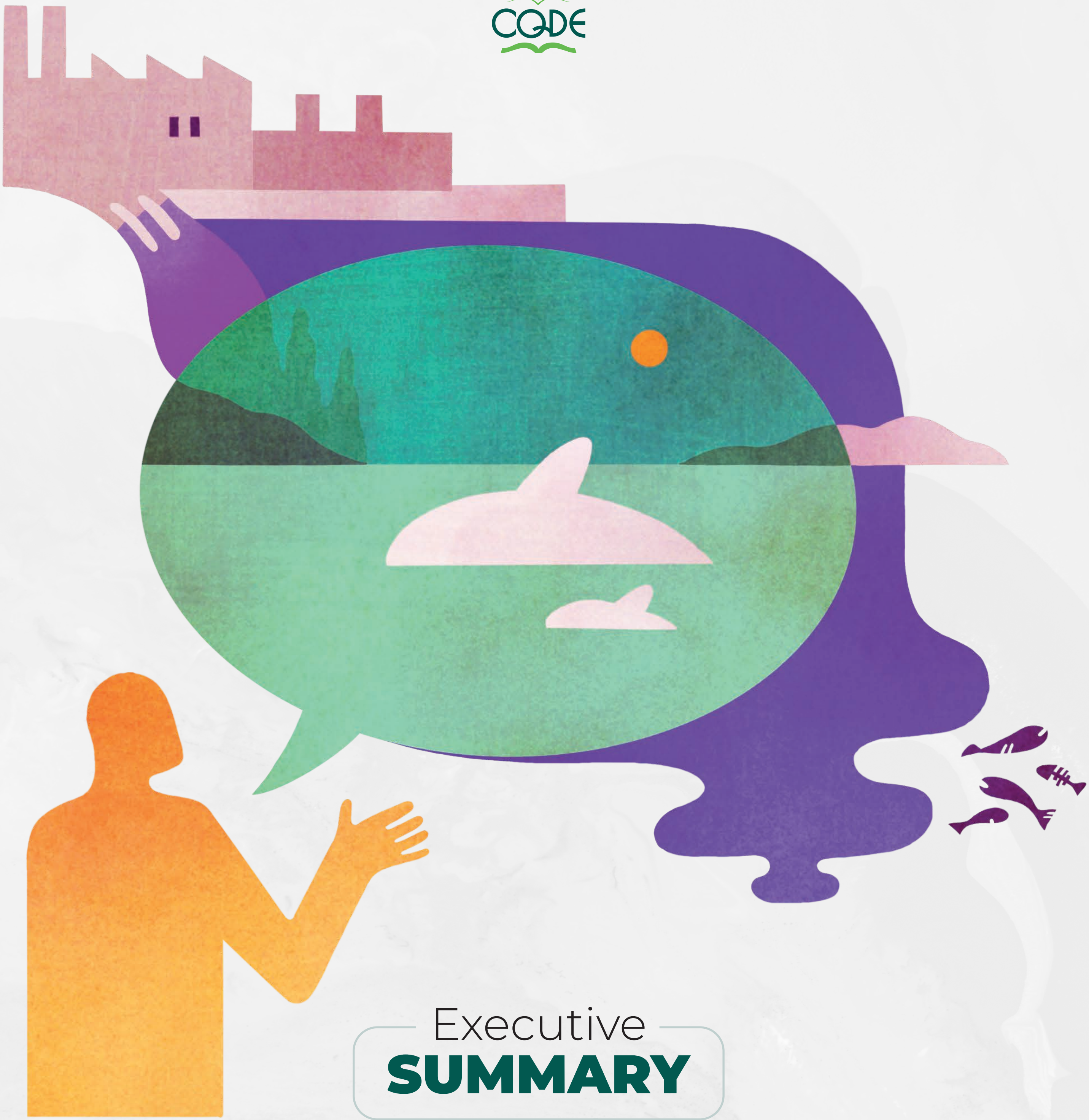

Executive
**SUMMARY**

# Greenwashing in the financial sector:
## time for transparency and accountability

REPORT BY THE **QUEBEC ENVIRONMENTAL LAW CENTER**

Executive
# SUMMARY

## **Greenwashing in the financial sector:** time for transparency and accountability

The market for "responsible investment", "sustainable finance" and "ESG" financial solutions (collectively, **SFRI**) has significant grown in recent years, propelled by public pressures, rising investor demand and new regulatory requirements.

This trend has pushed **listed companies and financial institutions to disclose more information** about their environmental and social risks, impacts and commitments, notably through marketing campaigns and the publication of sustainable development reports. It also led market actors to **develop new types of services**, such as SFRI-related financial advice, data, rating and index services, and **new financial products**, such as ESG investment funds, green bonds and sustainability-linked loans.

The development of the SFRI segment, if done appropriately, has the potential to accelerate the **allocation of capital towards a low-carbon, resilient, just and inclusive global economy**. However, several studies have shown that **greenwashing risks are widespread** in this sector. For example, in a 2023 study, researchers found that among 250 of the largest passive investments funds marketed as "socially responsible" or "environmentally friendly", only 5% were aligned with the goals of the Paris Agreement.[1]


**Greenwashing occurs when an organization makes false, misleading or unsubstantiated claims** that give an overly positive impression of its environmental and social performance or that of its products or activities.[2] In the financial context, such "performance" may relate to both risks and impacts generated by a company's products or activities.

**Greenwashing is a serious problem** for the environment and for society in general, but also for the integrity and stability of financial markets. If left unchecked, it can **prevent investors from making informed decisions**, **threaten the stability of the financial system** and most importantly, **prevent the allocation of capital towards a low-carbon, resilient and just society**. Greenwashing may also harm organizations making genuine environmental and social claims by **breeding skepticism among investors**. Greenwashing risks include the possibility that:

- **listed firms** make generic and vague sustainability claims without providing details about the scope and meaning of these claims.
- **banks** formulate "sustainable financing" commitments that fail to translate into net positive environmental or social impact and may even result in additional harm.
- **financial intermediaries** provide incorrect or misleading advice about the environmental characteristics of certain investment products, notably due to a lack of understanding of these products.
- **ESG data providers** distribute ESG ratings that fail to effectively measure environmental and social performance, rely on incomplete data and reward firms engaged in controversial or harmful activities.
- **green bonds** be used to raise funds for projects that fail to achieve positive environmental and social impacts or that result in negative impacts.
- **sustainability-linked loans** be used by financial institutions to signal their environmental or social credentials, even if such loans are unlikely to translate into additional positive impact.
- **investment funds** be labelled as "ESG" even if their investment strategies fail to incorporate any ESG factor.

**Existing financial laws and regulations**, which already prohibit false or misleading representations, may address some of these risks. Moreover, in recent years, financial regulators have published several **guidelines or draft regulations** aimed at standardizing and improving the quality of environmental information communicated within financial markets. Several NGOs have relied on these laws to file **greenwashing complaints** against allegedly deceptive financial claims.

However, despite these laws, regulations and guidelines, **the existing framework remains insufficient to prevent greenwashing**. Many aspects of the SFRI segment remain **entirely deregulated**, and the current regulatory framework has **significant gaps**. To address this situation, this report recommends a total of 25 measures, which are summarized in **six categories** below.

## 1 REGULATE THE SUPPLY OF EMERGING PRODUCTS AND SERVICES, SUCH AS VOLUNTARY CARBON OFFSETS, GREEN BONDS AND ESG RATING SERVICES.

A large portion of the SFRI segment is currently unregulated. For example, "green" or "sustainability-linked" debt instruments and voluntary carbon offsets are not subject to any legally binding substantive or procedural standards. Similarly, the provision of ESG data, ratings and indices is not subject to mandatory transparency and conflict of interest requirements. This lack of binding rules facilitates the mislabelling of assets and the provision of products and services that fail to meet sufficient quality and transparency standards. To address this situation, policymakers should: Regulate the provision of ESG data services, such as ESG ratings and indices.

- Regulate the provision of ESG data services, such as ESG ratings and indices.
- Establish specific quality and procedural requirements for the issuance of use-of-proceeds instruments (such as green bonds) and performance-based (such as sustainability-linked bonds) instruments.
- Establish specific quality and procedural requirements for issuance and use of voluntary carbon offsets.

## 2 STRENGTHEN SUSTAINABILITY DISCLOSURE REQUIREMENTS AND LABELLING STANDARDS.

The guidelines and regulations that require reporting issuers and financial institutions to disclose information about sustainability are currently insufficient. For instance, they often lack specificity, fail to address key aspects of sustainability performance beyond climate (such as biodiversity and pollution), focus exclusively on risks (as opposed to impact), and do not apply to certain categories of financial products or actors. To address this situation, policymakers should:

- Strengthen the sustainability disclosure requirements applicable to listed firms and financial institutions using a double materiality approach that covers both sustainability risks and impacts. The definition of sustainability should include environmental, social, human rights and governance factors, as defined in the United Nations Sustainable Development Goals.
- Adopt a mandatory, science-based sustainability taxonomy and require reporting issuers, investment funds and financial institutions to comply with its criteria.
- Require investment fund managers to disclose more specific information about their use of ESG data services.
- Accelerate the adoption of data disclosure standards and obligations across all sectors of the economy, beyond financial institutions and listed firms.
- Establish sustainability disclosure obligations for proxy advisors and segregated funds.

## 3 STRENGTHEN THE PROFESSIONAL OBLIGATIONS OF FINANCIAL INTERMEDIARIES.

The legal framework applicable to financial intermediaries currently limits their ability to offer SFRI products. First, investment professionals' mandatory qualification programs often overlook the topic, resulting in a limited expertise among intermediaries and an inability to recommend SFRI products while complying with know-your-product obligations. This knowledge gap is compounded by the lack of clear requirement for intermediaries to ask their clients about their sustainability preferences. Consequently, the cycle of not knowing about, not asking about, and not offering SFRI products persists, leaving client demand for SFRI products largely unmet. To address this situation, policymakers should:

- Engage with training providers to ensure that sustainability topics are incorporated into the mandatory training programs undertaken by investment professionals.
- Expand financial intermediaries' know-your-client and suitability obligations to ensure that their clients have the opportunity to discuss their sustainability preferences.
- Require financial intermediaries to understand the sustainability characteristics of the products they offer, including the environmental risks and impacts associated with these products, as part of their know-your-product obligations.
- Require investment services providers to proactively communicate information on the material sustainability risks and impacts of the financial products that they offer.

## FACILITATE LEGAL REMEDIES AGAINST WRONGDOERS. 4

**Issue:** The current legal framework provides for penal and civil remedies against entities that communicate false, misleading or incomplete environmental information. However, the provisions that establish these remedies, which often require the proof that a deceptive statement has resulted in price effects, are not well adapted to the particularities of greenwashing cases. Moreover, the climate-related disclosure requirements established in prudential guidelines are not accompanied by sufficient enforcement mechanisms. To address this situation, policymakers should:

- Amend the Québec *Securities Act* to facilitate legal remedies against wrongdoers in greenwashing cases that do not impact the price of securities.
- Adopt stronger enforcement mechanisms regarding violations of the prudential guidelines that establish financial institutions' climate-related disclosure obligations.

## 5 INTENSIFY ENFORCEMENT MEASURES AGAINST GREENWASHING.

**Issue:** Several studies, surveys and reviews have showed that greenwashing is widespread in the financial sector. While financial regulators have been monitoring the environmental claims of listed firms and investment funds and advocating for better environmental and social disclosure practices, the authorities have yet to take public enforcement actions against wrongdoers. This contrasts with other jurisdictions, such as Australia and the United States, which have both undertaken several enforcement cases targeting the deceptive communications to investors. To address this situation, policymakers should:

- Set greenwashing as an enforcement priority and report on the results of their enforcement efforts.
- Issue sustainability marketing guidelines for federal financial institutions.

## 6 INFORM AND RAISE AWARENESS AMONG THE PUBLIC.

**Issue:** Canadians currently have a limited understanding of SFRI products and services: according to a 2024 survey, 70% of Canadian retail investors know "little or nothing" about responsible investment, and 21% have "never heard of it".[3] This lack of knowledge widens the information asymmetry between financial institutions and their customers, amplifying the potential for greenwashing. To address this situation, policymakers should:

- Incorporate content on sustainability and SFRI products into public financial literacy educational programs.

These anti-greenwashing measures will help **improve the quality and quantity of sustainability information** available to investors. While these measures **cannot replace structural reforms** aimed at ensuring the sustainability and fairness of the financial system, they are an essential step towards more **transparency and accountability** in the financial sector.

Moreover, they are **likely to garner large public support**. In a 2022 survey, 75% of Canadian retail investors indicated being concerned about greenwashing, and in 2023, 78% of Canadians supported more stringent financial regulation to address greenwashing.[4]

The jurisdiction to implement these measures is shared between several entities, including the Government of Québec, the Government of Canada, Québec's Autorité des marchés financiers, the Canadian Securities Administrators, the Financial Consumer Agency of Canada, the Office of the Superintendent of Financial Institutions, the Canadian Investment Regulatory Organization and the Chambre de la sécurité financière.

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1. Fichtner et al. (2023). Similarly, a study by Kim and Yoon (2023) of US active mutual funds that had signed the United Nations Principles for Responsible Investment, a voluntary initiative aimed at promoting ESG investing (**UN PRI**), showed that signatories did not improve their fund-level ESG scores after joining the initiative.
2. Montgomery et al. (2023).
3. Responsible Investment Association (2024).
4. Responsible Investment Association (2022); Ecojustice (2023).