WHITE PAPER

Preparing for the EU Green Claims Directive

How companies can eliminate greenwashing at its source

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Preparing for the EU Green Claims Directive

Many companies have attempted to improve their environmental behavior, not least in order to meet customer and stakeholder expectations. However, the absence of clear and established rules on how to verify green claims in an officially approved way has complicated this undertaking, creating an ambiguity that has left companies potentially vulnerable to accusations of greenwashing. As a result, regulators are now acting to impose clarity, in this way facilitating companies' endeavors and helping to strengthen consumer trust in green claims.

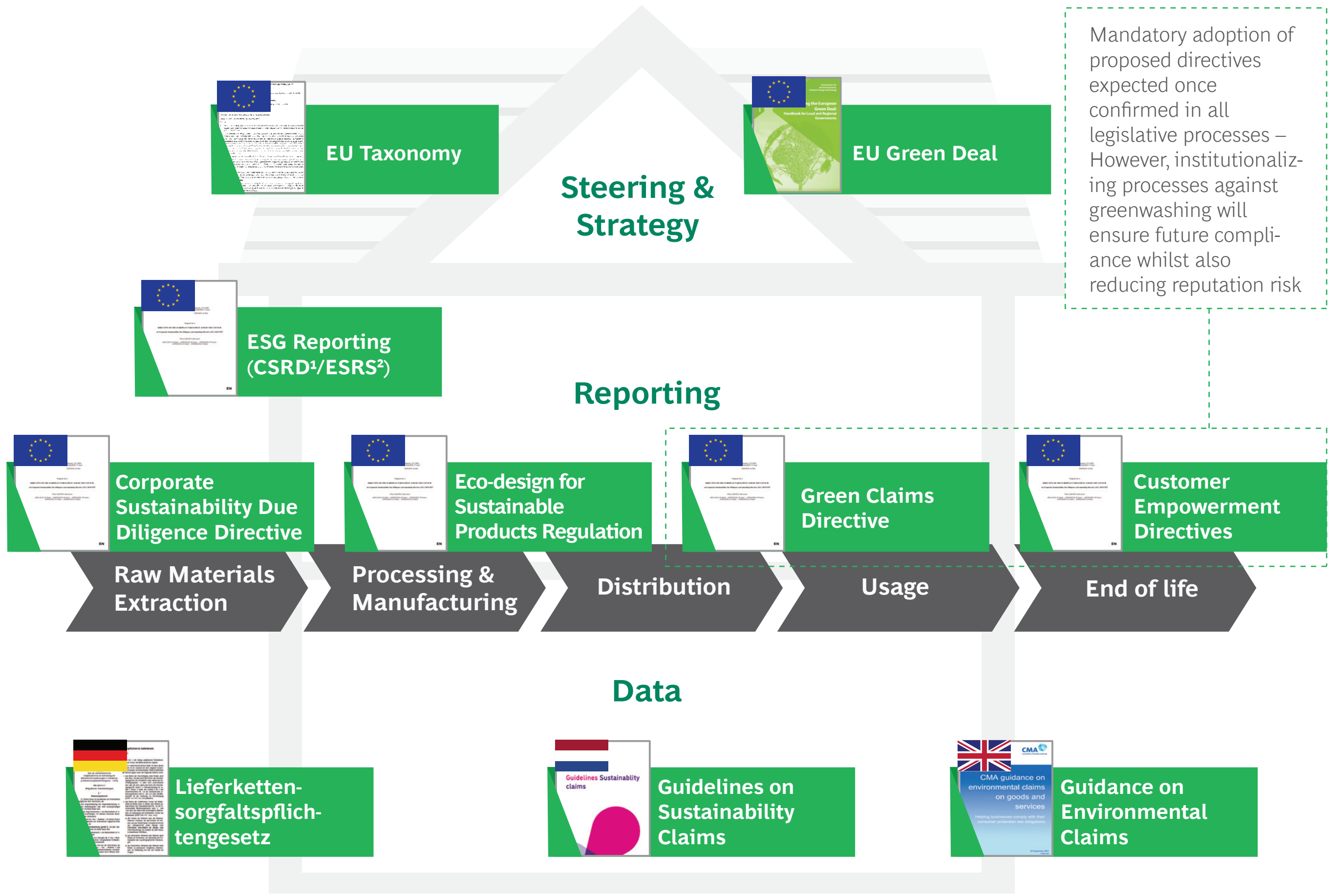
On March 22, 2023, the European Commission published a proposal for a directive that aims to create a harmonized set of rules on the substantiation and communication of green claims. It offers much-needed clarity and guidance for companies on what they can say about their general record on sustainability or about the environmental benefits of specific products. This proposal represents the very latest in a plethora of recent regulatory developments related to the broader issue of sustainability – such as the EU taxonomy for sustainability activities, the Corporate Sustainability Reporting Directive (CSRD), the European Sustainability Reporting Standards (ESRS), the Corporate Sustainability Due Diligence Directive (CS3D), and the Ecodesign for Sustainable Products Regulation.

Companies should not downplay these regulatory developments, nor adopt a piecemeal or reactive response to them. Instead, they should view the trend as an opportunity. They can seize control of the issue, adopting a holistic approach that rigorously and continually evaluates green claims throughout the product life cycle as part of their everyday organizational routine. In this way, companies can institutionalize a system of continuous validation that will differentiate the company's brand and reputation from its competitors, foster credibility with the consumer, and ensure compliance.

To summon the necessary focus, the systemic fight against greenwashing should be incorporated within the company's broader strategy and governance in the environmental, social and governance (ESG) sphere. Internal standards and controls specific to greenwashing will also need to be instituted throughout the organization.

The human factor is, of course, indispensable to the holistic, company-wide approach. Leaders at the top of the organization must buy into and communicate the importance of combatting greenwashing throughout the organization. Technical expertise is essential for the substantiation of claims. Individual and divisional responsibility must be clearly established, with ESG teams as well as the compliance and product compliance departments fulfilling vital control functions in the second line of defense. It should be clarified who is in charge of coordinating the respective efforts of the various departments (such as procurement, production, sales and marketing) that have a role in eliminating the potential for greenwashing.

Exhibit 1 - Regulatory Landscape (Selection of EU regulations)



1 Corporate Sustainability Reporting Directive.

2 European Sustainability Reporting Standards.

Growing consumer concerns about greenwashing

Intense pressure from various stakeholders has brought sustainability and ESG issues to the forefront of the corporate agenda. Companies have reacted accordingly, seeking to reassure the concerned public that they are doing everything they can to protect the environment. However, without unambiguous guidelines on verification, it was inevitable that the green claims of some companies would be questioned or even condemned.

Most greenwashing accusations have to date centered on environmental claims, although incriminations concerning any allegedly over-zealous assertions about a company's social impact or governance are also likely to become more prevalent in the future.

Several examples of environmental greenwashing have hit the headlines in recent years. For example, the directors of one global oil company are being personally sued over their alleged failure to manage climate risks properly despite claiming that its environmental plans are "industry-leading" and entirely consistent with the goals of the Paris Agreement, the international treaty on climate change.

In the aviation industry, various prominent European airlines have been accused of making false claims about how sustainable their flights are. One company's advertising campaign has been banned, while another company is being sued by environmental groups. Meanwhile, several consumer goods companies have been condemned for boasting of their impeccably green packaging, when the alleged reality is quite the opposite – that they rank among the world's worst plastic polluters.

These are not isolated incidents. In 2021, the European Commission and national consumer authorities analyzed green claims from various business sectors such as garments, cosmetics and household equipment. The study found that 42% of claims were "exaggerated, false or deceptive and could potentially qualify as unfair commercial practices under EU rules."

Such practices inevitably sap consumer confidence in the truthfulness of corporate assertions about their green behavior. A BCG consumer survey from June 2022 revealed the extent of the disillusionment. An overwhelming proportion of those interviewed in eight major markets felt that "companies talk about sustainability only to improve their image or sales."

At the very least, according to the European Commission, "it is difficult for consumers, companies and other market actors to make sense of the many environmental labels and initiatives on the environmental performance of products and companies." When consumers lose confidence in this way, hopes of swift progress towards a more sustainable future are dealt a hammer blow. Individuals have been buying products that they believe are green but are in fact harming the environment, while presumably not purchasing others that are genuinely green because they have ceased to believe what companies are telling them.

It goes without saying that companies do not want their reputation to be tarnished in such a way among their loyal customer base. Clear regulatory direction on green claims can help them to revisit the whole area of green marketing, but this time on much firmer ground.

Regulatory push forces companies to act

Several recent lawsuits against alleged company greenwashing have been based on more general national legislation related to consumer protection, focusing for example on safeguarding individual human rights vis-à-vis vendors. However, the growing awareness of greenwashing and its negative impact on sustainability have generated the impetus for more targeted regulation. Such a development will make it far easier for plaintiffs to sue companies directly. At the same time, it will provide companies a higher level of security around expectations towards green claims.

On March 22, 2023, the European Commission issued a proposal for a directive that outlines its expectations on sustainability claims. Under the proposed regulation, companies will have to evaluate environmental claims they make in a more explicit way. The key elements of this proposal for a directive are as follows:

- The target aspiration is that companies substantiate environmental claims using a **methodology** based on scientific evidence and technical knowledge, identifying all relevant environmental impacts throughout the life cycle. Earlier discussions indicated more stringent methodological requirements by making the adoption of Organizational Environmental Footprint and Product Environmental Footprint methodologies a requirement (See our break-out box to illustrate the key components of these rigorous methodologies). The European Commission has eventually proposed a less stringent approach that allows for more flexibility towards methodologies used.

- **Comparative claims** – saying that one product is greener or more environmentally friendly than another – should be supported by the same methodology and data. The EU directive will also stipulate how such information should be made available for third-party review.

- Clear and convincing **measurability** is an essential element of this substantiation. The investment arm of one German bank was recently penalized for failing to meet such standards. The bank had claimed that its investment fund had "measurable ecological impact." However, the court ruled that investors had not been properly briefed on how the stated reduction in carbon dioxide was calculated.

- Any company communication of green claims should be **easy to understand**, allowing consumers to make swift and evidence-based judgments on such pronouncements and the methodology behind them.

- Any **labelling** that offers information about a product's environmental benefits must be based on established certification schemes.

- For claims that refer to **future environmental performance**, companies shall include time-bound milestones in advance, with regular updates on improvements.

- **Penalties** for failure to meet these regulatory demands are left to national authorities from member states to determine. However, these will certainly not be negligible. In France, for example, courts may impose a fine of up to €300,000, or 10% of the company's annual turnover, or 50% of the costs incurred to create the advertising containing the wrongful environmental claim.

Breakout Box: Organization & Product Environmental Footprint Sector Rules

Many different methodologies and initiatives for calculating and communicating environmental impact have been developed over the years. This has created confusion for consumers, additional costs for companies, and a heightened risk of greenwashing accusations if the methodologies are not properly applied. To harmonize efforts and create a common way of measuring environmental performance, the EU has designed methods to measure environmental footprint.

Organizational Environmental Footprinting (OEF) and Product Environmental Footprinting (PEF) are frameworks based on Life Cycle Assessments (LCA) that measure the environmental impact both of organizations as a whole (including operations, products and services) and of individual products. While OEF examines the environmental impact of an overall organization, the PEF considers the entire supply chain of a particular product, from raw material extraction to distribution, use and disposal. Whereas the PEF has been recognized as the leading environmental footprint methodology for products, the Greenhouse Gas Protocol is the main standard used and requested by international reporting or target setting initiatives (such as the Science Based Targets initiative and Carbon Disclosure Project). This has inevitably reduced adoption of the OEF methodology across organizations.

Organization Environmental Footprint Sector Rules (OEFSR) and Product Environmental Footprint Category Rules (PEFCRs) complement the methods of OEF and PEF. They provide specific guidelines on how to conduct environmental studies at the unique sector or product category level, focusing on the most relevant aspects and parameters. Within these guidelines, multiple steps are considered, such as organizational and product boundaries, the collection and calculation of environmental impact data, the definition of product categories, and recommendations for improvement. In this way, OEFSR and PEFCR can guide organizations on their data collection and calculation methodologies, and ensure consistency and comparability across different organizational and product categories.

Institutionalizing the anti-greenwashing process

The directive is expected to be adopted and implemented once confirmed in all legislative processes. However, there is no time for companies to waste in the meantime. We have seen that the courts are already actively pursuing greenwashing cases, with a media eagerly reporting on them. Besides, immediately embedding the anti-greenwashing process into everyday practice will ensure future compliance with the rapidly growing volume of regulation, bolster credibility with the consumer, avoid court actions by non-governmental organizations (NGOs) and prevent potential reputational damage.

Relevant regulation can relate either to claims about a company's overall environmental footprint, or about one of its products or services at any stage of the life cycle, right through from design and production through to its end of life. As any failure to ensure compliance will have far-reaching consequences, companies should see impending legislation as an opportunity to act proactively and assertively, differentiating themselves from rivals by systematically eliminating the potential for greenwashing accusations.

Companies should not downplay these regulatory developments, nor adopt a piecemeal or reactive response to them. Instead, they should view the trend as an opportunity, by seizing control of the issue and adopting an anti-greenwashing holistic approach that rigorously and continually evaluates green claims.

Our recommended holistic approach to greenwashing risks involves a comprehensive appraisal of the various dimensions of a company's existing ESG Target Operating Model (TOM). To ensure long-term compliance, companies need to integrate greenwashing validation within this TOM.

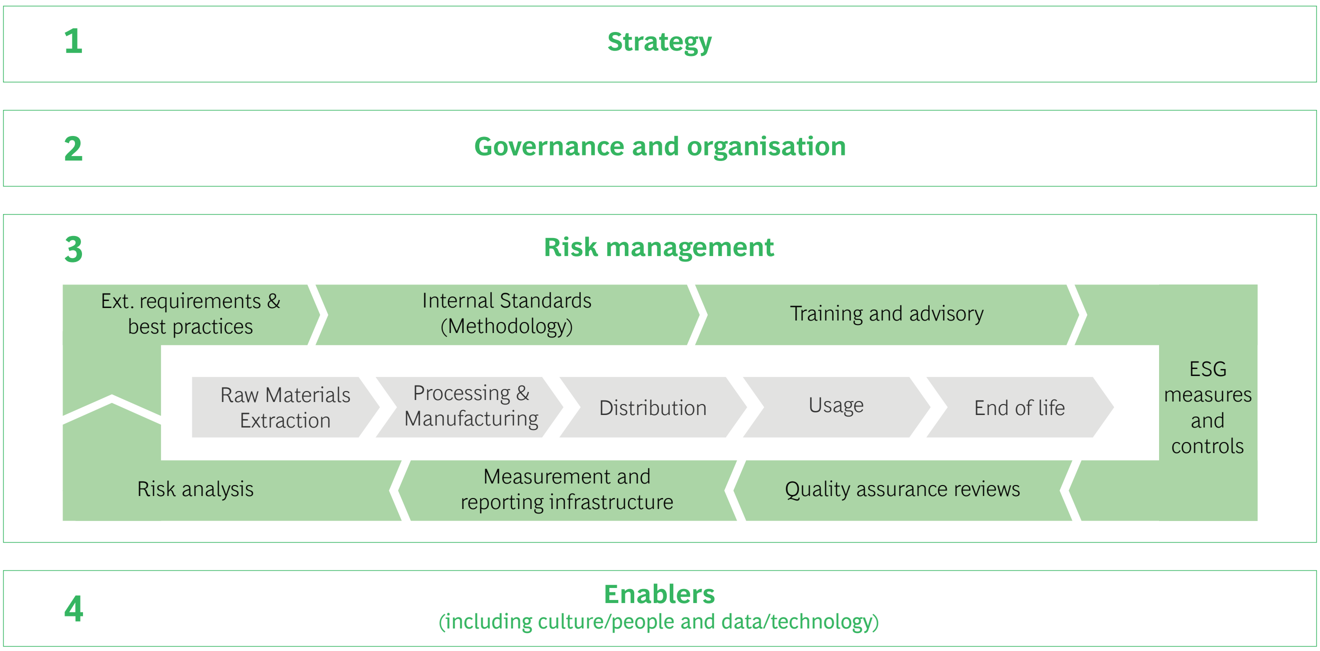
In this way, the processes implemented to reduce greenwashing exposure can ultimately be institutionalized. Accomplishing the goal of institutionalization will require changes across the four ESG TOM dimensions – strategy, governance and organization, risk management, and enablers.

Strategy
An overall ESG strategy outlines a company's sustainability ambitions in detail. Anti-greenwashing goals form one important part of these ambitions, and should be disseminated throughout the entire organization. Hence, senior-level commitment is critical to anti-greenwashing commitments being successfully implemented.

Governance and Organization
Many companies have made progress in establishing structures to manage ESG topics effectively. This has involved the participation of various stakeholders. Greenwashing is one further ESG topic that will require similar collaboration across functions and disciplines, from product design and marketing to compliance, legal and risk management departments. This collaboration could include, for example, a cross-functional committee to approve claims before they are communicated externally.

In the same way, a comprehensive governance structure should be implemented to combat the potential for greenwashing. This would involve instituting formal escalation processes and clarifying individual and departmental accountability.

Exhibit 2 - BCGs "Anti-greenwashing" Target Operating Model



Risk Management

External regulatory requirements will call for a range of internal standards and procedures, and a risk management and assessment framework that encompasses the entire product value chain.

An important requirement of the anti-greenwashing legislation is for companies to substantiate claims based on scientific methodology. In many companies, it is likely that ESG departments would be responsible for providing such methodological guidance.

Anti-greenwashing controls also need to be developed to ensure the efficiency and effectiveness of the implemented standards and procedures. One of the necessary controls would be to ensure that the above methodological guidance has been properly formulated and communicated throughout the organization. Other controls might include automated system-integrated input and output devices, and random spot testing of claims.

Enablers

Two categories underpin the enabler dimensions. These are people and culture as well as data and technology.

The battle against greenwashing will require people with a range of capabilities, such as traditional risk management skills, technical expertise in sustainability (including life cycle assessment specialists), and detailed regulatory knowledge. Creating an extensive green culture and spreading awareness of greenwashing risks will help to ensure that the company does not fall foul of the regulatory authorities. Achieving this aim will involve comprehensive training and clear communication from top management.

Further, data and technology support the substantiation of environmental claims, assisting in the compilation of evidence, boosting transparency and facilitating disclosure to the authorities.

What should companies do now?

The above holistic target operating model represents the ideal state for companies that are seeking to comply with ever-growing anti-greenwashing legislation. In terms of a practical course of action towards that goal, we recommend the following first steps:

Conduct Health Check and Apply Remediation

Companies must first achieve a clear understanding of who is currently responsible for coordinating and overseeing the relevant efforts of the various departments (such as procurement, production, marketing and sales) in combatting the potential for greenwashing.

Companies must also identify their current exposure to greenwashing accusations. This exercise will fulfill two objectives – first, to identify any immediate areas of concern where unsubstantiated or unrealistic claims have been made so that these can be handled appropriately; second, to evaluate the maturity level of current prevention mechanisms when set against the target operating model, so that green claims on a company or product level can be aligned with regulatory expectations.

Formulate Target Picture

Once leaders understand the level of organizational preparedness, and where the major gaps lie, they can then move ahead with devising a detailed concept of the target operating model that incorporates the four key dimensions discussed above. This stage would also entail starting to build concrete measures, methodologies and internal standards for green claim risk management.

Establish Roadmap

The next stage is to formulate a roadmap for the implementation of comprehensive anti-greenwashing processes throughout the organization. The roadmap involves a set of tasks to be completed, such as assigning responsibilities at the outset and then setting timelines to implement the various elements of the holistic target operating model.

Conclusion: Seizing the initiative

The lack of clear parameters on the verification of green claims has made it difficult for companies to know what they can and cannot say about their sustainability efforts. At the same time, the feeling among consumers that green claims are not being properly overseen has damaged public trust in company pronouncements.

It is not surprising, therefore, that regulators have stepped in to help both companies and customers to navigate this previously problematic area. With the introduction of the proposal for a Green Claim Directive, companies must now substantiate green claims within an officially approved and consistent framework.

Rather than responding in a piecemeal fashion to this regulation, companies should put in place institutionalized and holistic processes that eradicate greenwashing at its source before it sees the light of day. Those that grasp the initiative in this way will ensure future compliance, reinforce their credibility among consumers, and dramatically reduce the risk to their reputation. Companies can thus live up to the standards they have set themselves, and gain a major advantage over more passive rivals.

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