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The growing role of Environmental, Social and Governance (ESG) criteria in investments

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I hereby declare that the work submitted is mine and that where I have made use of another's work, I have attributed the source(s) according to the Regulations set in the Student's Handbook.

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ABSTRACT

Due to the rapid global changes, such as Climate Change and the spread of Covid-19, the issue of sustainability has come to the forefront of interest. Public authorities and financial market participants attempt to contribute to the transition to a more sustainable society. This is a very critical issue that constitutes a priority at an international level. Each country attempts to encourage and motivate companies, institutions and investors to adopt and apply new methods. One of these methods is the adoption of ESG criteria. The term ESG refers to criteria that are linked to environmental, social and governance issues. These non-economical elements are crucially contributing not only to the company's profitability but also to its future existence. Nowadays, the protection of the environment, human rights, and ethical values attract the interest of the public. So there is an idea under which sustainability is linked not only with the operation of a company but also with its success and profitability. It is considered that a company that has adopted ESG criteria will have high returns and will be more resilient to radical changes.

The main aim of this dissertation is to introduce the ESG criteria and products, as well as the legal framework under which the issues of ESG are settled. The dissertation is organized into four chapters excluding the conclusion. In the first chapter, the history of ESG is included, as well as historical facts that were important for the genesis of the ESG term. The second chapter provides an analytical review of the ESG criteria and their products. There is a clear separation in the term E, S, and G in order to be fully understood. Then, there is a detailed reference to ESG financial products, which focuses mainly on green bonds and their framework. Additionally, in the third chapter, the advantages and disadvantages of the ESG are listed. In the fourth chapter, the legal framework that regulates ESG issues and prevents also greenwashing is mentioned. The overview of the legislation focuses on the EU level. Firstly, the Taxonomy Regulation (EU Reg*. 2020/852)* is referred under which the investors can understand if an economic activity is substantial or not. Then, an analysis of the Sustainable Finance Disclosure Regulation (EU Reg*. 2019/2088*) is made. It gives attention to the classification of financial products to grey and green. After this, the regulation (EU) 2019/2089 under which the benchmark regulation (EU) 2016/1011 (BMR)

is amended, is also mentioned. Finally, a conclusion based on the four previous chapters is made.

CONTENTS

INTRODUCTION

One of the greatest challenges that humanity faces is climate change and the urgent need for global warming to be reduced to 1.5 degrees Celsius. However, in 2020, the spread of Coronavirus (COVID-19) caused additional problems that need to be addressed. Besides the important health issue, the pandemic has also led to the increase of the challenges that the financial world should manage. More specifically, investors have more problems to deal with, as COVID-19 has affected costs and prices, and generally has created great volatility in the market. Furthermore, many businesses filed for bankruptcy and investors have suffered losses. A great example of the fluctuation of financial instruments is the CSI300[1] which is a benchmark that tracks the performance of the top 300 shares on the Shanghai and Shenzhen Stock Exchanges[2].

China's stock markets closed for the Chinese New Year shortly after the initial lockdown (on January 23, 2020). The CSI300 index dropped dramatically from 5,200 to 4,800 once the capital systems reopened on February 3. Markets quickly recovered, and for the rest of February, the stock hovered around 5,000 points. COVID-19 did, however, become a global pandemic in March and as a result, global markets plummeted, and the CSI300 index had sunk to 4,600 points.

So this pandemic was a brutal reminder that market participants must work for the sake of the planet and not solely for economical purposes. Covid-19 has shown the importance of ESG criteria through which a company can enhance not only its sustainability method but also its resilience against critical changes. As consequence, the interest of investors in ESG has been increased due to the social pressure towards companies to protect the environment and society, and also due to the general idea that the adoption of ESG criteria can increase the value of a company.

[1] Ζοπουνίδης, Κ. και Εσκαντάρ, Μ.,(2021). Ο ρόλος της επίδοσης ESG σε περιόδους οικονομικής κρίσης. [online] Οικονομικός Ταχυδρόμος - ot.gr. Available at: https://www.ot.gr/2021/04/20/apopseis/experts/o-rolos-tis-epidosis-esg-se-periodous-oikonomikiskrisis-stoixeia-apo-tin-covid-19-stin-kina/

[2] CSI 300 Index (n.d) Wikipedia. Available at: https://en.wikipedia.org/wiki/CSI_300_Index

All the above have led to the extensive use of ESG. The idea that environmental, social, and governance factors can bring monetary benefits, and at the same time, assist in mitigating the financial losses, contributes to the increasing promotion of ESG.

1. HISTORY OF ESG

Nowadays, the rapid increase of ESG criteria has been observed in many investments, particularly after the spread of COVID-19. More and more organizations, but also individual investors, are moving towards using ESG criteria to make an investment or to grant a loan. So the question that always comes up is when and where it all started.

The first reference to ESG was made in 2005[3] through a detailed Report called "Who Cares Wins" (2005). The Report was yielded by a joint initiative under the UN Global Compact[4] with the International Finance Corporation (IFC)[5] and the Swiss government.[6] However, before this event, there are other historical events that are worth to be addressed.

Back in the 1960s[7], investors excluded from their portfolios financial products that conflicted with certain moral and ethical values and beliefs. Many boycotted and protested against activities that weren't respectful to the environment and the health of citizens or weren't socially accepted. For instance, investors excluded from their portfolios products and industries that were related to the tobacco industry or the apartheid regime.

In 1970s[8] many investors as mentioned above, excluded from their portfolios, financial products related to the apartheid regime in South Africa. As an answer to all anti-apartheid protests, the Reverend Leon Sullivan who was a member of General Motors' Board in the United States, created a Code of Conduct (known as the Sullivan

[3] Kell, G. (2018) The Remarkable Rise Of ESG. [online] Forbes. Available at: https://www..com/sites/georgkell/2018/07/11/the-remarkable-rise-of-esg/?sh=387a86ba1695

[4] According to Wikipedia the United National Global Compact was formed in 2000 and it is a "non-binding United Nations pact to encourage businesses and firms worldwide to adopt sustainable and socially responsible policies and to report on their implementation".

[5] According to Wikipedia IFC is an international financial organization and a part of World Bank Group that provides financial advices and services to governments and enterprises in order to boost economy in developing countries.

[6] Ganapathi, L., (2021). ESG – A Good Deed With An Incentive To Scam [online] IFC Review. Available at: https://www.ifcreview.com/articles/2021/december/esg-a-good-deed-with-an-incentive-to-scam/].

[7] *The Evolution of ESG Investing*(n.d) [online] Msci.com. Available at: https://www.msci.com/esg-101-what-is-esg/evolution-of-esg-investing

[8] Environmental, social and corporate governance (n.d) Wikipedia. [online] Available at: https://en.wikipedia.org/wiki/Environmental,_social_and_corporate_governance.

Principles) in 1971 in order to persuaded American companies in Africa to oppose against the country's apartheid policies. In addition, during that decade Milton Friedman[9] supported that social responsibility had a detrimental impact on the profitability of a company. He claimed that the corporate assets belonged only to the shareholders and that’s why the main goal of the management board had to be the increase of shareholder value (high returns). This approach is better known as the ‘Friedman doctrine[10]’. However, this doctrine had gained an opponent in 1988 when James S. Coleman coined the phrase "social capital", which is based on relationships among all those who have an interest in the company.

Moreover, in 1992 the United Nations Framework Convention on Climate Change (UNFCCC)[11] [12] was signed. It was the first global measure that attempted to settle the important problem of Climate Change. It enforced all the parties to initiate national programs to decrease greenhouse gas (GHG) emissions. The Convention entered into force in 1994. But this wasn’t enough. So, the UNFCCC's signatories also signed the Kyoto Protocol in 1997, which got into effect in 2005.

One of the most important facts that are highly linked with the ESG is the adoption of the *2030 Agenda for Sustainable Development*[13] on 25 September 2015. Through this Agenda United Nations (UN) established Sustainable Development Goals (SDGs). A collection of 17 interlinked global goals which expressed the current global challenges, in order to provide all countries with an effective response to global problems. The UN claimed that these goals were created as a blueprint to achieve a more sustainable society for everyone. These SDGs, which include aims, such as no poverty, zero hunger, industry innovation, etc., are set to be achieved in 2030. They are typically used to serve ESG investment frameworks.

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[9] Environmental, social and corporate governance (n.d) Wikipedia. [online] Available at: https://en.wikipedia.org/wiki/Environmental,_social_and_corporate_governance.

[10] Friedman doctrine (n.d) Wikipedia[online]. Available at: https://en.wikipedia.org/wiki/Friedman_doctrine

[11] Barnes, K.(2021) ESG Timeline: A History of Environmental, Social & Governance Programs. [online] sgENGAGE. Available at: https://npengage.com/companies/esg-history/

[12] United Nations Framework Convention on Climate Change.(n.d) ,[online]wikipedia. Available at: https://en.wikipedia.org/wiki/United_Nations_Framework_Convention_on_Climate_Change

[13] Christino, C. (2021)“ESG: the new paradigm for business – Timeline”. ExcellenceBlog. Available at:https://blog.softexpert.com/en/esg-timeline/

Furthermore, on 12 December 2015, the *Paris Agreement*[14] was adopted. The Paris Agreement is essentially an international action plan to reduce global warming, and consequently the greenhouse effect. It is an international legally binding treaty which was signed by 196 countries and was ratified by the European Union on 4 October 2016. This treaty got into effect on 4 November 2016. It intends to keep the increase of Earth's average temperature to below 2°C and aspires to limit it to 1, 5°C in comparison to pre-industrial levels (art.2). Each country committed to reducing their emissions and starting to collaborate, if it is needed, in order to deal with the impacts of Climate Change. This agreement also includes a five-year review under which the signatory countries shall communicate every five years (art.4) starting from 2018 and forward. This strengthens the transparency of the whole agreement because every five years everything that has been achieved by each country will be assessed; and also every time, the future targets and the potential need for further proposed measures will be examined. The agreement also provides a framework under which the efforts of the countries to manage the issues of climate change will be strengthened.

Afterward, Jean-Claude Juncker presented in March 2017 a White Paper[15] before the European Parliament that included mainly 5 proposals on what Europe should do after the Brexit. Based on the debate triggered by the above-mentioned White Paper on the future of the EU, the Commission published the Sustainable Development Report[16] in 2019 which aimed to stimulate a discussion on how the EU intends to fulfill the sustainable development goals (SDGs) by 2030.

Finally, another strategy of the European Commission that runs in parallel with the Paris Agreement and the 2030 Agenda is the European Green Deal[17][18] which was

[14] Unfccc.int. (n.d.) [online] Available at: https://unfccc.int/process-and-meetings/the-paris-agreement/the-paris-agreement

[15] European Commission (2017) White Paper on the future of Europe (COM 2017/2025 final). Available at: https://eur-lex.europa.eu/legal-content/EN/TXT/?uri=COM:2017:2025:FIN

[16] European Commission(2019) Reflection paper. Towards a Sustainable Europe by 2030 (COM 2019/22 final). Available at: https://ec.europa.eu/info/publications/reflection-paper-towards-sustainable-europe-2030_en

[17] Green Deal (n.d),Wikipedia [online] Available at: https://en.wikipedia.org/wiki/European_Green_Deal.

[18] European Commission (2019) Communication from the Commission:The European Green Deal (COM/2019/640 final). Available at: https://eur-lex.europa.eu/legal-content/EN/TXT/?uri=COM%3A2019%3A640%3AFIN

presented on 11 December 2019 and aims to make Europe the '*first climate-neutral continent*'[19]. The European Commission has planned to cut GHG emissions by 55% (compared to 1990) by 2030.

[19] European Commission(n.d) A European Green Deal. Available at: https://ec.europa.eu/info/strategy/priorities-2019-2024/european-green-deal_en

2. DEFINITION OF ESG

The term "ESG" refers to Environment, Society and Governance. These three criteria can affect a company's long-term ability to generate value. Using these criteria[20], investors and financial institutions, such as banks, can assess a company's financial performance and evaluate its credibility and sustainability in order to make an investment or grant a loan. So, a company's good performance in environmental, social, and corporate governance areas can lead to a development of its financial results through which many investors will be attracted and banks will grand loans for future investments. The market participants[21], who use ESG, are able to determine how resilient and ready a company is to cope with changes in its own environment. So the investments based on ESG criteria have a double meaning[22]. This type of investment can offer investors profitability while allowing them to contribute to sustainable development and to raise awareness of the key areas that affect this development. By adopting these criteria, market participants prove in practice their responsibility towards the environment, society and corporate governance.

2.1 DEFINITION OF 'E', 'S' AND 'G'

The above mentioned three (3) areas are the main pillars of ESG. More specifically:

1. *The Environmental Pillar:*

The environmental criteria examine how a company operates directly or indirectly concerning nature. The investors and the financial institutions take into account issues[23] related to the environment, living and non-living natural systems, such as the soil, the air, the water, and the ecosystems in general.

The environmental criteria can refer[24] to various factors such as hazardous waste, air and water pollution, energy consumption, emission of greenhouse gases, Carbon footprint, and generally the respect for the environment. These criteria are also used

[20] Αυλωνάς, Ν., (2021) Τα κριτήρια ESG και ο ρόλος του οικονομικού διευθυντή | Η ΚΑΘΗΜΕΡΙΝΗ. [online] Kathimerini.gr. Available at: https://www.kathimerini.gr/economy/561486268/ta-kritiria-esg-kai-o-rolos-toy-oikonomikoy-dieythynti-k

[21] ESG Reporting Guide 2019.(2019) [ebook] Athens Stock Exchange, p.12. Available at: https://www.athexgroup.gr/web/guest/esg-reporting-guide

[22] Eurobankam.gr. n.d. Επενδυτική Φιλοσοφία ESG. [online] Available at: http://www.eurobankam.gr/el/esg

[23] ESG Reporting Guide 2019.(2019) [ebook] Athens Stock Exchange, p.11. Available at: https://www.athexgroup.gr/web/guest/esg-reporting-guide.

[24] Environmental, Social, & Governance (ESG) Criteria Definition.(2021) [online] Investopedia. Available at: https://www.investopedia.com/terms/e/environmental-social-and-governance-esg-criteria.asp.

to assess a company's actions and manage its risks. For instance, a company may have various issues in relation to the environment that affect its operations i.e. the company may not comply with the environmental laws or it may dispose toxic waste, which would probably end up in the ground, the water, or the air.

The adoption of the '2030 Agenda' facilitates also the above attempt to define the environmental aspect of ESG (non-exhaustive). One dimension of 'The Agenda 2030' is the protection of the environment. According to article 9 of the EU Reg*. 2020/852,* the environmental objectives of the Reg. are *"the climate change mitigation, the climate change adaptation, the sustainable use and protection of water and marine resources, the transition to a circular economy, the pollution prevention and control and the protection and restoration of biodiversity and ecosystems."* So in order to achieve the above goals, companies adopt environmental strategies and practices. These practices[25] are not only related to the production process but also to the final product or the service. In this way, the companies guarantee the environmental quality and credibility of their products, or services through the dissemination of adequate information

Furthermore, in order to inform Greek companies about ESG, the Athens Stock Exchange issued in 2019 an ESG Reporting Guide, which is mainly directed[26] towards the issuers listed on the Athens Stock Exchange, but it also can provide useful information to any other Greek company wishing to adopt the environmental practices that were being published in the Guide. According to this ESG Reporting Guide, there are specific ESG indicators ("metric structure")[27] that evaluate broad and more specific environmental issues, such as direct greenhouse gas emissions, indirect emissions, energy consumption within the organization, etc.[28]

[25]Orsato R.J.(2003) "Competitive environmental strategies: when does it pay to be green?"California Management Review.

[26]ESG Reporting Guide 2019.(2019) [ebook] Athens Stock Exchange, p.10. Available at: https://www.athexgroup.gr/web/guest/esg-reporting-guide

[27] The metric structure comprises of economy-wide and sector-specific metrics. Economy wide metrics are divided into Core and Advanced metrics. The *core metrics* are the metrics that all companies are advised to report on. Also, the *Advanced metrics* are the metrics that focus on advanced ESG performance. Finally, the *sector-specific metrics* are the metrics that are specifically created for each of the industry sectors represented in the Athens Stock Exchange.

[28] ESG Reporting Guide 2019.(2019) [ebook] Athens Stock Exchange, p.22-23 Available at: https://www.athexgroup.gr/web/guest/esg-reporting-guide

2. *Social pillar:*

An organization, besides the high financial performance that desires to succeed every year, also aims to stable and successful working relationships. The phrase "working relationships", includes two aspects. On the one hand, it has to do with the relationships that the organization has with its employees, and on the other hand with the relationships that have been developed between a company and its customers, suppliers, investors, etc.

The social aspect of ESG refers to social responsibility[29] and the non-monetary goals that a company desires to succeed. The social responsibility, according to the 'GREEN PAPER: Promoting a European framework for Corporate Social Responsibility', is defined as *"a concept whereby companies integrate social and environmental concerns in their business operations and in their interaction with their stakeholders on a voluntary basis"*. To put it another way, if a company wants to be social responsible, should not only comply with its own legal and financial obligations, but it also has to create and strengthen the relationships with its stakeholders[30]. Moreover, as the saying goes '*happy workers are productive workers*'. Of course, this doesn't mean that an employee has to be happy to be productive, but nevertheless, if an employee works in a healthy environment without pressure and exhaustive deadlines, he or she will probably perform the assigned task better than usually. So with strong and solid relations between the stakeholders, the organization will potentially have better results in its productivity.

However, social responsibility is not obligatory. The organizations (mainly multinational enterprises) have decided to be social responsible over the years. So the corporate social responsibility shouldn't be mixed up with the obligatory-to-all legislation! There should be a common framework for all kinds of enterprises (SMEs, MNEs etc.), in order for the enterprises to be more productive, while there will not be double standards.

[29] Halbritter, G., & Dorfleitner, G.(2015) The wages of social responsibility — where are they? A critical review of ESG investing. Review of Financial Economics,p.26.

[30] European Commission (2019) Green Paper on Promoting a European framework for Corporate Social Responsibility (COM2001/366/1). Available at: https://ec.europa.eu/commission/presscorner/detail/en/DOC_01_9

In an enterprise, the practices for the corporate social responsibility are concerning[31] both the employees (internal dimension) and the wider part of local society (external dimension) which includes not only the clients/customers but also suppliers, shareholders, creditors, public authorities, and non-profit organizations. Regarding the internal dimension[32], it includes for example Human resources management and Health and safety at work, while the external includes[33] i.e. Protection of Consumers, Sponsoring[34] and Fair competition.

To sum up, the "S" in the ESG promotes business ethics[35], trust, confidence and good cooperation between an enterprise and its stakeholders. So the term social responsible investment refers to the social criteria of ESG that, as they mentioned above, have no monetary aspects. The social criteria have to do only with the relations that the enterprise has developed in and out of it.

Finally, it is worth to mention a few of the social criteria of ESG regarding the listed companies on the Athens Stock Exchange[36] i.e. female employees, human rights policy, Customer privacy, labour law violations, ESG integration in business activity etc.

3. *Governance Pillar:*

The Organisation for Economic Co-operation and Development (OECD[37]) defines the term Corporate Governance as "*the methods and procedures by which an organization is directed and controlled"*. It is a system[38] of policies and strategies that refers

[31] European Commission (2019) Green Paper on Promoting a European framework for Corporate Social Responsibility (COM2001/366/1). Available at:
https://ec.europa.eu/commission/presscorner/detail/en/DOC_01_9

[32] European Commission (2019) Green Paper on Promoting a European framework for Corporate Social Responsibility (COM2001/366/1)p. 8-12 Available at:
https://ec.europa.eu/commission/presscorner/detail/en/DOC_01_9

[33] European Commission (2019) Green Paper on Promoting a European framework for Corporate Social Responsibility (COM2001/366/1)p. 13-18. Available at:
https://ec.europa.eu/commission/presscorner/detail/en/DOC_01_9

[34] What is corporate social responsibility (CSR)?(2019) IONOS Startupguide. [online] Available at:
https://www.ionos.com/startupguide/grow-your-business/corporate-social-responsibility/

[35] Acting ethically means going above and beyond the legal requirements and meeting the expectations of society.

[36] ESG Reporting Guide 2019. (2019) [ebook] Athens Stock Exchange, p.21-51. Available at:
https://www.athexgroup.gr/web/guest/esg-reporting-guide

[37] OECD is a group of 37 member countries that discuss and develop economic and social policy. OECD members are typically democratic countries that support free-market economies.

[38] Chen, J. (2021). Corporate Governance. [online] Investopedia. Available at:
https://www.investopedia.com/terms/c/corporategovernance.asp.

to the operation and the administration of the organization, while at the same time it contributes to assure the interests of the stakeholders. This system specifies the rights and the obligations of all those who are associated with the organization, such as customers, suppliers, shareholders, CEO, board of managers, etc.

In addition to the above definition, the OECD gives a more specific definition[39] as "*a set of relationships between a company's management, its board, its shareholders and other stakeholders. In other words, the Corporate Governance provides the structure through which the objectives of the organization are set*". An Effective Governance should provide motives to the Board of managers in order to lead the board to achieve the goals. These goals will be beneficial to the whole organization and the stakeholders. At the same time, not only the Board of Managers but also the CEO, should align their personal interests with the collective interest of the organization. This way, faith and trust will prevail between the stakeholders, and due to the assurance of transparency the value of the business will be increased.

The main object of Corporate Governance is to increase the value of the enterprise through the development of production, while it attempts to create an environment of confidence, transparency, and integrity. A few of its goals[40] are the discipline, transparency, independence, accountability, responsibility and impartiality that are going to be achieved through the formal adoption of policies. At this point, it is worthwhile mentioning that each organization has its own policy. For instance one enterprise gives the right to vote to all of its shareholders, but another enterprise gives this right only to the shareholders who own more than 30%.

Finally, the listed companies on the Athens Stock Exchange are being assessed in accordance with indicators[41] such as the sustainability oversight, business ethics policy, data security policy, materiality, whistleblower policy, etc.

[39] Organisation For Economic Co-Operation And Development (2004). OECD principles of corporate governance. Paris: Oecd. Available at: https://www.oecd.org/corporate/ca/corporategovernanceprinciples/31557724.pdf

[40] Λαζαρίδης, Θ. και Δρυμπέτας, Ε. (2011). Εταιρική Διακυβέρνηση. Θεσσαλονίκη: Εκδόσεις Σοφία.

[41] 2019. ESG Reporting Guide 2019. [ebook] Athens Stock Exchange, p.21-54. Available at: https://www.athexgroup.gr/web/guest/esg-reporting-guide

2.2. FINANCIAL PRODUCTS

With the daily rise of ESG investing, many firms, organizations, and even governments, use or contribute to the dissemination of financial products that aims to promote ESG. These products, better known as green assets, include (non-exhaustive list):

i. Green Bonds

In the last few years, the green bonds are becoming surprisingly increased. According to the Climate Bonds Initiative, the green, social, sustainability, SLB, and transition bonds have shown a 59% increase regarding 2020; and they seem to increase up to 25% throughout 2022[42].

Green bonds[43] are a relatively new form of investment, and are used to fund projects that will benefit the environment and climate change. So this kind of bonds operates like a regular bond with the difference that the issuers ensure that the bond proceeds are used for green projects. Green bonds are issued by firms, organizations (e.g. Japan finance Organization for municipalities), financial institutions (e.g. European Investment Bank), and governments. Additionally, according to the International Capital Market Association and its Green Bond Principles (GBP), *"Green Bonds are any type of bond instrument where the proceeds or an equivalent amount will be exclusively applied to finance or re-finance, in part or in full, new and/or existing eligible Green Projects[44]".* This definition is the most widely accepted but still, there are countries that do not accept this definition, and have developed their own principles for green bonds by using as a basis the GBP.

Furthermore, according to the Climate Bonds Initiative, there are many types of green bonds[45] including (not exhaustive list):

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[42] Climate Bonds Initiative.(n.d.) Green bonds market on track for a record half trillion year: USD496.1bn issued across all sustainable debt labels in H1 2021 as markets surge. [online] Available at: https://www.climatebonds.net/resources/press-releases/2021/08/green-bonds-market-track-record-half-trillion-year-usd4961bn-issued

[43] Segal, T. (2021) Green Bond. [online] Investopedia. Available at: https://www.investopedia.com/terms/g/green-bond.asp.

[44] ICMA (June 2021), Green Bond Principles. P.3, available at: https://www.icmagroup.org/sustainable-finance/the-principles-guidelines-and-handbooks/green-bond-principles-gbp/

[45] Trompeter, L.(2017) "Green Is Good: How Green Bonds Cultivated into Wall Street's Environmental Paradox," Sustainable Development Law & Policy: Vol. 17 : Iss. 2 , Article 3. Available at: http://digitalcommons.wcl.american.edu/sdlp/vol17/iss2/3

1. *"Use of Proceeds" Bond.* This bond is similar to traditional bond where the issuers must repay the investor an exact amount that was given plus interest through the proceeds of the investment project.
2. *"Use of Proceeds" Revenue Bond.* In this type of bond, the issuer repays the investor through revenue streams i.e taxes and fees.
3. *Project Bond.* In this category, the debt is backed only by the project's assets and the balance sheet. The investor in this case faces a direct exposure to the risk.
4. *Securitisation (ABS) Bond.* In this case, the debt may be backed by pools of green projects such as solar leaser or green mortgages. In simple terms, this bond is used as collateral.

Types of green bonds

Type	Proceeds raised by bond sale are	Debt recourse	Example
"Use of Proceeds" Bond	Earmarked for green projects	Recourse to the issuer: same credit rating applies as issuer's other bonds	EIB "Climate Awareness Bond" (backed by EIB); Barclays Green Bond
"Use of Proceeds" Revenue Bond or ABS	Earmarked for or refinances green projects	Revenue streams from the issuers though fees, taxes etc are collateral for the debt	Hawaii State (backed by fee on electricity bills of the state utilities)
Project Bond	Ring-fenced for the specific underlying green project(s)	Recourse is only to the project's assets and balance sheet	Invenergy Wind Farm (backed by Invenergy Campo Palomas wind farm)
Securitisation (ABS) Bond	Refinance portfolios of green projects or proceeds are earmarked for green projects	Recourse is to a group of projects that have been grouped together (e.g. solar leases or green mortgages)	Tesla Energy (backed by residential solar leases); Obvion (backed by green mortgages)
Covered Bond	Earmarked for eligible projects included in the covered pool	Recourse to the issuer and, if the issuer is unable to repay the bond, to the covered pool	Berlin Hyp green Pfandbrief; Sparebank 1 Bolligkredit green covered bond
Loan	Earmarked for eligible projects or secured on eligible assets	Full recourse to the borrower(s) in the case of unsecured loans. Recourse to the collateral in the case of secured loans, but may also feature limited recourse to the borrower(s).	MEP Werke, Ivanhoe Cambridge and Natixis Assurances (DUO), OVG
Other debt instruments	Earmarked for eligible projects		Convertible Bonds or Notes, Schuldschein, Commercial Paper, Sukuk, Debentures

Picture (1): Types of green bonds (Source: https://www.climatebonds.net/)

The important role of green bonds in financial markets is proven by the attempts to regulate them. So the most known framework is *"The Green Bond Principles (GBP)".* These principles[46] are a set of voluntary global guidelines that were published by the International Capital Market Association (ICMA)[47] in order to promote accuracy,

[46]ICMA (June 2021), Green Bond Principles, available at: https://www.icmagroup.org/sustainable-finance/the-principles-guidelines-and-handbooks/green-bond-principles-gbp/

[47] According to ICMA site , ICMA is an association of almost 600 participants located in 62 countries among Zurich, London, Paris and Hong Kong. It aims to promote high standards of market practice, appropriate regulation, trade support, education and communication

transparency, and integrity in the green bond market when the issuers disclose information about the green investment.

GBP refers not only to EU issuers but also to non-EU issuers[48]. The issuers of green bonds shall be any kind of company, no matter its business model, on the condition that they fund '*eligible green projects*'[49] (Substantial contribution to environmental objectives, do not harm, social safeguards and technical screening criteria[50]). So, according to ICMA, a green bond is a bond which is used to fund environmental and sustainable projects and is also aligned with the 4 core components[51] that are set out in GBP:

- Use of proceeds

This refers to the definition of '*eligible green projects*'. In simple terms concerns the type of projects that are funded by the money that has been raised due to the bond. The projects should contribute to environmental objectives such as renewable energy, buildings, pollution control, waste and water management, transport, etc.

These principles do not define what a green project is but allow the issuers to decide what their definition of green is. So the investors should decide if they agree or not with the definition of green that is given by each issuer.

- Process for Project Evaluation and Selection

The issuer needs to provide to the investors, information about the objectives of the project, the criteria under which the projects were selected and evaluated, and the process through which the projects will achieve the environmental targets. Simply

[48] EU Technical Expert Group on Sustainable Finance(2020) Proposal for an EU Green Bond Standard.p 28-29.
Available at:
https://ec.europa.eu/info/sites/default/files/business_economy_euro/banking_and_finance/documents/200309-sustainable-finance-teg-green-bond-standard-usability-guide_en.pdf

[49] EU Technical Expert Group on Sustainable Finance(2020) Proposal for an EU Green Bond Standard.p 27-28.
Available at:
https://ec.europa.eu/info/sites/default/files/business_economy_euro/banking_and_finance/documents/200309-sustainable-finance-teg-green-bond-standard-usability-guide_en.pdf

[50] See below in Taxonomy Regulation

[51] ICMA (June 2021), Green Bond Principles,p. 4-6 available at:
https://www.icmagroup.org/sustainable-finance/the-principles-guidelines-and-handbooks/green-bond-principles-gbp/

put, the process is there to assure that the selected project meets the requirements under the definition of green.

- Management of Proceeds

The profits of Green Bonds should be verified and tracked through a suitable process. The money should be earmarked, or at least be traceable in order not to be mixed up with other money from other sources.

- Reporting

The major goal of this component is transparency towards investors and the market. The issuer provides information about the type of projects that the green bond is funding, and the benefits that may be achieved. The issuer should keep up-to-date the information on the proceeds and renew it at least once a year. At this point, it is worthwhile to mention that many times, investors may request a more comprehensive description of the results of the projects. This is called Impact reporting and exceeds the minimum requirements of GBP

In addition to the above 4 core components, the ICMA adds a fifth element that is not considered as a core component but as a recommendation. This is the external review[52]. It is an independent external evaluation. Issuers should appoint an external party to evaluate the environmental features and objectives of the projects. In simple terms, the third party will assess and verify whether the selected project is aligned with sustainability.

Besides GBP, there is another attempt to regulate green bonds through European Union. On 6 July 2021, the European Commission published its proposal for a framework on the *"European Green Bond Standard" (EUGBS),* in order to create a uniform 'tool" for green bonds either globally or within Europe[53]. So it should apply to EU and non-EU issuers regardless of the main activity of the company, on the condition that the green bonds fund '*eligible green projects*'. Furthermore, the

[52] ICMA (June 2021), Green Bond Principles,p.7 available at: https://www.icmagroup.org/sustainable-finance/the-principles-guidelines-and-handbooks/green-bond-principles-gbp/

[53] EU Technical Expert Group on Sustainable Finance(2020) Proposal for an EU Green Bond Standard Available at: https://ec.europa.eu/info/sites/default/files/business_economy_euro/banking_and_finance/documents/200309-sustainable-finance-teg-green-bond-standard-usability-guide_en.pdf

EUGBS[54] is a voluntary standard which aims to promote transparency and comparability of these bonds towards the market participants. Despite its voluntary aspect, the investors or the issuers who will decide to rely on this standard have to follow and comply with all the necessary requirements that are set in the EUGBS. The proposed framework set 4 key requirements[55]:

- Taxonomy-alignment

The use of proceeds must be aligned with the Taxonomy Regulation[56]

- Transparency

Transparency will be achieved through detailed reports. The issuer has to explain the objectives which need to be achieved, as well as the relationship between the bonds and the strategy through which the issuer will achieve the preferable objectives. So under this requirement, the issuers must fill out many documents such as allocation and impact reports. The allocation report refers to where the money of the bond is going to be used, where it actually was spent, and what was the impact.

- External review

These reviews take place to evaluate if the bonds meet the standard requirements. The external reviewers need to be accredited or registered within Europe and supervised by ESMA, and then they can verify the reporting.

- Supervision by the European Securities Markets Authority (ESMA) of reviewers.

Currently, the reviewers do not have supervision. So as an alternative they can be supervised by local supervisors, but still, this will not solve the problem of the harmonization that the EUGBS attempts to achieve.

ii. Social Bonds[57]

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[54] Ammann, J. (2021). EU launches world's largest green bond issuance to date. [online] euractiv.Available at: https://www.euractiv.com/section/economy-jobs/news/eu-launches-worlds-largest-green-bond-issuance-to-date/

[55] EU Technical Expert Group on Sustainable Finance(2020) Proposal for an EU Green Bond Standard. Available at: https://ec.europa.eu/info/sites/default/files/business_economy_euro/banking_and_finance/documents/200309-sustainable-finance-teg-green-bond-standard-usability-guide_en.pdf

[56] See below

[57] ICMA (June 2021), Social Bond Principles , available at: https://www.icmagroup.org/assets/documents/Sustainable-finance/2021-updates/Social-Bond-Principles-June-2021-140621.pdf

The proceeds of these bonds are going to finance solely social projects, such as greater access to education and healthcare, affordable housing or clean drinking water. The ICMA released the Social Bond Principles, a set of voluntary guidelines that promote the same values as the GBP.

iii. Sustainability linked Bonds(SLBs)[58]

It is a financial tool that relates to the future performance of each issuer. Unlike the connection of green bonds proceeds to a specific green project, the SLB is not bound to finance specific projects. The proceeds of it can be used in broader areas of sustainable development. For instance, they can monitor specific indicators throughout a company's business plan, such as reducing carbon dioxide emissions. Also, the issuers are explicitly bound (e.g. in documents related to the issuance of bonds) to improve their sustainability performance within a predetermined time. Finally, the International Capital Market Association has also released the Sustainability-Linked Bond Principles.

iv. Exchange-Traded Funds (ETFs)[59]

Like every other fund, ETFs pull together money from investors into a portfolio of different investments, such as bonds, shares etc. By spreading the funds' money into different securities, ETFs can generally provide the investor with diversification that can balance the risk. Moreover, there are different types of ETFs like index, commodities, stocks etc. The BlackRock and Vaneck along with other global investment managers-firms, manage ETFs that focus on ESG. The BlackRock has also introduced ESG screened ETFs[60] that aim to eliminate the exposure of the business due to its controversial activities, that create risk, or aren't aligned with the preference of the investor. Basically, these funds will exclude companies that do not comply with the fund's ESG standards and are involved with products or services, such as Controversial

[58] ICMA (June 2020)Sustainability-Linked Bond Principles, available at: https://www.icmagroup.org/sustainable-finance/the-principles-guidelines-and-handbooks/sustainability-linked-bond-principles-slbp/

[59] Chen, J. (2021). Exchange-Traded Fund (ETF). [online] Investopedia. Available at: https://www.investopedia.com/terms/e/etf.asp.

[60] ESG screened ETFs – Sustainable investing (n.d) BlackRock [online] Available at: https://www.ishares.com/ch/intermediaries/en/themes/sustainable-investing/esg-screened-etfs?switchLocale=y&siteEntryPassthrough=true

Weapons, Nuclear Weapons, Thermal Coal, Tobacco, Oil Sands, and Thermal energy, Fossil Fuels Reserves, and Small arms.

3. ADVANTAGES AND DISADVANTAGES

Approximately until 2015, just a few investors were interested in environmental, social and corporate governance criteria. Nowadays, these criteria are widely used. Investing in companies with bad ESG performance is often avoided by investors because they believe that the same factors that cause low ESG ratings would also cause poor financial performance.[61] So investors are looking for high-performance ESGs due to the better economic results. However, there are times that the companies which implement the above criteria do not see benefits and are disappointed. For this reason, companies, organizations and investors in general, have to understand that ESG investing has not only advantages but also disadvantages.

The greatest advantage of ESG investing is the creation of value. According to the definition[62] of value, it is "*giving something valuable to receive something else that's more valuable to you*". In the context of business, the value[63] is interpreted as any type of value that will add to the long term success and health of the business. It is more than an economical value. It includes the satisfaction of employees, moral values, expenses, good skills in management, etc. ESG is linked with Sustainable Development. Every reference to ESG is a reference to Sustainable Development. So Sustainable Development has as an aim to create value not only for the company but also for the shareholders, employees, consumers, suppliers, local community and authorities. This value will be created when the organization will develop a competitive advantage[64], a feature of the company that helps the company to achieve better results than its competitors. There are factors that assist the company to produce more/better and cheaper in comparison with its competitors. In simple terms, these factors contribute to the profitability of the company against its competitors.

There are five ways[65] that ESG can create value:

I. Top line growth

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[61] Serafeim, G. (2020). Social-Impact Efforts That Create Real Value. [online] Harvard Business Review. Available at: https://hbr.org/2020/09/social-impact-efforts-that-create-real-value.

[62] How Does Value Creation Lead to Business Success?(2020) [online] CFO Perspective. Available at: https://cfoperspective.com/how-does-value-creation-lead-to-business-success/.

[63] How Does Value Creation Lead to Business Success?. (2020)[online] Available at: https://cfoperspective.com/how-does-value-creation-lead-to-business-success/

[64] Competitive advantage (n.d) [online] Wikipedia.Available at: https://en.wikipedia.org/wiki/Competitive_advantage

[65]Henisz, W., Koller, T. and Nuttall, R. (2019). Five ways that ESG creates value. Mckinsey Quarterly.

Strong ESG practices benefit investors and organizations. Nowadays climate change and other environmental and social issues are not just ‘fashionable’ but rather crucial for today’s world. More and more investors are likely to invest in green products than in non-green, regardless of the cost. There is an enormous interest in sustainable products. Even the largest companies are willing to buy/ invest in them regardless of the cost. So focusing on sustainability, and promoting products that are either sustainable or made in a way that appeals consumers, lead to additional revenue growth, which creates value. Also, organizations that engage in social-environmental activities are more likely to be trusted by the authorities. So the authorities may give them more easily approvals, licenses and other benefits.

II. Cost reduction

Through ESG the operational costs will be reduced. The reduction of the energy cost of the industry leads to the reduction of the production costs; and so the final products become cheaper.

III. Reduced regulatory and legal interventions

In simple terms, this way refers to the good relations between companies and regulators. In many industries all over the world, it is important to have good relations with the regulators in order to create values for the stakeholders.

IV. Employee productivity uplift

With the adoption of strong ESG practices, a company can give its employees opportunities and, in general, different types of motivation (bonuses, promotions, etc.) in order to keep them productive. By doing beneficial acts towards the environment and social community, there is academic evidence that shows that a strong correlation between employees' motivation and productivity is being created.

V. Investment and asset optimization

ESG can offer high performance to the business through the allocation of capital to more sustainable opportunities, such as waste reduction. Regarding the investment aspect of optimization, ESG can also assist companies to avoid investments that will not get them high returns due to issues in the environment (e.g. investment in oil companies). In addition regarding the asset optimization, companies can create value by lowering, for example, the amount that they have to spend by building facilities. This is often more environmentally friendly but also can lead to the creation of the shareholders' value due to lower cost.

Regarding these 5 ways to create value, the companies should be creative in finding resolutions. If the company doesn't do even a few of the above things, it may destroy its value because the competitors will probably do these activities, expected to get high returns. So another advantage of ESG is the high returns[66]. The investors and the experts expect ESG investments to benefit the companies in the long-run because ESG is proved to have high resilience against the volatility of the markets. For instance, during covid-19 non-ESG products have lost their value, while ESG funds were stable or have increased their value. An asset management company, called Arabesque, after research[67] found that the top companies (ranked in 80-100%) of S&P 500(it is a stock market index that counts the 500 largest companies in U.S.) that followed ESG criteria have performed 25% better than the companies that ranked in the bottom quintile (0-20%) from 2014 to 2018. So ESG shares have the same or better performance than non-ESG. Moreover, ESG evaluates risks and opportunities. In this way, the portfolio's risks are reduced. For example, in 2019, the first climate change bankruptcy happened[68]. The company PG&E filed for bankruptcy because it had billions of dollars in losses due to the catastrophic fires that hit the United States. More specific 84 persons died in November 2018 due to the fire which was caused by a short circuit in the outdated and poorly maintained transformers of the company; and this had completely destroyed the town of Paradise. If PG&E has taken into consideration ESG factors, the above catastrophe might never have happened. Also, ESG practices keep away the activists[69]. Activists usually use the protection of the environment and the governance irregularities as a reason to protest. So

[66] How ESG Investing Can Produce Higher Returns with Less Risk. (2021) [online] INN.Available at: https://investingnews.com/innspired/esg-investing/

[67] Doing Well By Doing Good: 5 Stocks to Buy for 2019. (2018) Fortune. [online] Available at: https://fortune.com/2018/12/05/best-stocks-esg-2019-walmart-abbott-merck/

[68] Bailey, R., (n.d.) Climate Change Has Claimed Its Biggest Corporate Victim. [online] Marshmclennan.com. Available at: https://www.marshmclennan.com/insights/publications/2019/mar/climate-change-has-claimed-its-biggest-corporate-victim.html

[69] Atkins, B. (2018). Strong ESG Practices Can Benefit Companies and Investors: Here's How. [online] Nasdaq.com. Available at: https://www.nasdaq.com/articles/strong-esg-practices-can-benefit-companies-and-investors-2019-03-13.

if companies comply with ESG criteria, they have no reason to be afraid of potential protests against them.

No matter what, nowadays capital is invested in companies and activities that are related to Sustainable Development and fulfilled ESG criteria. This means, in simple terms, that ESG investing attracts more and more investors every day. However, there are plenty of investors and companies that believe that ESG is 'another scam'[70] in the financial markets. Many think that when investors buy ESG funds, they are doing nothing actually for the environment, the governance or the social life, but they make a difference on Wall Street and their fee.

Another downside of ESG is the *'Greenwashing'*[71]. It is a marketing strategy which is used in order to make an investment to seem "green" or "greener". So through inaccurate marketing, the financial players will be convinced that a specific investment would have beneficial effects for the environment but in reality, the alleged environmental product or service not only does not have a positive effect on the environment but on the contrary may assist to harm the environment while it claims to be green. This tactic creates a competitive advantage when in reality non environmental requirements are followed. More specifically, in recital 11 of the Taxonomy Regulation the Greenwashing is defined as "*the practice of gaining an unfair competitive advantage by marketing a financial product as environmentally friendly, when in fact basic environmental standards have not been met."* Moreover, Greenwashing can be achieved through several methods, but the most common are[72]:

- Environmental Imageries.

  This method uses images such as green trees and happy animals, in order to make the investor think that the service or the product is fulfilling an environmental cause.

- Misleading labels.

[70]Investoradar (2021). Is ESG investing just a scam? [online] Medium. Available at: https://medium.datadriveninvestor.com/is-esg-investing-just-a-scam-a092a4e28c77

[71] Busch, D., Ferrerini, G. and Grünewald, S., (eds.)(2021) Sustainable Finance in Europe: Corporate Governance, Financial Stability and Financial Markets. Basingstoke: Palgrave Macmillan, p.357.

[72]Fesmina Faizal (2018). What Is Greenwashing? – Types & Examples. [online] Feedough. Available at: https://www.feedough.com/what-is-greenwashing-types-examples/.

Many times, products are attached with “green labels” (i.e. ‘organic’, ‘certified’) without any other document that can support the green claim.

- Hidden trade-offs

Companies can classify their products or services as green, but in reality, there is no adequate information to support this claim.

- Irrelevant Claims

In this case, only the good aspect of the product/service is advertised. For instance, a company can advertise that its products are free of CFC but in reality they may contain other harmful chemicals.

- Lesser of two evils

This term refers to what a company does against its competitors. For example, if two firms move in the same sector of the financial market, one of them could claim that its product is greener than the others. In simple terms, they may both companies harm the environment, but the one is harming it less.

Nowadays, many companies claim to follow ESG criteria but in reality, they don’t. A notorious example is the Volkswagen scandal[73] in 2015. Volkswagen advertised that its diesel car was friendlier for the environment because the emissions of Volkswagens cars were less than the other cars. But in reality, the company cheated on the government emission test through ‘defeat devices’.

Most of the time the greenwashing is intentional, but there are times that this is not the case[74]. Almost every single country has a different definition for what is ‘sustainable’ and ‘green’. There isn’t a worldwide accepted definition for each of these terms. So for example an investor who has his/her own opinion on what sustainable investment is, wants to find the ‘alleged’ sustainable characteristics to any fund that is called sustainable.

[73] Partridge, K. (2015.)VW Scandal Just the Tip of the Greenwashing Iceberg. [online] Ideas & Insights. Available at: https://www8.gsb.columbia.edu/articles/ideas-work/vw-scandal-just-tip-greenwashing-iceberg

[74] Hale, J. & Bioy, H.(2021). What Is Greenwashing, and Answers to Your Other Questions. [online] Morningstar, Inc. Available at: https://www.morningstar.com/articles/1062642/what-is-greenwashing-and-answers-to-your-other-questions

Both intentional and unintentional greenwashing can be settled by legal framework[75] (i.e.Taxonomy) and through appropriate education of the investors. The companies must be transparent and the fund managers need to provide in early-stage information about what is sustainable or green regarding their products/services.

Moreover, the phenomenon of Greenwashing is supported by the lack of a common framework. ESG is not a regulation but only a standard. So if a company that is said to be following ESG proved to be eventually harmful to the environment, the company will not have any responsibilities[76] against nobody. So, ESG investing isn't standardized[77]. Investment firms just use criteria to analyze ESG factors. So there is no standard to dictate how lenient ESG parameters can be on certain issues (e.g. There are many ESG funds that hold fossil fuel or tobacco companies that in general perspective are harmful to the environment.). At this point, it is worth mentioning that in the U.S.,[78] the companies aren't required to track their ESG performance which means that investors' decisions can be based mainly on the advertisement.

In addition, ESG creates the impression that ethical practices are more important than financial[79]. This would be valid in a world where everything is resolved. But in today's real life this is not the case. The options for ESG investments may be limited in relation to non-ESG opportunities, and probably the potential investors will pay more for such investments. In simple terms in a 'regular' non ESG investment, the aim is the high financial performance of a product and eventually the high return, but in ESG investment the first aim is the protection of environment, society and governance. Linked to the above disadvantage is that investors who want to invest

[75] Charco & Dique (2020) New Taxonomy Regulation to put a stop to greenwashing - Charco & Dique. [online] Available at: https://charcoendique.nl/en/articles/taxonomy-regulation-to-stop-greenwashing/

[76] Investoradar (2021). Is ESG investing just a scam? [online] Medium. Available at: https://medium.datadriveninvestor.com/is-esg-investing-just-a-scam-a092a4e28c77.

[77] Zinn, D.(2021) Here Is Everything You Need To Know About ESG: A Socially Responsible Way of Investing [online] Time.com. Available at: https://time.com/nextadvisor/investing/investing-in-esg/

[78] Nelson, R. (2021) Examining the state of worldwide mandatory ESG disclosures [online] Goby. Available at: https://www.gobyinc.com/examining-worldwide-mandatory-esg-disclosures/

[79]Επενδύοντας: Τα πλεονεκτήματα και μειονεκτήματα της κοινωνικά υπεύθυνης επένδυσης. (n.d) Money-h [online] Available at: https://el.money-h.com/pros-and-cons-of-socially-responsible-investing-4441

under ESG criteria can lose many other opportunities[80] to make money easily. For example, the investors may not invest in a promising investment only because it is not in accordance with ESG. So a company that has a weak or zero ESG policy, may not be in many investors' portfolios even if it has many potentials and can improve the consumers' life (i.e. Burberry[81]). Also, due to the limited opportunities in ESG investing as mentioned above, there is a lack of diversity[82] among ESG products. Usually, the companies that comply with ESG are the large ones and so the shares that they establish are the large-cap shares (They are the shares of the largest companies in one place or with over 10 billion capitalization.[83]). For this reason, most of the portfolios will be almost the same; while there will be probably a few or none with small and mid-cap shares. Moreover, ESG is responsible for the exclusion of profitable industries such as oil and tobacco[84] from portfolios. On one hand, this is positive for the environment and society but on the other hand, this is going to increase the risk because almost all investors will place their attention on a single industry, such as electric cars.

Last but not least, ESG factors are difficult to be analyzed. There are a lot of details to be considered such as the company's operations, suppliers, employees, clients, etc. For example, the Tesla cars are at first glimpse better for the environment than the 'traditional' one. So many investors will think that this investment is beneficial for the environment. But after research, experts found out that the batteries of Tesla are made from nickel[85], the mining of which is under question about the environmental effect that it has. Also, a crucial environmental factor that investors should

[80] Επενδύοντας: Τα πλεονεκτήματα και μειονεκτήματα της κοινωνικά υπεύθυνης επένδυσης. (n.d)[online] Available at: https://el.money-h.com/pros-and-cons-of-socially-responsible-investing-4441

[81] Gard, J., (2020) 20 Global Companies With The Lowest ESG Risks. [online] Morningstar UK. Available at: https://www.morningstar.co.uk/uk/news/206914/20-global-companies-with-the-lowest-esg-risks.aspx

[82] Cizmeci, D.(2020) Investing in a Brighter Future: The Pros and Cons of Sustainable Investing. [online] Available at: https://daglar-cizmeci.com/sustainable-investing/.

[83] Ross, S. (2021) What's the Difference Between Small Cap Stocks and Large Cap Stocks?. [online] Investopedia. Available at: https://www.investopedia.com/articles/markets/022316/small-cap-vs-mid-cap-vs-large-cap-stocks-2016.asp

[84] Επενδύοντας: Τα πλεονεκτήματα και μειονεκτήματα της κοινωνικά υπεύθυνης επένδυσης.(n.d) [online] Available at: https://el.money-h.com/pros-and-cons-of-socially-responsible-investing-4441

[85] Ahuja, K. (2020) Environmental concerns mount use of nickel in EVs. [online] The Sunday Times. Available at: https://www.driving.co.uk/news/environmental-concerns-mount-use-nickel-evs/.

take into consideration about Tesla cars is the electricity that is consumed in order for the car to be fully charged. At this concept, it is worth to mention that are many tobacco and oil companies that claim to be in accordance with ESG[86]. Altria Group is one of these companies. Altria[87] is one of the largest tobacco companies in the world that claims to be an ESG company when all its activities not only do not comply with ESG criteria but on the contrary, harm the environment.

[86] Is ESG investing just a scam? (2021)[online] Medium. Available at: https://medium.datadriveninvestor.com/is-esg-investing-just-a-scam-a092a4e28c77.

[87] 12 Worst ESG Companies | Stocks to Avoid. (2021) [online] THE IMPACT INVESTOR Available at: https://theimpactinvestor.com/worst-esg-companies/

4. ESG LEGAL FRAMEWORK

As previously mentioned in the chapter on ESG disadvantages, the ESG isn't a 'common language' globally. This means that different countries use different criteria to define ESG but also to measure the performance of a company. The financial market participants tend to comply with guidelines, principles or voluntary initiatives. So there are legislative instruments that deal with corporate governance and supervisory practices issues[88]. Companies and organizations follow governance rules in order to have in the future high returns and a good performance in the long run. But by doing this, they also assist in the creation of a better 'environment'. For example, EU companies comply with the (EU) 2017/828 Directive which among other targets, it includes corporate governance, social, and environmental aims[89]. Moreover, the supervisory practices of financial instruments have included ESG in the area of risk management and supervision. For instance, the Network for Greening the Financial System (NGFS), which includes global central banks and financial supervisors, promotes the transition to a low-carbon economy[90].

At an EU level, Commission attempts to standardize ESG by setting uniform rules but at the same time promotes green goals. A very important step to this attempt was the development of the Action Plan on Financing Sustainable Growth. In March 2018, the European Commission introduced the Sustainable Finance Action Plan (SFAP)[91]. This plan is a part of a broader framework for Sustainable Finance, created as a response to the recommendations of the High-Level Expert Group[92] (HLEG) on Sustainable Finance. The Commission recommended in December 2016 to create an efficient strategy regarding Sustainable Finance that will refer also to environmental

[88] Busch, D., Ferrerini, G. and Grünewald, S., (eds.)(2021) Sustainable Finance in Europe: Corporate Governance, Financial Stability and Financial Markets. Basingstoke: Palgrave Macmillan, p.337-339.

[89] Directive (EU) 2017/828. Recital 14, 22, 29. Available at: https://eur-lex.europa.eu/legal-content/EN/ALL/?uri=LEGISSUM%3Al33285

[90] Busch, D., Ferrerini, G. and Grünewald, S., (eds.)(2021) Sustainable Finance in Europe: Corporate Governance, Financial Stability and Financial Markets. Basingstoke: Palgrave Macmillan, p.338.

[91] European Commission, (2018) Renewed sustainable finance strategy and implementation of the action plan on financing sustainable growth. [online] European Commission. Available at: https://ec.europa.eu/info/publications/sustainable-finance-renewed-strategy_en

[92] It is a group of 20 members, including European experts and international institutions, who propose to the European Commission how to act in specific issues related to Sustainable Finance.

risks and climate-change concerns[93]. So the Commission adopted the SFAP in order to assist the reorientation of the capital flow towards sustainable investments. Besides this, the plan also aims to promote transparency to deal with financial risks. The plan includes various fields of action, such as the incorporation of ESG considerations and sustainability into the financial market regulations, and the promotion of transparency.

4.1 REGULATION (EU) 2020/852

The backbone of the SFAP is the Regulation (EU) 2020/852 of the European Parliament and the Council, known as the Taxonomy Regulation[94]. The Taxonomy has gotten into force from 12 July 2020, and it includes a system of classification to determine whether an economic activity at EU level should be called sustainable, while at the same time, sets a disclosure framework for financial factors and corporates about the extent up to which the investments or economic activities are sustainable[95]. This disclosure framework completes the disclosure requirements set by SFDR[96]. Furthermore, the regulation applies according to the art.1 of the reg.[97] to:

- financial market participants that offer financial products (including credit institutions, investment firms, insurance companies, asset managers and banks that offer portfolio management.).
- Corporates that are obliged to publish a non-financial report.
- EU and its member states when they adopt measures for financial products.

[93] European Commission (2018) Communication from the Commission to the European Parliament, the European Council, the Council, the European Central Bank, the European Economic and Social Committee and the Committee of Regions- Action Plan: Financing Sustainable Growth (COM/2018/097 final). Available at: https://eur-lex.europa.eu/legal-content/EN/ALL/?uri=CELEX:52018DC0097

[94] European Commission(n.d.) EU taxonomy for sustainable activities. Available at: https://ec.europa.eu/info/business-economy-euro/banking-and-finance/sustainable-finance/eu-taxonomy-sustainable-activities_en

[95]The Taxonomy Regulation – The EU unveils grand plan to define green business.(2020) Global law firm [online] Herbert Smith Freehills. Available at: https://www.herbertsmithfreehills.com/insight/the-taxonomy-regulation-%E2%80%93%C2%A0the-eu-unveils-grand-plan-to-define-green-business

[96] See below.

[97] Regulation (EU) 2020/852 of the European Parliament and of the Council of 18 June 2020 on the establishment of a framework to facilitate sustainable investment, and amending Regulation (EU) 2019/2088

The Taxonomy regulation aims, among others, to harmonize[98] the sustainability frameworks through the EU. There should be uniform criteria under which an activity is defined to be sustainable. It is not possible in one European country the criteria to be different compared to another European country's criteria. This harmonization will exceed the borders and will create a single market for investments, where each market participant will use the same framework and criteria. This will facilitate the environmental investments but also will attract investors from abroad. Nevertheless, this regulation is going to affect not only EU participants but also businesses outside of the EU. For example, a non-EU company may have EU investors who want their activities to be aligned with EU Taxonomy[99]. However, Taxonomy isn't mandatory for all[100], while there are companies that comply with its provisions voluntarily exactly because they know that they will be benefited from the existence of uniform criteria. Nevertheless, Taxonomy doesn't prohibit financial market participants to finance or invest in activities that aren't eligible according to it.

Among the aims that Taxonomy wants to fulfill are the avoidance of greenwashing and the achievement of a net zero GHG emissions by 2015[101]. So through Taxonomy, a company's activities regarding the environment will be transparent, and everyone who is interested in investing will be able to know in advance, without doing research, all the required information that is needed. More specific the regulation will also assist investors to assess if the financial products that are offered by market participants are really linked to sustainable investments[102]. Moreover, the development of Taxonomy may be useful to the banking sector too. In the future, banks may

[98] Busch, D., Ferrerini, G. and Grünewald, S., (eds.)(2021) Sustainable Finance in Europe: Corporate Governance, Financial Stability and Financial Markets. Basingstoke: Palgrave Macmillan, p. p355-357,341.

[99] Gallagher, E., Bancilhon, C. and Berruti, G. (2021)What you should know about the EU Taxonomy |. [online] Greenbiz. Available at: https://www.greenbiz.com/article/what-you-should-know-about-eu-taxonomy.

[100]Pankov, S.(2021). The EU Taxonomy explained. [online] DFGE - Institute for Energy, Ecology and Economy. Available at: https://dfge.de/the-eu-taxonomy-explained/.

[101]European Commission (2021). FAQ: What is the EU Taxonomy and how will it work in practice?. Available at: https://ec.europa.eu/info/sites/default/files/business_economy_euro/banking_and_finance/documents/sustainable-finance-taxonomy-faq_en.pdf

[102] Busch, D., Ferrerini, G. and Grünewald, S., (eds.)(2021) Sustainable Finance in Europe: Corporate Governance, Financial Stability and Financial Markets. Basingstoke: Palgrave Macmillan, p.341.

use Taxonomy to decide whether to grant a loan or to which conditions they have to disclose in asset ratio for the loan portfolio themselves (2022 onwards)[103].

In addition, the definition of a sustainable activity is laid down on art.3 and 9 of the Taxonomy Regulation. If a company works in one of the following fields (art. 9) can be considered being at least partially sustainable:

I. *Climate change mitigation*

The Intergovernmental Panel on Climate Change (IPCC), on its Report on Global Warming, highlighted that is important to limit the temperature increase to 1.5 ° C above the pre- industrial levels. This can be accomplished e.g. by using renewable energy and materials, by storing energy, etc. (art. 10)

II. *Climate change adaptation*

It relates to the process of adjustment to today's and future climate change, and its potential adverse impacts. This could include solutions that whether reduce the potentially risk of the expected impacts of climate change, or keep the risk stable. (art.11)

III. *Sustainable use and protection of water and marine resources*

This could be achieved through prevention of the aggravation of the situation or by taking action to preserve a good status, or to control the aggravation. (art.12)

IV. *Transition to a circular economy*

The circular economy is an economic system where materials and products do not lose their value or preserve their value as long as possible. Hence the products are designed in a way that can be used again (i.e. moderation, recycling) in order to reduce the adverse effect on the environment due to their usage. (art.2 par. 9, art. 13)

V. *Pollution prevention and control*

This can be achieved by cleaning up and generally by taking action to reduce pollution. (art14)

VI. *Protection and restoration of biodiversity and ecosystems*

A company can achieve this objective by finding ways to preserve and protect all types of biodiversity and by agricultural practices (art. 15)

[103]Schuller, M. (2021). Banks take up gauntlet against climate risks. [online] ING Think. Available at: https://think.ing.com/articles/banks-take-up-gauntlet-against-climate-risks

If a sustainable economic activity contributes to one or more of the above 6 criteria or enables other activities to do so (art.10-16), that doesn't mean that is automatically sustainable. According to art.3, the activity must also "do not do significant harm", meaning that the activity mustn't affect negatively one of the other five categories that doesn't meet (DNSH test). In addition, the activity must meet the minimum social safeguards[104] such as Human Rights, OECD Guidelines, and the UN principles. Finally, the activity needs to meet several technical screening criteria (art. 19) to assess whether it is eligible at all to contribute to the objectives and scope of the regulation. All the above prerequisites constitute an *'eligible green project'* according to ICMA.

For each of the above 6 categories, the Commission will issue[105] delegated acts which will specify technical screening criteria (TSC). The technical standards for the adaption and mitigation of climate change have been already drafted and the Climate Delegated Act[106] that confirms and specifies them, got into force on 1 January 2022. In practice, this means that companies can use these TSC in order to determine if their economic activities are eligible (regarding climate adaptation and mitigation), and meet the Taxonomy standards; and as a result, the investors will be in a position to know whether their invested money is linked with sustainability or not. Nevertheless, the delegated act ('Environmental Delegated Act') related to the technical screening criteria for the remaining 4 objectives (art. 12-15 of Taxonomy)will be developed later in the future.(It is expected to be adopted in 2022 and get into force in 2023[107])

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[104] Busch, D., Ferrerini, G. and Grünewald, S., (eds.)(2021) Sustainable Finance in Europe: Corporate Governance, Financial Stability and Financial Markets. Basingstoke: Palgrave Macmillan, p. 371.

[105] Regulation (EU) 2020/852 of the European Parliament and of the Council of 18 June 2020 on the establishment of a framework to facilitate sustainable investment, and amending Regulation (EU) 2019/2088 [2020] OJ L198/13, art.10-15. Available at: https://eur-lex.europa.eu/legal-content/EN/TXT/?uri=CELEX%3A32020R0852

[106] Commission Delegated Regulation (EU) 2021/2139 of 4 June 2021 supplementing Regulation (EU) 2020/852 of the European Parliament and of the Council by establishing the technical screening criteria for determining the conditions under which an economic activity qualifies as contributing substantially to climate change mitigation or climate change adaptation and for determining whether that economic activity causes no significant harm to any of the other environmental objectives(2021) Official Journal L 442, p.1.

[107] Havard-Williams, V. & Feijao, S (2021) EU Taxonomy: Platform on Sustainable Finance publishes preliminary draft technical screening criteria for remaining 4 environmental objectives. Linklaters. [online] Available at: https://sustainablefutures.linklaters.com/post/102h4h8/eu-taxonomy-platform-on-sustainable-finance-publishes-preliminary-draft-technica

It is worth mentioning that according to art.16 the substantial contribution of an economic activity doesn't be narrowed down to art.10-15, but according to art.16 sustainable can be an economic activity that *'directly enabling other activities to make a substantial contribution to one or more of those objective'*. The economic activity can be an *enabling* or a *transitional* activity[108]. Regarding the enabling activities, their services and products enable a substantial contribution to be made to other activities (e.g. manufacture of low-carbon technologies that can be used by other firms.), meaning that the activity needs to have a good impact on the environment but also doesn't lock in assets that damage in the long run, the environmental targets. Transitional are those activities that have been already low carbon and support the transition to a climate neutral economy by phasing out the greenhouse gas emissions[109]. (On the gas and nuclear energy areas, there is a debate about them constituting transnational activities.)

Moreover, there are undertakings according to the regulation that are obliged[110] to publish non-financial reports[111] including Key Performance Indicator (KPIs), turnover, capital expenditure ('CapEx') and operating expenditure ('OpEx'). So according to art.8 par. 2, non-financial firms that are subject to the Non-Financial Reporting Directive (NFRD)[112], are expected to report the alignment with Taxonomy growth in terms of proportion of their revenues, capital, and operational expenditures. This means for example that the companies need to report how much (in percentage) of their turnover goes into activities that contribute i.e. to climate mitigation.

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[108] European Commision(2019) Questions and Answers: political agreement on an EU-wide classification system for sustainable investments (Taxonomy). Available at: https://ec.europa.eu/commission/presscorner/detail/it/qanda_19_6804

[109] Busch, D., Ferrerini, G. and Grünewald, S., (eds.)(2021) Sustainable Finance in Europe: Corporate Governance, Financial Stability and Financial Markets. Basingstoke: Palgrave Macmillan, p.365.

[110] ESMA(2021)Final Report Advice on Article 8 of the Taxonomy Regulation. Reference ESMA30-379-, p.9. Available at: https://www.esma.europa.eu/sites/default/files/library/esma30-379-471_final_report_-_advice_on_article_8_of_the_taxonomy_regulation.pdf

[111] European Commission (2021) FAQs: How should financial and non-financial undertakings report Taxonomy-eligible economic activities and assets in accordance with the Taxonomy Regulation Article 8 Disclosures DelegatedAct?, p.3. Available at: https://ec.europa.eu/info/sites/default/files/business_economy_euro/banking_and_finance/documents/sustainable-finance-taxonomy-article-8-report-eligible-activities-assets-faq_en.pdf

[112] Directive 2014/95/EU of the European Parliament and of the Council of 22 October 2014 amending Directive 2013/34/EU as regards disclosure of non-financial and diversity information by certain large undertakings and groups Text with EEA relevance

As regards NFRD, it was adopted in 2014 but got into force in 2018 for all EU member states[113]. It applies to public interest entities and generally large companies that exceed 500 employees[114] (Just because NFDR is a directive, it leaves space for member states to decide the way they want to implement the rules into their national framework. That's why the number of employees may differ from country to country, i.e. in Greece the employees must be more than 10[115][116]). Banks, listed companies, insurance companies can be included too[117]. So usually no SMEs can fall under the scope of NFRD[118]. The undertakings have to publish annual reports or sustainability reports on the strategy and methodologies they implement regarding ESG, bribery, anticorruption, human rights, etc.

However, NFRD and its reporting aren't very sufficient and lack standards; therefore the comparability of the companies is very challenging. For this reason, the European Commission proposed on April 2021 a Directive which will amend the NFRD; and will have as main objective to standardize the reporting process. This directive is called Sustainability Reporting Directive (CSRD)[119] and is going to bring changes in Transparency Directive[120], Audit Directive[121] and Regulation[122], and Accounting Directive[123]. CSRD will have a larger scope, as it is going to apply to almost 50.000 companies including large, listed and private companies, as well as SMEs. CSRD sets requirements on what companies must report on and how concerning sustainability

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[113] Busch, D., Ferrerini, G. and Grünewald, S., (eds.)(2021) Sustainable Finance in Europe: Corporate Governance, Financial Stability and Financial Markets. Basingstoke: Palgrave Macmillan, p. 52,182.
[114] The EU Non-Financial Reporting Directive and the Proposal for Corporate Sustainability Reporting Directive (2021) | Insights | Greenberg Traurig LLP. [online] Available at: https://www.gtlaw.com/en/insights/2021/5/eu-non-financial-reporting-directive-proposal-corporate-sustainability-reporting-directive
[115] The Non-Financial Reporting Directive: What You Need To Know (n.d) Available at: https://www.datamaran.com/non-financial-reporting-directive/
[116] The NFRD was transposed into Greek legislation by Law 4403/2016, which was incorporated into Law 2190/1920 and then transferred to Law 4548/2018, in articles 151 and 154.
[117] European Commission(n.d.) Corporate sustainability reporting. Available at: https://ec.europa.eu/info/business-economy-euro/company-reporting-and-auditing/company-reporting/corporate-sustainability-reporting_en
[118] European Commission(2021) Questions and Answers: Corporate Sustainability Reporting Directive proposal. Available at: https://ec.europa.eu/commission/presscorner/detail/el/QANDA_21_1806
[119] Proposal for a Directive of the European Parliament and of the Council amending Directive 2013/34/EU, Directive 2004/109/EC, Directive 2006/43/EC and Regulation (EU) No 537/2014, as regards corporate sustainability reporting, 21.04.2021, COM (2021) 189.
[120] Directive 2004/109/EC
[121] Directive 2006/43/EC
[122] Regulation 537/2014/EU
[123] Directive 2013/34/EU

and ESG. Additionally, it includes a mandatory audit and requires also a more extensive disclosure reporting known as the 'double materiality perspective[124]' (the disclosure refers not only to the impacts of the company on the environment, economy, and society but also how the company is affected by the environment).

4.2 REGULATION (EU) 2019/2088

In order to promote investments into sustainable projects (action 3 of the plan)[125], the Commission adopted in 2019 the European Sustainable Finance Disclosure Regulation (SFDR)[126], and declared that this regulation (EU Reg. 2019/2088) would get into force on 10 March 2021(at least regarding the level 1 requirements)[127]. SFDR is an EU regulation under which financial market participants (FMPs) must comply with certain transparency and disclosure requirements both on an entity and product level[128]. So everybody who falls under the scope of SFDR needs to disclose information in pre-contractual documents, perioding reporting and on the websites[129]. The FMPs must disclose[130] their adopted policies and actions that they have taken in order to deal with sustainability and sustainable risks[131]. Also, they need to disclose how they integrate the risk (i.e. art. 5 par. 1) into the investment decision-making process. So, this legislation attempts to standardize[132] the metrics, and the way that firms disclose and report on ESG issues across the financial market. It also, will take into consideration the adverse sustainability risk and will try to mitigate it. Second, it aims to

[124] European Commission (2021) Questions and Answers: Corporate Sustainability Reporting Directive proposal. Available at: https://ec.europa.eu/commission/presscorner/detail/el/QANDA_21_1806.

[125] European Commission (2018) Communication from the Commission to the European Parliament, the European Council, the Council, the European Central Bank, the European Economic and Social Committee and the Committee of Regions- Action Plan: Financing Sustainable Growth (COM/2018/097 final), p.5-6. Available at: https://eur-lex.europa.eu/legal-content/EN/ALL/?uri=CELEX:52018DC0097

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

[127] Busch, D., Ferrerini, G. and Grünewald, S., (eds.)(2021) Sustainable Finance in Europe: Corporate Governance, Financial Stability and Financial Markets. Basingstoke: Palgrave Macmillan, p.342,349.

[128] PWC (n.d.)The Sustainable Finance Disclosure Regulation, p.3.

[129] PWC (n.d.)The Sustainable Finance Disclosure Regulation, p.3.

[130] PWC(n.d.)The Sustainable Finance Disclosure Regulation, p.4.

[131] Busch, D., Ferrerini, G. and Grünewald, S., (eds.)(2021) Sustainable Finance in Europe: Corporate Governance, Financial Stability and Financial Markets. Basingstoke: Palgrave Macmillan, p.342,349.

[132]Busch, D., Ferrerini, G. and Grünewald, S., (eds.)(2021) Sustainable Finance in Europe: Corporate Governance, Financial Stability and Financial Markets. Basingstoke: Palgrave Macmillan, p.399.

promote transparency[133] in financial and economic activities. Therefore the investors will be more positive to finance green because the boosting of the transparency will minimize the risk of potential greenwashing. Finally, it will also promote the ESG characteristics[134] and the sustainable investments. Summing up, SFDR is a mandatory[135] regulation that lays down harmonized rules[136] for FMPs and advisors at an entity and product level. Additionally, SFDR is a very broad regulation and applies to FMPs, financial advisors and financial products. But because it uses its own vocabulary only the financial entities and products that are being included in the definition of art.2 can fall within the scope of SFDR. The term "financial market participant" (art.2 par.1) is quite broad and covers for example an alternative investment fund manager, an investment firm which provides portfolio management, an insurance undertaking that makes available an insurance-based investment product (IBIP), an institution for occupational retirement provision (IORP), an alternative investment fund manager (AIFM), a manufacturer of a pension product, etc. The definitions of 'financial adviser' and 'financial product' lay down on art.2 (11), (12).

As with every EU regulation, this regulation, is processed based on a slightly changed Lamfallusy Report.[137](Instead of the initial 4 levels, EU reformed these levels into 3.) In level 1, there is the basic act, where the Parliament and the Council adopt the main framework of the directive or regulation. The directive or the regulation has articles that delegate powers to the Commission to issue delegated or implementing acts in order to specify certain requirements (level 2). Also at the same time power is delegated to the EU instruments to issue technical standards on matters that require technical experience. And then finally the Commission enforces these requirements (level 3). Under the SFDR, level 1 was adopted and the main provisions have gotten

[133] Busch, D., Ferrerini, G. and Grünewald, S., (eds.)(2021) Sustainable Finance in Europe: Corporate Governance, Financial Stability and Financial Markets. Basingstoke: Palgrave Macmillan, p.399.
[134]Busch, D., Ferrerini, G. and Grünewald, S., (eds.)(2021) Sustainable Finance in Europe: Corporate Governance, Financial Stability and Financial Markets. Basingstoke: Palgrave Macmillan, p.399.
[135] SFDR - a Snapshot.(2021)KPMG's Creative Services. Available at: https://assets.kpmg/content/dam/kpmg/ie/pdf/2021/03/ie-sustainable-finance-disclosure-reg-sfdr.pdf
[136] Busch, D., Ferrerini, G. and Grünewald, S., (eds.)(2021) Sustainable Finance in Europe: Corporate Governance, Financial Stability and Financial Markets. Basingstoke: Palgrave Macmillan, p.398.
[137] European Commission. (2021). Regulatory process in financial services. [online] Available at: https://ec.europa.eu/info/business-economy-euro/banking-and-finance/regulatory-process-financial-services/regulatory-process-financial-services_en.

into force since 10/3/2021, but the level 2 rules have been delayed due to the unexpected spread of covid-19 virus[138]. However, the Commission has stuck to its decision to initiate the application of level 1 in 2021. Level 1 has to do with the disclosures on the entity level. In simple terms, the FMPs must categorize their funds as art.6, 8 or 9[139].

The regulatory technical standards (RTS) that are going to give details on severe vague issues[140] of SFDR are drawn up by the 'European Supervisory Authorities' (ESA) which is comprised of the European Securities and Markets Authority (ESMA), the European Insurance and Occupational Pensions Authority (EIOPA) and the European Banking Authority (EBA). ESA developed the draft of RTS in two tranches. At first, ESA published its final Report on RTS on 4 February 2021 and later on 22 October 2021[141] . Also, because the Commission desires to merge the above 2 reports into one single instrument (delegated act), the RTS, after delays[142], are now expected to be applied from 1 January 2023[143]. In practice, under the RTS of level 2, FMPs will need to justify why they categorize their products as art. 6, 8 or 9 through mandatory disclosures related to principal adverse impact[144]. This means that SFDR until now, was disclosing and reporting without based neither on definitions regarding what is considered to be 'good' or 'bad' SFDR performance nor on performance benchmarks.

As previously mentioned the disclosure is required both on entity and product level.

[138] Andrew, T. (2021) European Union delays SFDR 'level 2' until January 2023. ETFStream. Available at: https://www.etfstream.com/news/european-union-delays-sfdr-level-2-until-january-2023/

[139] KPMG(2021)SFDR - a Snapshot. KPMG's Creative Services. Available at: https://assets.kpmg/content/dam/kpmg/ie/pdf/2021/03/ie-sustainable-finance-disclosure-reg-sfdr.pdf

[140] SFDR: "Vague" Article 8 definition increases risk of greenwashing. (2021) ETF Stream. [online] Available at: https://www.etfstream.com/features/sfdr-vague-article-8-definition-increases-risk-of-greenwashing/

[141] Final Report on draft Regulatory Technical Standards with regard to the content and presentation of disclosures pursuant to Article 8(4), 9(6) and 11(5) of Regulation (EU) 2019/2088.

[142] Schoemaker, A. (2021). Delays, Questions and Confusion: Updates on the EU's Sustainable Finance Disclosure Regulation. [online] sustainalytics.com. Available at: https://www.sustainalytics.com/esg-research/resource/investors-esg-blog/delays-questions-and-confusion-updates-on-the-eu-s-sustainable-finance-disclosure-regulation.

[143] McErlane, C., Shah , S., & Everitt, K. (2022) EU: Commission Delays Sustainable Finance Disclosure Regulation Regulatory Technical Standards Implementation to 2023. Global Compliance News. Available at: https://www.globalcompliancenews.com/2022/01/05/eu-commission-delays-sfdr-rts-implementation-to-2023-08122021/

[144] Axelsson, J. (2021) Another Delay for SFDR Level 2. Available at: https://nordsip.com/2021/12/01/another-delay-for-sfdr-level-2/

- *Regarding the entity-level disclosure[145]:*

The SFDR imposes obligations for disclosure both on FMPs and financial advisors:

- They must *'publish on their websites information about their policies on the integration of sustainability into their investment decision making*'.(art. 3)
- *They must consider the principal adverse impacts of investment decisions or advices on sustainability factors* (art.4). The principal adverse impact is the negative impact that the investment strategies have on the environment and society, including the way of managing such an impact (recital 20). Moreover, every time that they don't take into consideration the adverse impacts they have to explain clearly the reasons and uploaded them on their websites. At this point, it needs to be clarified that from 30/06/2021 onwards, FMPs must always consider adverse impacts if they have more than 500 employees or exceed their balance sheet date. (art.4 para.3 &4)
- They must publish their remuneration policies after explaining how these policies are connected with the integration of sustainability risks (art.5)

- *Regarding the product-level disclosure[146]:*

Additionally to the above mentioned disclosure obligations regarding risk management and adverse impacts, more actions must be taken if the financial products fit under the categories that SFDR set. The SFDR set a classification system of financial products divided into 3 categories. So based on the FMPs decisions on what category classified their products, there are additional disclosure obligations that need to be done. These disclosure obligations affect (i) pre-contractual disclosure (art.6, 8 & 9) (ii) period reporting (art.11) and (iii) website disclosure (art.3-5).

The first classification in art.6, known as *'grey products'*, is considered to be the lowest classification standard, as it lays down the minimum requirements and obliga-

[145] PWC (n.d.)The Sustainable Finance Disclosure Regulation, p.4.
[146] PWC (n.d.)The Sustainable Finance Disclosure Regulation, p.5.

tions that must be fulfilled in all financial products and portfolios[147]. Every product of the FMPs must meet the art.6 requirements, regardless of the fact that FMPs may classify them as art.8 or 9 products. In other words, art.6 isn't optional. According to art.6 both FMPs and advisors must include in their pre-contractual documents the description of how they incorporate sustainability risks into their investment decisions or insurance advices, and also the outcomes of the valuation of potential consequences of sustainability risks in the performance of the financial products. FMPs and advisors, like the entity level, must explain clearly the reasons due to which they didn't consider sustainability risks.

The second classification, known as *'light green products'*, is set out in art.8.These products promote environmental and social characteristics or combination of them, and at the same time exclude assets that don't comply with the policies of good governance. According to this article, FMPs must conclude in their pre-contractual documents not only how the above characteristics are met but also the index that they may be defined as a threshold, and how it is aligned with the objectives.

Besides the above, art.8 is many times characterized as a vague[148] article because of the word 'promote'. For instance, any product that promotes ESG characteristics can be classified as a green light. That's why art.8 is called a catch-all category. This creates panic in the financial market because of the potential increase of greenwashing that can be created due to the broadness of the term 'promote'.
Nevertheless, art.8 is used as a supplement in art.10 and 11. So the funds that have been categorized as art.8 funds must also follow the additional disclosure obligations regarding the websites that they lay down in art.10 and 11.

The final classification is known as the *'dark green products'*. Products that belong to article 9 have the highest threshold of obligations, as they have as an objective the

[147] SKAGEN Funds. (n.d.). Sustainable Finance Disclosure Regulation (SFDR). [online] Available at: https://www.skagenfunds.ch/sustainability/sustainable-investing/sustainable-finance-disclosure-regulation-sfdr/
[148] SFDR: "Vague" Article 8 definition increases risk of greenwashing. (2021) ETF Stream. [online] Available at: https://www.etfstream.com/features/sfdr-vague-article-8-definition-increases-risk-of-greenwashing/

direct positive impact on the environment and the society, while they cause no significant harm to any other similar objective[149]. The article applies to products that aim to sustainable investments[150] or the reduction of carbon emission.

The described objectives must be measured by performance indicators. More specifically, FMPs must publish in their pre-contractual[151] documents information (when the target is a sustainable investment) about how the indicator is in alignment with the target, and how the target-objective is succeeded, in case that the indicator is defined as a reference benchmark. In addition, if the product aims to the reduction of carbon emissions, then the FMPs have to provide in their pre-contractual documents information about the exact objective in order to achieve the long-term global warning goals that are set in Paris agreement. Also, the art.9, as the art.8 does, has to comply with the additional disclosure requirements set in art.10 and 11 regarding the websites and periodic reports.

In addition, according to a Morningstar research[152] which covered 81,6% of all EU funds, only 2,8% have classified as art.9 funds, while art.8 funds reached 21,8%. This means that the SFDR can actually assist in differentiating and identifying those funds that are truly sustainable. This also shows that there is a distinction between funds that are truly contributing to a sustainable objective and to funds whose main objective isn’t sustainability.

Finally, as previously mentioned, SFDR attempts to set uniform rules related to disclosure through European Union. However, this attempt is quite challenging[153]. First

[149] DELOITTE (n.d.)Sustainable Finance Disclosure Regulation- Article 9 Funds or “Dark Green Funds, p.2.

[150] ‘Sustainable investment’ is defined in art. 2(17) of SFDR as an investment in an economic activity that contributes to an environmental objective, as measured, for example, by key resource efficiency indicators on the use of energy, renewable energy, raw materials, water and land, on the production of waste, and greenhouse gas emissions, or on its impact on biodiversity and the circular economy, or an investment in an economic activity that contributes to a social objective, in particular an investment that contributes to tackling inequality or that fosters social cohesion, social integration and labour relations, or an investment in human capital or economically or socially disadvantaged communities, provided that such investments do not significantly harm any of those objectives and that the investee companies follow good governance practices, in particular with respect to sound management structures, employee relations, remuneration of staff and tax compliance

[151] Deloitte(n.d)Sustainable Finance Disclosure Regulation- Article 9 Funds or “Dark Green Funds”, p.4.

[152] MORNINGSTAR (2021)SFDR: Four Months After Its Introduction-Article 8 and 9 Funds in Review, p. 2-3.

[153] Busch, D., Ferrerini, G. and Grünewald, S., (eds.)(2021) Sustainable Finance in Europe: Corporate Governance, Financial Stability and Financial Markets. Basingstoke: Palgrave Macmillan, p.432-442.

of all, FMPs and advisors have the alternative not to follow the rules and just explain why. Secondly, many terms are vague and need to be specified under levels 2 and 3, which have been delayed due to the unexpected spread of COVID-19. Thirdly, the data to calculate the 'adverse impact' are not available; therefore the subjects need to get them from a third party. Also, regarding the 'subjects' that fell under the SFDR, they are defined narrowly, meaning that if an entity or a product does not fit in the definitions that lay down in art.2, then they fall outside the regulation. For instance FinTech and crypto assets that are an important part of today's financial market fall outside the scope and this may disrupt the harmonization. Moreover, there is a lack of central supervision, meaning that a supervisor to one EU country may be more lenient than another supervisor to another EU country. Each member state shall supervise and impose sanctions in any event of breach of the disclosure rules. So, because each member state will be based on its own civil law and administrative sanctioning regime, this is likely to create insufficient harmonization.

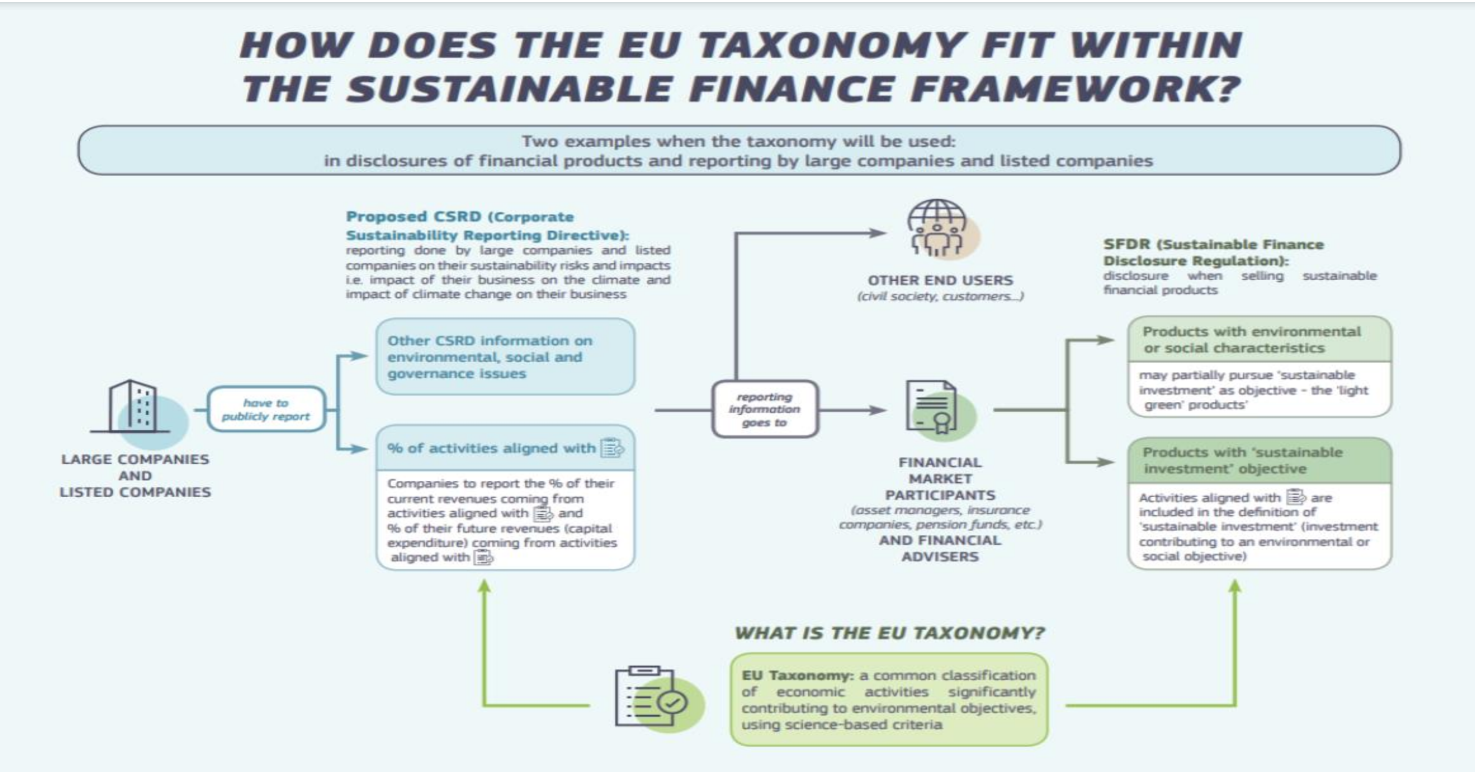
At this point, after mentioning the above EU legislation, it is worth mentioning that the Taxonomy Regulation (TR), SFDR, and the proposal of CSRD are interlinked.[154] First of all, it is important to mention that the TR is a classification system under which is determined whether an economic activity is sustainable or not. Also, TR itself is under development and therefore only the first two objectives (related to climate) are currently completed and ready to be used. So the TR set the basis for the SFDR and CSRD. FMPs and companies must report to what extent their activities are sustainable and aligned with the TR[155]. More specifically, TR was developed after the SFDR, and therefore its provisions are compatible with the RTS (level 2 SFDR). FMPs and advisors must report the sustainability degree of their products/services as well as the actions that they take to resolve 'adverse sustainability impacts'. In addition, ESA with its final report on RTS in October 2021 aims to create a single rulebook which will introduce additional obligations for disclosures related to SFDR pre-

[154] European Commission (2021b), Communication from the Commission to the European Parliament, the Council, The European Economic and Social Committee and the Committee of the Regions, Strategy for Financing the Transition to a Sustainable Economy, COM(2021) 390 final.,06.07.2021, p.14.

[155] European Commission (2021). FAQ: What is the EU Taxonomy and how will it work in practice?, p.5-6 Available at: https://ec.europa.eu/info/sites/default/files/business_economy_euro/banking_and_finance/documents/sustainable-finance-taxonomy-faq_en.pdf

contractual and periodic disclosures, as well as products disclosures under TR. So the transparency of SFDR is enhanced by the further disclosure obligations on the financial products set on art.5 and 6 of TR.

But before reporting, FMPs and financial advisors need to be informed about the companies in which they intend to invest (CSRD).So the proposed CSRD aims to enhance the quality and availability of investee companies. CSRD will attempt to ensure that the related companies will publish their sustainability information in order to comply with the SFDR obligations.



*The picture (2): "How does the EU Taxonomy fit within the sustainable finance framework?" (Source:https://ec.europa.eu/)

4.3 REGULATION (EU) 2019/2089

The establishment of sustainability Benchmarks is another piece of the puzzle that will lead gradually to the completion of the broader puzzle, called the EU Action Plan on Sustainable Finance[156]. In accordance with the action plan, the Commission pro-

[156] European Commission (2018) Communication from the Commission to the European Parliament, the European Council, the Council, the European Central Bank, the European Economic and Social Committee and the Committee of Regions- Action Plan: Financing Sustainable Growth (COM/2018/097 final), p.5-6. Available at: https://eur-lex.europa.eu/legal-content/EN/ALL/?uri=CELEX:52018DC0097

posed on May 2018 two types of benchmarks, (Climate Transition Benchmarks and EU Paris-aligned Benchmarks) as well as disclosure obligations for ESG benchmarks[157]. In February 2019 the European Parliament and Council agreed to amend the existing benchmark regulation (EU) 2016/1011 (BMR). In order to assist with the implementation of the above benchmarks, TEG[158] published in September 2019 its final Report including the minimum standards that need to be met. On 27 November the Commission adopted the (EU) 2019/2089 regulation[159], which amended the BMR. The expected day of application of the new regulation was on 30 April 2020, but on 29 April ESMA published a No Action Letter[160] regarding ESG disclosure obligations, knowing that the administrators would face difficulties to meet the ESG requirements before the application of the related Delegated Acts. So on 17 July 2020[161] the Commission adopted 3 delegated acts (Date of force: 23/12/2020) on how participants and authorities should act under this new regulation.

The new climate benchmarks seem to regard mainly the administrators but actually, they affect indirectly the investments[162] too. Many asset managers and end investors (e.g. pension funds, insurances, high net worth individuals etc.) use the benchmarks in order to assess the performance of a product, to underline the passive investments strategies, or to encourage firms to increase the ESG criteria that they follow. The new regulation increases transparency[163]; hence they create trust to the end user when he/she is searching for sustainable solutions. This way the green-

[157] Busch, D., Ferrerini, G. and Grünewald, S., (eds.)(2021) Sustainable Finance in Europe: Corporate Governance, Financial Stability and Financial Markets. Basingstoke: Palgrave Macmillan, p.345.

[158] Technical expert group on sustainable finance was created in 2018 and has been assisting the European Commission to implement the Action Plan on Financing Sustainable Growth.

[159] Regulation (EU) 2019/2089 of the European Parliament and of the Council of 27 November 2019 amending Regulation (EU) 2016/1011 as regards EU Climate Transition Benchmarks, EU Paris-aligned Benchmarks and sustainability-related disclosures for benchmarks

[160] ESMA issues No Action Letter on the new ESG disclosure requirements under the Benchmarks Regulation. (2020) [online] Available at: https://www.esma.europa.eu/press-news/esma-news/esma-issues-no-action-letter-new-esg-disclosure-requirements-under-benchmarks

[161] Busch, D., Ferrerini, G. and Grünewald, S., (eds.)(2021) Sustainable Finance in Europe: Corporate Governance, Financial Stability and Financial Markets. Basingstoke: Palgrave Macmillan, p.345.

[162] EU Technical Expert Group on Sustainable Finance (2019) Final Report on Climate benchmarks and benchmarks ESG,p 11. Available at: https://researchrepository.ucd.ie/bitstream/10197/11708/2/190930-sustainable-finance-teg-final-report-climate-benchmarks-and-disclosures_en.pdf

[163] EU Technical Expert Group on Sustainable Finance (2019) Final Report on Climate benchmarks and benchmarks ESG,p 8. Available at: https://researchrepository.ucd.ie/bitstream/10197/11708/2/190930-sustainable-finance-teg-final-report-climate-benchmarks-and-disclosures_en.pdf

washing is also prevented (recital 9). Moreover, it creates visibility[164] into the actual performance and footprint regarding environmental areas as well as social impacts, while at the same time allows the comparability[165] of the benchmarks. All these will assist the industry to reallocate the capital towards the financing of low-carbon, and will create a more resilient economy.

Furthermore, the benchmarks under the BMR reflect[166] the status quo and the recent strategies; and as a consequence many index providers create their own ESG indexes and therefore there are a lot of ESG methodologies (e.g. the Dow Jones Sustainability Indices) that each of them has different categories and degrees. All these have as a consequence that not only the traditional but also the current ESG benchmarks do not suffice to assess the performance of sustainable investments. That's why the Commission adopted ESG benchmarks in order to capture sustainable goals. So the (EU) 2019/2089 regulation introduces the EU Climate Transition Benchmarks (CTBs), and the EU Paris-Aligned Benchmarks (PABs), as well obligations to administrators to publish specific information about ESG indices. Both benchmarks aim to reduce GHG emissions, and generally to assist to the transition to a low-carbon economy. However, they have different ambitions and therefore different thresholds.

There are 3 different aspects that need to be understood in the benchmark regulation. Firstly, the regulation introduces CTBs and PABs. Secondary, it specifies the minimum requirements for the construction of the benchmark to classify and obtain the label.

[164] EU Technical Expert Group on Sustainable Finance (2019) Final Report on Climate benchmarks and benchmarks ESG,p 20. Available at: https://researchrepository.ucd.ie/bitstream/10197/11708/2/190930-sustainable-finance-teg-final-report-climate-benchmarks-and-disclosures_en.pdf

[165] EU Technical Expert Group on Sustainable Finance (2019) Final Report on Climate benchmarks and benchmarks ESG,p 8. Available at: https://researchrepository.ucd.ie/bitstream/10197/11708/2/190930-sustainable-finance-teg-final-report-climate-benchmarks-and-disclosures_en.pdf

[166] Busch, D., Ferrerini, G. and Grünewald, S., (eds.)(2021) Sustainable Finance in Europe: Corporate Governance, Financial Stability and Financial Markets. Basingstoke: Palgrave Macmillan, p.37.

The *PAB*[167](art. 3 par.1) is a highly ambitious[168] strategy and concerns users that want to be at the forefront of the transition. It includes stricter measures and identifies assets which are ahead and lead the pack (e.g. the reduction of carbon up to 50% in global investments). The benchmark is aligned with the Paris agreement and its aim regarding the limitation of global warming to below 1,5 °C above the pre-industrial levels. Also, the strictness of this benchmark is shown in art.12 of (EU) 2020/1818 delegated regulation[169], where administrators must exclude specific firms from the PABs. On the other hand, *CTB* (art.3 par.1) leads a portfolio through a decarbonization trajectory[170]. The term decarbonisation[171] encompasses carbon emissions that came directly from an entity (scope1), emissions from the consumption of purchased sources of energy (scope 2), and 'all' indirect emissions regarding the operation of the firm (scope 3). Regarding the scope 3 emissions art.5 of 2020/1818 delegated regulation sets out a timeline. CTBs aim to cut carbon emissions to 30%. , while they also intend to help investors identify assets and allocate capital towards low-carbon economy.

Exhibit 3: Minimum Technical Standards for EU CTBs and PABs

MINIMUM STANDARDS	CTB	PAB
Minimum Scopes 1, 2, and (3) GHG Emission Intensity Reduction Compared with the Underlying Benchmark	30%	50%
Scope 3 Phase-in Period	Up to four years	
Baseline Exclusions	Controversial weapons and societal norm violators	
Activity Exclusions	None	• Coal (≥ 1% revenues) • Oil (≥ 10% revenues) • Natural gas (≥ 50% revenues) • Electricity producers with lifecycle GHG emissions higher than 100 gCO2e/kWh (≥ 50% revenues)
Year-on-Year Self-Decarbonization of the Benchmark	At least 7% on average per year: in line with or beyond the decarbonization trajectory from the IPCC's 1.5°C scenario (with no or limited overshoot)	
Minimum Green Share/Brown Share Ratio Relative Compared with Investable Universe (Voluntary)	At least equivalent	Significantly larger (factor 4)
Exposure Constraints	Minimum exposure to sectors highly exposed to climate issues is at least equal to equity market benchmark value.	
Corporate Target Setting	Weight increases considered for companies that set evidence-based targets under strict conditions to avoid greenwashing	
Immediate Disqualification	If misaligned with trajectory for two consecutive years	

Source: S&P Dow Jones Indices LLC, The EU Technical Expert Group on Sustainable Finance. Table is provided for illustrative purposes.

[167] obeco.com. (2021). Climate transition benchmarks - Sustainable investing.(2021) [online] Available at: https://www.robeco.com/en/key-strengths/sustainable-investing/glossary/climate-transition-benchmarks.html

[168] EU Technical Expert Group on Sustainable Finance (2019) Final Report on Climate benchmarks and benchmarks ESG,p 9. Available at: https://researchrepository.ucd.ie/bitstream/10197/11708/2/190930-sustainable-finance-teg-final-report-climate-benchmarks-and-disclosures_en.pdf

[169] COMMISSION DELEGATED REGULATION (EU) 2020/1818 of 17 July 2020 supplementing Regulation (EU) 2016/1011 of the European Parliament and of the Council as regards minimum standards for EU Climate Transition Benchmarks and EU Paris-aligned Benchmarks

[170] According to Reg.(EU) 2019/2089 art.1, par.1 (23c) the decarbonisation trajectory is *"a measurable, science-based and time-bound trajectory towards alignment with the objectives of the Paris Agreement by reducing Scope 1, 2 and 3 carbon emissions as referred to in point (1)(e) of Annex III."*

[171] Brühl, V. (2021). Green Finance in Europe — Strategy, Regulation and Instruments. Intereconomics, p.10.

Furthermore, the second and third aspects[172] of the regulation focus on ESG transparency (concerning benchmarks). According to the regulation, administrators must disclose information on how ESG factors are integrated into the benchmark methodology (recital 20, 22& 24). The benchmarks' providers need to disclose information on how ESG factors are included in the methodology and in the construction of the benchmarks. The providers must also state the case that they are not including ESG, meaning that the ESG factors aren't part of either the construction process or their methodology. So in this case they have to check the box 'not included' (second aspect). Regarding the third aspect, the regulation requires benchmarks' administrators to elaborate and explain how ESG factors are impacting the benchmarks[173]. These data will be updated more frequently[174], i.e. once a year. So this will develop transparency, and there will be information on ESG profiles of all used benchmarks that are impacted by the regulation, but also of conventional benchmarks. So the additional disclosure obligations will be imposed on all benchmarks (not only on the ESG ones). This transparency will improve the quality of the investments choices and also will put an end to the excuses of investors who say that they don't know where they have allocated their capital.

[172]S&P Dow Jones Indices(n.d.) "Frequently Asked Questions-EU Low Carbon Benchmark Regulation". Available at: https://www.spglobal.com/spdji/en/documents/education/faq-spdji-approach-to-the-eu-low-carbon-benchmark-regulation-disclosure-requirements.pdf

[173] EU Technical Expert Group on Sustainable Finance (2019) Final Report on Climate benchmarks and benchmarks ESG,p 14. Available at: https://researchrepository.ucd.ie/bitstream/10197/11708/2/190930-sustainable-finance-teg-final-report-climate-benchmarks-and-disclosures_en.pdf

[174] EU Technical Expert Group on Sustainable Finance (2019) Final Report on Climate benchmarks and benchmarks ESG,p 38. Available at: https://researchrepository.ucd.ie/bitstream/10197/11708/2/190930-sustainable-finance-teg-final-report-climate-benchmarks-and-disclosures_en.pdf

CONCLUDING REMARKS

The term sustainable finance has been circulating among financial markets for many years but after the publication of the EU Sustainable Finance Action Plan, the ESG has started to become more appealing. Now, there is a legal framework within the European Union that regulates ESG issues and prevents, or solves any kind of problems that can be caused by the issue of ESG products or generally by the adoption of ESG criteria (i.e. Greenwashing). Therefore, regulations such as Taxonomy and SFDR assist FMPs to classify their products and be more transparent due to sustainability disclosure obligations.

Nowadays, especially after the spread of Covid-19, the ESG attracts more and more attention from the FMPs. It is a development that will contribute to the transition to a more sustainable future, while it takes into consideration the protection of the environment, human rights, and the relations between a company and its employees.

However, the ESG topic except from being popular is also being debated. Many FMPs wonder why to comply with ESG criteria. Companies and investors run their businesses to make a profit and not just for 'charity'. The sole purpose of an investment is the creation of profit. Companies, in order to make profit, will not estimate what consequences their economic activities will have i.e. to the environment or society. So the question that arises is why companies, investors, and managers would like to comply with ESG criteria if there is nothing to gain. There is no reference, until now, in any existing legal framework or legislative proposal that those who follow ESG would receive any benefits. They are not benefited by economic or tax incentives such as tax exemption or reduction.

Finally, another problem that comes up is that the EU legal framework is quite vast and constantly changed. The Commission keeps adding new proposals without even approving the already existing ones. So those who are interested in ESG, they may get confused and as a result, they may become reluctant to comply with ESG.

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