REGULATING SUSTAINABLE FINANCE IN CAPITAL MARKETS: A PERSPECTIVE FROM SOCIALLY EMBEDDED DECENTERED REGULATION

IRIS H-Y CHIU*

I
INTRODUCTION

Sustainable finance is an umbrella term that generally refers to private-sector financing for causes related to achieving environmentally or socially sustainable outcomes,[1] such as those articulated in the United Nations' Sustainable Development Goals (SDGs).[2] These include economic development and financial inclusion. Private-sector financing can take many forms. For instance, it could be in the form of bank finance, such as for infrastructure and projects that may have both developmental and sustainable implications (both positively and negatively at times).[3] Such financing also includes social banking, which specializes in lending for sustainable projects such as wind farms or social

---

Copyright © 2021 by Iris H-Y Chiu.
This Article is also available online at http://lcp.law.duke.edu/.
* Professor of Corporate Law and Financial Regulation, University College London. I am grateful to participants at the UCL Centre for Ethics and Law Sustainable Finance Roundtable, 9 Nov 2018, including Professors Iain MacNeil, Catherine Malecki, Steven Schwarcz, Bert Scholtens, Henry Schaefer, and all at the Conference on Financial Inclusion and Sustainable Finance, Durham Law School, April 2019, organized by Professor John Linarelli and Dr Orkun Akseli in honor of Professor Steven Schwarcz. All errors and omissions are mine.

1. Refer to selected sources for explanations of select terminology. For Environmental, Social and Corporate Governance (ESG), *see* Hager Jemel-Fornetty, Céline Louche & David Bourghelle, *Changing the Dominant Convention: The Role of Emerging Initiatives in Mainstreaming ESG*, *in* FINANCE AND SUSTAINABILITY: TOWARDS A NEW PARADIGM: A POST-CRISIS AGENDA: CRITICAL STUDIES ON CORPORATE RESPONSIBILITY, GOVERNANCE AND SUSTAINABILITY 85, 85–117 (William Sun, Céline Louche & Roland Perez eds., 2011) (exploring environmental, social and governance outcomes); for Triple Bottom Line, *see* FRANCISCO SZEKELY & ZAHIR DOSSA, BEYOND THE TRIPLE BOTTOM LINE: EIGHT STEPS TOWARD A SUSTAINABLE BUSINESS MODEL 29–47 (2017) (defining TBL as towards measurability of combined social and economic value creation).

2. *See generally* Jesse Griffiths, *Financing the Sustainable Development Goals (SDGs)*, 61 DEV. 62 (2018); *See also* Alma Pekmezovic, *The New Framework for Financing the 2030 Agenda for Sustainable Development and the SDGs, in* SUSTAINABLE DEVELOPMENT GOALS: HARNESSING BUSINESS TO ACHIEVE THE SDGS THROUGH FINANCE, TECHNOLOGY, AND LAW REFORM 87, 87–105 (Julia Walker, Alma Pekmezovic & Gordon Walker eds., 2019).

3. WORKING GRP. ON INFRASTRUCTURE FIN., STERN SCH. OF BUS., THE INFRASTRUCTURE FINANCE CHALLENGE 28–35 (Ingo Walter ed., 2016).

enterprises,[4] and microcredit and sustainable lending to individuals and households. As global assets under management have grown in the trillions of euros,[5] sustainable finance is also being sourced in global capital markets. These financings include initiatives ranging from venture capital funding in social enterprises,[6] social crowdfunding,[7] green bonds and impact bonds offering investors a familiar financial instrument but whose purpose or return is based on the attainment of sustainable outcomes,[8] and retail funds that may be marketed as engaging in socially responsible investing within the conventional universe of corporate equities and bonds.

Sustainable finance can be distinguished from development finance, which generally involves achieving developmental goals for less-developed countries while being led by the public sector.[9] This is the case whether domestic or international, such as in the case of multilateral development banks. However, even development finance is increasingly being blended with private sector involvement.[10]

This Article focuses on sustainable finance for capital markets, as there is a determined policy movement in the European Union to make sustainable finance mainstream as investment products. Assets under management in the European Union reached 23.1 trillion euros in mid-2019,[11] and the private financial sector is in control of significant power and resources to direct finance towards economic wealth-creation that can meet public-interest needs in long-term sustainability

4. Such as that financed by Triodos, a social bank based in the Netherlands. *Wind Farm Ransonmoor,* TRIODOS BANK, https://www.triodos.co.uk/projects/wind-farm-ransonmoor/19498 [https://perma.cc/7LWD-UTD7]; Olaf Weber, *Social Banks' Mission and Finance, in* ROUTLEDGE HANDBOOK OF SOCIAL AND SUSTAINABLE FINANCE 467, 467–79 (Othmar M. Lehner ed., 2016); *see generally* Nicholas E. Florek, *Enabling Social Enterprise Through Regulatory Innovation: A Case Study from the United Kingdom,* 3 J. SUSTAINABLE FIN. & INV. 155 (2017).

5. Nicolas Moreau, *Asset Managers Can Help Society While Rebuilding Wealth*, FIN. TIMES (June 24, 2020), https://www.ft.com/content/1a36ac32-8c3a-453a-900a-a9734d658b4c [https://perma.cc/Q88X-D7DW].

6. Pascale Château Terrisse, *In What Conditions Can Venture Capital and Social Justice Co-Exist? A Case Study of a French Venture Capital Fund Investing Ethically in Africa, in* FINANCE AND SUSTAINABILITY: TOWARDS A NEW PARADIGM? A POST-CRISIS AGENDA 211, 211–32 (William Sun, Céline Louche & Ronald Perez eds., 2011).

7. Othmar M. Lerner, *Crowdfunding Social Ventures: A Model and Research Agenda*, 15 ROUTLEDGE VENTURE CAP. J. 283, 284-5 (2013).

8. Stephen Kim Park, *Investors as Regulators: Green Bonds and the Governance Challenges of the Sustainable Finance Revolution*, 54 STAN. J. INT'L L. 1, 5–10 (2018); M. Chiesa & S. Barua, *The Surge of Impact Borrowing: The Magnitude and Determinants of Green Bond Supply and Its Heterogeneity Across Markets*, 9 J. SUSTAINABLE FIN. & INV. 138, 142 (UNDER PARA 2.3) (2019).

9. Lucien Georgeson & Mark Maslin, *Putting the United Nations Sustainable Development Goals into Practice: A Review of Implementation, Monitoring, and Finance*, 5 GEOGRAPHY & ENV'T 1, 14 (2018).

10. ORG. FOR ECON. COOP. & DEV., MAKING BLENDED FINANCE WORK FOR THE SUSTAINABLE DEVELOPMENT GOALS 1, 100 (2018), https://read.oecd-ilibrary.org/development/making-blended-finance-work-for-the-sustainable-development-goals_9789264288768-en [https://perma.cc/HQ2V-6WCH].

11. *European Assets Under Management Have More Than Doubled*, EUR. FUND & ASSET MGMT. ASS'N. (Sept. 17, 2019), https://www.institutionalassetmanager.co.uk/2019/09/17/278738/european-assets-under-management-have-more-doubled-last-decade-says-efama [https://perma.cc/BAD2-8QHN].

and social wellbeing. Hence European policymakers have endorsed a reform agenda to galvanize the engagement of conventional investment funds in sustainable finance.[12] The mainstreaming agenda affects two systems of law: financial regulation and corporate law.

With regard to financial regulation, the mainstreaming agenda makes it mandatory for conventional investment funds to engage with sustainable finance.[13] Law reforms have been introduced to compel investment fund managers of all manners of conventional and alternative funds to integrate sustainability risks into their investment strategies.[14] New legislation has also been introduced to clarify what sustainable investments are,[15] but this effort is more developed in terms of environmental sustainability, with social sustainability being a work in progress.[16]

In corporate law, the mainstreaming agenda is targeted at greater transparency of the sustainable behavior and performance of corporations that are the conventional objects of financial investment. This would allow investment funds to take into account the sustainability of firms' operations when evaluating and pricing their debt and equity, thereby exerting market discipline to shape corporate behavior. It should be noted that corporate behavior is also directly shaped by other policies and measures such as environmental regulation;[17] carbon permits;[18] other corporate regulation in product liability, health and safety;[19] and so on. However, there are gaps in regulation where corporations have an impact

---

12. EU HIGH-LEVEL EXPERT GRP. ON SUSTAINABLE FIN., FINANCING A SUSTAINABLE EUROPEAN ECONOMY (2018), https://ec.europa.eu/info/sites/info/files/180131-sustainable-finance-final-report_en.pdf [https://perma.cc/ELA4-ENSU] [hereinafter HLEG REPORT].

13. Commission Regulation 2019/2088 of Nov. 27, 2019, Sustainability related Disclosures in the Financial Services Sector, art. 1, 2019 O.J. (L 317) [hereinafter Disclosure Regulation].

14. *Id.* at arts. 3, 4–6.

15. *Id*. at art. 2.

16. *See generally ESMA Responds to European Commission Consultation on Renewed Sustainable Finance Strategy*, EUR. SEC. & MKT. AUTH. [ESMA] (July 16, 2020), https://www.esma.europa.eu/press-news/esma-news/esma-responds-european-commission-consultation-renewed-sustainable-finance [https://perma.cc/A54T-XAUY] (ESMA has quickly, on the back of recent EU legislative reforms for sustainable finance, pointed out gaps for work in progress).

17. BENJAMIN J. RICHARDSON & BEATE SJÅFJELL, *Capitalism, the Sustainability Crisis, and the Limitations of Current Business Governance*, *in* COMPANY LAW AND SUSTAINABILITY 1, 1–5 (2015).

18. *See* Richard B. Stewart, *Climate Finance for Limiting Emissions and Promoting Green Development: Mechanisms, Regulation, and Governance, in* CLIMATE FINANCE REGULATORY AND FUNDING STRATEGIES FOR CLIMATE CHANGE AND GLOBAL DEVELOPMENT 1, 5, 8–9, 23 (Benedict Kingsbury & Bryce Rudyk eds., 2009) (discussing carbon credits trading markets).

19. *See generally* JOHN BRAITHWAITE & PETER DRAHOS, GLOBAL BUSINESS REGULATION (2000) (reviewing successful reforms).

on sustainable outcomes, such as social or human development,[20] that have been left to voluntary measures of corporate responsibility.[21]

This Article locates the mainstreaming agenda of sustainable finance within the theoretical framework of decentered regulation,[22] reflecting how both financial and corporate constituents are embedded in structures of social relations.[23] This framework goes beyond characterizing the mainstreaming agenda as merely market-based or neoliberal, as the agenda does not only leverage incentive-based drivers on the part of financial and corporate constituents. Rather, the reforms contain certain prescriptive, enabling,[24] and meta-regulatory[25] elements that are consistent with allowing these constituents to co-contribute towards the public good. However, the mobilization of financial and corporate constituents takes place within certain theoretical boundaries, rationalities, and institutional structures in the systems of financial regulation and corporate law, which we call "systems internalities" in this Article.[26] These internalities interact with the reform agenda to produce incremental changes in fund investment and corporate behaviors, decreasing the likelihood that the current agenda will produce significant radical changes.

Incrementalism has been criticized as insufficient for the public-interest goals of maintaining sustainable planetary boundaries,[27] meeting the Paris Agreement's climate change target,[28] or delivering on the SDGs. However, incrementalism is likely to be less disruptive for economic and social life while

---

20. David Wood, *What Do We Mean by the S in ESG? in* THE ROUTLEDGE HANDBOOK OF RESPONSIBLE INVESTMENT 553, 553–64 (Tessa Hebb, James P. Hawley, Andreas G. F. Hoepner, Agnes L. Neher & David Wood eds., 2015).

21. *See* PATRICIA H. WERHANE, KENNETH E. GOODPASTER, ARCHIE B. CARROLL, KENNETH J. LIPARTITO, JAMES E. POST, CORPORATE RESPONSIBILITY 1, 1–5 (2012) (reviewing the evolution of voluntary CSR practices).

22. Decentered regulation refers to the concept of private firms overseeing actors, and imposing regulation through private action. *See* Dimity Kingsford Smith, *Beyond the Rule of Law? Decentered Regulation in Online Investing*, 23 LAW & POL'Y 439, 444–45 (2004) ("[T]he essential feature of decentering is that the state is not central in the creation, implementation, or enforcement of regulation.").

23. Jay Cullen & Jukka Mähönen, *Taming Unsustainable Finance, in* THE CAMBRIDGE HANDBOOK OF CORPORATE LAW, CORPORATE GOVERNANCE AND SUSTAINABILITY 100, 100–13 (Beate Sjåfjell & Christopher M. Bruner eds., 2020).

24. *See* Barak Orbach, *What is Regulation?* 30 YALE J. ON REGUL. ONLINE 1, 4–5 (2012) (explaining that regulation does not need to be restrictive and constraining in character and can enable and facilitate activities).

25. *See* Cary Coglianese & Evan Mendelson, *Meta-Regulation and Self-Regulation*, *in* THE OXFORD HANDBOOK OF REGULATION 146, 146–68 (R. Baldwin, M. Cave & M. Lodge eds., 2010); CHRISTINE PARKER, THE OPEN CORPORATION 245–47 (2002) (setting out the broad framework of regulatory principles and outcomes and delegates implementation to regulated entities).

26. *See infra* Parts II and III (exploring the effects of systems internalities on regulatory initiatives intended to promote sustainability).

27. *See* Beate Sjåfjell, *Redefining the Corporation for a Sustainable New Economy*, 45 J. L. & SOC'Y 29, 31 n.n.2–3 (2018) (defining planetary boundaries as environmental phenomena that have been scientifically identified as important for preservation).

28. *See generally* Howard Covington, *Investment Consequences of the Paris Climate Agreement,* 7 J. SUSTAINABLE FIN. & INV. 54 (2017).

preparing for further change. Looking at the theoretical design of decentered and socially embedded regulation from the perspective of systems internalities has implications for considering what radical regulatory and policy designs may be needed to achieve radical change.

II
SUSTAINABLE FINANCE AS SOCIALLY EMBEDDED DECENTERED REGULATION AND GOVERNANCE

Embeddedness is explained in Mark Granovetter's classic work as a perspective of economic activity that is neither over-nor under-socialized.[29] Under-socialization relates to the depiction of economic activity in the reductionist terms of being incentive-driven and instrumentally-motivated.[30] Over-socialization is a view of economic activity that is too dependent on social forces and contexts such that the individual will is underplayed.[31] Granovetter sees economic activity as being embedded in social contexts, situations and institutions, between the under-socialized and over-socialized ends of the spectrum.[32]

Although private-sector finance can be regarded as transactions that provide for private financial needs, the financialization of the modern economy is a socio-economic phenomenon at grand scale. Where, for example, societies and states have retreated from ordering citizens' financial welfare through state-owned banks and generous state pensions, private financial institutions have stepped into the gaps.[33] Financialization has been defined as "the increasing role of financial motives, financial markets, financial actors and financial institutions in the operation of the domestic and international economies."[34] The increasing importance of finance may be observed in steady increases in Gross Domestic Product (GDP) accounted for by the financial sector in the United States,[35] the

29. *See* Mark Granovetter, *Economic Action and Social Structure: The Problem of Embeddedness,* 91 AM. J. SOCIO. 481, 481–85 (1985) (noting that economic action is neither driven purely by individual incentives nor by the social pressures or context for an individual, it is often driven by a mixture of both).

30. *See* NEIL J. SMELSER AND RICHARD SWEDBERG, *Introduction to Economic Sociology, in* THE HANDBOOK ON ECONOMIC SOCIOLOGY 3, 3–20 (2005) (challenging the rationale for individuals in economic action as part of a holistic understanding of how individuals' economic actions are motivated in contrast to incentive-based understanding promoted in economics).

31. *Id.*

32. *Id*.

33. Financialization promotes the liberalization of financial markets to serve sovereigns' corporations, households' borrowing and investment needs. *See generally* GERALD A EPSTEIN, *Introduction: Financialization and the World Economy*, *in* FINANCIALIZATION AND THE WORLD ECONOMY, 1 (2005) (canvassing the rise of financial markets and the economic effects of financialization, e.g. the widening gap between those who derive incomes from financial activity and conventional economic activities).

34. *Id.* at 3.

35. Thomas Philippon, *Has the U.S. Finance Industry Become Less E cient? On the Theory and Measurement of Financial Intermediation*, 105 AM. ECON. REV. 1408, 1431–34 (2015).

United Kingdom,[36] and Europe.[37] Hence, in achieving the pan-European goals of development, environmental sustainability, and social wellbeing, policymakers see the financial sector as an essential actor in achieving the goals of public good. In its allocative role, finance is able to work at the micro levels of transactions to fund activities. It is imperative that finance contributes not only to private value creation but also to collective outcomes that would ultimately result in mitigating harm and delivering longer-term public good.[38] This policy direction is not merely based on win-win rhetoric that relies on the financial sector's own incentives to do good by doing well. Rather, it endorses an imperative view of directing and enabling financial-sector actors, firmly locating finance within the social fabric of Europe.[39] In this manner, social embeddedness theoretically anchors the mainstreaming agenda for sustainable finance.

However, social embeddedness does not give rise to command-and-control forms of regulation to prescribe how financial institutions should fund objects of investment. There is no singular means for achieving sustainable goals and regulators have over the years adopted more flexible regulatory techniques to address the complexity of regulatory needs. In particular, Julia Black argues that decentered regulation in the financial sector is appropriately characterized by five characteristics: complexity, fragmentation, interdependencies, ungovernability, and the rejection of a clear private-public distinction.[40] Complexity refers to the nature of problems that may need to be dealt with. Fragmentation refers to the division of knowledge, resources, and capacity for control in the regulatory space. Interdependencies refer to the dynamics between the participants in the regulatory space, co-producing and co-enforcing norms of governance. Ungovernability refers to the autonomy and unpredictability of actor behavior in the regulatory space. In a decentered landscape, there is, some argue, no public-private distinction as all participants contribute to governance. The decentered analysis has been applied to financial regulation,[41] as the financial services industry is a powerful and innovative industry with resources for governance. Stefano Pagliari also argues that regulators look favorably upon leveraging market-based discipline in finance so as to develop forms of reflexive governance.[42]

---

36. *See* Chris Rhodes, *Financial services: contribution to the UK economy,* HOUSE OF COMMONS LIBR. (July 31, 2019), https://commonslibrary.parliament.uk/research-briefings/sn06193/ [https://perma.cc/BP7J-3D53] (estimating that the sector contributes about 7% of the UK's GDP).

37. Guillaume Bazot, *Financial Consumption and the Cost of Finance: Measuring Financial Efficiency in Europe* 16 J. EUROPEAN ECON. ASS'N 123, 134 (Paris Sch. of Econ., Working Paper Version 1, 2014), (2018).

38. HLEG REPORT, *supra* note 12, at 12.

39. *Id.*

40. Julia Black, *Enrolling Actors in Regulatory Systems: Examples from UK Financial Services Regulation*, *in* PUBLIC LAW 63, 63–65 (Andrew Le Sueur & G. Marshall eds., 2003).

41. Julia Black, *Mapping the Contours of Contemporary Financial Services Regulation,* 2 J. CORP. L. STUD. 253, 254–55 (2002).

42. Stefano Pagliari, *Who Governs Finance? The Shifting Public-Private Divide in the Regulation of Derivatives, Rating Agencies and Hedge Funds,* 18 EUR. L.J. 44, 50 (2012).

The EU's mainstreaming agenda bears the hallmarks of decentered regulation as the law reforms are intended to stimulate capital market mobilization for sustainable finance and to make such markets work better, such as in relation to price formation.[43] Moreover, the agenda also includes steering and motivating market-based actors and stakeholders to improve visibility and evaluative bases for hard-to-value collective goods.[44] Hence policymakers supply frameworks for market-building but financial institutions still need to reconfigure their investment objectives and behavior, and corporations need to respond in turn. The reform agenda therefore mobilizes but does not micromanage.

This Article argues that such mobilization necessarily requires financial sector and corporate actors to co-contribute their existing governance capacity and resources to the decentered regulation landscape to build up a robust and governed market for sustainable finance. However, this process is likely to be incremental in nature. The co-contribution roles of the private sector bring with them the existing baggage of their systems internalities. In this manner, incrementalism is the likely trajectory. Policymakers need to determine if such outcomes are within their intentions and expectations or that more radical shifts are needed.

III
SYSTEMS INTERNALITIES AND THE REFORM AGENDA FOR INVESTMENT FUNDS

The reform agenda for investment funds comprises two key features. The first is that an explicit duty to integrate sustainability risks is introduced in investment management,[45] overcoming doubts regarding whether fiduciary duties can accommodate sustainability considerations. The second is regulatory standardization for sustainably labelled financial products in relation to quality and marketing.[46] These two measures are aimed at existing inhibitors for the galvanization of sustainable finance in mainstream investment fund management, namely the perception that funds' fiduciary duties are incompatible with pursuing sustainability objects and that sustainably labelled investment fund products lack standardization and therefore credibility.

In 2017, the European Shareholders' Rights Directive introduced a comply-or-explain requirement for asset owners and their managers to make transparent how their investment policies would meet their liabilities, and how engagement

43. Such is the function of Article nine of the Disclosure Regulation, which treats investment firms' mandatory disclosures about products' sustainable performance as pre-contractual disclosures so that civil actions based on falsehood can subsequently be carried out if warranted. *See* Disclosure Regulation, *supra* note 13, at art. 9.

44. *See e.g.,* Disclosure Regulation, *supra* note 13 (requiring periodic reporting of sustainable investments' performance in relation to sustainability impact).

45. *Id.* at art. 2.

46. *Id.* at arts. 8–11; Commission Regulation (EU) 2020/852 of June 18, 2020, The Establishment of a Framework to Facilitate Sustainable Investment, and Amending Regulation (EU) 2019/2088, arts. 3–7, 2020 O.J. (L 198) 13.

with their investee companies in both financial and non-financial performance would affect the objectives of their investment management.[47] This non-binding measure is a firm nudge for asset owners and managers towards shareholder engagement with their investee companies more generally, while referring to but not exclusively focusing on environmental and social matters. The Rights Directive now requires investment funds and managers to disclose in their policies and marketing communication how they integrate sustainability risks into their investment strategies.[48] This means that such integration is not optional, stepping up from the comply-or-explain nature of the 2017 reform.

These reforms have frontally challenged the conservative view that investment funds' fiduciary duties to savers are confined to achieving financial performance and that they cannot be distracted by social objectives.[49] The separation of financial and non-financial objectives in earlier jurisprudence can be regarded as in need of modernization where a non-financial issue entails material consequences.[50] The reforms provide some clarity in response to funds' aversion to legal risk in relation to uncertainties in interpreting their fiduciary duties. However, as in the nature of new governance regulatory strategies,[51] investment funds are co-opted to implement the integration of sustainability risks into their structures and business models, therefore providing their own processes and procedures such as in relation to due diligence and evaluation. The open-ended nature of implementation is characteristic of a decentered approach to regulation,[52] allowing regulated entities to refine a dynamic interpretation of such risks in a co-learning and co-evolving approach with the regulator. Nevertheless, the way funds integrate sustainability risks depends on the systems

---

47. Disclosure Regulation, *supra* note 13, at art. 3(g)–(h).

48. Larger firms are subject to more prescriptive behavior in that integration includes due diligence policies and implementation to measure prescribed adverse sustainability impact. *Id.* at arts. 3–6.

49. *See generally* Cowan & Ors v. Scargill & Ors, 1990 Pension L. Rep. 170 (High Ct., Ch. 1990).

50. *See* UN ENV'T PROGRAMME, FIDUCIARY RESPONSIBILITY IN THE 21st CENTURY, 21 (2019) (clarifying that according to the traditions of investment managers' fiduciary duties in many jurisdictions, material ESG factors that affect investment performance should be incorporated into investment management). *See* Jennifer Bender, Todd Arthur Bridges & Kushal Shah, *Reinventing Climate Investing: Building Equity Portfolios for Climate Risk Mitigation and Adaptation,* 9 J. SUSTAINABLE FIN. & INV. 191, 193–94 (2019) (discussing the financial materiality of climate change concerns in relation to risk management, risk of stranded assets); *see also* Bob Buhr, *Assessing the Sources of Stranded Asset Risk: A Proposed Framework,* 7 J. SUSTAINABLE FIN. & INV. 37, 48–51 (2017) (providing an overview of the financial implications of climate risk such as operational, transition, natural capital risks as well as stranded asset risk which means that asset values deteriorate due to the impact of environmental degradation and climate change).

51. *See* Cristie Ford, *New Governance, Compliance, and Principles-Based Securities Regulation,* 45 AM. BUS. L.J. 1, 27–30 (2008) (arguing that regulatory design that requires the regulated to implement regulatory principles in order to achieve broadly-framed outcomes is sound, though potentially flawed by potential pitfalls such as lax light-touch supervision).

52. *See* Timothy Cadman*, Evaluating the Governance of Responsible Investment Institutions: An Environmental and Social Perspective,* 1 J. SUSTAINABLE FIN. & INV. 20, 21–22 (2011) (noting that responsible investment institutions engage with multi-stakeholders as well as seek to achieve outcomes that are environmentally or socially salient, though there is a lot of fragmentation in practice in terms of stakeholder engagement and measuring environmental or social achievements).

internalities of the investment fund industry. This can create limitations for how funds understand and implement these new obligations, especially within the investment chain.

The investment chain describes the web of delegation and division of labor that services the management of assets for asset owners.[53] John Morley describes the key phenomenon in investment management as the separation of funds from managers.[54] Funds are incorporated in separate entities and management of assets is delegated to different portfolio managers. Portfolio managers are further serviced by service providers such as custodians, proxy advisers, and brokers. We argue that the systems internalities of the investment chain are important for shaping the integration of sustainability risks into investment management, and that this leads to an incremental and not radical approach to internalizing sustainability in investment management.

The obligation to internalize sustainability risks is imposed at the fund manager level. However, fund managers serve as agents for investment funds, which act as principals. Although the EU reforms intend investment funds as principals to monitor their fund managers through the latter's integration approaches and disclosures, it is likely that funds would also be wary of any contradiction between the duty of integration and the contractual mandates between funds and asset managers. New legal risk and uncertainty on both sides may result in conservative approaches. Further, the U.K. has introduced non-binding soft law in the form of the Stewardship Code to encourage alignment between asset owners and managers in terms of objectives, strategies and better governance of this relational paradigm.[55] The soft law is open-ended in nature and does not address the real problem, which is the common uncertainties faced by funds and their managers in navigating sustainability risks. Asset owners are often less sophisticated than managers in the pension fund context,[56] while mutual funds constituted by large investment firms are conflicted in being beholden to the asset manager.[57] These dynamics are not addressed by the broad-brush approach in the Stewardship Code.

Further, asset owners are also under a duty to consider value for money in relation to the expenses of investment management,[58] and mutual funds in particular have a duty to uphold fund liquidity. These duties disincentivize engaging in unfamiliar investments whose expense profiles or liquidity profiles

53. DEP'T FOR BUS. INNOVATION & SKILLS, EXPLORING THE INTERMEDIATED SHAREHOLDING MODEL 14 (2016), https://assets.publishing.service.gov.uk/government/uploads/system/uploads/attachment_data/file/489357/bis-16-20-intermediated-shareholding-model.pdf [https://perma.cc/25AY-93PH] (focusing on the investment chain in terms of exercising rights in investee companies).

54. John Morley, *The Separation of Funds and Managers: A Theory of Investment Fund Structure and Regulation,* 123 YALE L.J. 1228, 1234 (2013–14).

55. FIN. REP. COUNCIL, THE UK STEWARDSHIP CODE 2020, at 8-9 (2020).

56. FIN. CONDUCT AUTH., ASSET MANAGEMENT MARKET STUDY FINAL REPORT, annex 1, 4 (2017).

57. *Id.* at annex 1, 11.2.

58. FIN. CONDUCT AUTH., FCA HANDBOOK, COLL 4.5.7, 6.6.20-22, 8.3.5A, 8.5.16-19.

are not as predictable.[59] Faced with conflicting regulatory demands in terms of being both rational and socially-oriented, being willing to engage in new sustainability profiles in investments while being tied to familiar liquidity expectations, asset owners and fund managers are likely to pursue conservative strategies, such as making small allocations to sustainably-labelled products or monitoring excessively the financial performance of these products. Fund managers also tend to rely on other service providers such as exchange indices that classify sustainable companies,[60] or external providers of environmental, social, and corporate governance (ESG) ratings to manage sustainability risks in order to offer services that seem to meet funds' financial needs and the needs to invest responsibly.[61] The universe of socially responsible investing has evolved to provide some distinction from conventional investments without going too radically far.[62]

Perhaps a greater allocation by asset owners to socially responsible funds may result from the EU reforms,[63] but this would likely be incremental. On the pension fund end, a greater allocation would result if advised by investment consultants,[64] but it is unlikely that these agents would take the trailblazing approach of radically changing asset owners' allocations for fear of repercussions in legal risk. For mutual funds, their liquidity needs remain a constraint in relation to considering the integration of sustainability risks, and radical moves away from conventional allocations may be avoided. The collapse in the U.K. of mutual funds managed by Neil Woodford, famous British investor and founder of Woodford Investment Management, would serve as a cautionary tale to many

59. *See generally* Roger M. Barker & Iris H-Y Chiu, *Investment Management and Corporate Governance, in* CORPORATE GOVERNANCE AND INVESTMENT MANAGEMENT, 198–256 (2017).

60. *See generally* Steve Lydenberg & Alexi White, *Responsible Investment Indexes, in* THE ROUTLEDGE HANDBOOK OF RESPONSIBLE INVESTMENT, *supra* note 20, at 527 (providing background on socially responsible index funds).

61. Examples of external providers of 'ESG' ratings include Vigeo-Eiris, and Sustainalytics. Mohamed Chelli & Yves Gendron, *Ratings and the Disciplinary Power of the Ideology of Numbers*, 112 J. BUS. ETHICS 187, 193 (2013). For a critique of sustainability ratings providers, *see generally* Dan Esty & Todd Cort, *The Data Challenges that Remain*, *in* SUSTAINABLE INVESTING: REVOLUTIONS IN THEORY AND PRACTICE 91 (Cary Kronsinsky & Sophie Purdom eds., 2017) (discussing reliability of data, opacity of methodology, etc.).

62. *See* Christin Nitsche & Michael Schröder, *Are SRI Funds Conventional Funds in Disquise or do They Live up to Their Name?*, *in* RESEARCH HANDBOOK OF INVESTING IN THE TRIPLE BOTTOM LINE, 414, 442 (Sabri Boubaker, Douglas Cumming & Duc Khuong Nguyen, eds., 2018) (finding that SRI funds tend to have higher ESG ratings than conventional funds, although the "fund holdings of SRI and non-SRI funds are very similar"). However, commentators also argue that screenings do achieve substantive differences. *See generally* Marco Heimann, Sébastien Pouget, Étienne Mullet & Jean-François Bonnefon, *The Experimental Approach to Trust in Socially Responsible Investment Funds*, *in* FINANCE AND SUSTAINABILITY, *supra* note 1, at 169.

63. Disclosure Regulation, *supra* note 13.

64. *See* DEP'T FOR BUS. INNOVATION & SKILLS and John Morely, *supra* notes 53–54(describing the disintermediated nature of the investment chain, where decision-making in asset allocation is often dependent on third-party advisors).

fund managers, who will remain concerned with liquidity risk while managing new mandates.[65]

Commentators have been skeptical that socially-responsible investing, which is an incremental step from conventional investment management, has structurally changed corporate behavior or achieved substantive sustainable outcomes.[66] Where asset owners invest in passive mandates due to cost-effectiveness and are tied to, for example, the FTSE4Good Index, the allocation of funds is directed at an evaluation outsourced to another entity.[67] Even in active management mandates where fund managers are to pick stocks, empirical research finds heavy reliance by fund managers on indices, as they may not have superior sources of diligence or information.[68] More radical investment strategies, such as shareholder activism by funds or their asset managers in companies so as to improve those companies' sustainable behavior, are relatively more expensive strategies, but are on the rise.[69] Further, fund investment in assets that are directly connected to a sustainable purpose or outcome, such as green and impact bonds, remains a small diversification of conventional portfolios.[70] In other words, the investment management industry responds to rather than shapes corporate responsibility and sustainability in its allocation and pricing roles.

It may be argued that the European Union's reform to introduce a taxonomy of sustainable investments to standardize and improve investment fund labelling

65. *See* Joseph Cordahi, *Woodford saga gives investors a lesson on liquidity risk*, FIN. TIMES (June 30, 2019), https://www.ft.com/content/d4cc5879-4f13-3ef0-8906-bf126bbde4ee [https://perma.cc/9VKT-NJKR] (discussing how Neil Woodford's Equity Income Fund's "assets halve[d] in two years").

66. Beate Sjåfjell, *Achieving Corporate Sustainability: What is the Role of the Shareholder?*, *in* SHAREHOLDERS' DUTIES ch. 18 (Hanne S Birkmose, ed., 2017).

67. *See* Katherina Glac, *The Influence of Shareholders on Corporate Social Responsibility*, 9 ECON., MGMT. & FIN. MKTS. 34, 44–55 (2014) (discussing the history and emergence of SRI's); *see generally* Benjamin Richardson, *Fossil Fuels Divestment: A Strategy for Sustainability? in* SUSTAINABLE TRADE, INVESTMENT AND FINANCE 280 (Clair Gammage & Tonia Novitz eds., 2019) (discussing the emergence of SRI's and divestment from fossil fuels).

68. *See* Xing Chen & Bert Scholtens, *The Urge to Act: A Comparison of Active and Passive Socially Responsible Investment Funds in the United States*, 25 CORP. SOC. RESP. & ENV'T. MGMT. 1, 8–10 (2018) (comparing levels of active management between actively managed SRI's and index funds).

69. Erwin Eding & Bert Scholtens, *Corporate Social Responsibility and Shareholder Proposals*, 24 CORP. SOC. RESP. & ENV'T MGMT. 648, 648 (2017) (finding that shareholders file responsible proposals in companies already doing good, not to change ill-performing ones). Further, many proposals are withdrawn and result in incremental corporate change only. *See generally* Jody Grewal, George Serafeim, & Aaron Yoon, *Shareholder Activism on Sustainability Issues*, (Harv. Bus. Sch., Working Paper No. 17-003, 2016) (analyzing how proposals on material versus immaterial issues are related to firms' subsequent environmental or social performance and market valuation); Giovanna Michelon & Michelle Rodrigue, *Demand for CSR: Insights from Shareholder Proposals,* 35 SOC. & ENVTL. ACCOUNTABILITY J. 157 (2015) (analyzing a study of CSR proposals from 1996-2009). Shareholder activism is however on the rise. *See* Frank AJ Wagemans, CSA (Kris) Van Koppen & Arthur PJ Mol, *Engagement on ESG issues by Dutch Pension Funds: Is It Reaching Its Full Potential?* 8 J. SUSTAINABLE FIN. & INV. 301 (2018); *see also* Frank Jan de Graaf & Matthew Haigh, *Activism in European Pension Funds: Exerting Pressure on Intermediaries*, *in* FINANCE AND SUSTAINABILITY, *supra* note 1, at 119.

70. Emily Chasan, *Bonds to Save the Planet*, BLOOMBERG (April 23, 2019), https://www.bloomberg.com/news/articles/2019-04-23/bonds-to-save-the-planet [https://perma.cc/2UNG-RUK2] ("Green bonds represent just a little more than 1 percent of the $53 trillion global bond market.").

would compel fund managers to connect real sustainable outcomes with investment strategy.[71] This Taxonomy Regulation establishes outcome criteria for evaluating environmentally sustainable investments and classifying them. The taxonomy established by the new regulation relieves asset owners of the need to clarify which environmental sustainability objectives to integrate into their investment management. This reform also provides service providers in the investment chain with yardsticks for evaluating such sustainability. The taxonomy has the potential to cut across the investment chain and reconfigure systems internalities around the prescribed standards. However, the taxonomy can also be mediated by existing systems internalities to result in only incremental changes to investment management practice. Because the outcomes criteria only refer to environmentally sustainable investment labels, fund managers can avoid labelling their products as such if they are unable to meet the evaluative demands with certainty. Instead, they can carry on offering existing socially responsible investment products.[72]

The Taxonomy Regulation provides environmentally sustainable product standardization based on scientifically interrogated outcomes and is arguably a gold standard. It adheres to a market-choice approach rather than a prescriptive approach to product standardization and compliance.[73] Hence fund managers can continue to maintain a suite of diverse and competitive products for asset owners, including products that track sustainable performance based on indices or ESG ratings.[74] Perhaps this is the reason why Securities and Exchange Commission Chairman Jay Clayton cautions reliance on ESG ratings providers,[75] and why the Chairman of the European Securities and Markets Authority opines that ESG ratings providers should be regulated in the EU.[76] The systems internalities of the investment chain accentuate the challenges for each entity in the chain to undertake disruptive change, as these have knock-on effects within the chain. Hence it is likely that the investment chain as a whole would only embrace incremental change. This tendency is also likely to insulate the investment chain,

71. *See generally* Council Regulation 2020/852, art. 7, 2020 O.J. (L198) 13 [hereinafter Sustainable Investment Regualtion] (outlining a classification system of sustainable investment activities).

72. This labelling may be based on negative or positive screening, or best-in-class approaches that may include screening or otherwise. *See* INV. ASS'N, THE RESPONSIBLE INVESTMENT FRAMEWORK (2019), https://www.theia.org/sites/default/files/2019-11/20191118-iaresponsibleinvestmentframework.pdf [https://perma.cc/D9J4-GY7Q] (accommodating a wide range of approaches). The Sustainable Investment Regulation seems to envisage this marketing approach.

73. *See* Sustainable Investment Regulation, *supra* note 71 (allowing financial products to be labelled as not taking into account EU criteria for environmentally sustainable economic activities).

74. Robert G. Eccles, Jock Herron & George Serafeim, *Reliable Sustainability Ratings*, *in* THE ROUTLEDGE HANDBOOK OF RESPONSIBLE INVESTMENT, *supra* note 20, at 620; Robert G. Eccles & Judith C. Stroehle, *Exploring Social Origins in the Construction of ESG Measures* (Saïd Bus. Sch., U. Oxford Job Market Paper, 2019) (accounting for rating provider differences).

75. Chris Flood, *SEC Chair warns of risk tied to ESG ratings*, FIN. TIMES (May 27, 2020), https://www.ft.com/content/2c662135-4fd3-4c1b-9597-2c6f8f17faed [https://perma.cc/M5PH-BS97].

76. Steven Maijoor, Chair, Eur. Sec. & Mkts. Auth., Speech at European Financial Forum: Sustainable Financial Markets: Translating Changing Risks and Investor Preferences into Regulatory Action (Feb. 12, 2020).

focused upon its internal bilateral relationships, from the wider socially embedded objectives that legislation intends to draw attention to.

However, as the Taxonomy Regulation's strength lies in environmentally sustainable investment products, this may have a facilitative impact upon the growing standardization taking place already in green bonds, making them more appealing to conventional funds. For example, the Green Bonds Principles and Climate Bonds Standard have achieved a certain level of standardization for green bonds.[77] This could stimulate a larger market in green bonds and encourage a significant increase in portfolio allocation to them by conventional investment funds.[78] In this manner, green projects such as envisaged under the EU's Green Deal,[79] relating to constructing renewable energy facilities, renewable energy transport infrastructure, and retrofitting existing buildings, can be funded. Nevertheless, it remains to be seen if allocations to green bonds by conventional funds would rise, as this trend is relatively new[80] and it is uncertain if the trend is merely a fad. Further, the lack of similar stimulus for a social impact bond market does not appear to be forthcoming any time soon,[81] but a manner of standardization to facilitate such a market can be developed at a later stage.

IV
SYSTEMS INTERNALITIES AND THE REFORM AGENDA FOR INVESTEE COMPANIES

The current European reform agenda for companies can be traced back to the aftermath of the global financial crisis of 2008–09 that shook society-business relations as well as government-business relations, resulting in regulatory initiatives for companies in relation to a variety of areas of responsibility, from anti-corruption to human rights to environmental impact.[82] These reforms in the EU and U.K., however, center on mandatory disclosure. The EU's 2014 Non-Financial Disclosure Directive introduced the requirement for listed companies

77. *See generally* ICMA, GREEN BOND PRINCIPLES (2018), https://www.icmagroup.org/assets/documents/Regulatory/Green-Bonds/Green-Bonds-Principles-June-2018-270520.pdf [https://perma.cc/WT3J-TWK3]; *Certification under the Climate Bonds Standard*, CLIMATE BONDS INITIATIVE, https://www.climatebonds.net/certification [https://perma.cc/NW4P-HFKC].

78. *See generally* Cristina M. Banahan, *The Bond Villains of Green Investment: Why an Unregulated Securities Market Needs Government to Lay Down the Law*, 43 VT. L. REV. 841 (2019) (arguing for the creation of U.S. Green Standards Committee that would help increase the market for green bonds).

79. *A European Green Deal*, EUROPEAN COMM'N (2019), https://ec.europa.eu/info/strategy/priorities-2019-2024/european-green-deal_en [https://perma.cc/T4MU-C4DD].

80. Although in light of policy drivers, fund flows into 'green' labels have increased significantly from early 2020. Owen Walker, *Low Carbon Fund is Best-Seller in January*, FIN. TIMES (Feb. 21, 2020), https://www.ft.com/content/9dcdfecb-0446-4c06-8021-b80bfd7ffb6d [https://perma.cc/57T7-B95R].

81. Such stimulus could include social impacts such as social cohesion, social integration and labor relations, or an investment in human capital or economically or socially disadvantaged communities, but these are neither fully defined in relation to outcomes, unlike the EU Council Regulation 2020/852, nor exhaustive. The definition however provides a 'floor' that any sustainably labelled product must do no significant harm to enumerated environmental and social objectives above.

82. *See generally* Iris H-Y Chiu, *An Institutional Theory of Corporate Regulation*, 71 CURRENT LEGAL PROBS. 279 (2018) (outlining changes in corporate behavior after the 2007–08 financial crisis).

to report on their policies and performance with regard to environmental, human rights, employee, and anti-corruption aspects, highlighting the need for companies to adopt and disclose due diligence policies and non-financial key performance indicators.[83] This was followed by a slew of other social responsibility-based non-financial disclosure requirements such as EU importers' obligations to disclose and audit due diligence policies in sourcing for tin, tungsten, tantalum and gold from conflict regions,[84] the U.K.'s imposition of supply chain due diligence disclosure on certain private and public organizations under the Modern Slavery Act,[85] disclosure of directors' strategic consideration of stakeholder relations,[86] disclosure of large private companies' corporate governance,[87] pay ratio reporting,[88] gender pay gap reporting[89] and more recently, climate transition risks for listed companies.[90]

Commentators are of the view that mandatory disclosure introduces regulatory conditioning of companies' socially-facing behavior and leads to change from within.[91] But mandatory disclosure, even outside of the realm of securities regulation, such as under the Modern Slavery or Conflict Minerals legislations, operates within the systems internalities of the shareholder-investee company relationship.[92] Shareholders can bring a blend of social and market pressures upon their investee companies,[93] contributing to the remaking of a

---

83. *See* Iris H-Y Chiu, *Disclosure Regulation in Sustainability: Legalisation and Governance Implications*, *in* THE CAMBRIDGE HANDBOOK OF CORPORATE LAW, CORPORATE GOVERNANCE AND SUSTAINABILITY, *supra* note 23, at 523–24 (outlining the 2014 Non-Financial Disclosure Directive).

84. *See generally* Council Regulation (EU) 2017/821, 2017 O.J. (L130) 1.

85. 2015, c. 30, §54 (Eng.).

86. UK Companies Act 2006, c. 4, §414 (Eng.).

87. *Id*. at sched. 7.

88. *Id.* at sched. 8.

89. The Equality Act 2010 (Gender Pay Gap Information) Regulations 2017, SI 2017/172 (UK).

90. The UK Financial Conduct Authority intends to require premium-listed companies to report climate transition risks according to the Task Force on Climate Disclosure's template. TASK FORCE ON CLIMATE-RELATED FIN. DISCLOSURES, RECOMMENDATIONS OF THE TASK FORCE ON CLIMATE-RELATED FINANCIAL DISCLOSURES (June 2017), https://assets.bbhub.io/company/sites/60/2020/10/FINAL-2017-TCFD-Report-11052018.pdf [https://perma.cc/9MVW-JFVS].

91. *See generally* Federica Murmura, Laura Bravi & Federica Palazzi, *Evaluating Companies' Commitment to Corporate Social Responsibility: Perceptions of the SA 8000 Standard*, 164 J. CLEANER PROD. 1406, (2017) (explaining how regulations can create changes from within organizations); Ioannis Ioannou & George Serafeim, *The Consequences of Mandatory Corporate Sustainability Reporting* (Harv. Bus. Sch., Working Paper 11-100, Aug. 20, 2014) (outlining how sustainability reporting influences organizations' behavior).

92. *See generally* Genevieve LeBaron & Andreas Rühmkorf, *Steering CSR Through Home State Regulation: A Comparison of the Impact of the UK Bribery Act and Modern Slavery Act on Global Supply Chain Governance*, 8 GLOB. POL'Y 15 (2017) (discussing the impacts of mandatory reporting on corporate behavior).

93. Many institutions' beneficiaries are socially interested, if not pro-social. *See generally* George Apostolakis et al., *Predicting Pension Beneficiaries' Behaviour When Offered a Socially Responsible and Impact Investment Portfolio*, 8 J. SUSTAINABLE FIN. & INV. 213 (2018); Lei Delsen & Alex Lehr, *Value Matters or Values Matter? An Analysis of Heterogeneity in Preferences for Sustainable Investments*, 9 J. SUSTAINABLE FIN. & INV. 240 (2019). Investors evaluate the sustainable risks and profiles of companies and price stocks accordingly. Pricing pressures, which affect a company's stock price, access to capital, the CEO's remuneration etc., would incentivize changes to corporate behavior. Michael Schröder,

sustainable business model. Indeed, empirical research finds corporate behavior change driven by compliance with regulatory obligations.[94] This may allow us to consider that regulatory obligations such as mandatory disclosure can affect the systems internalities of the shareholder-investee company relationship, framed in an agency-based paradigm, in order to change corporate behavior to an extent.[95]

European policymakers see shareholders' roles as potentially constructive due to their being socially embedded in a landscape of decentered regulation. But some commentators are of the view that the dominant tenet of shareholder primacy in many jurisdictions' corporate law is a primary handicap to companies' social citizenship and to their sustainability goals and the SDGs.[96] Shareholders are ultimately concerned with financial performance and their incentives are insufficient for galvanizing companies to become sustainable enterprises,[97] not to mention that their incentives can be misleading or even perverse.[98] Commentators call for reform to the effect that company directors should have direct duties of sustainability,[99] or enforceable duties owed to stakeholders and supply chains,[100] or that companies should serve corporate purposes that serve

---

Financial Effects of Corporate Social Responsibility: A Literature Review 4 J. SUSTAINABLE FIN. & INV. 337, 339-340 (2018); *but see* Marien de Haan, Lammertjan Dam & Bert Scholtens, *The Drivers of the Relationship Between Corporate Environmental Performance and Stock Market Returns*, 2 J. SUSTAINABLE FIN. & INV. 338 (2012) (finding pricing effects are negligible).

94. Rosa Maria Dangelico & Devashish Pujari, *Mainstreaming Green Product Innovation: Why and How Companies Integrate Environmental Sustainability*, 95 J. BUS. ETHICS 471, 474 (2010).

95. Suggested in. David Wood, Ben Thornley & Katie Grace, 'Institutional Impact Investing: Practice and Policy' (2013) 3 J. SUSTAINABLE FIN. & INV. 75, 82.

96. For case studies on corporate law, corporate governance and sustainability, *see* THE CAMBRIDGE HANDBOOK OF CORPORATE LAW, CORPORATE GOVERNANCE AND SUSTAINABILITY, *supra* note 17, at 129–518. *See also* Griffiths, *supra* note 2.

97. Rajna Gibson Brandon & Philipp Krüger, *The Sustainability Footprint of Institutional Investors*, (ECGI - Finance Working Paper No. 571/2018, 2018), https://ssrn.com/abstract=2918926 [https://perma.cc/7AG6-6AVV]; *see* Heather Hachigian & Sarah M. McGill, *Reframing the Governance Challenge for Sustainable Investment*, (2012) 2 J. SUSTAINABLE FIN. & INV. 166, 169 (explaining that traditional incentives are "no longer adequate to engage with sustainability problems.").

98. *See generally* Reint Gropp & Matthias Köhler, *Bank Owners or Bank Managers: Who is Keen on Risk? Evidence from the Financial Crisis*, (Eur. Bus. Sch., Research Paper No. 10-02, 2010), http://ssrn.com/abstract=1555663 [https://perma.cc/36CY-HFXY] (suggesting shareholders pressure banks into excessive risk-taking before the global financial crisis).

99. Andrew Johnston & Beate Sjåfjell, *The EU's Approach to Environmentally Sustainable Business: Can Disclosure Overcome the Failings of Shareholder Primacy?*, *in* RESEARCH HANDBOOK ON EU ENVIRONMENTAL LAW 405 (Marjan Peeters & Mariolina Eliantonio eds., 2020); *see generally* Thomas Clarke, *The Search for Sustainability in Financial Markets: Carbon Bubbles, Shifting Tectonic Paradigms, and Natural Capital Coalitions*, 10 L. & FIN. MKT. REV. 139 (2016) (discussing the duties of directors in light of threats from climate change). *But see* Florian Moslein & Karsten Engsig Sorensen, *Nudging for Corporate Long-Termism and Sustainability: Regulatory Instruments from a Comparative and Functional Perspective*, 24 COLUM. J. EUR. L. 391 (2018) (describing a more cautious approach to encouraging sustainable practices through regulation).

100. *See generally* Jingchen Zhao, *Extraterritorial Attempts at Addressing Challenges to Corporate Sustainability*, *in* THE CAMBRIDGE HANDBOOK OF CORPORATE LAW, CORPORATE GOVERNANCE AND SUSTAINABILITY, *supra* note 17, at 29–42; Sybren C. de Hoo & Mieke Olaerts, *Sustainable Development and the Need for Sustainable Oriented Corporate Law and Regulation*, (Univ. of Oslo,

multiple stakeholders or are oriented towards global sustainability.[101] These would entail a public interest conception of the company wherein all privately innovated economic activity should be nested within the social fabric or be dominantly shaped by it.

Such reforms purport to radically change the systems internalities revolving around the corporation. However, these are empirically observed to be more complex than being labelled as shareholder-focused or stakeholder-focused. Corporations are at the same time more internally as well as externally shaped in relation to their strategies and behavior than envisaged by those subscribing to shareholder primacy or stakeholder-based theories of the corporation. First, corporations are themselves an internal system of organizational power and knowledge implementation and are not necessarily 'remade' by shareholders or stakeholders. Corporations can be affected by their resource constraints and managerial or structural insularity in taking incremental or even cosmetic responses to sustainability challenges.[102] However, corporations may choose to be strategically innovative and hence have a culture that may internalize new sustainability challenges more positively and effectively.[103] Leadership and key employees matter in the value framing of sustainability,[104] as well as in the structural agility of companies.[105] Further, corporations may be externally influenced by collective stakeholder perceptions,[106] and not just by pressure

---

Faculty of Law Legal Studies Research Paper Series No. 2011-29, 2011), http://ssrn.com/abstract=1926065 [https://perma.cc/2MB4-KNWR].

101. *See generally* RICHARDSON & SJÅFJELL, *supra* note 17.

102. *See generally* Wojciech Przychodzen & Justyna Przychodzen, *Sustainable Innovations in the Corporate Sector: The Empirical Evidence from IBEX 35 Firms*, 172 J. CLEANER PROD. 3557 (2018) (discussing the factors that influence firms' levels of sustainable innovation); *see also* Stefan Schaltegger et al., *Involving Corporate Functions: Who Contributes to Sustainable Development?*, 6 SUSTAINABILITY 3064 (2014) (discussing involvement of different functional groups within corporations and their impacts on sustainable developments).

103. *See generally* Katharina Fellnhofer, *Drivers of Innovation Success in Sustainable Businesses*, 167 J. CLEANER PROD. 1534 (2017) (discussing the impact of entrepreneurial business culture and innovation in sustainable practices); Esben Rahbek et al., *Exploring the Relationship Between Business Model Innovation, Corporate Sustainability, and Organisational Values within the Fashion Industry*, 149 J. BUS. ETHICS 267 (2018) (discussing the impact of organizational values on the development of innovative sustainable practices in the fashion industry).

104. Romana Rauter et al., *Going One's Own Way: Drivers in Developing Business Models for Sustainability*, 140 J. CLEANER PROD. 144, 151 (2017); *see generally* Sandra Naomi Morioka et al., *Transforming Sustainability Challenges into Competitive Advantage: Multiple Case Studies Kaleidoscope Converging into Sustainable Business Models*, 167 J. CLEANER PROD. 723 (2017) (discussing how business purpose and employees' values on sustainability interact); M. Yang et al., *Value Uncaptured Perspective for Sustainable Business Model Innovation*, 140 J. CLEANER PROD. 1794 (2017) (discussing how to incorporate sustainability into value propositions); for the effect of corporate governance, *see also* Paul Shrivastava & Amr Addas, *The Impact of Corporate Governance on Sustainability Performance*, 4 J. SUSTAINABLE FIN. & INV. 21 (2014).

105. Romain Allais, Lionel Roucoules & Tatiana Reyes, *Governance Maturity Grid: A Transition Method for Integrating Sustainability into Companies?*, 140 J. CLEANER PROD. 213 (2017) (discussing how to use maturity grids to help companies transition efficiently to sustainable business models).

106. *See generally* Esben Rahbek et al., *From Resistance to Opportunity-Seeking: Strategic Responses to Institutional Pressures for Corporate Social Responsibility in the Nordic Fashion Industry*, 119 J. BUS. ETHICS 245 (2014) (discussing institutional pressures and their influence on corporate behavior).

applied by particular interest groups, industry trends, and network collaborations, in determining strategic and operational reform to meet sustainability challenges.[107] In other words, those relying on shareholder- or stakeholder-based legal reforms to change corporate behavior see only the agency-based systems internalities that affect corporations, and fail to take into account resource-based and isomorphic views of the systems internalities revolving around them.[108]

It is arguable that legal requirements too heavily presume that law, mobilizing external forces—whether shareholders or stakeholders—would entail causative changes to corporate behavior. This may be the case regardless of whether we are relying on the shareholder-focused mandatory disclosure rules that we hope would change corporate behavior, or the more radical reforms proposed by commentators to expand directors' duties and accountability or stakeholders' roles in corporate governance. Accountability to stakeholders does not mean that companies would adjust their share of carbon emissions or planetary boundary preservation. A complex set of stakeholders could also influence companies to focus on their insular and bilateral demands upon the company, such as in the co-determination context observed by Klaus Hopt.[109] It is a much more complex challenge to connect the systems internalities of corporate structures and culture with public-interest objectives. At the same time, corporate contributions toward or support of public interest goals does not mean the vision or preferences of particular entrepreneurs and the freedom of private enterprise and wealth creation are swallowed up. The EU's mainstreaming agenda in sustainable finance intends to have a massive impact, resulting from the simultaneous reorientation of investors' and their investee companies' prioritization of sustainability objectives. However, due to the interrogation of these reforms within the systems internalities of the institutional investment industry and the corporate sector, these effects are likely to be patchier than envisaged.[110]

---

107. *See generally* Johan Frishammar & Vinit Parida, *Circular Business Model Transformation: A Roadmap for Incumbent Firms*, 61 CAL. MGMT. REV. 5 (2019) (discussing network collaboration by firms in the context of transitions to circular business models); Eva Niesten et al., *Sustainable Collaboration: The Impact of Governance and Institutions on Sustainable Performance*, 155 J. CLEANER PROD. 1 (2017) (explaining how collaboration-based governance strategies can lead to sustainable outcomes); Ronan Bolton & Matthew Hannon, *Governing Sustainability Transitions Through Business Model Innovation: Towards a Systems Understanding*, 45 RES. POL'Y 1742 (2016) (discussing how a systems-based approach to analyzing business models can reveal new insights into improving sustainability).

108. *See* Bryan W. Husted & José Milton de Sousa-Filho, *The Impact of Sustainability Governance, Country Stakeholder Orientation, and Country Risk on Environmental, Social, and Governance Performance*, 155 J. CLEANER PROD. 93, 100 (2017) (finding that collaborative sustainability governance has the greatest impact on ESG performance); *see generally* Robert Sroufe, *Integration and Organizational Change Towards Sustainability*, 162 J. CLEANER PROD. 315 (2017) (arguing for integration and factoring in sustainability metrics as performance metrics).

109. *See* Klaus Hopt, *Labor Representation on Corporate Boards: Impacts and Problems for Corporate Governance and Economic Integration in Europe*, 14 INT'L REV. L. ECON. 203 (1994) (discussing relationship between labor co-determination and corporate governance).

110. *See generally* Karen Delchet-Cochet & Linh Chi Vo, *CSR Implementation in French SMEs: An Adapted Framework*, in RESEARCH HANDBOOK OF INVESTING IN THE TRIPLE BOTTOM LINE, *supra* note 62, at 373 (discussing the implementation of CSR in small and medium-sized enterprises).

V
CONCLUSION

Mobilizing capital markets for sustainable finance products still needs to be connected with achieving overall sustainable goals.[111] This is because sustainable finance does not necessarily remake private economic behavior. Policymakers may need to be more proactive in steering conventional economic behavior as well as promoting alternative forms of economic behavior that are socially oriented. The decentered regulatory space perhaps needs to be re-centered upon regulators and policymakers who can supply steering.[112] For example, should regulators provide more definitive guidance as to the share of burdens or responsibility on private sector entities' part, in relation to hard targets such as the SDGs or planetary boundaries?[113]

One wonders if regulating sustainable finance needs to be more radical, like the remaking of bank regulation after the global financial crisis. Post-crisis reforms included regulatory interventions into bank risk management, corporate governance,[114] individual management responsibility,[115] and financial institution transparency,[116] culminating in new relational paradigms between regulated subjects and their more vigilant regulators.[117] The rebuilding of regulatory systems for finance gave rise to new systems internalities where regulatory supervision and regulatory accountability became focal while interacting with the

---

111. *See* Jay Cullen, *After 'HLEG': EU Banks, Climate Change Abatement and the Precautionary Principle*, 20 CAMBRIDGE Y.B. EUR. LEGAL STUD. 61 (2018) (arguing for further intervention in financial markets to mitigate the uncertain risks of climate change).

112. *See generally* Joern Fischer et al., *Human Behavior and Sustainability*, 10 FRONTIERS ECOLOGY & ENV'T 153 (2012) (arguing for the need for global stewardship for sustainability); ANTONI ESTEVADEORDAL & LOUIS W. GOODMAN, 21ST CENTURY COOPERATION: REGIONAL PUBLIC GOODS, GLOBAL GOVERNANCE, AND SUSTAINABLE DEVELOPMENT (2017) (explaining the importance of regional public goods for sustainable development).

113. *See, e.g.*, Alma Pekmezovic, *Re-Orienting the Global Finanacial System Towards Sustainability*, *in* SUSTAINABLE DEVELOPMENT GOALS, *supra* note 2, at 121, 121–42 (discussing reforms that would steer the financial system toward sustainability goals); Geoff Kendall & Martin Rich, *The Future-Fit Business Benchmark: Flourishing Business in a Truly Sustainable Future*, *in* SUSTAINABLE DEVELOPMENT GOALS, *supra* note 2, at 235, 235–51 (same); *see generally* Christoph Butz et al., *Towards Defining an Environmental Investment Universe Within Planetary Boundaries,* 13 SUSTAINABILITY SCI. 1031 (2018) (discussing a planetary boundaries framework for setting sustainability targets).

114. Council Directive 2013/36, art. 86–90 2013 O.J. (L176) 338, 382–385; *see generally* IRIS H-Y CHIU, REGULATING (FROM) THE INSIDE: THE LEGAL FRAMEWORK FOR INTERNAL CONTROL IN BANKS AND FINANCIAL INSTITUTIONS 256–59 (2015) (discussing corporate governance of financial institutions).

115. *See* IRIS H-Y CHIU & JOANNA WILSON, BANKING LAW AND REGULATION 295 (2019) (discussing the senior managers and certified persons regime under the UK Prudential Regulation Authority Rulebook and Financial Conduct Authority Handbook).

116. *See generally* Iris H-Y Chiu, *Transparency Regulation in Financial Markets- Moving into the Surveillance Age?* 3 EUR. J. RISK & REG. 303 (2011) (discussing transparency regulations that were imposed after the financial crisis).

117. Financial regulators employ more judgment-based regulation, i.e. forward-looking addressing of potential problems, *see* FCA, JOURNEY TO THE FCA (2012), http://www.fsa.gov.uk/static/pubs/other/journey-to-the-fca-standard.pdf [https://perma.cc/T98C-G85D] (explaining the creation and purpose of the UK's Financial Conduct Authority).

systems internalities of finance as private enterprises.[118] Corporations should concurrently be: the private enterprises that create wealth for their circles of stakeholders; the social citizens that contribute to mitigation and abatement of environmental and social harms; and contributors to positive fulfilment of the SDGs. Further, policymakers and regulators should enable and facilitate alternative business forms and fundraising, such as by social enterprises.[119] It is likely that economic contribution to sustainability objectives can be more effectively achieved by a combination of diverse approaches with more deliberate policy leadership.[120]

118. *See generally* MADS ANDENAS & IRIS H-Y CHIU, THE FOUNDATIONS AND FUTURE OF FINANCIAL REGULATION (2014).

119. *See generally* Nicholas E. Florek, *Enabling Social Enterprise Through Regulatory Innovation: A Case Study from the United Kingdom*, 3 J. SUSTAINABLE FIN. & INV. 155 (2013) (discussing how social enterprises obtain their resources); Carol Liao, *Limits to Corporate Reform and Alternative Legal Structures*, *in* COMPANY LAW AND SUSTAINABILITY *supra* note 17, at 274 (discussing the importance of the emerging social enterprise model in sustainability outcomes).

120. *See generally* Halina Ward, *The ISO 26000 International Guidance Standard on Social Responsibility: Implications for Public Policy and Transnational Democracy*, 12 THEORETICAL INQUIRIES L. 665 (2011).