FOCUS

GREENWASHING

Engaging with regulators on ESG concerns

Recent years have seen a significant increase in investigations and enforcement relating to environmental, social and governance (ESG) issues. As ESG matters have moved further up the agendas of businesses and their stakeholders, regulators and prosecutors both in the UK and abroad have assessed their priorities and powers. Organisations need to consider best practice for engaging with regulators if they find themselves facing the sharp end of an investigation.

Enforcement action has particularly focused on variants of greenwashing, specifically misrepresentations or omissions in corporate communications as to an organisation's ESG impacts or those of its investments (*see Exclusively online article "Misleading environmental claims: the dos, don'ts and pitfalls of green claims", www.practicallaw.com/w-031-4434*). Non-governmental organisations (NGOs) are increasingly looking for new and innovative ways to hold businesses to account. Emma Howard Boyd, chair of the Environment Agency, recently warned that widespread deception from businesses is compromising efforts to prepare for climate impacts and praised the work of environmental NGOs for highlighting greenwashing (*www.gov.uk/government/speeches/finance-resilience-net-zero-and-nature*).

Current regulatory action in ESG matters is often founded on the broad powers that regulators have in their existing frameworks, including principles-based regulation. However, in some instances, regulators are seeking novel powers and frameworks to police corporate ESG commitments.

Recent developments

A number of recent developments in the UK and abroad, with a particular focus on greenwashing, illustrate the broader trend in this area (*see box "US and German investigations"*).

Green Claims Code. The Competition and Markets Authority (CMA) published its Green Claims Code (the code), which is aimed at protecting consumers from misleading environmental claims and related concerns about unfair competition (*www.gov.uk/government/publications/green-claims-code-making-environmental-claims*). The code affects any business that makes an environmental claim stating a positive environmental impact in respect of its products or services. The CMA identifies textiles, fashion and fast-moving consumer goods as particular risk industries and has stated that it will undertake further enforcement action where non-compliance is found, possibly brought by other enforcement bodies including Trading Standards.

FCA action. The capacity for global regulators to share information and co-operate may further accelerate the intention of the Financial Conduct Authority (FCA) to become more active on ESG matters in the UK, particularly after the recent release of its ESG strategy document and its feedback statement of 29 June 2022, which expressed support for regulating ESG data and ratings agencies and a globally consistent regulatory approach (*www.fca.org.uk/publications/corporate-documents/strategy-positive-change-our-esg-priorities; www.fca.org.uk/publications/feedback-statements/fs22-4-esg-integration-uk-capital-markets; see feature articles "ESG standards and ratings: know the score", www.practicallaw.com/w-035-4811 and "FCA and PRA enforcement actions: trends and predictions", www.practicallaw.com/w-034-1498*).

Although the FCA's existing Principles for Businesses are sufficiently broad to support potential enforcement action in relation to ESG issues, its dedicated new rules for climate-related disclosures in the ESG sourcebook will clarify and enhance its ability to act (*www.practicallaw.com/w-032-0252*). The ESG sourcebook, which will have wide application in financial services from 1 January 2023, establishes specific annual disclosures for firms at both an entity level; that is, how the firm takes into account climate-related measures in managing or administering investments, as well as at a more detailed product level. The first set of disclosures under the ESG rules is not due until mid-2023, but a breach of these obligations may lead to supervisory intervention or enforcement action against both firms and senior management.

Get to know the regulators

In the UK, unlike in the US, no single regulator has claimed responsibility for the enforcement of ESG matters. The regulation of different ESG factors, including human rights, diversity and inclusion, climate and the environment, data protection, and bribery and corruption, falls to different UK agencies, depending on how the harm manifests.

To complicate matters further, the list of UK agencies that may have responsibility for any given ESG factor is in flux, as the government struggles to keep up with developments in technology, the ever-increasing demands of investors and the fight to achieve net zero carbon emissions. UK agencies with a mandate to investigate claims in relation to ESG matters include the CMA, the Crown Prosecution Service, the FCA, the Information Commissioner's Office (ICO), Ofcom, the Office of Environmental Protection, the National Contact Point and the Serious Fraud Office. Some agencies, such as the Audit, Reporting and Governance Authority, are in development (*see News brief "Queen's Speech: a question of priorities", www.practicallaw.com/w-035-6590*).

It is important to understand a regulator's priorities with respect to ESG matters. Regulators, through their statutory powers,

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now play a much bigger role in delivering policy, as well as economic objectives, and are increasingly tasked with regulating more complex situations. The various UK agencies each have distinct objectives and accordingly approach the regulation of ESG matters from different viewpoints, although there may well be overlap. For example, a financial services firm that is alleged to have breached the FCA's Principles for Business or other Handbook rules with respect to greenwashing may also be vulnerable to an investigation by the CMA under the code and face the possibility of concurrent investigations by both agencies. Although the underlying allegations may be the same in each investigation, there will be nuanced differences in how the two approach ESG matters. Businesses should stay up to date with developments: regulators often provide extensive published guidance to those they regulate and to the public, including practical advice and guidance on how regulated entities should adhere to legislation and how enforcement mechanisms operate.

Proactive compliance culture

A culture of compliance is the best preventative tool for businesses to militate against regulatory breaches (*see feature article "Managing ESG compliance: challenges for UK listed companies", www.practicallaw.com/w-025-9225*). This involves:

- Holding frank and open conversations and training within the organisation about best regulatory practice and its benefits to the business.
- Designing internal policies and systems with the relevant requirements firmly in place.
- Obtaining genuine buy-in from senior management about the importance of the regulatory framework.

Given the increasing importance of ESG issues to businesses and the public, general counsels may find that internal stakeholders are receptive and willing to embed the requirements of ESG regulation into the business.

US and German investigations

Following the US Securities and Exchange Commission's (SEC) creation of a taskforce for climate and environmental, social and governance (ESG) enforcement in March 2021, the SEC has launched a number of investigations about corporate sustainability. Most recently, it is reported to be investigating certain Goldman Sachs funds that have "clean energy" or "ESG" in their names (*www.reuters.com/business/us-sec-investigating-goldman-sachs-over-esg-funds-wsj-2022-06-10/*). This follows reports of a similar investigation also by the SEC into the use of sustainable investing criteria by Deutsche Bank's asset management division, DWS, which is said to have faced a recent dawn raid in Germany in a parallel investigation by the German financial watchdog BaFin (*www.reuters.com/business/german-police-raid-deutsche-banks-dws-unit-2022-05-31*).

A culture of compliance is also well demonstrated by constructive and proactive engagement with regulators, which can be essential for improving the relationship between the regulator and the regulated organisation. Responsible businesses can provide helpful information to regulators, assisting them to understand the position of the market and sharpen their regulatory priorities. This can be done both informally and through formal processes, such as consultations. The value of corporate engagement is particularly key in new industries and technology, such as artificial intelligence, where businesses may have a stronger understanding of the market than government agencies and regulators. The provision of information to and engagement with regulators, especially on emerging ESG issues, can assist businesses in their relationships with the relevant agencies, and help to ensure that regulatory policies are sound and rational in the context of the relevant market.

Proactive engagement can mean, in some circumstances, the initiation of an internal investigation to look into allegations, including a self-report to the relevant regulator (*see feature article "Corporate investigations: key issues for boards and in-house lawyers", www.practicallaw.com/0-619-0485*). The risks and possible benefits of this approach must be carefully balanced on a case-by-case basis.

Facing an investigation

If an external investigation cannot be avoided, the first thing that an organisation will need to consider is its strategy in engaging with its regulator. Broadly speaking, the question is whether to engage constructively with the regulator, with the intention of mitigating any damage and trying to exercise a degree of control over the scope of any investigation, or whether to challenge the regulator from the outset. In order to make this decision, those leading on the investigation will need clear advice about the regulator's legal framework and its scope of investigatory and enforcement powers, including the likely sanction. There can be considerable variance of these powers between major regulators; for example, although compulsory interviews are routine for many agencies in regulatory investigations, the ICO does not have the power to hold compulsory interviews for breaches of the Privacy and Electronic Communications Regulations 2003 (*SI 2003/2426*).

Understanding the regulator's legal framework and investigation and enforcement policies will enable an organisation to determine whether the regulator is acting within its powers from a public law perspective, as well as fairly and rationally, to help determine the organisation's strategy. It can be the case, particularly in emerging areas such as ESG regulation, that regulators are subject to a degree of external pressure to show decisive and clear action, which can lead regulators to aim for ambitious interpretations of their powers. Sound advice is needed in these circumstances. Understanding the framework will also give organisations an indication of the regulator's

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priorities in respect of the particular action. This will enable informed judgments about the likely best possible outcomes of the investigation and how an organisation might be able to achieve them.

Any legal strategy needs to be linked closely to the business's commercial and reputational strategy when facing an ESG investigation. Engaging a specialist communications agency can be beneficial in ensuring that communications about the investigation are timely, measured and send appropriate information to stakeholders and the market. Any communications must be made with care, however, given the risk of further allegations of greenwashing and their admissibility in subsequent litigation (*see feature article "ESG litigation risks: building momentum", www.practicallaw.com/w-035-5489*).

The future of ESG regulation

ESG regulation will continue to develop, becoming more frequent and further harmonised among regulators. There is likely to be further and intensified co-operation between both domestic and international agencies. An important development is the EU's proposed directive on corporate sustainability due diligence. This would require large EU companies, and some non-EU companies, to assess their actual and potential human rights and environmental impacts throughout their operations and supply chains, and to take action to prevent, mitigate, and remedy identified human rights and environmental harms, underpinned by regulatory and civil penalties (*see News brief "Corporate sustainability due diligence duty: gathering momentum", www.practicallaw.com/w-034-8795 and feature article "Sustainability in supply chains: due diligence in focus", www.practicallaw.com/w-035-5415*). It remains to be seen, following the draft directive, whether there will be a number of regulators with concurrency arrangements, or single national regulatory bodies in EU member states, and to what degree the UK may follow suit.

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