IBM, 'Meet the 2020 consumers driving change Why brands must deliver on omnipresence, agility, and sustainability' (2020), https://www.ibm.com/downloads/cas/EXK4XKX8; Rosmarin R., Sustainability sells: Why consumers and clothing brands alike are turning to sustainability as a guiding light (2020), www.businessinsider.com;

[2] Globescan, 'Healty & Sustainable Living'. A global consumer insight project' (2020), https://globescan.com/.

[3] De Socio 'The 'last mile' of consumer sustainability behavior' (2021), www.greenbiz.com.

[4] Lane E, 'Consumer Protection in the Eco-mark Era: A Preliminary Survey and Assessment of Anti-Greenwashing Activity and Eco-mark Enforcement' (2010) 9 *J. Marshall Rev. Intell. Prop. L.* 742.

[5] Grodsky JA, 'Certified Green: The Law and Future of Environmental Labeling' (1993) 10 *Yal Reg* 147 150.

[6] European Commission, European Green Deal, Brussels, 11.12.2019 COM(2019) 640 final, https://ec.europa.eu/info/files/annex-roadmap-and-key-actions_en.

[7] The notion of greenwashing was coined first in 1986 by the environmentalist Jay Westervelt, and is defined as the practice of 'promoting environmentally friendly programs to deflect attention from an organization's

As public concern over greenwashing growths, research further upholds that the proliferation of sustainability-related disinformation has become a substantive element of the market, and that multiple companies are involved in instrumentally asserting environmental and social values that are not supported by actual corporate activities.[8] In addition, greenwashing strategies have been progressively sophisticating and are likely to occur according to different methods,[9] which makes it even more complex to establish a unitary approach.[10]

Being related to communication and marketing strategies, greenwashing constitutes an transversal challenge across different sectors and, as such, it is subject to normative scrutiny by means of different areas of law: *inter alia*, much attention has been devoted to the phenomenon by consumer protection[11] and corporate governance law scholars,[12] calling for a functional interpretation of positive regulation at the EU level – such as the Unfair Commercial Practices Directive[13] - to qualify greenwashing communications as misleading and therefore unfair, or by welcoming a substantive standardization in the way in which information regarding sustainability is disclosed to consumers.[14]

---

environmentally unfriendly or less savoury activities'. See also Wahida Shahan T., 'Green Washing: An Alarming Issue' (2013) *ASA University Review* 7 1 81-88.

[8] E.g. Walker K & Wan F, 'The harm of symbolic actions and greenwashing: Corporate actions and communications on environmental performance and their financial implications' (2012) *Journal of Business Ethics* 109 227-242; Watson B., 'The troubling evolution of corporate greenwashing' (2016) theguardian.com; Furlow N., 'Greenwashing in the new millenium (2010) *Journal of Applied Business and Economics*, 10(6) 22-25.

[9] Lyon T & Montgomery A, 'The means and end of greenwashing (2015) *Organization and Environment* 28(2) 223-249.

[10] See Vieira de Freias Netto S & Falcao Sobral M & Bezerra Ribeiro A & da Luz Soares G, 'Concepts and forms of greenwashing: a systematic review' (2020) *Environmental Sciences Europe* 32 19.

[11] *Ex multis* Feinstein N, 'Learning from Past Mistakes: Future Regulation to Prevent Greenwashing' (2013) 40 *B.C. Envtl. Aff. L. Rev.* 229; Lorance A, 'An Assessment of U.S. Responses to Greenwashing and Proposals to Improve Enforcement' (2010) *Hofstra Law Student Works* 3; Keirsbilck B & Terryn E et al, 'Sustainable Consumption and Consumer Protection Legislation. How can sustainable consumption and longer lifetime of products be promoted through consumer protection legislation?' (2020) *Policy Department for Economic, Scientific and Quality of Life Policies In-Depth Analysis Requested by the IMCO committee of the European Parliament*; Schmuck D & Matthes J & Naderer B, 'Misleading Consumers with Green Advertising? An Affect–Reason–Involvement Account of Greenwashing Effects in Environmental Advertising' (2018) *Journal of Advertising* 47(2) 127-145; Mihajlović B., 'The Role of Consumers in the Achievement of Corporate Sustainability through the Reduction of Unfair Commercial Practices' (2020) *Sustainability* 12 3 1009.

[12] See recently Tsagas G, 'A Proposal for Reform of EU Member States' Corporate Governance Codes in Support of Sustainability' (2020) *Sustainability* 12; Cherry M., 'The Law and Economics of Corporate Social Responsibility and Greenwashing' (2014) 14 *U.C. Davis Business Law Journal* 282.

[13] Directive 2005/29/EC of the European Parliament and of the Council of 11 May 2005 concerning unfair business-to-consumer commercial practices in the internal market and amending Council Directive 84/450/EEC, Directives 97/7/EC, 98/27/EC and 2002/65/EC of the European Parliament and of the Council and Regulation (EC) No 2006/2004 of the European Parliament and of the Council

[14] See European Commission 'Screening of websites for 'greenwashing': half of green claims lack evidence (2021) https://ec.europa.eu/commission/presscorner/detail/en/ip_21_269.

2. Greenwashing in Financial Markets.

Apparently, the second abovementioned approach is currently the most favored one when the regulation of greenwashing in the financial sector – in which greenwashing as reached, in recent years, an extensive dimension as ESG became a part of the investment mainstream[15] – is considered.

Greenwashing of financial products and services grew significantly in consideration of the increasing effort made by policymakers to rely on financial markets to promote sustainable finance[16] and to mitigate externalities such as resource depletion, environmental degradation and inequality by means of reallocating economic resources towards virtuous investments and of delegating environmental policing to corporations as well,[17] also in light of the crescent financialization of markets.[18]

The demand for Socially Responsible Investments, incorporating social and ecological factors into evaluation indicators, became a preferred solution in a field that historically constitutes a major source of subsidy for the fossil fuel industry,[19] as confidence arose that green investments could prevent financial risks arising from underlying environmental and social problems.

Even if the reasons behind investors and shareholders' interest for Corporate Social Responsibility (CSR) are disputed – with scholars distinguishing (at least) the three theories of "doing well by doing good"[20]; "delegated philanthropy"[21]; and "corporate philanthropy"[22] – this shift towards sustainability is generally welcomed,[23] mostly in light of limitations that governments showed in policing environmental externalities.[24] This, even acknowledging that is difficult to univocally identify determinants and trade-offs in CSR strategies and to pinpoint greenwashing phenomena, and also considering that greenwashing is present in companies that display promising CSR outcomes as well.[25]

[15] See Mooney A, 'Greenwashing in finance: Europe's push to police ESG investing' (2021) https://www.ft.com/content/74888921-368d-42e1-91cd-c3c8ce64a05e.

[16] European Commission, 'Action Plan: Financing Sustainable Growth' (2018) COM(2018) 97 final.

[17] Pacces A, 'Sustainable Corporate Governance: the Role of the Law' (2020) *ECGI Working Paper Series in Law* 550.

[18] Lagoarde-Segot T, 'Financialization: Towards a New Research Agenda' (2016) 51 *International Review of Financial Analysis* 113-123; Van Der Zwan N, 'Making Sense of Financialization' (2014) 12 *Socio-Economic Review* 1.

[19] In 2019, the average amount received per year from the financial sector was around $370bn, with only 10-30% of those funds being spent in promoting the transition to clean energy. See Carrington D, 'Just 10% of fossil fuel subsidy cash 'could pay for green transition' (2019), www.theguardian.com.

[20] Bérnabou R & Tirole J, 'Individual and Corporate Social Responsibility' (2010) *Economica* 77(305) 1-19; Ilhan et al, 'Climate Risk Disclosure and Institutional Investors (2020) *ECGI Finance Working Paper* 671/2020.

[21] Weisbach D & Sunstein C, 'Climate Change and Discounting the Future: Guide for the Perplexed' (2009) *Yale Law & Policy Review* 27(2) 433-458; Hart O & Zingales L, 'Companies should maximize shareholder welfare not market value' (2017) *Journal of Law, Finance and Accounting* 2(2) 247-275.

[22] Sjafjell B, 'Achieving Corporate Sustainability: What is the Role of the Shareholder?' in H Birkmose (ed.) *Shareholders' Duties in Europe* (Kluwer 2017); Winter J, 'A behavioral perspective on Corporate Law and Corporate Governance' in JN Gordon & W-G Ringe (eds.) *The Oxford Handbook of Corporate Law and Governance* (Oxford 2018) 159-183.

[23] Pacces A (n 17) 8.

[24] Kaakman et al, *The Anatomy of Corporate Law: A Comparative and Functional Approach* (Oxford 2017).

[25] See Aggarwal P & Kadyan A, 'Greenwashing: The Darker Side Of CS' (2014) *Indian Journal of Applied Research* 4(3) 61-66.

In order to hold up to the promise that sustainable finance subtends to foster responsible development, a significant effort was made in recent years by European institutions to introduce sustainability-related rules on investments. In particular, the recently enacted Sustainable Finance Disclosure Regulation (SFDR)[26] and the Taxonomy Regulation (TR)[27] are supposed to shape an uniform system for qualifying, indexing, and reporting sustainable investments, reducing information asymmetry between end-investors and financial market participants, ultimately favoring aware investments considering sustainability risks and adverse impacts.

Amongst the provisions set to contrast greenwashing, product-related disclosure has been identified as a prominent tool and, after laying down a set of principle-based provisions in the SFDR and in the TR (Level 1 rules), the European institutions mandated the European Supervisory Authorities (ESAs) and the Commission to draft a set of Regulatory Technical Standards (RTS) and Technical Screening Criteria (TSC) to specify those obligations (Level 2 rules). In the meanwhile, though, the SFDR nevertheless applies since March 11, 2021 (while the TR is supposed to be in force from January 2022 onwards): according to the European commission, the application of the SFDR is in fact not conditional on the presence of Technical Standards, given the self-sufficiency of general principles of sustainability-related disclosures.

In this context, the RTS are relevant both in assessing the compliance burden which will apply later, and for the insight they give into the ESA's views on some of the known unknowns concerning the primary legislation already on the statute book. This insight is provided mainly through some of the recitals to the draft RTS, with the last available Report published by the ESAs in February 2021.[28]

As far as greenwashing is considered, though, this approach seems disputable since - in absence of stringent harmonizing standards - financial market participants might opportunistically exploit the principles set by the SFDR: while being apparently compliant with the regulation, they could engage in strategies that, profiting on the complexity and framing of information and from cognitive overload over products’ characteristics, have detrimental effects on retail investments’ decision-making.

Many of these issues, in addition, might not be solved even after the Level 2 rules are enacted.

Against this background, the article investigates whether the current (and perspective) regime for sustainability disclosure at product level can promote the goals related to investors’ protection and sustainability or if, on the contrary, it might end up being counterproductive, favoring misleading assertions related to greenwashing.

Accordingly, the research provides a general overview of the main risk factors arising from greenwashing in the financial sector (Section 3), and concisely present the main characteristics of the (short and medium term) rules set by the Action Plan with regards to product level disclosure to retail investors (Section 4). The, by highlighting the ‘asymmetric’ nature of the current regulation (Section 5) and by illustrating expected shortcomings likely to emerge both *before* and *after* the enactment of the

[26] Regulation (EU) 2019/2088 of the European Parliament and of the Council of 27 November 2019 on sustainability-related disclosures in the financial services sector.

[27] Regulation (EU) 2020/852 of the European Parliament and of the Council of 18 June 2020 on the establishment of a framework to facilitate sustainable investment, and amending Regulation (EU) 2019/208.

[28] Joint Committee of the European Supervisory Authorities, Final Report on draft Regulatory Technical Standards with regard to the content, methodologies and presentation of disclosures pursuant to Article 2a(3), Article 4(6) and (7), Article 8(3), Article 9(5), Article 10(2) and Article 11(4) of Regulation (EU) 2019/2088, JC 2021 03.

Technical Standards (Section 6), the article ultimately defends that, despite constituting an advancement towards the attainment of responsible behaviors in promoting sustainable investing, the regulatory framework is still inadequate to provide effective protection to retail investors against greenwashing, and that the multi-track informational venue designed by the regulator together with the absence of a unitary synthetic index (especially for social factors) is likely to create grey zones for greenwashing to operate.

3. Greenwashing at product level, and non-financial disclosure as a regulatory tool to empower retail investors.

As soon as financial companies started modernizing their products, making them eco- and social-friendly aligning to ESG principals, the integration of sustainability risks and factors in the investment protection regime to avoid greenwashing emerged as a primary goal of the European strategy within the Financing Sustainable Growth Action Plan:[29] as part of their duty to act in the best interest of clients, financial markets participants – and, in particular, advisors – are required to inform investors on the adverse impacts their decisions have on sustainability factors, in order to reduce the principal-agent informational asymmetry lying at the core of greenwashing phenomena.[30]

This is mainly due to the fact that, given the systemic relevance of financial markets in the allocation of resources and determination of business cycles, a greenwashed financial product – e.g. a sustainability-branded pension found devoting funding to fossil fuels, pesticide or other environmentally harming practices – is likely to cause sector-specific externalities, which are additional to the ones that are traditionally related to greenwashing in consumption.

On the one hand, financial greenwashing misallocates capital, therefore indirectly hindering the transformative process that should characterize the transition towards sustainable markets; on the other hand, it has a direct effect on corporate performance as well,[31] affecting corporate legitimacy and reputation (it should be noted that, in a context characterized by greenwashing, this might happen even when a specific accusation is later proved to be false).[32] It increases investors' confusion about CSR[33] and has a negative effect on investment propensity, regardless of the actual level of corporate involvement in greenwashing practices.[34] In addition, financial greenwashing in the long run is likely to affect investors' attitude, behaviors and intention, increasing their skepticism over environmental

---

[29] Communication from the Commission to the European Parliament, the European Council, the Council, the European Central Bank, the European Economic and Social Committee and the Committee of the Regions action plan: Financing Sustainable Growth, Com/2018/097 Final.

[30] Siri M & Zhu S, 'Will the EU Commission Successfully Integrate Sustainability Risks and Factors in the Investor Protection Regime? A Research Agenda' (2019) *Sustainability* 11 6292.

[31] Walker K & Wang F, 'The harm of symbolic actions and greenwashing: corporate
actions and communications on environmental performance and their financial implications' (2012) *Emerald Management Review* 109 (2), 227-239;

[32] Seele P & Gatti L, 'Greenwashing revisited: in search of a typology of and accusation-based definition incorporating legitimacy strategies' (2017) *Business strategy and the Environment* 26(2) 239-252.

[33] Furlow N, 'Greenwashing in the new millennium' (2010) *Journal of Applied Business and Economics* 10(6) 22-25.

[34] De Vries G et al, 'Sustainability or profitability? How communicated motives for environmental policy affect public perceptions of corporate greenwashing' (2015) *corporate Social Responsibility and Environmental Management* 22 142-154.

commitments as a whole[35] and diminishing investors' trust, which is widely acknowledged as a major condition for the proper functioning of financial markets.[36]

In order to prevent these risks, European institutions identified the need to increase transparency regarding the sustainability of marketed products as a priority and – being greenwashing regarded as an information disclosure decision[37] - it is not surprising that mandatory disclosure at different levels has been pinpointed as a leading resource for managing change towards a sustainable global economy, combining long-term profitability with social justice, environmental protection, and investor's empowerment.[38]

Disclosure rules have been seen as a multi-faceted tool in pursuing environmental policy goals: they benefit investors and, at the same time, raise firms' accountability and improve corporate environmental performance by creating internal and external incentives for firms to improve their sustainable management practices; this, with a minimal direct involvement by government regulators, against traditional Command & Control strategies.[39] In the institutions' view, mandatory disclosure is supposed to reduce information asymmetries between firms and shareholders, boosts corporate reporting of financial data, to increase confidence in capital markets, and to enhance investor' trust in sustainability reporting by promoting robust methodological standards that facilitate comparability across sustainability issues;[40] at the same time it should reduce nonreporting and selective-reporting problems.[41]

Consistently with these considerations, the Action Plan for Sustainable Finance devotes a major effort to the establishment of disclosure duties towards end-investors for all market participants; for what concerns product level information, in particular, the most relevant provisions do arise from the abovementioned Taxonomy Regulation and Sustainable Finance Disclosure Regulation.

4. The product level disclosure framework set in the SFDR and in the TR.

---

[35] Chen Y & Chang C, 'Greenwash and green trust: The mediation effects of green consumer confusion and green perceived risk (2013) *Journal of Business Ethics* 114 489-500.

[36] *Ex multis* Guiso L & Sapienza P & Zingales L, 'Trusting the stock market' (2008) *J. Financ.*, LXIII (6) 2557-2600; Brescia RH, 'Trust in the Shadows: Law, Behavior and Financial Re-Regulation' (2009) 57 *Bur L. Rev* 1361; Stout L, 'Trust Behavior: The Essential Foundation of Securities Markets' (2015) *UCLA School of Law, Law & Econ. Research Paper* 09; Colombo RJ, 'The Role of Trust in Financial Regulation' (2010) 55 *Vill. L Rev* 577; Tomasic R & Akinbami F, The Role of Trust in Maintaining the Resilience of Financial Markets (2011) *Journal of Corporate Law Studies* 11(2) 369-394.

[37] Bowen F *After Greenwashing. Symbolic Corporate Environmentalism and Society* (Oxford 2014) 26.

[38] See Directive 2014/95/EU of the European Parliament and of the Council of 22 October 2014 amending Directive 2013/34/EU as regards disclosure of non-financial and diversity information by certain large undertakings and groups, Recital 8.

[39] Case DW, 'The Law and Economics of Environmental Information as Regulation' (2001) 31 *Envtl L Rev* 10 773; Stewart RB, 'A New Generation of Environmental
Regulation?' (2001) 29 *Cap U L Rev* 21 131.

[40] Lydenberg S et al, 'From Transparency to Performance: Industry-Based Sustainability Reporting on Key Issues' (2019) *Initiative Responsible Inv* 5.

[41] Etsy D & Karpillow Q, 'Harnessing Investor Interest in Sustainability: The Next Frontier in Environmental Information Regulation' (2019) *Yale Journal on Regulation* 36 668.

In determining the content and structure of disclosure related to the sustainability level of products offered on the financial markets, the structure of the TR and the SFDR are substantively intertwined.

The Sustainable Finance Disclosure Regulation entered into force in late 2019, and began to apply in the European territory from 10 March 2021: the Regulation establishes a set of harmonized sustainable-related disclosure rules, in order to overcome the previously diverging standards existing at national level and to raise investors awareness on sustainability risks.[42] The modes and layouts of disclosure is then to be established by RTS.

Due to the Covid-19 pandemic, though RTSs' implementation has been delayed and currently they are not expected to come into force until January 2022. With the Final Draft published in February 2021, RTS have now been submitted to the European Commission for endorsement, which should be accomplished within three months: the European Commission could endorse the RTS in part only, or with amendments, but if it makes amendments, it must resubmit them to the ESAs. If endorsed, the European Commission must put them to the European Parliament and Council, who may formally object to the drafts. Only if there are no objections, then the RTS will enter into force on the specified date.[43]

The Taxonomy Regulation, which entered into force on July 2020, will begin to apply from January 2022 and 2023 respectively, depending on the different environmental objects considered:[44] the TR aims at establishing a European uniform classification system to clarify which activities and products can be qualified as sustainable, and at which level; in addition, it provides the baseline framework for the development of specific standards and labels for sustainable financial products by means of secondary regulation and delegated acts (Technical Screening Criteria, TSC),[45] which will also explore the potentials arising from the use of eco-labels for financial products. The TSC are supposed to be issued in late 2021, whereas the TR is undergoing a first set of review at the end of the year.

Disclosure rules present in the SFDR are directed to all financial market participants, including financial advisers, and are meant to operate indistinctively for all financial products;[46] sustainability disclosure are divided between disclosure occurring at entity level[47] and at product level.[48] Within product level disclosure rules, provisions distinguish between pre-contractual disclosure to investors, general disclosure to be made on market participants' websites, and disclosure to be delivered in the context of periodic reports. It should be noted, in addition, that all disclosures and marketing

[42] SFDR Recital 9 and 10.

[43] A comprehensive overview of the SFDR disclosure is operated in Busch D, 'Sustainable Financial Disclosure in the EU Financial Sector' (2020) *EBI Working Paper Series* 70 2020.

[44] See *infra* n 54.

[45] For an overview of the TR see Busch D & Ferrarini G & van den Hurk A, 'The European Commission's Sustainable Finance Action Plan and Other International Initiatives' (2020) *EUSFiL Research Working Paper Series* 3 8.

[46] Defined according to Art. 2 of the SFDR as encompassing individually managed portfolios, collective investment schemes, insurance-based investment products, pension products or schemes and pan-European Personal Pension Products.

[47] Section III SFDR.

[48] Sections IV, V, VI,

communication shall be conjugated with other financial markets regulation as well – in particular with regards to the MiFID II.[49]

Considering pre-contractual disclosure, all financial markets participants (including financial advisers) are required to provide information on the manner in which sustainability risks – defined on the basis of Art 2(22) SFDR[50] - are integrated within the investment or insurance promoted, as well as an assessment of their likely impact on the return of the financial products available. In addition, specifics of the disclosure are diversified based on whether the advised product (a) promotes environmental and/or social characteristics (light green financial products);[51] (b) has sustainable investment as its objective (dark green products)[52] or (c) has an adverse sustainability impact (other products)[53]. In each of these cases, a clear and reasoned disclosure shall be provided to investors. Other products information must be provided to the extent to which sustainability risks are taken into consideration in investment decisions and how these affect returns or, if sustainability risks are not relevant to investment decisions, a justification must be given (comply or explain approach); disclosure regarding both light and dark green products focuses on how the environmental characteristics promoted or pursued by the investment are met, on the (optional) presence and design of an index as a reference benchmark and on how and to what extent the investments underlying the financial product are in sustainable economic activities, considering the proportions to all investments selected for the portfolio. Criteria for distinguishing between light and dark green products are supplemented by the Taxonomy Regulation: by identifying six environmental objectives,[54] the Regulation requires that green products make a significant contribution to (at least) one of them while not significantly harming the others[55], and empowers the Commission to adopt delegated and implementing acts to establish quantitative and qualitative Technical Screening Criteria for each environmental objective, which are functional to the classification of products. TCS for different economic activities should be granular and specific for different economic activities, regularly adapted to reflect scientific and technological insights, and specific for each one of the objectives set in the TR. Lastly, the content and presentation of the above information for the different types of products shall be disclosed in accordance with the Regulatory Technical Standard developed by the ESAs, taking into account the typologies of financial products, their characteristics and the differences between each class.

Specific disclosure at product level shall be provided on financial market participants' websites' as well: according to the SFDR, the website must contain a description of the environmental or social

---

[49] Directive 2014/65/EU of the European Parliament and of the Council of 15 May 2014on markets in financial instruments and amending Directive 2002/92/EC and Directive 2011/61/EU.

[50] Sustainability risks are all those ESG events or conditions that are likely to exercise an actual or potential negative impact on the value of the investment.

[51] Art. 8 SFDR.

[52] Art. 9 SFDR. The distinction between light and dark green products can be traced back, in European institution acts, to the European Commission 'Defining "green" in the context of green finance' Report (2017) www.ec.europa.eu.

[53] Art. 6 SFDR.

[54] Art. 9 TR: (a) climate change mitigation; (b) climate change adaptation; (c) sustainable use and protection of water and marine resources; (d) transition to a circular economy; (e) pollution prevention and control; (f) protection and restoration of biodiversity and ecosystem.

[55] Artt. 11, 12, 13, 14 and TR depicts a first set of elements to take into account in order to assess the substantive contribution to each of the objectives.

characteristics of the products, information on the methodologies to assess, to measure and to monitor them, and regarding the impact of the sustainable investments selected for the financial product. This information shall include the relevant data sources, screening criteria for the underlying assets, and the relevant sustainability indicators used to measure the sustainable impact of the product considered. Lastly, it must provide information regarding the classification of the product as light or dark green according to the rules for pre-contractual disclosure, and the sustainability information set out in periodic reports.[56] Financial markets participants are required to keep information up to date, with a clear explanation of any amendment made, and to present them according to the criteria set out in the relevant RTS.

Lastly, description of how, and to what the extent to which financial products meet or promote environmental, social, or sustainable investments must be provided regularly by means of including it within periodic reports disclosed to investors,[57] according to the content and layout defined by the RTS.

5. Preliminary considerations regarding the disclosure regime at product level, and the uncertainty it unfolds.

It is undeniable, that the establishment of a uniform block of rules for disclosure on sustainability of financial products constitute a major and challenging effort for the European authorities, and that a multi-layered approach by means of both Level 1 and Level 2 rules was in part needed due to the (concomitant) far-reaching scope of the regulation and to the urgency to deter non-responsible conducts by market actors.

In particular, with the elimination of greenwashing being identified as one of the primary goals of the regulation,[58] and as disclosure of ESG performance emerged as the main empowering tool for investors (consistently with the position of scholarships defending that unclear communication and information asymmetries are the main driver of investors' related prejudice)[59] it is not surprising that the regulator tried to conjugate the identification of a set of immediately applicable principles and the subsequent release of specifying documents – anticipated to the industry by means of drafts. This also considering that, given the forward-looking nature of financial markets, the delegated acts' driving effects might start materializing earlier than the actual enactment of the RTS and TSC, as soon as standards are known with sufficient reliability.[60]

Still, organizing product level disclosure according to a 'multi-speed' track is prone to significant risks as well, especially when greenwashing dynamics and the persuasive nudging effect of sustainability-related information on unsophisticated investors are considered.[61] In the absence of a clear standardization of the disclosure, which allows investors to handily discern the content of the information provided and to compare the characteristics of (allegedly or actually) sustainable products,

---

[56] Art. 10 SFDR.

[57] Art. 11 SFDR.

[58] See Hooghiemstra SN 'The ESG Disclosure Regulation – New Duties for Financial Market Participants & Financial Advisers' (2020) https://ssrn.com/abstract=3558868.

[59] See n. 41.

[60] Pacces (n 17).

[61] See e.g. Ceccarelli M & Ramelli S & Wagner AF, 'Low-carbon Mutual Funds' (2020) *European Corporate Governance Institute (ECGI) - Finance Working Paper* 659/2020; Hartzmark SM & Sussman AB, 'Do Investors Value Sustainability? A Natural Experiment Examining Ranking and Fund Flows' (2019) *Journal of Finance* 74(6) 2789-2837.

the framework designed by the regulator might prove ineffective or even counterproductive, as advisers freeride on ambiguous and unclear provisions to exploit end-investors' preference for sustainable investments and to distort their decisions.

The significant effort led by the European institutions in periodically releasing draft on the development of RTS demonstrate an awareness of these risks, which is also underlined in Recital 9 of the SFDR:[62] stringent operational harmonization is required to tackle market fragmentation, to avoid distortions of competition and to prevent the confusion resulting from significant differences in disclosure standards, that might exacerbate the inefficiencies in the functioning of sustainable finance.

Against this background, though contingent events related to the Covid-19 pandemic delayed the drafting process of the delegated documents, increasing the temporal gap between the Level 1 and Level 2 rules and creating concerns for regulatory uncertainty.[63] In addition, the currently envisioned structure of the RTS – in its interaction with the provisions of the TR and the TSC – raise doubts with regards to its effectiveness in preventing greenwashing by means of providing clear and concise information to end-investors.

Hence, it is arguable whether the current framework might paradoxically end up facilitating greenwashing strategies in product level disclosure, with financial advisers opportunistically exploiting the principles set by the SFDR – while being apparently compliant with the Regulation and engaging in strategies that are detrimental both for investors and for reaching the goals related to sustainability.

6. Shortcomings in the product level disclosure regimes.

In order two provide an overview of the critical aspects, that might undermine the effectiveness of the framework designed by the European institutions to contrast greenwashing, a preliminary taxonomy must be operated: on the one hand, a first set of problems arises as the result of the temporal gap existing between the entrance into application of the SFRD (March 2021) and the subsequent bodies of law, that will occur – at the earliest – in January 2022 (with some aspects programmed for 2023

[62] "In the absence of harmonised Union rules on sustainability-related disclosures to end investors, it is likely that diverging measures will continue to be adopted at national level and different approaches in different financial services sectors might persist. Such divergent measures and approaches would continue to cause significant distortions of competition because of significant differences in disclosure standards. In addition, the parallel development of market-based practices that are based on commercially-driven priorities that produce divergent results currently causes further market fragmentation and might even further exacerbate inefficiencies in the functioning of the internal market in the future. Divergent disclosure standards and market-based practices make it very difficult to compare different financial products, create an uneven playing field for such products and for distribution channels, and erect additional barriers within the internal market. Such divergences could also be confusing for end investors and could distort their investment decisions. In ensuring compliance with the Paris Agreement, there is a risk that Member States adopt divergent national measures which could create obstacles to the smooth functioning of the internal market and be detrimental to financial market participants and financial advisers. Furthermore, the lack of harmonised rules relating to transparency makes it difficult for end investors to effectively compare different financial products in different Member States with respect to their environmental, social and governance risks and sustainable investment objectives. It is therefore necessary to address existing obstacles to the functioning of the internal market and to enhance the comparability of financial products in order to avoid likely future obstacles."

[63] See Maleva-Otto A & Wright J, 'New ESG Disclosure Obligations' (2020) *Harvard Law School Forum on Corporate Governance*; Hooghiemstra (n 58).

already); these issues can be referred to as 'intertemporal drawbacks'. On the other hand, concerns exist, more in general, regarding the overall system designed by the regulator for disclosure on sustainable products: in particular, the existence of a multi-track system, which operates both vertically (considering the interaction between different level of rules) and horizontally (e.g. establishing different venues for the disclosure on the sustainability features of products) can constitute a significant hardship for analyzing and comparing information; in addition, the provisions regarding the layout and the content of information duties raise doubts with regards to their effective capacity to vehiculate a clear, concise, and comparable disclosure to end-investors. These group of shortcomings can be broadly labeled as 'structural drawbacks'.

6.1 Intertemporal drawbacks.

Complications that might arise due to the temporal gap existing between the application of the SFDR and the other bodies of law regulating financial disclosure for sustainable products are multifaceted and emerge from both systemic aspects and specific provisions in the Regulation. Moving from an exploratory perspective, it is possible to hypothesize fogginess effects as the result of: *a)* the existence of a principle-based framework alone; *b)* specific products definition in the absence of RTS; *c)* "confusopoly" of methodologies for the sustainability assessment; and d) over-reliance on unsettled standards.

a) As for the first aspect, as it has been already observed, the effective SFDR application date was maintained in spite of the delays investing the development of Regulatory Technical Standards, requiring financial market participants and advisers subject to comply with its high level and principle-based requirements from 10 March 2021 onwards.[64] In particular, European institutions considered that an early application of the SFDR is nevertheless possible, since the principles set in the Regulation already provide enough indication to consider sustainability risks in internal processes and disclosures. In addition, since the compliance to the SFDR in this phase can be demonstrated on an evidenced "best efforts" basis, firms are expected to be stimulated to start gathering data and developing procedures, which will be then tested and evaluated when the RTS are in a more advanced state.

While it is legitimate to conceive (as probably the Commission did) that the immediate application of the SFDR could foster market participants' convergence towards responsible management of sustainability risk in their internal process, as well as provide supervisory authorities with an additional set of tools to scrutinize firms' behavior – therefore increasing their accountability and indirectly enhancing investors' protection – this strategy is not necessarily optimal for preventing greenwashing at product level.

In the current scenario, strictly speaking, companies are entitled to begin to comply with the Level 1 requirements of SFDR while ignoring the requirements of the RTS:[65] unlike other parts of the Regulation, though, financial product disclosure to be made in respect of light green and dark green financial products (Artt. 8, 9, 10 and 11) heavily relies on Regulatory Technical Standard to identify which content and structure information to end-investors should offer.

[64] European Commission, Application of Regulation (EU) 2019/2088 on the sustainability-related disclosures in the financial services sector (2020) https://www.esma.europa.eu/sites/default/files/library/eba_bs_2020_633_letter_to_the_esas_on_sfdr.pdf

[65] Allen & Overy LLP, 'New RTS for sustainable finance disclosure regulation (SFDR) – key points for fund and asset managers' (2020) www.jdsupra.com

In particular, in the absence of stringent and harmonized procedures setting qualitative and quantitative thresholds for the information on how environmental and social characteristics are met in light green products, or without clarifications regarding how to disclose the characteristics of indexes used as reference benchmark (and to compare it to mainstream indexes) a significant risk exists, that ambiguous or incomplete information is provided to end-investors, exploiting the open-ended nature of the principle-based provisions. This is particularly compelling considering that data reliability constitutes an already established threat to the provision of clear ESG disclosure, being often unreliable and manipulable.[66] In addition, firms could take advantage of the lack of a structural indication regarding the modes of disclosure (with the SFDR recitals offering general indications on clarity and conciseness only) to provide investors with disproportionate amounts of partial and non-needed information, favoring cognitive overload and counterparties' confusion. In such cases, firms could be even stimulated to engage in greenwashing strategies, freeriding on the absence of a clear format for disclosure regarding sustainability and fictionally promoting their products as virtuous. It is, indeed, doubtful whether the mere request for informational transparency, without introducing a uniform mode of disclosure, would result in an actual empowerment of end-investors.

b) Problems with the absence of clear RTS are present, also with regards to some notions set in the SFDR that would require further clarification in order to properly operate. The definition of light green product is a prominent case: whereas Art. 8 defines them as products "promoting environmental and social characteristics" (against Art. 9 products, which have "sustainable investment" as their objective), a specific explanation of what such a definition entails is not present. Doubts have been subsequently raised with respect to the Art. 8 scope: e.g,. it is currently doubtful, whether a product that does not explicitly promote environmental or social characteristics, but which considers sustainability risks, would qualify as an Article 8 fund[67]. This also considering that the choice of classifying products currently rests with the fund managers of financial market participants.[68] Further aspects needing clarification are present in the SFDR with regards to the thresholds used to distinguish between Art. 8 and Art. 9, and amongst products within the same category: it has been observed that funds placed in the same category could exhibit very different sustainable characteristics (e.g. Article 9 funds might include any fund tracking the Paris Aligned Benchmark or a Climate Transition Benchmark which, however, is not a requirement for inclusion)[69] and that this could lead to multiple sub-sets of Article 9 funds without uniformity, hindering the ability for end-investors to adequately compare funds under the SFDR classification system. As a secondary effect, regulatory uncertainty could lead fund manager to label their funds as Article 6 or 8 to prevent liability issues; this would increase confusion about what are and what are not the more sustainably-focused products, further exacerbating the chance of greenwashing.

---

[66] Busch T et al, 'Sustainable Development and Financial Markets' (2016) *Bus Soc* 55 303-329; Schoenmaker D & Schramade W, 'Investing for Long-Term Value Creation' (2018) *Erasmus Platform for Sustainable Creation Working Paper* 1/2018.

[67] Autorité des Marchés Financiers, 'Guidance on the implementation of the EU's Sustainable Finance Disclosure Regulation (SFDR)' (2020) https://www.amf-france.org/en/news-publications/news/implementation-sfdr-regulation-asset-management-companies-march-10-2021.

[68] Cross G, 'Sustainable Finance: the changing regulatory landscape', speech by the Director of Financial Regulation of the Central Bank of Ireland (2020) www.centralbank.ie.

[69] Eckett T, 'SFDR 'opens door' to greenwashing' (2021) www.etfstream.com.

c) Related to the absence of a clear RTS framework is also the widely intended risk of the current framework designed by the SFDR favoring 'confusopoly strategies'[70] for sustainability claims (which is also related to the structural drawback of operating in an "open-index" environment, which will be discussed in the next section): since the discussion on how to enhance the reliability of ESG ratings is still in its infancy, and the number of methodologies to identify positive and negative contribution to environmental and social issues through products and services grows day by day,[71] a clear-cut definition of acceptable indexes would have reduced the likelihood of confusion for end-investors, especially in those fields – such as social sustainability – in which the identification of reliable methodologies is still in-development and quantitative data are less established. This aspect is further exacerbated by the fact that – without delegate acts specifying these aspects – the principle-based regulation in the SFDR embraces a 'one fits all' approach for defining the categories of financial products and investors', without providing indication regarding how to distinguish the specific characteristics of different types of financial products in the disclosure, and how to decline them considering the sophistication level of the investor.[72]

d) Lastly, a potential drawback of the current framework in terms of "grey spaces" for greenwashing might come from the industry's opportunistic exploitation of the over-reliance on in-development RTS and TSC. While, as it was already observed,[73] drafts might serve as informal guidelines to establish how to comply with the SFDR, it should also be considered that the current versions are all but definitive: with the European Commission expecting to evaluate the RTS within 3 months of their publication (i.e. by May 2021) – and, at the same time, postponing the TCS definition and approval date due, *inter alia*, to uncertainties on the role of natural gas as a transition energy source and the potential inclusion of nuclear power in the taxonomy[74] – standards might still undergo significant changes before their enactment. In such a situation, there is the concrete risk that uncertain standards are used by market participants and advisers by referring to aspects of the RTS and TCS, which are not 'on point' yet, to create a shadow of legitimacy over their claims, and to ultimately mislead investors.

6.2 Structural drawbacks.

If the contingent condition of the system might allow for the exploitation of normative shortcomings and facilitate greenwashing, some problems are nevertheless unrelated to the unavailability of final RTS and TSC, being due to the inner structure of the framework designed by the EU regulator, and are likely to persist even after RTS and TSC are developed.

---

[70] The term generally indicates all those strategies based on confusing marketing designed to prevent the buyer making informed decisions. The notion was developed in Adams S, *Dilbert Future* (United Feature Syndicate 1997) 159.

[71] Siri & Zhu (n 30) 7; See also MSCI, 'A Proposed Article 8 / 9 Framework based on MSCI Client. Overview And Analysis Of MSCI ESG Indexes Based On A Set Of Assumptions Discussed With Investors' (2021) www.msci.com 10.

[72] It is worth observing, that this aspect is present in the final draft RTS as well, and the ESAs in the document observe that "feedback from the public survey and consumer testing on the pre-contractual and periodic financial product templates confirmed that the information was too complex for retail investors, but the presentation was too simple for institutional investors". See Joint Committee of the European Supervisory Authorities, Final Report on draft Regulatory Technical Standards (n 27) 8.

[73] See *supra* Section 5.

[74] Feijao S, 'EU Taxonomy Regulation: delay to technical screening criteria' (2021) www.linklaters.com.

As far as these inherent shortcomings of the product level disclosure on sustainability are concerned, risks of actually favoring (rather than eradicating) greenwashing could arise from: *a)* informational complexity across different modes of disclosure, and within each specific mode of disclosure; *b)* reputational counterbalances of the "comply or explain" system and *c)* operating in an "open-index" environment.

a) Considering the first aspect, the regulatory choices regarding structure and design for disclosure at product level result in a multi-track system, in which information is to be provided on the market participants' website, in pre-contractual documents, and periodically.

While this choice was arguably meant to reduce information overload, keeping the pre-contractual disclosure as concise as possible and referring to website information for more information, including the one on methodologies and data sources,[75] it is worth observing that allocating information amongst different sources is likely to raise search costs for investors, discouraging them from looking for relevant information in different venues. This is true, in particular, for the relationship between pre-contractual and website disclosure, which are supposed to be sources of concurrent information for the investors, with the first one being attributed a specific saliency in the advisory process. In addition, since websites might not necessarily raise the same level of attention of pre-contractual disclosure, they risk being neglected by investors, who might lose track of significant element such as the relevant sustainability indicators used to measure the characteristics of the product. Lastly, even if cognitive overload and no-reading are a well-known source of inefficiency in decision-making,[76] framing bias and information dispersion are equally significant:[77] with market participants and advisers allowed to distribute information amongst different sources, they might be incentivized to strategically allocate the most significant (or problematic) aspects in the website, embracing a *de minimis* approach in drafting pre-contractual disclosure. This concern is further exacerbated by the absence of a clear level 2 framework, that was already investigated in the previous section, and finds an additional ground in the outcome of the experimental studies conducted to verify the clarificatory effect of the draft RTS on end-investors.[78] The abovementioned studies also stress that, despite the SFDR's that disclosure should be accurate, fair, clear, not misleading, simple and concise,[79] the template present in the final RTS draft are lacking both in terms of perceived clarity and simplicity (even when icons and schemers are used); therefore, it is advisable for the European Commission to conduct a further scrutiny into the information design of the disclosure.

---

[75] Joint Committee of the European Supervisory Authorities, Final Report on draft Regulatory Technical Standards (n 27) 8.

[76] *Ex multis* see Ayres I & Schwartz A., 'The No-Reading Problem in Consumer Contract Law' (2015) *Stanford Law Review* 66 545; Ben-Shahar O., 'The Myth of the "Opportunity to Read" in Contract Law' (2009) 1 *European Review of Contract Law*.

[77] Levin I et al., 'All Frames Are Not Created Equal: A Typology and Critical Analysis of Framing Effects' (1998) 76 *Organizational Behav.&Hum.Decision Processes* 149, 150 (describing the role of framing effects in studies across a variety of fields).

[78] See Cicirko M & Kawiński M & Petelczyc J, 'Consumer testing of pre-contractual and periodic ESG financial product information by the Warsaw School of Economic' (2020) www.eba.europa.eu; Zijlstra W & Puylaert G & du Chattel Z 'Consumer testing of pre-contractual and periodic ESG financial product information by the AFM' (2020) *ibidem*.

[79] See Art. 8 SFDR.

Furthermore, the critical aspects emerging from the use of different venues for product disclosure are intertwined with interpretative cross-overs existing between the SFDR and the TR and their secondary acts in relation to concepts such as 'do no significant harm' and 'sustainable investments', or between the SFDR and other bodies of law such as the Non-Financial Reporting Directive (NFRD).[80] This interaction – while necessary to reach a cross-sectorial harmonization – is likely to further raise search costs and obfuscate clarity in communication, especially for non-sophisticated investors. Considering that literature on greenwashing already highlighted that these techniques are often based not only on selective disclosure, but also on decoupling information and behavior,[81] the risk of companies exploiting these aspects to create confusion in investors is therefore present and significant.[82]

b) When the specific risks connected to greenwashing are considered another (seemingly minor, and still) problematic aspect can emerge from the "comply or explain" mechanism as declined in the Level 1 and provisional Level 2 acts. Requiring an explanation or a warning for deeming sustainability risks not relevant[83] and (especially) for not considering the adverse impacts of investment decisions on sustainability factors[84] undoubtedly constitutes a powerful nudging factor; yet – also considering the strong effect of sustainability claims on investors' perception – if not structured properly and accompanied by stringent thresholds for the verification of compliance, this duty might further push firms towards fictional claims, in order to avoid possible reputational harm caused by displaying no environmental or social concerns.

c) Lastly, a general consideration should be made with regards to the choice not to refer to one or more specific market indexes to establish the relevant benchmark according to which products should be qualified for disclosure under the SFDR. According to the Regulation, products promoting environmental or social characteristics (*i.e.* light green products) can be identified *via* proprietary indexes designated as a reference benchmark and, in such cases, information must be provided on how the specific index is consistent with those characteristics; sustainable investments (*i.e.* dark green products) can be classified on the basis of a specifically designed index as well, as long as disclosure is provided regarding the differences existing from a broad market index.

Once again, the *rationale* behind this regulatory option is to provide the industry with flexibility in the early days of the Regulation; nonetheless, it is doubtful whether this choice is effective either: *c1)* to provide univocal disclosure regarding the quality of products offered; or *c2)* to actually empower end-investors, which should be the essential goal of disclosure rules.

c1) As for the first aspect it should be noted that, while for some of the goals identified by the Taxonomy Regulation – e.g. carbon emissions, with a significant role played by the revised EU Benchmark Regulation[85] – the framework for benchmarks is converging towards fairly standardized

[80] Directive 2014/95/EU.

[81] Vieira de Freias Netto et al (n 10); Siano A & Vollero A & Conte F & Amabile S, 'More than words: expanding the taxonomy of greenwashing after the Volkswagen Scandal' (2017) *J Bus Res* 71 27-37.

[82] See also Ho VH, 'Disclosure Overload? Lessons for risk disclosure & ESG reporting reform from the regulation S-K concept release' (2020) *Villanova L R* 65 67-133.

[83] Art. 6 SFDR.

[84] Art. 7 SFDR.

[85] Regulation (EU) 2016/1011 of the European Parliament and of the Council of 8 June 2016 on indices used as benchmarks in financial instruments and financial contracts or to measure the performance of investment funds and amending Directives 2008/48/EC and 2014/17/EU and Regulation (EU) No 596/2014.

measurements (and, therefore, comparison between indexes and performance is feasible), indexes in other areas display significant heterogeneity in assessment criteria and measurements, even when broad market indexes only are considered.[86] A wide array of standards and ratings tools emerged in recent years,[87] especially for social sustainability determinants. Since each provider can use a wide set of analytic strategies, results might vary markedly between mainstream indexes, even when robust methodologies are used.[88] The capacity to capture sustainability goals in sound, transparent indexes to measure financial products' impact constitute an essential condition to reduce greenwashing; yet, the indications coming from the SFDR still leave significant margins of appreciation for firms, that could be exploited by market participants and advisers in choosing how to classify their products and how to justify their choice – this especially considering that, for light green products, Art. 8 seems to qualify indexes as a merely optional resource.

c2) Lastly, with regards to the second abovementioned aspect, it is doubtful whether the explanation of how a proprietary index is designed (or, in some cases, even the reference to a mainstream index) actually constitutes a meaningful information for unsophisticated investors in order to decide how to allocate their investments. In recent years, economic and legal scholars largely debated on the effectiveness of structured disclosure regarding financial products characteristics for retail investors, who do not present significant financial literacy:[89] whereas basic information on the environmental and social performance of the products and on the adverse risks seems appropriate (and should be presented, for example, by means of the currently in-development system of green labels) it could be argued that providing data regarding the elaboration of the indexes used to measure products' sustainability is more relevant for supervisory authorities than for the average retail investors, and that it could even be a confusing information for them, further favoring greenwashing.

7. Concluding remarks.

After investigating the provisions contained in the SFDR, the TR, and their delegated acts, it is indeed problematic to express a univocal evaluation regarding the likelihood of the framework traced by the European regulators to eradicate greenwashing: if the (still partial) harmonization of sustainability-related disclosure rules certainly constitutes an advancement in the promotion of environmental and social considerations in finance and in investors' protection, uncertainties are still present and significant, considering both the current situation – in which level 2 rules still need to be implemented – and the forthcoming scenarios.

In order to conclude by further elaborating the elements that have been already laid down in the article, it is worth observing two general aspects regarding product level disclosure provisions.

---

[86] See Berg F & Koelbel JF & Rigobon R, 'Aggregate Confusion: The Divergence of ESG Ratings' (2019) *MIT Sloan School Working Paper* 5822-19; Diez-Cañamero B et al, 'Measurement of Corporate Social Responsibility: A Review of Corporate Sustainability Indexes, Rankings and Ratings' (2020) *Sustainability*12 2153.

[87] Brandon J, 'Will ESG Standards and Ratings Heterogeneity Kill the Sustainable Finance Market?' (2018) www.bondsloans.com.

[88] Li F, Polychronopoulos A, 'What a Difference an ESG Ratings Provider Makes!' (2020), www.researchaffiliates.com.

[89] Lusardi A & Mitchell O, 'The Economic Importance of Financial Literacy: Theory and Evidence' (2014) 52 *Journal of economic literature* 1 5-44.

First, some information required by information duties – e.g. the methodologies to develop indexes in pre-contractual disclosure, and data in the website one – appear to be significant for public supervision and inspection, rather than for investors' decision-making: even if alleviating the information load constitute one of the allegedly leading aspects of the regulation, it seems like this concern did not actually promote an in-depth scrutiny on the information that are actually meaningful for investors. Secondly, and as a corollary of this aspect, the analysis of the regulation (and especially of the RTS templates) fosters the impression that the disclosure regime has been designed with a fictional, empowered investor in mind, rather than focusing on the needs of the average retail investor, or distinguishing between different levels of sophistication; in such sense, hypothesizing multi-layered disclosure rules based on the counterparty's literacy is a solution worth exploring.

On a more general perspective – and in light of the abovementioned aspects – it is reasonable to believe that, on the one hand, the disclosures set by the SFDR might ultimately be effective in reducing the risk of *absolute* greenwashing, i.e. discouraging market participants and advisers from marketing products that have no (or even that have adverse) environmental and social effects as sustainable ones. On the other hand, though, grey zones and – both intertemporal and structural – shortcomings existing in the regulation might actually enhance the risk of incurring in *relative* greenwashing, such as overstatements of the sustainable quality of products, and more in general determine investors' confusion.

It is conceivable that, in forthcoming times and through adjustments of the regulation and its delegated acts, the system has margin to properly develop – especially when this process is coupled with a desirable normative convergence towards a unitary synthetic index, to be used as benchmark to assess products' sustainability, and with the simplification of information in the disclosure. Still, in the current condition, the framework definitely requires some fine tuning, and the path for investors' protection against greenwashing still seems far from concluded.

EUSFiL

The Jean Monnet Centre of Excellence on EU Sustainable Finance and Law

The Jean Monnet Centre of Excellence on European Union Sustainable Finance and Law (EUSFiL), located at the Department of Law of the University of Genoa and directed by Professor Michele Siri, is a Centre of studies focused on the sustainable finance field, with a particular focus on the recent reform of the EU financial system. The Centre engages in research, education, and publications that broadens inquiry, dialogue, and debate beyond traditional academic boundaries, bridging the gap between theory and practice. The Centre gathers researchers from EU and non-EU countries affiliated to the following universities:

- Radboud University,The Netherlands
- University of Zurich, Switzerland
- Università Bocconi, Italy
- Superiore Sant'Anna di Pisa, Italy
- Universität Tübingen, Germany
- Łazarski Univesity, Poland
- KU Leuven University, Belgium
- University of Geneva, Switzerland
- Utrecht University, The Netherlands
- Essec Business School Paris and Oxford University, France
- Monash University, Australia
- University of Lodz, Poland
- Vienna Institute of Economics and Business, Austria
- Universidad Carlos III de Madrid, Spain
- Durham European, School of Law, United Kingdom
- Università degli Studi di Parma, Italy
- Università Cattolica del Sacro Cuore, Italy
- University of Oslo, Norway

Electronic Access to the Research Working Paper Series

The full set of EUSFIL Research Working Papers can be accessed through the Centre's Web-site (https://www.eusfil.eu/working-papers).

With the support of the Erasmus+ Programme of the European Union