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The EU's strategy towards incorporating sustainability considerations into the financial regulatory framework: recent developments and future prospects

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Οι απόψεις και θέσεις που περιέχονται σε αυτήν την εργασία εκφράζουν τον συγγραφέα και δεν πρέπει να ερμηνευτεί ότι αντιπροσωπεύουν τις επίσημες θέσεις του Εθνικού και Καποδιστριακού Πανεπιστημίου Αθηνών.

From the bottom of my heart, I would like to thank my family for always believing in me and for giving me strength along my journey in life. I will forever owe my achievements to them. I would also like to express my profound gratitude to Professor Dr. Christos V. Gortsos, whose continuous guidance, encouragement and support has been invaluable throughout the past academic year.

Abstract

The present thesis aims at providing a concise but comprehensive overview of the measures taken both at the global and European Union level in order to integrate sustainability considerations into the financial regulatory framework. It is structured into three Chapters. Chapter A deals with the theoretical foundations and the historical roots of the concepts of sustainability and sustainable development, while also attempting to shed some light on the economic approach to sustainability and on the role of the financial system in channeling funds towards sustainable projects. The first Chapter also focuses on the initiatives undertaken by the international community to align the financial sector with sustainable development. Chapter B discusses in detail the European strategy on sustainable finance, which aims to foster green finance and promote sustainable growth in the EU. Lastly, Chapter C presents specific legal acts adopted recently by the European Union to implement the European Commission's 2018 Action Plan on Financing Sustainable Growth and briefly describes some proposed measures expected to be enacted by the European Union in the near future.

Keywords: sustainable finance, sustainable development, ESG, Taxonomy Regulation, Sustainable Finance Disclosure Regulation, Low Carbon Benchmarks Regulation, European Commission Action Plan on Financing Sustainable Growth, European Commission Action Plan on Building a Capital Markets Union, High-Level Expert Group on Sustainable Finance (HLEG), European Green Deal, International Platform on Sustainable Finance, Technical Expert Group (TEG), Paris Agreement, Sustainable Development Goals (SDGs)

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List of Abbreviations

AIFM	Alternative Investment Fund Managers
AIFMD	Alternative Investment Fund Managers Directive
BCBS	Basel Committee on Banking Supervision
BMR	Benchmarks Regulation
CDM	Clean Development Mechanism
CMU	Capital Markets Union
COP	Conferences of the Parties
CRAs	Credit Rating Agencies
CRAR	Credit Rating Agencies Regulation
CRD	Capital Requirements Directive
CRR	Capital Requirements Regulation
EBA	European Banking Authority
EC	European Commission
EFSI	European Fund for Strategic Investments
EFSD	European Fund for Sustainable Development
EIB	European Investment Bank
EIOPA	European Insurance and Occupational Pensions Authority
ESAs	European Supervisory Authorities
ESFS	European System of Financial Supervision
ESG	Environmental Social Governance
ESMA	European Securities and Markets Authority
ESRB	European Systemic Risk Board
ET	Emissions Trading
EU	European Union
EU GBS	EU Green Bond Standard
FSAPs	Financial Sector Assessment Programs
FSB	Financial Stability Board
GDP	Gross Domestic Product
GHGs	Greenhouse Gases
HLEG	High-Level Expert Group
IBIP	Insurance-based Investment Product
IDD	Insurance Distribution Directive

IFD	Investment Firms Directive
IFR	Investment Firms Regulation
IFRS	International Financial Reporting Standards
IMF	International Monetary Fund
IORP	Institutions for Occupational Retirement Provision
IOSCO	International Organisation of Securities Commissions
IPSF	International Platform on Sustainable Finance
JI	Joint Implementation
JTM	Just Transition Mechanism
KPI	Key Performance Indicators
MDGs	Millennium Development Goals
MiFID II	Markets in Financial Instruments Directive II
NCAs	National Competent Authorities
NDCs	Nationally Determined Contributions
NGFS	Network for Greening the Financial System
NFRD	Non-Financial Reporting Directive
OECD	Organisation for Economic Co-operation and Development
PEPP	Pan-European Personal Pension Product
RTS	Regulatory Technical Standards
SDGs	Sustainable Development Goals
SFN	Sustainable Finance Network
SFDR	Sustainable Finance Disclosure Regulation
SMEs	Small and Medium-sized Enterprises
TCFD	Task Force on Climate-related Financial Disclosures
TFCR	Task Force on Climate-related Financial Risks
TFEU	Treaty on the Functioning of the European Union
TEG	Technical Expert Group on Sustainable Finance
TR	Taxonomy Regulation
UCITS	Undertakings for the Collective Investment in Transferable Securities
UN	United Nations
UNCED	United Nations Conference on Environment and Development
UNFCCC	United Nations Framework Convention on Climate Change
USD	United States Dollar
WCED	World Commission on Environment and Development
WHO	World Health Organisation

Introduction

"It is fair to say that the global financial sector was part of the problem which ultimately affected all in our society. Never again should short-term profits prevail over our long-term future. So, as we reform our financial system from top to bottom, I believe the financial sector has a responsibility to help Europe prepare for the economy of tomorrow. To be part of the solution, not the problem."
Extract from the keynote speech by former President of the European Commission Jean-Claude Juncker at the High-Level Conference on Financing Sustainable Growth, 22 March 2018, Brussels.

Nowadays, sustainability is one of the most widely discussed and debated topics worldwide. As Jean-Claude Juncker righteously pointed out in his keynote speech at the High-Level Conference on Financing Sustainable Growth in Brussels, the financial system has a responsibility to contribute to the transition to a low-carbon economy. To effectively address the catastrophic and unpredictable consequences of climate change, environmental degradation and resource depletion, urgent action is needed to adapt public policies to this new reality. The financial system needs to be reformed to support the transition towards a greener and more sustainable economy. It is imperative that the regulatory framework of the financial system be fundamentally overhauled in order to channel private capital to more sustainable investments.

This transformation towards a more sustainable economy requires large-scale investments. According to the European Commission, to achieve the EU's targets for energy and climate policy alone, additional annual investments of €170 billion are required, while the investments needed to meet the Sustainable Development Goals (SDGs) will be even higher. This investment gap calls for rapid and substantial mobilisation of capital towards sustainable activities that shall ensure the long-term competitiveness of the global economy and promote employment and productivity. A new model of economic development is needed which accommodates the needs of present generations without compromising those of future generations. Such a model should contribute to new employment and investment opportunities and boost economic growth. It is evident that more efforts are needed to foster long-term investment, to address undue short-termism in the corporate sector while maintaining financial stability. However, the idea of pursuing environmental and social goals through the greening of the financial system is not new. The only thing that changed now is the momentum behind its implementation after the adoption of the 2030 Agenda for Sustainable Development and the Paris Agreement.

The signature of the Paris agreement on 12 December 2015 constitutes a turning point in modern history and global economy. The world economy is slowly but steadily moving towards a low-carbon society, where renewable energy and smart technologies improve our life quality and contribute to job creation and growth without endangering our planet. The EU attempts to lead this transition by pledging to reduce CO_2 emissions by 40% in all sectors of the EU economy by 2030. Sectors such as energy efficient buildings, renewable energy, low-carbon transportation, waste and water management, sustainable agriculture and forestry need large amounts of capital. However, it is obvious that the amount of the investment needed is well beyond the capacity of the public sector alone. To effectively address the funding gap, bold reforms should be made in the regulatory framework to direct a significant amount of private capital towards environmentally and socially sustainable economic activities.

The ongoing COVID-19 pandemic has showed that we should be better prepared against different types of risks and imminent threats to public health and safety and confirmed the critical need to enhance the resilience of our societies and focus more on devising proactive

comprehensive plans of actions which cover all potential risks (including environmental and natural catastrophe risks) in order to respond better and recover faster from such emergencies.

The following chapters of this study provide a short but comprehensive overview of the most important measures and policies adopted at the global and European Union level to facilitate the transformation towards a greener financial system.

Chapter A. The concepts of sustainability and sustainable development-Global initiatives

1. Sustainability: theoretical foundations and historical roots

Sustainability is the theme of our time. However, the idea of sustainability has not been discovered in the 20th century. To fully understand this fuzzy concept, we need to shed light on its historical roots.

According to Du Pisani, while the words "sustainability" and "sustainable" first emerged in the Oxford English Dictionary in the second half of the 20th century, the equivalent terms in French ("durabilité" and "durable") and German ("Nachhaltigkeit" and "nachhaltig") have been used for a long time[1]. It was not until the 18th century, when the German Hans Carl von Carlowitz used for the first time the word "sustainability" in his book "Sylvicultura Oeconomica" in 1713. Carlowitz proposed the simple but important idea of "nachhaltende Nutzung" (sustainable use) of forestry, meaning that we need to strike a balance between the number of trees already cut and the number of new trees that have to be planted in order to restore the regenerating capacity of a forest. There had also been other Germans who criticized the practice of over-exploitation of forests and suggested policies to help prevent the destruction of them[2]. In parallel to that, there were growing concerns about food resources depletion because of the excessive consumption. That sparked the idea of the need to restrict human population, which was first championed by Thomas Robert Malthus, famous English cleric, scholar and influential economist, in his book called "An Essay on the Principle of Population"[3]. Malthus' basic assumption was that the population increases geometrically, while the food production would increase only arithmetically. Therefore, humans had the tendency to use all available resources to reproduce rather than securing higher living standards, which is commonly referred to as the "Malthusian trap".

After the Industrial Revolution, the world witnessed tremendous growth in population and production. Between 1700 and 1950 world population rose from around 603.490 to 2.524.324, while in the same period the World GDP climbed from 371.269 million dollars to 5.329.719 million dollars[4]. The unprecedented growth rates during 1950s and 1960s stimulated expectations of unlimited economic growth and never-ending abundance. Nevertheless, the fear that economic growth and excessive consumption have a negative impact on the environment made people more concerned about the survival of humanity and our planet. Against that background, growing concerns over an ecological catastrophe, sparked a new model of thinking about economic development and paved the way for sustainable development as a measure to address the repercussions of unlimited economic growth. The expectations of unlimited economic growth were not materialized. As a consequence of the first oil crisis in 1973, a global recession followed, which showed the impact of resource shortages on the economy.

The economic slowdown caused by market turbulence due to the outbreak of the oil crisis led many people to reflect upon the potential limits to economic growth. To that end, the Club of Rome[5], a group of notable scientists, economists, businessmen and businesswomen, high level

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[1] See **Jacobus A. Du Pisani (2006)**, pp. 83-96.
[2] See ibid, pp. 85-87, with further references.
[3] For more details on that, see **Ehrlich, Isaac and Lui, Francis Tingming (1997)**, pp. 207-210.
[4] For the statistics see **Maddison, A. (2001)**, pp. 256-263.
[5] According to its website, "The Club of Rome is an organisation of individuals who share a common concern for the future of humanity and strive to make a difference. Our members are notable scientists, economists, businessmen and businesswomen, high level civil servants and former heads of state from around the world. Their efforts are supported

civil servants and former Heads of State from around the world, published in 1972 the famous report under the title "The limits to growth"[6]. This international team of researchers at the Massachusetts Institute of Technology conducted a study on the impact of continued worldwide growth. First, they assessed five key parameters, which limit economic growth: planet-population increase, agricultural production, nonrenewable resource depletion, industrial output and pollution generation. Then, they imported data on these five factors into a computer model and examined the behavior of the model under different scientific assumptions to extract alternative scenarios for the future of humanity. The book that they published constituted a nontechnical report of their findings. The message of the book was clear and stunning. Du Pisani admits that "the authors came to an apocalyptic conclusion"[7]:

"If the present growth trends in world population, industrialization, pollution, food production and resource depletion continue unchanged, the limits to growth on this planet will be reached sometime within the next one hundred years. The most probable result will be a rather sudden and uncontrollable decline in both population and industrial capacity"[8].

In 1972, the United Nations Conference on the Human Environment took place in Stockholm from 5 to 16 June. It was the first Conference organized under the auspices of the United Nations, which served as a forum of exchanging ideas on specific global measures to protect the environment. The members of the Conference adopted a Declaration which included 26 principles concerning the environment and development, an Action Plan for the Human Environment, a Resolution of Institutional and Financial Arrangements and other Recommendations for action at the national level. Article I point 5 of the Declaration of the United Nations Conference on the Human Environment confirms that:

"A point has been reached in history when we must shape our actions throughout the world with a more prudent care for their environmental consequences. Through ignorance or indifference, we can do massive and irreversible harm to the earthly environment on which our life and well-being depend. Conversely, through fuller knowledge and wiser action, we can achieve for ourselves and our posterity a better life in an environment more in keeping with human needs and hopes."

This paragraph reflects the core of the concept of sustainability. As Dellis puts it, both the seminal book published by The Club of Rome titled "The limits to growth" and the Declaration of Stockholm of 1972, point out that the depletion of non-renewable resources leads inevitably to the collapse of the global economy in a few decades[9]. In order to promote social welfare, we need sustainable (not continuous) economic growth which can be achieved through prudent use of natural resources and the utilization of technology (hybrid motors, solar panels etc.). The author connects sustainability with the concept of "intergenerational equity", an idea proposed by the philosopher John Rawls in his famous book "Theory of Justice". He proposes that present generations must not only act to satisfy their own selfish interests but also as agents of future

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by the Secretariat in Winterthur, Switzerland, the European Research Centre registered in Constance, Germany and National Associations in more than 30 countries. The Club of Rome conducts research and hosts debates, conferences, lectures, high-level meetings and events. The Club of Rome's mission is to promote understanding of the global challenges facing humanity and to propose solutions through scientific analysis, communication and advocacy."

[6] See **Donella H. Meadows, Dennis L. Meadows, Jorgen Randers, William W. Behrens III (1972)**

[7] See **Jacobus A. Du Pisani**, supra, p. 90

[8] See **Donella H. Meadows et al.**, supra, p. 23

[9] See **Georgios Dellis (2018)**, pp. 195-197.

generations, of the unborn children whose interests tend to be undermined by our society[10].

1.1. Defining sustainable development: the Brundtland Commission and the Agenda 21

Almost ten years after the United Nations Conference on the Human Environment, in 1983 the UN Secretary-General, Javier Pérez de Cuéllar, tasked the former Prime Minister of Norway, Gro Harlem Brundtland, with the goal of setting up an independent Commission whose mandate was to report on strategies for the sustainable development. The General Assembly of the UN welcomed in its Resolution 38/161 of 19 December 1983 the establishment of that Commission. This new forum was named "the Brundtland Commission", or more formally, the "World Commission on Environment and Development" (WCED). The WCED was composed of 22 personalities from both developed and developing countries who came together to propose sustainable economic policies for the world economy. On 4 August 1987, the UN General Assembly adopted the Report of the WCED, which was entitled "Our common future".

Du Pisani points out that the main concern of the authors of the Brundtland Report was to ensure that all human beings, regardless of their nationality, can adequately satisfy their basic universal needs. Thus, redistribution is among the most important topics of the Report. The Report adopted also the three-pillar approach to sustainability, which means that sustainability is composed of three main aspects: the economy, society and the environment. Additionally, the authors admitted that economic growth and environmental conservation are two conflicting goals. Thus, they proposed that we need to take action in order to promote that kind of growth that is in line with high environmental standards, especially for developing countries[11].

The impact of that Report on public policy was enormous. The Brundtland Commission has provided us with one of the most widely used definitions of the term "sustainable development":

"Sustainable development is development that meets the needs of the present without compromising the ability of future generations to meet their own needs."[12]

However, Redclift underlines the fact that this definition has many inherent deficiencies. For example, it is more than obvious that the needs of people change rapidly. Thus, future generations might have different needs than present generations. We also have to reflect upon the different needs across various cultures, which may pose problems to the consistency and the uniformity of the proposed solutions. Furthermore, other pressing questions remain, namely how we determine which policies are sustainable and who will decide on that[13].

Five years after the Brundtland Report, the UN Conference on Environment and Development (UNCED) was held in Rio de Janeiro, Brazil, from 3 to 14 June 1992. The outcome of the UNCED, also known as Earth Summit, was the adoption by 178 Governments of the Agenda 21. Agenda 21 is a detailed non-binding action plan of 351 pages which contains specific measures to be implemented at the global, national and local level to combat poverty, promote and protect biodiversity and integrate sustainability into economic policymaking. The Agenda 21 emphasises the need for coordinated global action to deliver solutions to our common threats and underscores the necessity of public participation in the decision-making as a precondition for achieving

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[10] See ibid, p. 197.
[11] See **Du Pisani**, supra, pp. 92-93.
[12] On the problems of that definition see: **Redclift, Michael R. (2009)**, pp. 33-50.
[13] See ibid, pp. 35-36.

sustainable development. Through the diffusion and free flow of information everyone can contribute to mitigating the adverse effects of economic activity on the environment and to safeguarding the survival of our species. Finally, it highlights the importance of science, technology and education in raising public awareness on climate change and sustainable development.

1.2. The three-pillar approach to sustainable development: social, economic and environmental

Most theorists have concluded that sustainable development can be described as a concept which incorporates three different dimensions or aspects. These three factors are complementary to each other and create a multifaceted approach to sustainability. As Purvis, Mao, & Robinson put it, "this tripartite description is often, but not always, presented in the form of three intersecting circles of society, environment, and economy, with sustainability being placed at the intersection"[14]. The three-pillar approach has become commonplace in public discourse. Deriving from the Brundtland Report, the core of this principle is that we must maintain a balance between three goals: economic growth, protection of the environment and social equity. By pursuing these goals simultaneously, we attempt to find an equilibrium. This "balancing of trade-offs between seemingly equally desirable goals within these three categorisations"[15] leads to sustainable development.

While we might take this approach for granted, others propose different aspects as parts of the concept of sustainable development. Many theorists have added institutional, cultural or even technical dimensions to this approach[16]. Others reject the idea of multiple dimensions claiming that society as a whole must be sustainable covering every aspect of human life.

Nevertheless, turning to the popular three-pillar approach as the prevalent one, we can observe that this viewpoint has emerged as a quasi-universal theory on sustainable development. These three intertwined aspects have been established in literature. The social aspect involves defending human rights, equity and adequate access to basic resources. The environmental dimension covers the protection of marine life and plants, promoting biodiversity, tackling global warming, reducing air and water pollution and generally combatting climate change. The last pillar, economic growth, must be pursued through the lens of the other two principles. In other words, sustainability attempts to place some limits on the economic activity with a view to attaining social equity as well as environmental conservation[17].

2. The economic approach to sustainability

2.1. Looking into sustainability economics

Global environmental change, changes in ecosystems due to loss of biodiversity, stratospheric ozone depletion, lack of freshwater supplies and many other manifestations of environmental degradation have already alarmed the international community about the impact of these phenomena on humanity. As a consequence, not only environmental scientists but also economists

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[14] See **Purvis, B., Mao, Y. & Robinson, D. (2019)**, pp. 681–695.
[15] See ibid, p. 685.
[16] See ibid, p. 686, with extensive literature on this issue.
[17] On that see **Brown, B.J., Hanson, M.E., Liverman, D.M. et al. (1987)**, pp. 713–719.

started looking into the concept of sustainability.

The scientific field of Ecological economics first emerged thirty years ago and was developed in light of the idea that economists should focus more on understanding the relationship between humans and nature. According to Costanza[18], "Ecological economics is a new transdisciplinary field of study that addresses the relationships between ecosystems and economic systems in the broadest sense. These relationships are central to many of humanity's current problems and to building a sustainable future but are not well covered by any existing scientific discipline". The subject matter of Ecological economics is how ecosystems and economic activity interrelate. However, ecological economics goes beyond our normal conceptions of scientific disciplines and tries to integrate and synthesize many different disciplinary perspectives. It uses the tools of conventional economics, but it differs substantially from it, since it is oriented towards the normative idea of sustainability. As Costanza puts it, it is "the science and management of sustainability".

So far there are few contributions of economists (mainly ecological economists and environmental and resource economists) to the scientific discussion about the main aspects of sustainability. According to Baumgärtner and Quaas, until 2010 there was not a unifying notion or specific structures (e.g. specific institutions or conferences) of the concept of sustainability economics[19]. The authors reviewed the existing economic literature in light of the idea of sustainability and found four recurrent attributes that define the emerging field of sustainability economics: i) the newly established field focuses on the relationship between humans and nature; ii) it is oriented towards the long-term and inherently uncertain future; iii) its normative foundation is in the idea of justice, between humans of present and future generations as well as between humans and nature; iv) there is a concern for economic efficiency, understood as non-wastefulness, in the allocation of natural goods as well as their human-made substitutes and complements[20].

Moreover, they argue that sustainability economics is ethically founded on the vision of sustainability, which focuses on justice between human and nature. This concept is further divided into three specific relationships: (i) justice between humans of different generations ("intergenerational" justice), (ii) justice between different humans of the same generation ("intragenerational" justice), and (iii) justice between humans and nature ("physiocentric ethics")[21].

The authors also propose that the second ethical foundation of sustainability economics lies in the normative goal of modern economics, which is the satisfaction of human needs in the most efficient way given scarce resources. The objective of satisfaction of individual needs is rooted in the political theory of liberalism. This philosophical movement advocates the right of individuals to pursue their own self-interests, provided that they exercise this right in a way which does not prevent others from seeking their own happiness. This idea is associated with utilitarianism and was first championed by the philosophers Jeremy Bentham, James Mill and John Stuart Mill. The overarching principle of Bentham's philosophy is the idea of utility maximization, which is a fundamental concept of modern economics[22].

The normative goal of efficiency is a central tenet of modern economics. This is clearly

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[18]See **Costanza, Robert (1993),** p. 3**.**

[19]See **Baumgärtner, Stefan and Quaas, Martin F. (2010)**, p. 2.

[20] See ibid, p. 2.

[21] See ibid, p. 3.

[22] See ibid, p. 4.

reflected in the definition of economics by Lionel Robbins, according to whom "Economics is the science which studies human behaviour as a relationship between ends and scarce means which have alternative uses."[23] This definition highlights another important idea that forms an integral part of the theory of modern economics, namely that of opportunity cost. The opportunity cost is conceptually associated with scarce resources which may be used in alternative ways. It reflects the potential benefit that would have been derived by an option not chosen.

By bringing these two normative foundations together, Baumgärtner and Quaas conclude that sustainability economics is founded on the idea of efficiency for achieving the two normative goals of i) the satisfaction of the needs and wants of individuals and ii) justice between humans of present and future generations and justice towards nature.[24]

Sustainability economics deals with problems of efficiency and justice. Rather than focusing exclusively on environmental ethics or resource scarcity, it asks how we-as human beings-perceive our relationship towards nature and how we manage it in order to satisfy our needs efficiently in conformity with principles of justice. Thus, the aim of sustainability economics is twofold: first, the understanding of these interrelationships and secondly, the effective management of them.

As a result, it is obvious that sustainability economics is not a traditional positive and value-free scientific field. Even though it aims at providing us with accurate explanations of these relationships, it also pursues normative goals, namely it aspires to manage human-environment ecosystems in light of the sustainability principle. This is a characteristic which clearly distinguishes sustainability economics from other purely positive scientific fields.

2.2. The role of the financial system and the Environmental, Social, and Governance (ESG) criteria for sustainable investments

As we mentioned earlier, sustainable development is an integrated concept with three aspects: economic, social and environmental. On the environmental front, climate change, biodiversity loss and depletion of natural resources are destabilising the ecosystems on Earth. Apart from that, poverty, hunger, homelessness and lack of access to healthcare prove that many people live below minimum social standards. Sustainable development aims at providing current and future generations with the resources needed, such as food, water, shelter, healthcare and energy, without pushing the Earth beyond its natural limits.

Having said that, the question arises: why and how should finance contribute to sustainable development? The answer can be found by pointing to the main task of the financial system, namely the allocation of funding to its most productive use. According to Schoenmaker and Schramade, finance can play a pivotal role in allocating capital to sustainable firms and projects and thus accelerate the transition to a low carbon, green and more circular economy[25]. Moreover, investors can influence the firms in which they invest by giving them motives to conform with sustainable business practices. Finance can also help in pricing risk for valuation purposes and can thus address the inherent uncertainty about environmental issues, such as the impact of carbon emissions on environmental degradation.

How can the financial system assist in meeting sustainability goals? To answer that question,

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[23] See **Lionel Robbins (1935)**, p. 15.
[24] See **Baumgärtner, Stefan and Quaas, Martin F. (2010),** p. 5.
[25] See **Schoenmaker, Dirk and Schramade, Willem (2019)**, pp. 18-20.

we have to identify first the main functions of the financial system. These are the following[26]: i) it produces information ex ante about possible investments and allocates capital; ii) it monitors investments and exerts corporate governance after providing finance; iii) it facilitates the trading, diversification and management of risk; iv) it mobilises and pools savings; v) it eases the exchange of goods and services.

Finance plays a key role in mobilizing capital towards where it is needed the most. It helps companies to make strategic decisions in order to reach sustainable goals. However, investors need to know certain information about a company's performance to assess if it has adopted sustainable policies and decide in which companies they might want to invest. The most common and safest way for investors to evaluate a company's sustainability performance is the use of the Environmental, Social and Governance (ESG) criteria[27]. These criteria form a set of standards that investors use to screen potential investments or the activities of a company in terms of their compliance with environmental, social and governance considerations. Bassen and Kovacs refer to these criteria as "extra-financial material information about the challenges and performance of a company on these matters" which allow "more differentiated investment judgements by enabling investors to better assess risks and opportunities."[28]. This is the reason why more and more companies are trying to provide investors with updated data on these extra-financial aspects which are not accounted for within regular financial data.

In order to evaluate a company based on ESG criteria, investors take into consideration different datasets that correspond to a broad range of company characteristics which help them identify companies that share the same values with them.

Environmental criteria typically refer to climate change and the depletion of natural resources, company's energy use, waste production, pollution and treatment of animals. Investors need to know to which environmental risks a company is exposed and how the company is managing those risks. Social criteria include considerations on how the company treats its workforce and focuses on employee relations and diversity, working conditions, giving back to local communities through donations and volunteering work, having positive social impact, health and safety of the employees and maintaining good business relationships. In relation to governance issues, investors want to know how companies are run. Especially, they focus on areas such as corporate board diversity, effective risk management and avoidance of excessive executive compensation, protection of minority shareholders' rights, sound reporting and disclosing information mechanisms, transparent accounting methods, avoidance of conflicts of interest and adoption of antibribery, anticorruption and whistleblowing policies.

Amel-Zadeh and Serafeim[29] conducted a global survey to see if, how and why investors use ESG information. They found that most respondents (82%) take into account ESG information when making investment decisions. Using survey data, they also found that most of the investors that do consider ESG information in their investment decisions do so, because ESG information is highly associated with better investment performance of their portfolios. Client demand, product strategy, bringing change in companies and ethical considerations are also a source of motivation for investors to use ESG data.

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[26] See ibid, p. 18.

[27] See **Max M. Schanzenbach and Robert H. Sitkoff (2020),** p. 388. The authors define ESG investing as "an umbrella term that refers to an investment strategy that emphasizes a firm's governance structure or the environmental or social impacts of the firm's products or practices."

[28] See **Alexander Bassen and Ana Maria Masha Kovacs (2008)**, p. 184

[29] See **Amir Amel-Zadeh and George Serafeim (2018),** pp. 11-15

This trend is evident at different levels in the financial sector. Using the example of banks, they have started to incorporate ESG factors into their lending processes to support their customers in the process of transforming to a more sustainable business model. During the last three years, the banking sector has witnessed a fundamental shift towards green and sustainability linked loans (SSL). In broad terms, the key feature of a green loan is that the proceeds are used for green projects, while sustainability linked loans are characterized by the fact that pricing is tied to the borrower's performance against certain pre-determined sustainability criteria. In the same vein, more and more investment funds choose to invest in environmentally sustainable projects or companies and direct their capital towards green assets. In general, the financial sector plays a leading role in financing and accelerating the transition to a low-carbon and more circular economy by opting for sustainable companies and projects.

Regarding the monitoring of their investments, investors can also exert influence on the companies in which they have invested. They can play a key role in controlling and directing a company's governing board by urging to adopt greener corporate strategies. Apart from that, the governing body needs to balance the diverse interests of a company's stakeholders, taking into consideration also environmental and societal concerns.

Finance is also good at pricing the risk of future cash flows for valuation purposes. Since there is inherent uncertainty about environmental issues (e.g. how rising carbon emissions will affect the climate), financial risk management could assist in dealing with these uncertainties. As an example, scenario analysis is widely used to assess risk and valuation under different climate scenarios.

3. Global initiatives

3.1. The road to Paris Agreement

The adoption of the Paris Agreement on 12 December 2015 has been welcomed by many commentators across the globe as a huge diplomatic success and described as having "historic nature"[30]. However, in order to understand how the global community reached that landmark decision, we have to briefly summarize the existing legal framework prior to that Agreement.

The Paris Agreement was concluded within The United Nations Framework Convention on Climate Change (UNFCCC), which is an international treaty. The UNFCCC was adopted on 9 May 1992. Pursuant to Art. 20 of the UNFCC, it was open for signature from 4 to 14 June 1992 and from 20 June 1992 to 19 June 1993. According to Art. 22, "the Convention is subject to ratification, acceptance, approval or accession by States and by regional economic integration organizations"[31]. On 21 March 1994, the 50th instrument of ratification, acceptance, approval or accession had been deposited. Thus, on that day, the UNFCCC entered into force in accordance with Art. 23 par 1.

According to the information provided by the Depositary, the Secretary-General of the United Nations, there are 165 signatories and 197 parties to the UNFCCC (196 States and 1 regional economic integration organization). Pursuant to Art. 2 of the UNFCCC, "the ultimate objective of this Convention …is to achieve, in accordance with the relevant provisions of the Convention, stabilization of greenhouse gas concentrations in the atmosphere at a level that would prevent

[30] See **Coral Davenport (2015)**

[31] Thus, enabling the EU to become party to the Convention.

dangerous anthropogenic interference with the climate system". Governed by the principle of "common but differentiated responsibilities", the Parties have undertaken various responsibilities, including the need to curb anthropogenic emissions, to provide financial support to developing countries, to report on their climate change policies and measures and also to submit an annual inventory of their greenhouse gas emissions.

Art. 7 of the UNFCC establishes the Conference of the Parties (COP). According to Art. 7 par. 2, "The Conference of the Parties, as the supreme body of this Convention, shall keep under regular review the implementation of the Convention and any related legal instruments that the COP may adopt, and shall make, within its mandate, the decisions necessary to promote the effective implementation of the Convention." Using that clause, the COP has met several times to evaluate progress on the implementation of policies dealing with climate change.

On 11 December 1997, the Kyoto Protocol to the UNFCC was adopted. It entered into force on 16 February 2005 and there are 192 parties to the Protocol. In a nutshell, the Kyoto Protocol is based upon the experience gained from the UNFCCC. It aims to commit developed countries to reduce greenhouse gases (GHGs) emissions in accordance with binding targets set in the Annex B, to adopt policies and measures on climate change and to report periodically on them. As in the case of the UNFCCC, the Protocol is based on the principle of common but differentiated responsibilities: it obliges only the industrialized countries to limit their anthropogenic harmful emissions based on the scientific evidence that the developed countries produce very large amounts of greenhouse gases, thus they must be held accountable for the current levels of the carbon emissions in the atmosphere.

The main obligation imposed upon developed countries derives from Art. 3 par. 1 of the Protocol. Pursuant to that, "The Parties included in Annex I shall, individually or jointly, ensure that their aggregate anthropogenic carbon dioxide equivalent emissions of the greenhouse gases listed in Annex A do not exceed their assigned amounts…with a view to reducing their overall emissions of such gases by at least 5 per cent below 1990 levels in the commitment period 2008 to 2012."

One of the most crucial novelties of the Kyoto Protocol was the creation of flexible market mechanisms to combat climate change. The system was based on the trade of emissions permits. The Protocol introduces for the first time the legal framework for a global scheme of emissions rights trading. The parties to the Protocol have committed to limiting the GHG emissions. To achieve this commitment, they can take not only domestic measures but also activate the so-called flexible mechanisms of the Kyoto Protocol: Emissions Trading (ET)[32], Joint Implementation (JI)[33] and Clean Development Mechanism (CDM)[34].

According to Padmanabhan[35], Art. 17 of the Kyoto Protocol creates a system of emissions rights trading "whereby one Annex I country might directly purchase from another Annex I country some of its rights to emit GHG, known as Assigned Amounts, or some of the emission reductions generated under Articles 6 or 12". The author points out that this scheme is an efficient way to promote environmental and economic sustainability. This system is based upon the basic principle of modern economics that human behavior is governed by self-interest. That means that self-interested economic agents have the motive to sell the emission rights that they have in surlpus to

[32] See Art. 17 of the Protocol.
[33] See Art. 4 of the Protocol.
[34] Envisaged in Art. 12 of the Protocol.
[35] See **Padmanabhan Aishwarya (2008),** p. 5

those nations that need them more, thus allowing the market to allocate emission rights efficiently. In other words, countries that have emission rights to spare can sell this excess amount of rights to other countries that have exceeded their predefined limit. In that way, atmospheric pollution is being contained, while the innovative right "to pollute" is considered as an opportunity for profit. Padmanabhan defines this right "as the right to emit a certain quantity of a specified substance during a defined period of time."[36]

On 12 December 2015 in Paris, the Conference of the Parties to the UNFCCC at its 21st session (also known as COP 21) adopted the Paris Agreement through the Decision 1/CP.21. According to Art. 20 par. 1 of the Agreement, "this Agreement shall be open for signature and subject to ratification, acceptance or approval by States and regional economic integration organizations that are Parties to the Convention. It shall be open for signature at the United Nations Headquarters in New York from 22 April 2016 to 21 April 2017."

Pursuant to Art. 21 par. 1 of the Paris Agreement, "this Agreement shall enter into force on the thirtieth day after the date on which at least 55 Parties to the Convention accounting in total for at least an estimated 55 per cent of the total global greenhouse gas emissions have deposited their instruments of ratification, acceptance, approval or accession." Based on that Article, the Agreement entered into force on 4 November 2016, 30 days after the conditions of that Article (namely, ratification by 55 countries that account for at least 55% of global emissions) had been met. Since then, there are 195 signatories and 189 Parties to that Agreement.

The Paris Agreement constitutes a historic agreement which aims at combatting climate change, promoting sustainable development, facilitating the transition to a green economy and directing cash flows to sustainable economic activities with low carbon footprint. The Agreement is based upon the UNFCCC and reflects "equity and the principle of common but differentiated responsibilities and respective capabilities, in the light of different national circumstances."[37] In accordance with Art. 2 par. 1, "this Agreement, aims to strengthen the global response to the threat of climate change by: (a) holding the increase in the global average temperature to well below 2°C above pre-industrial levels and pursuing efforts to limit the temperature increase to 1.5°C above pre-industrial levels, b) increasing the ability to adapt to the adverse impacts of climate change and foster climate resilience and (c) making finance flows consistent with a pathway towards low greenhouse gas emissions and climate-resilient development." To achieve these goals, "Parties shall cooperate in taking measures, as appropriate, to enhance climate change education, training, public awareness, public participation and public access to information, recognizing the importance of these steps with respect to enhancing actions under this Agreement."[38]

The Agreement contains also effective transparency systems. According to Art. 13 par. 1, "In order to build mutual trust and confidence and to promote effective implementation, an enhanced transparency framework for action and support, with built-in flexibility which takes into account Parties' different capacities and builds upon collective experience is hereby established." The Parties should regularly report on their anthropogenic emissions to track the progress made in implementing the measures provided under the Agreement and periodically assess the collective progress towards achieving the purpose of this Agreement and its long-term goals (referred to as the "global stocktake"). The first global stocktake will be conducted in 2023 by the COP and every

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[36] See ibid, p. 5.
[37] See Art. 2 par. 2 of the Agreement.
[38] See Art. 12 par. 1 of the Agreement.

five years thereafter unless otherwise decided by the COP serving as the meeting of the Parties to this Agreement.

One of the key features of the Paris Agreement are Nationally Determined Contributions (NDCs). The NDCs are contributions that each country should make to attain the worldwide long-term temperature goal and are being determined by each individual country. Art. 4 par. 2 states that "Each Party shall prepare, communicate and maintain successive nationally determined contributions that it intends to achieve. Parties shall pursue domestic mitigation measures, with the aim of achieving the objectives of such contributions." As Bodansky puts it, the NDCs included in the Paris Agreement "differ from the Kyoto Protocol's emission targets in four respects. First, they are nationally determined rather than internationally negotiated. Second, they are not legally binding: there is no obligation under the Paris Agreement to achieve them. Third, they are to be recorded in a public registry to be established by the secretariat later this year, rather than in an annex to the agreement, as some countries proposed. Fourth, they are required of all parties, rather than only Annex I parties."[39]

The Paris Agreement constitutes a paradigm shift towards climate change mitigation and adaptation. This legally binding instrument differs from the Kyoto Protocol in that "it applies not only to developed countries, like the Kyoto Protocol, but also to developing countries, which account for a growing share of global emissions"[40].

3.2. "Transforming our world: the 2030 Agenda for Sustainable Development"

On 25 September 2015 the UN General Assembly, composed of Heads of State and Government and High Representatives, meeting at the United Nations Headquarters in New York from 25 to 27 September 2015 adopted the Resolution A/RES/70/1 entitled "Transforming our world: the 2030 Agenda for Sustainable Development". The overarching goal of this Agenda is the unanimous adoption of a universal framework to tackle global issues such as poverty, pollution, gender equality and to achieve sustainable development by the end of 2030 through coordinated action and a shared vision. The 2030 Agenda is composed of 4 parts: (i) A political Declaration (ii) the 17 Sustainable Development Goals (SDGs) and 169 relevant targets (iii) the Means of implementation and the Global Partnership (iv) the Follow-up and review part.

The 17 SDGs form an integral part of this Agenda and are based upon the earlier Millennium Development Goals (MDGs). The MDGs were adopted by the UN General Assembly in 2000 as part of the UN Millennium Declaration. The SDGs mark a historic achievement for the UN towards the adoption of a single sustainable development agenda with the aim to foster economic and social development without compromising environmental sustainability. These goals also highlight the need to place target-setting at the epicentre of global public policy.

The approach of the Agenda is a novel one. A key element of it is that the SDGs are global in nature but take into consideration national capacities, challenges and the level of economic development of each individual country. The participating States have a common responsibility to achieve the SDGs and they all have to take specific measures at the local, national and international level. The Agenda has to be implemented as a whole. That means that countries have a set of interlinked targets to achieve in a way that prevents them from adopting only those policies that

[39] **Bodansky, Daniel (2016)**, p. 24.
[40] See ibid, p. 3.

promote one target but undermine the others. Furthermore, in order to make sure that the Agenda is being implemented efficiently and to ensure transparency, the Agenda introduces a comprehensive "follow-up and review mechanism", which aims to evaluate the impact of the measures that have been taken by each country. This mechanism is being operated and managed at the international level by the High-Level Political Forum on Sustainable Development, whose task is to assess every year the progress that has been made by the countries.

As previously highlighted, the Agenda introduces a new way of global governance putting aside the classic model of top-down regulation. It makes use of non-legally binding targets set globally by UN Members to reach a common goal. This method of global regulation through goals has some specific distinguishing features that are worth taking a look at. According to some scholars, these characteristics "amount to a unique and novel way of steering and distinct type of institutional arrangement in global governance."[41]

Firstly, this novel method of regulating through goals appears to be disconnected from the traditional international legal order. The SDGs do not impose legal obligations on UN Members and the Resolution that adopted these goals does not have immediate legal effect in each Member State. Thus, to be bound to implement the aforementioned measures, countries must transpose the Resolution in their domestic legal order, which is a matter of political will. In that regard, the Agenda differs from traditional legally binding treaties[42].

Furthermore, Biermann, Kanie and Kim argue that the institutional oversight of that mechanism is weak at the global level and differs from other sectors where more complex models of governance have been introduced to efficiently oversee the implementation of the measures. While the High-Level Political Forum on Sustainable Development has been mandated to oversee the implementation of the SDGs, some argue that this institutional arrangement is not a safeguard. However, others point out that the existence of a forum in which countries as stakeholders share the motive to track the progress of the other members is an important feature of that mechanism which might prove successful over time.

Besides that, the SDGs are addressed to both developing and developed countries, whereby the MDGs imposed obligations only upon developed countries[43]. Thus, all countries are being treated equally. All of them share the burden to develop sustainable development policies in order to align with the actions of their peers regardless of the continent they belong to. Nevertheless, there is some degree of discretion as regards the design and the implementation of specific policies. Due to the fact that non-legally binding goals have only guiding value, the targets set in the Agenda, be them qualitative or quantitative, can be achieved through a wide set of different national measures. That gives a lot of leeway to the countries to choose the ways in which they wish to put into effect the predefined goals.

3.3.FSB's initiatives on sustainable finance

The Financial Stability Board[44] (FSB) was established in 2009 by a decision taken at the G20 London Summit. The FSB is an international forum (thus, it lacks legal personality) located in

[41] See **Frank Biermann, Norichika Kanie, Rakhyun E Kim (2017)**, pp. 26-27.
[42] See ibid, p. 26.
[43] See ibid, p. 27.
[44] For a detailed presentation of FSB's historical development, its objectives and tasks see **Gortsos, Ch. V. (2019)**, pp. 61-63.

Basel and its institutional role consists in safeguarding the stability of the international financial system. Since September 2009, it also has a formal Charter containing provisions on several matters such as its objectives and tasks, the admissions criteria for its members and its internal Committees, Groups and other organs. FSB's membership is composed of central banks, ministries of finance, supervisory and regulatory authorities, international financial organisations and standard setting bodies. However, the Charter explicitly states that it is not legally binding upon its members.

According to its Charter, FSB is entrusted with the objective to coordinate at the international level the efforts of national authorities and international standard setting bodies towards the promotion and implementation of effective regulatory and supervisory policies in the financial sector.[45] To achieve this goal, the FSB monitors-among others-global best practices in the financial industry, identifies potential vulnerabilities and proposes relevant supervisory action to address them, facilitates information exchange among national supervisory authorities, develops Guidelines and coordinates the work of international standard setting bodies[46].

In December 2015 the FSB launched the Task Force on Climate-related Financial Disclosures (TCFD). The goal of this industry-led Task Force, chaired by Michael R. Bloomberg, is to develop recommendations on climate-related financial disclosures by companies. The Report of the TCFD providing its final recommendations was published in June 2017[47]. These recommendations are applicable to both financial and non-financial firms and aim to ensure comparable, reliable and effective climate-related disclosures. The recommendations focus on four topics: i) governance: company's governance regarding climate-related risks and opportunities; ii) strategy: the impact of climate-related risks and opportunities on the firm's business strategy; iii) risk management: the methods used by a company to identify and manage climate-related risks; iv) metrics and targets: the metrics and targets used to assess and manage climate-related risks and opportunities.

On 26 September 2018[48] and on 5 June 2019[49] the TCFD published two Status Reports on the adoption of the TCFD recommendations on climate-related financial disclosures. These Reports assess the extent to which companies in their 2017 and 2018 financial statements included information compliant with the TCFD recommendations published in June 2017. According to the first Report, the TCFD found that most companies publish climate-related information, but few disclose information on the impact of climate change on company's financial position. It also points out that the data relating to strategy resilience under different climate-related scenarios is not sufficient[50]. The 2019 Report of the TCFD highlighted the need for companies to increase disclosure of climate-related financial information, which is still insufficient for investors and pushed for more clarity on the implications of climate risks for the firms[51].

Further to the abovementioned initiatives, the FSB published on 22 July 2020 its stocktake[52] of financial authorities' experience in including physical and transition climate risks[53] as part of their financial stability monitoring. The Report found that around three-quarters of survey respondents

[45] See Art. 1 of FSB's Charter.
[46] See Art. 2 of FSB's Charter.
[47] See **TCFD (2017)**
[48] See **TCFD (2018)**
[49] See **TCFD (2019)**
[50] See **TCFD (2018)**, p. iii.
[51] See TCFD (2019), p. iv.
[52] See **FSB (2020)**
[53] For a definition of these types of risk, see below under Section 3.4.

take into consideration climate-related risks when monitoring financial stability. While the majority of them “focuses primarily on the impact of changes in asset prices and credit quality”, only some of them “also consider the implications for underwriting, legal, liability and operational risks”[54].

According to the Report, some national supervisors also consider the impact of these risks for the institutions themselves. Climate-related credit and market risk faced by banks and insurance companies appears more advanced than that of other risks. Some financial authorities have quantified or have been trying to quantify these risks but there is a lack of consistent data on financial exposures to climate risks. Some members also reported that they have integrated into microprudential supervision of banks and insurance firms climate-related risks and have set out their expectations regarding disclosure of climate-related risks[55].

3.4. BCBS’s role in sustainable finance

The Basel Committee on Banking Supervision (BCBS) was established in 1974 in Basel as a response to the global crisis caused by the collapse of Herstatt Bank. Pursuant to its Charter, the Committee’s mandate is to “strengthen the regulation, supervision and practices of banks worldwide with the purpose of enhancing financial stability”. In essence, BCBS is the primary global standard setting body for the prudential regulation of banks and constitutes a forum for regular cooperation on banking supervisory matters. Its members comprise central banks and banking supervisors from 28 jurisdictions. However, BCBS is not a supervisory authority itself. The Basel Committee is an international financial forum which does not have legal personality and its decisions are not binding upon its members. Rather, the Committee relies on its members' commitments to pursue its goals. The Committee reports to the Group of Central Bank Governors and Heads of Supervision and seeks its endorsement for major decisions[56]. To achieve its mandate, the BCBS shares-among others- information with its members on current developments in the banking sector in order to assess any risks or opportunities, exchanges best practices in the banking supervisory sector, establishes guidelines and sound practices for the regulation and supervision of banks and monitors the implementation of BCBS standards in member states.

On 30 April 2020 BCBS published a stocktake Report[57] which describes its members’ regulatory and supervisory initiatives on climate-related financial risks. The report was prepared by the Committee’s High-level Task Force on Climate-related Financial Risks (TFCR). This Report defines climate-related financial risks as those related to climate change that could potentially endanger the robustness of financial institutions and have systemic nature. The distinction is made between physical and transition risks. Physical risks refer to potential financial losses resulting from the increasing severity and frequency of extreme climate change-related events. Transition risks result from the process of adjusting to a low-carbon economy[58].

The Report finds that most Committee members have already undertaken several initiatives on climate-related financial risks. While there are still variations between members, most Committee members have taken steps to measure climate-related financial risks, to raise awareness of such

[54] See ibid, p. 1.
[55] See ibid, p. 1-2
[56] For a detailed analysis of BCBS see **Gortsos Ch. V. (2019)**, pp. 105-120.
[57] See **BCBS (2020)**
[58] See ibid, p. 1.

risks with all relevant stakeholders (especially with banks) through various channels such as conferences and meetings and to survey banks on climate-related financial risks[59].

3.5. IOSCO's approach to sustainable finance

The International Organization of Securities Commissions (IOSCO) was established in 1983 as the international body that brings together the world's securities regulators and is recognized as the global standard setter for the securities sector. IOSCO's members are divided into three categories[60]: ordinary, associate and affiliate. The ordinary members comprise the national securities commissions with regulatory and supervisory powers over securities and derivatives markets in their jurisdictions. Associate members are usually intergovernmental international organizations and other international standard-setting bodies that have some authority over these markets. Affiliate members are self-regulatory organizations, securities exchanges, financial market infrastructures, international bodies other than governmental organizations with an appropriate interest in securities regulation, investor protection funds and compensation funds and other bodies with an appropriate interest in securities regulation.

IOSCO's objective is to promote cooperation between its members to better carry out their respective missions. In particular, it aims to protect investors and maintain fair, efficient and transparent capital markets by enabling members to exchange information with a view to: (a) developing securities markets and improving their efficiency; (b) coordinating the enforcement of securities regulation; and (c) implementing common standards[61].

In 1998 IOSCO adopted a comprehensive set of Objectives and Principles of Securities Regulation (IOSCO Principles[62]), which are now recognized as the international regulatory benchmarks for all securities markets. This prominent Report contains the core principles which provide the framework for the evaluation of the securities sector of the most economically powerful member states within the Financial Sector Assessment Programs (FSAPs) of the International Monetary Fund (IMF) and the World Bank.

On 14 April 2020 the Board of IOSCO published its Report on Sustainable Finance and the Role of Securities Regulators and IOSCO[63], which was prepared by the Sustainable Finance Network of IOSCO (SFN[64]).

This Report provides a stocktake of current measures, taken by regulatory authorities and firms of the financial sector, and highlights the most relevant ESG-related international initiatives and standards. It also mentions several areas where the regulatory framework should be amended and emphasises the role of IOSCO in this area. The SFN pointed out the need to improve the comparability of sustainability-related disclosures in order to facilitate cross border financial activities and dispel any investor protection concerns. IOSCO is expected to play a leading role in coordinating and addressing transparency issues. The Report underlines three important sources of concern: multiple and diverse sustainability frameworks and standards, a lack of common

[59] See ibid, pp. 3-6
[60] For a detailed analysis of IOSCO's membership, tasks and objectives see **Gortsos, Ch. V. (2019)**, pp. 94-96.
[61] See IOSCO's By-Laws, Part 1, General Provisions.
[62] For the most updated version of the Principles see **IOSCO (2017)**.
[63] See **IOSCO (2020)**
[64] The SFN of IOSCO was established in 2018 to provide a discussion forum for members in order to share experiences and best practices on sustainability issues. It has focused mainly on sustainable finance disclosure issues as well as on the promotion of industry-led initiatives.

definitions of sustainable activities and greenwashing and other challenges to investor protection[65].

To address the issues described in this Report, IOSCO Board decided to establish a Board-level Task Force on Sustainable Finance. The objective of the Task Force is to enhance climate–related disclosures, to cooperate with other international organizations and regulatory authorities and to conduct case studies and analyses of transparency, investor protection and other issues in relation to sustainable finance.

3.6.The Network for Greening the Financial System

In the context of the "One Planet Summit" held in Paris in December 2017, eight[66] central banks and supervisory authorities established the Network of Central Banks and Supervisors for Greening the Financial System (NGFS). According to Art. 1 of its Charter (which is not intended to create any legal rights or obligations[67]), the NGFS is a "group of authorities willing, on a voluntary basis, to exchange experiences, share best practices, contribute to the development of environment and climate risk management in the financial sector, and to mobilize mainstream finance to support the transition toward a sustainable economy".

Pursuant to Art. 4 of the Charter, "NGFS Members commit to: i) actively contribute to the work of the NGFS and dedicate the appropriate resources to support their participation; ii) appoint relevant expert(s) in at least one NGFS Workstream; iii) raise the awareness on the work of the NGFS in their jurisdiction, their geographic area and within the international or regional standard setting, regulatory, supervisory and central bank bodies they are involved in; iv) participate when appropriate in the outreach exercises conducted by the NGFS vis a vis external stakeholders."

The aim of the NGFS is to contribute to the accomplishment of the goals set in the Paris Agreement by improving the risk management function of the financial system and by directing capital towards environmentally sustainable projects. To this aim, the Network develops best practices and conducts analytical work in the field of sustainable finance.

The organizational structure[68] of the Network consists of the NGFS Plenary, the NGFS Steering Committee, the Workstreams, the Chair and the Secretariat. To achieve its mandate, the NGFS has divided its work into three Workstreams: i) workstream 1 on "Microprudential/Supervision" ii) workstream 2 on "Macrofinancial"; iii) workstream 3 on "Scaling up green finance".

3.7.The International Platform on Sustainable Finance

Acknowledging the need to scale up environmentally sustainable investments to achieve the objectives of the Paris Agreement and the UN 2030 Agenda on SDGs, the European Union created on 18 October 2019 together with relevant authorities of Argentina, Canada, Chile, China, India, Kenya and Morocco the International Platform on Sustainable finance (IPSF).

Since its launch, Indonesia, New Zealand, Norway, Senegal, Singapore and Switzerland have also joined this initiative. The 14 members of the IPSF represent 50% of greenhouse gas emissions, 50% of the world population and 45% of global GDP.

The ultimate objective of the IPSF is to boost the channeling of private funds towards

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[65] See **IOSCO (2020)**, p. 1.

[66] The eight founding members were the Banco de Mexico, the Bank of England, the Banque de France and Autorité de Contrôle Prudentiel et de Résolution (ACPR), De Nederlandsche Bank, the Deutsche Bundesbank, Finansinspektionen (The Swedish FSA), the Monetary Authority of Singapore and the People's Bank of China.

[67] See Art. 15 of the Charter.

[68] See Art. 6 of the Charter.

environmentally sustainable investments. The Platform is not an institutionalised body (it does not have legal personality), nor does it create any binding, legal or financial obligations upon any Member State under domestic or international law. It constitutes a multilateral forum of dialogue for promoting the exchange of ideas and coordinating the initiatives on sustainable finance, in relation to climate-related disclosures and taxonomies. It is therefore addressed to policymakers who are in charge of developing sustainable finance regulatory policies to help investors identify sustainable investment opportunities that contribute to environmental objectives.

All members of the IPSF aim to: i) exchange and disseminate information to promote best practices in environmentally sustainable finance; ii) compare the different initiatives and identify barriers and opportunities to help scale up environmentally sustainable finance internationally; iii) enhance international coordination on environmentally sustainable finance issues.

The IPSF operates in an informal setting such as a Steering Committee, working groups and a secretariat. The IPSF is open to those who seek to undertake action and are willing to promote international cooperation and coordination in the area of environmentally sustainable finance.

Chapter B. The European strategy on sustainable finance and its connection with the Capital Markets Union

1. The European Commission Action Plan on Building a Capital Markets Union

The European Commission adopted on 30 September 2015 its "Action Plan on Building a Capital Markets Union"[69]. According to that Communication, in order to promote long-term investments in the European Union, capital markets should become stronger and more integrated. That would enable businesses to find alternative sources of funding, increase saving opportunities and help stabilising the economy. This is the reason why the European Commission, under Juncker's presidency, pledged to give high priority on the need to create a single market for capital in the EU.

The Commission points out that the free flow of capital was one of the guiding principles on which the EU was founded and a key element in the EU single market, enshrined in the TFEU[70]. It constitutes one of the four fundamental freedoms that underpin the EU single market. In accordance with settled case-law of the Court of Justice, Art. 63 TFEU has direct effect; that means that Member states are bound by the Treaty provision which does not need any implementing measures to become legally binding and confers rights and obligations upon individuals. Thus, EU citizens can directly invoke and enforce these rights before national courts without having to rely upon national implementing legislation. In C-163/94 - Sanz de Lera and Others, the CJEU noted that "Article 73b (1) of the Treaty lays down a clear and unconditional prohibition for which no implementing measure is needed…. It follows that that exception [provided for in Article 73c (1) of the Treaty] cannot preclude Article 73b (1) of the Treaty from conferring on individuals rights which they can rely on before the courts." (§ 41 and 47 of the judgement). In C-101/05-Skatteverket v. A, the Court found that "It follows that, as regards the movement of capital between Member and non-member States, Article 56(1) EC, in conjunction with Articles 57 EC and 58 EC, may be relied on before national courts and may render national rules that are inconsistent with it inapplicable, irrespective of the category of capital movement in question." (§ 27 of the judgement).

The goal of the liberalization of capital movement in the EU was to foster highly integrated and thus more efficient EU capital markets. However, the European Commission underlines the fact that EU financial markets still remain fragmented preventing small and medium businesses (SMEs) from harnessing potential financing opportunities. Through the interconnection between EU capital markets, efficiency gains will be generated, which will be passed on to SMEs and other private investors leading to higher growth in the EU as a whole.

The expected results of this harmonisation can enormously benefit the European economy. More robust capital markets add an alternative of funding to Europe's strong preference for bank-based financing. In Commission's words, "strong capital markets will: i) unlock more investment from the EU and the rest of the world, ii) better connect financing to investment projects across the EU, iii) make the financial system more stable, iv) deepen financial integration and increase competition"[71].

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[69] COM (2015) 468 final

[70] Art. 63 par. 1 of the TFEU stipulates that: "Within the framework of the provisions set out in this Chapter, all restrictions on the movement of capital between Member States and between Member States and third countries shall be prohibited."

[71] See COM (2015) 468 final, p. 3.

Following a step-by-step approach, the Commission identified a wide range of actions that need to be taken in order to deliver on the goal of a true CMU. The aim of these policy-actions is to remove any remaining obstacles which hamper the ability of firms and other negative savers to reach investors. The proposed framework should foster efficient channeling of funds at national and European level. To that effect, the action plan focuses on six priority areas: i) financing for innovation, start-ups and non-listed companies; ii) making it easier for companies to enter and raise capital on public markets; iii) investing for long term, infrastructure and sustainable investment; iv) fostering retail and institutional investment; v) leveraging banking capacity to support the wider economy; vi) facilitating cross-border investing[72].

Particularly relevant in our analysis is the third policy area, which connects the CMU Action plan with the EU agenda on sustainable finance. A smooth transition of the European economy towards a low-carbon green economy requires long-term and sustainable investments. Well-functioning capital markets have the potential to help investors when taking investment decisions by providing them with accurate information regarding investments in sustainable projects and by helping them to analyse, monitor and price relevant risks and to discover the investment opportunities arising from the shift towards a climate friendly economy.

The CMU can serve as a catalyst for the transition to a carbon-neutral economy. The CMU and the sustainable finance initiatives are two mutually reinforcing projects of the EU which can benefit from each other through the existing synergies between them. On the one hand, the advancement of the CMU could contribute to the EU's efforts towards a greener, low-carbon and less dependent on finite resources economy. This would enable investors to search for and find sustainable investment opportunities across Europe, while integrated and more liquid financial markets could assist in raising the funds needed to finance the transition to a green economy. This transformation requires not only more capital but also capital of better quality, in the sense that private capital which is invested in carbon-intensive activities might bring lower returns in the long-run. This rationale can be reinforced by another example. According to de Haas and Popov, equity financing seems to be more effective than debt financing in directing private capital towards green economic activities. Equity investing tends to focus on the long-term and equity investors have greater appetite for riskier high-return investments. Thus, they might be more suitable to finance environmentally sustainable projects compared to banks. This might prove why carbon emissions per capita are much lower in countries where equity financing is more important compared to bank lending[73]. By promoting the advancement of equity financing, the CMU could support the financing of low-carbon activities.

As is evident, the interaction between CMU and the sustainable finance agenda of the EU is significant. The EU policies aiming to reduce the fragmentation of capital markets can prove to be beneficial for the elimination of any existing barriers to the development of a truly integrated market for sustainable financial products.

[72] See COM (2015) 468 final, pp. 29-30.

[73] See **De Haas, R., and Popov, A. A. (2019),** pp. 2-3.

2. “Capital Markets Union - Accelerating Reform” and the High-Level Expert Group on sustainable finance

On 14 September 2016 the EC adopted the Communication entitled “Capital Markets Union - Accelerating Reform”[74]. The aim of this new Communication is to accelerate the implementation of the reforms set out in the CMU Action Plan of September 2015 in order to strengthen and promote the integration of capital markets in the EU. One year after the launch of the CMU Action Plan, the Commission sought to finalise the first CMU measures (implementation of the securitisation package, modernisation of the Prospectus rules, measures to strengthen venture capital markets) and progress towards the next phase of CMU actions (harmonisation of national insolvency frameworks, different taxation regimes, European personal pension product, development of FinTech sector etc.).

Among the necessary actions that should be prioritized, the Commission identified the need for reforms to sustainable finance with a view to direct investments in clean technologies, to make sure that the financial system can promote sustainable growth and contribute to the transition to a green economy. The implementation of these reforms is crucial for the EU in order to deliver on the goals set by the Paris agreement. In the same Communication, the EC announced that: “The Commission will establish an expert group to develop a comprehensive European strategy on green finance in the coming months.”[75]

To give effect to that clause, the EC adopted on 28 October 2016 the Decision on the creation of a High-Level Expert Group (HLEG) on Sustainable Finance in the context of the Capital Markets Union[76]. The group is composed of up to 20 highly qualified senior experts coming from civil society, the business community, academia and other non-public sector institutions. Pursuant to Art. 2 of that Decision, “the group’s tasks shall be: i) to submit to the Commission a set of policy recommendations that: (a) sets out the scale and dimensions of the challenges and opportunities that sustainable finance presents; and (b) recommends a comprehensive programme of reforms to the EU financial policy framework; ii) to engage in structured communication and advocacy towards interested parties - representing the various relevant stakeholder interests - about its work in respect of sustainable finance during its mandate”.

The appointed by the Commission HLEG -under the chairmanship of Christian Thimann-, having regard to the Decision setting up the group and to the standard rules of procedure of expert groups[77], adopted its own rules of procedure. In July 2017, the HLEG published its Interim Report[78]. This Interim Report of the HLEG acknowledges that the European financial system should pursue two goals. The first one is to strengthen financial stability, by enhancing the evaluation and management of long-term risks, especially those related to ESG issues. The second aim is to mobilize capital from the financial sector to sustainable and inclusive growth, by providing funding to long-term projects (such as innovation and infrastructure projects) and stepping up the efforts towards a resource-efficient, climate-neutral economy.

The Interim Report sets out key policy priorities and provides feedback to EU policymakers to assist them in their efforts to embed sustainability considerations into the regulatory framework.

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[74] COM (2016) 601 final
[75] See ibid, p. 5.
[76] COM (2016) 6912 final
[77] COM (2016) 3301 final
[78] See **High-Level Expert Group on Sustainable Finance (2017)**

The Report's structure is the following: Chapter I is introductory. Chapter II provides an overview of the vision for a sustainable financial system, the main obstacles in the way to achieve it and the available opportunities. Chapter III delves into various ways of incorporating sustainability into the EU's regulatory framework, including issues such as financial disclosures, accounting, fiduciary duty, corporate reporting and benchmarks. Chapter IV deals with market participants (banks, insurance companies, pension funds and asset managers) and market facilitators (including credit rating agencies and stock exchanges). Chapter V concentrates on actions to direct capital flows towards sustainable investments (both public and private) and touches upon the issue of sustainability taxonomies, standards and labels. Chapter VI addresses the first package of recommendations and Chapter VII identifies the steps forward.

On 31 January 2018 the HLEG published its Final Report[79]. The report outlines the HLEG's final recommendations to the EC. Chapter III of the Final Report sets out priority recommendations which represent key elements of future action with the aim to: i) "introduce a common sustainable finance taxonomy to ensure market consistency and clarity, starting with climate change; ii) clarify investor duties to extend time horizons and bring greater focus on ESG factors; iii) upgrade Europe's disclosure rules to make climate change risks and opportunities fully transparent; iv) empower and connect Europe's citizens with sustainable finance issues; v) develop official European sustainable finance standards, starting with one on green bonds; vi) establish a 'Sustainable Infrastructure Europe' facility to expand the size and quality of the EU pipeline of sustainable assets; vii) reform governance and leadership of companies to build sustainable finance competencies; viii) enlarge the role and capabilities of the ESAs to promote sustainable finance as part of their mandates."[80]

3. The European Commission Action Plan on Financing Sustainable Growth

The concept of sustainability has been a principle that lies at the foundations of the European Union project. Article's 3 par. 3 of the Treaty on European Union objective is to establish an internal market that works for the sustainable development of Europe, based, among other things, on balanced economic growth and a high level of protection and the improvement of the quality of the environment. Sustainability and the transition to a climate-neutral, more resource-efficient and circular economy are necessary conditions for achieving long-term growth and competitiveness of the EU economy.

In that context, the EC adopted on 8 March 2018 the Action Plan on Financing Sustainable Growth[81]. This Action Plan is based upon the recommendations made by the HLEG in its Final Report which forms the basis of EU's strategy on sustainable finance. According to the Commission, sustainable finance[82] is related to the process of taking into consideration ESG risks when making investment decisions in order to direct capital towards long-term, green projects. The environmental aspect refers to climate change mitigation and adaptation and to potential environmental risks and disasters (e.g. fire, earthquake, flooding). Social considerations are about social cohesion, inequality, inclusiveness, labor and working conditions, giving back to the community through donations and investments in human capital. Governance is a key element

[79] See **High-Level Expert Group on Sustainable Finance (2018)**

[80] See ibid, pp. 12-13.

[81] COM (2018) 97 final

[82] See ibid, p. 2.

which must be taken into account, because it serves the other two goals. Embedding environmental and social aims in the decision-making process can only be materialized through fruitful collaboration between various stakeholders, including managers, directors, shareholders and employees. These three fundamental considerations are intertwined, since -for example- disappointed managers or employees might not have any motives to act in an environmentally friendly way, thus leading to the deterioration of social problems.

As the EC points out, this Action Plan attempts to contribute towards further alignment of the financial sector with the needs of our planet to the benefit of the European and global economy. Three are the main goals of the EC agenda: a) reorientation of capital flows towards sustainable investment in order to achieve sustainable and inclusive growth; b) management of financial risks stemming from climate change, resource depletion, environmental degradation and social issues; and c) fostering transparency and long-termism in financial and economic activity[83]. To achieve these goals, the EC mapped out a set of ten policy areas, which connect financial regulation with sustainability considerations:

i. The first (and probably the most crucial) action is the proposed adoption of a unified EU classification system - or taxonomy - that should define which activities can be considered sustainable. The EC recognizes that "it is at this stage the most important and urgent action of this Action Plan"[84]. It aims to provide clarity on projects qualifying as contributing to climate change mitigation and adaptation and inform investors accordingly, based upon screening criteria, thresholds and metrics. This EU taxonomy should be embedded into the EU regulatory framework to promote investors' trust and create a common language for all relevant stakeholders. To that end, the Commission set up a technical expert group (TEG)[85] on sustainable finance in 2018 to assist in the preparation of legislative proposals in the following areas: a) an EU classification system –the so-called EU taxonomy – to determine whether an economic activity is environmentally sustainable; b) an EU Green Bond Standard; c) methodologies for EU climate benchmarks and disclosures for benchmarks; d) guidance to improve corporate disclosure of climate-related information.

ii. Linked to the first action is the creation of standards and labels for sustainable financial products. Based on the taxonomy, EU standards and labels for sustainable financial products help the investors to identify easier these products and build trust in the EU sustainable financial market. As an example of such a product, green bonds enable firms or even states to approach investors who are interested in financing green projects. This EU standard would provide easier access to the market and would contribute to the channeling of more capital in low-carbon projects. Labelling constitutes also an efficient and easy way for private investors to flag sustainable investments through websites using e.g. comparison tools or other instruments.

iii. The third priority area is fostering investments in green projects, especially for infrastructure. According to the EC, this a precondition for the shift towards a more sustainable economy. As OECD states, "unprecedented levels of infrastructure investment will be required to sustain growth and meet the basic needs generated by rapid population growth and urbanisation in developing countries, even before considering climate and pollution challenges. The OECD estimates that

[83] See ibid, p. 2.
[84] See ibid, p. 5.
[85] The TEG commenced its activities in July 2018 and is composed of 35 members from business, academia, the financial sector and other public and private EU institutions. Additional information on its members, the rules of procedure, the meetings, the groups and subgroups and its work streams can be found on the website of the Register of Commission Expert Groups and Other Similar Entities.

around USD 95 trillion of investments are needed from 2016 to 2030 in infrastructure (energy, transport, water and telecoms), equaling around USD 6.3 trillion per year without taking into account climate concern. The new estimates also suggest that for infrastructure to be consistent with the 2°C scenario, investment needs reach USD 6.9 trillion per year in the next 15 years, an increase of about 10% in total infrastructure investment"[86]. The need to develop sustainable infrastructure projects requires financing through both private investment and public funds. Also, advisory and technical assistance is needed to develop and implement such long-term projects. The EU plays an active role in that regard particularly through the EFSI and the European Fund for Sustainable Development (EFSD).

iv. Another key element of Commission's strategy is the integration of sustainability into investment advice and insurance distribution. Investment firms and insurance distributors have the capacity to contribute to this goal by steering the financial markets to sustainability. Before providing any advice, these intermediaries have to perform individual assessments regarding investors' goals and risk appetite. According to the Markets in Financial Instruments Directive[87] (MiFID II) and the Insurance Distribution Directive[88] (IDD), this process is a prerequisite for investment firms and insurance distributors in order to offer a suitable product that matches client's needs (suitability assessment). The aim here is to integrate sustainability in the process of selecting an investment/insurance product by asking the investor about his/her preferences (including ESG aspects). For this reason, the EC aims to amend the MiFID II and IDD delegated acts to ensure that sustainability factors are being considered in the suitability assessment.

v. The fifth priority of the EC is the development of benchmarks for sustainable investments. Benchmarks are standards or indices that help investors or mutual fund managers to assess the performance of a security or an investment portfolio. Thus, they represent useful tools for investors to track how successful was their investment. However, the EC points out that the methodologies of many long-established benchmarks (e.g. S&P or MSCI World Index) do not adequately address sustainability issues. To tackle that, the EC plans to adopt delegated acts which will complement the Benchmark Regulation (BMR). The objective of the EC is the creation of more transparent and sound methodologies especially for low-carbon indices to help investors or investment funds managers to evaluate easier the performance of their low-carbon portfolio.

vi. Connected with the above-mentioned initiative is the effort to put sustainability at the core of credit rating and market research. Credit rating constitutes an important component of capital markets, since it provides investors with an evaluation of the credit risk of a company or even a State. More and more CRAs have integrated ESG factors in their analysis but until now the market is not using universally accepted standards to assess sustainability risks. This practice has a negative impact on the trust of investors in the market's capacity to direct capital in an efficient way towards green investments. This is where the EC steps in and tries to monitor the way in which CRAs take due account of these factors in their ratings. To that end and to promote transparency in the relevant market, the EC mandated ESMA to advise on possible amendments to the legal framework to ensure that CRAs take into consideration sustainability when they perform credit ratings.

vii. Another very important priority for the EC is the integration of sustainability into the duties of

[86] See **OECD (2017)**, p. 30
[87] OJ L 173, 12.6.2014, pp. 349–496
[88] OJ L 26, 2.2.2016, pp. 19–59

asset managers and investment firms. European legislation[89] requires from investment firms "to act honestly, fairly and professionally in accordance with the best interests of its clients"[90] . This is a principle which derives from the commonly known fiduciary duty of the investment firm. Nevertheless, the EC underlines the fact that many asset managers and institutional investors do not adequately incorporate sustainability factors in the process of investment-making and do not provide relevant information to the investors regarding the degree to which they consider sustainability aspects in their analysis. To ameliorate that situation, the Commission proposed amendments to the current EU legislation in order to provide clarity on institutional investors' and asset managers' duties with regard to sustainability risks. The aim of this proposal is to explicitly require them to incorporate sustainability aspects in their analysis and to enhance transparency.

viii. The eighth policy area is related to prudential requirements for banks and insurance companies. These financial intermediaries constitute a major financing source for the EU and have the capacity to support long-term investments through the savings of the consumers. Despite that, these institutions might suffer losses stemming from climate-change related risks. Studies have already pinpointed the fact the EU financial system is currently highly exposed to these risks. The European Systemic Risk Board (ESRB), EU's macroprudential oversight body[91], has pointed out that "the EU financial system has significant direct exposure to fossil-fuel firms. Though the potential effect is difficult to quantify without better exposure data, Weyzig (2014) estimates that the exposures of European financial institutions (including banks, pension funds and insurers) to fossil-fuel firms exceed €1tn, and estimates potential losses of between €350bn and €400bn, even under an orderly transition scenario."[92] The risks to financial stability associated with environmental aspects are high and need to be addressed in prudential regulation. Based on that assumption, the EC will assess if additional capital requirements need to be integrated into the current EU legislation with the aim to better reflect the risk of holding unsustainable assets and absorb the losses incurred by them.

ix. Furthermore, the EC aims to improve the current framework of corporate reporting and accounting. Corporate disclosures on sustainability factors are fundamental for the assessment by the relevant stakeholders of the ability of a firm to manage sustainability risks and promote long-term investments. Key to achieving this goal is the EU Directive on the Disclosure of Non-Financial Information[93] (also known as NFRD) which requires large firms to disclose information on environmental, social and governance aspects and how they manage the risks associated with these factors. The EC has also expressed concerns on existing accounting rules, especially the International Financial Reporting Standard (IFRS) 9, regarding the impact that these standards might have on long-term investments. Therefore, the EC plans to make the necessary adjustments to the guidelines on non-financial information. These amendments will provide assistance to firms on how to disclose climate-related information, in accordance with the TCFD recommendations on climate-related financial disclosures.

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[89] See e.g. UCITS Directive, AIFMD and MiFID II.
[90] See Art. 24 par. 1 of Directive 2014/65/EU (MiFID II).
[91] Pursuant to Art. 3 par. 1 of Regulation (EU) No 1092/2010 of the European Parliament and of the Council of 24 November 2010 on European Union macro-prudential oversight of the financial system and establishing a European Systemic Risk Board, "The ESRB shall be responsible for the macro-prudential oversight of the financial system within the Union in order to contribute to the prevention or mitigation of systemic risks to financial stability in the Union.."
[92] See **ESRB (2016)**
[93] OJ L 330, 15.11.2014, pp. 1–9

x. The last (but not least) policy priority of the EC is corporate governance. Robust corporate governance has the potential to facilitate the smooth transition to a more sustainable economy, especially by allowing companies to engage in new business models which leverage new technologies and enhance their performance. In this way, firms can be more competitive and optimize their risk management strategies which is conducive to innovation and sustainable growth. However, many corporate managers tend to focus on short-term profit in capital markets and ignore the risks arising from ESG factors, thus leading to investments decisions which do not take due account of sustainability concerns. The short-term profit pressure urges managers and directors to prefer carbon-intensive sectors. To tackle that problem, the Commission plans to assess and -if necessary- to amend the regulatory framework so as to require corporate boards to disclose a sustainability strategy and the possible need to provide clarity regarding directors' duty to act in the company's long-term interest.

4. The ESA's strategy on sustainable finance

In November 2008, the EC assigned to a High-Level Group chaired by Jacques de Larosière to examine the causes of the 2007 financial crisis and make specific recommendations on how to promote stronger coordinated macroprudential and microprudential supervision, to develop a new regulatory agenda in order to reduce systemic risk to financial stability and to design effective crisis management solutions. The aim was to contribute to a stable and efficient financial system and restore trust in it. In its final report presented on 25 February 2009 (commonly referred to as the "de Larosière Report"[94]), the High-Level Group proposed reforms to the structure of supervision of the financial sector in the EU with a view to creating a European System of Financial Supervision[95] (ESFS), composed of three European Supervisory Authorities (ESAs), one for the banking sector, one for the securities sector and one for the insurance and occupational pensions sector, and recommended also the creation of a European Systemic Risk Council.

The ESFS has the form of a decentralised network of national and EU supervisory authorities. In this context, the competent authorities of Members States continue to function as supervisors of the firms of the financial sector, whilst the ESAs coordinate the implementation of common high-level supervisory standards. To achieve further harmonisation and consistent application of EU rules for financial institutions and capital markets, the three ESAs were established, namely the European Banking Authority (EBA), the European Insurance and Occupational Pensions Authority (EIOPA) and the European Securities and Markets Authority (ESMA) as well as a Joint Committee of the European Supervisory Authorities. These three ESAs, along with the European Systemic Risk Board (the ESRB)[96] and the competent or supervisory authorities in the Member States (as specified in the Union acts referred to in Art. 1 par. 2 of Regulation 1093/2010, Regulation (EU) No 1094/2010 and of Regulation (EU) No 1095/2010) form the European System of Financial Supervision (ESFS).

As Professor Gortsos[97] points out, the ESAs are not supranational supervisory authorities. They are EU agencies composed of national supervisory authorities and perform mainly regulatory

[94] See the report of **High-Level Group on Financial Supervision in the EU (2008)** (commonly known as the de Larosiere Report).
[95] See ibid, pp. 46-47.
[96] OJ L 331, 15.12.2010, pp. 1–11
[97] see **Gortsos, Ch.V. (2020)**, pp. 115-116.

functions by providing technical advice to the EC (also in the form of regulatory or implementing technical standards as provided under Art. 10 and 15-respectively- of the ESAs founding Regulations). The European Supervisory Authorities replaced their predecessors, namely the Committee of European Banking Supervisors established by Commission Decision 2009/78/EC, the Committee of European Insurance and Occupational Pensions Supervisors established by Commission Decision 2009/79/EC and the Committee of European Securities Regulators established by Commission Decision 2009/77/EC.

In order to smoothly implement the EC Action Plan on Financing Sustainable Growth, the EC called upon the European Supervisory Authorities (ESAs) to contribute to the realisation of the goals described in it. Accordingly, the EC mandated the ESAs to explore how sustainability factors can be integrated in the EU financial regulatory framework and to make specific proposals to fill any existing gaps in the relevant legislation.

4.1. EBA's strategy on sustainable finance

On 6 December 2019, the European Banking Authority published its own Action Plan on sustainable finance[98] which builds upon the EC Action Plan on Financing Sustainable Growth and outlines the EBA's work plan and key priorities related to ESG risks based on the mandates given to EBA. It further aims to consider how ESG factors can be integrated into the regulatory framework of EU credit institutions by examining relevant markets practices. The Action Plan provides also a timeline for the reports, advices, guidelines and technical standards which have been assigned to EBA.

As a result of EC's request included in Action 10 (fostering sustainable corporate governance and attenuating short-termism in capital markets) of its Action Plan: Financing Sustainable Growth, the EBA responded with a Report[99] which was published on 18 December 2019. The aim of this Report is to assess whether undue short-termism is present in the financial sector and if this practice constitutes a problem.

Short-termism is traditionally associated with the pursuit by corporate managers of short-term profits (to satisfy the shareholders of the firm) rather than long-term growth of the company. Based on the evidence collected by EBA, the available data on maturities of loans and securities do not reflect any particular short-term pressures.

According to that Report, regarding the asset side of bank's balance sheets, the current lending policies of banks promote long-term approaches. As a result, an increasing number of bank loans are linked to ESG goals (e.g. financing long-term infrastructure projects through bank loans) or banks themselves are active in the area of green finance as issuers or underwriters. In relation to the liability side, there is no evidence that banks' shareholders or capital markets exercise significant short-term pressure on bank's balance sheets. The EBA concludes that there is no significant short-term pressure on either side, thus cannot be characterized as undue. To encourage long-termism in the market, EBA proposes to the EC the following actions: i) to maintain a robust regulatory prudential framework; ii) to foster the adoption of long-term perspectives by institutions through more explicit legal provisions on sustainability; iii) to continue to enhance disclosures of

[98] See **EBA (2019a)**
[99] See **EBA (2019b)**

long-term risks and opportunities by both corporations and banks; and iv) to improve information flows and data access and support the role of the banking sector in raising awareness on sustainability challenges and environmental, social and governance (ESG) risks[100].

4.2. ESMA's strategy on sustainable finance

On 6 February 2020 ESMA published its strategy on sustainable finance[101]. The strategy set out by ESMA explains how ESMA will integrate ESG aspects in its various workstreams and analyzes its key priorities including (but not limited to) disclosure obligations, risk assessments and convergence of national supervisory practices on ESG factors. It aims to indicate how ESMA will take into consideration ESG related risks, when performing the four main tasks falling under its remit: development of a single Rulebook, supervisory convergence, direct supervision and risk assessment.

Regarding its first policy area, ESMA's objective is to incorporate sustainability in the development of the single rulebook. ESMA has already provided on 3 May 2019 technical advice[102] to the EC in relation to the integration of sustainability risks and factors into the Markets in Financial Instruments Directive II (MiFID II) and the Alternative Investment Fund Managers Directive (AIFMD) and the Undertakings in Collective Investment in Transferable Securities (UCITS) Directive. To ensure the existence of a level playing field for investors, issuers and other market participants across the EU, the ESMA aims to increase disclosure obligations, thus giving investors the opportunity to be easily informed about the ESG aspects of their investments. ESMA seeks to clarify that it will take into consideration ESG factors, when submitting technical advice or technical standards to the EC.

Another important priority for ESMA is supervisory convergence on ESG related issues. The aim here is to build a common supervisory culture among ESMA and the National Competent Authorities (NCAs) in order to make sure that EU legislation is consistently and efficiently interpreted and implemented in the EU. This common methodology will help to harmonise the rules and make the markets in each country more homogeneous.

ESMA also aims to play an important role in the integration of ESG factors into the legal framework which applies to the entities or activities under its direct supervision. In that context, ESMA's main priority is to ensure the implementation of ESMA's Guidelines on disclosure practices for credit ratings[103].

ESMA is also involved in the monitoring of trends and market developments and the identification of ESG related risks. The exercise will be based both on quantitative and qualitative data obtained from various sources in order to develop relevant indicators. The objective here is to perform an analysis of ESG risks arising from climate change and transition costs for different entities under ESMA's remit. Different policy areas will be covered, including green bonds, emission allowances, ESG ratings of EU investment funds and climate-risk stress testing, market integrity issues such as greenwashing risk[104]. The NCAs can also play a significant role here by

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[100] See ibid, pp. 4-5.
[101] See **ESMA (2020)**
[102] In accordance with Art. 16a par. 1 of Regulation (EU) No 1095/2010.
[103] For a brief analysis of these Guidelines, see Chapter 3, Section 3.
[104] As Steven Maijoor, ESMA's Chair, pointed out in his speech at the European Financial Forum in Dublin on 12 February 2020: "This [the greenwashing problem] refers to a wide variety of practices that range from mis-labelling

helping to identify relevant national indicators and share them with their peers in order to flag best practices in the area of sustainable finance.

4.3. EIOPA's strategy on sustainable finance

The European Insurance and Occupational Pensions Authority (EIOPA) is the third and last ESA which aims to and has already started taking into account sustainability in its various workstreams.

On 30 September 2019 EIOPA published its Opinion[105] on Sustainability within Solvency II[106] as a response to EC's request for an opinion on sustainability within Solvency II, especially in relation to climate change mitigation. The EC will leverage the opinion to prepare a report on Directive 2009/138/EC (Solvency II Directive), which is due by 1 January 2021. The EC asked EIOPA to provide its Opinion on the incorporation of sustainability factors into the Solvency II framework for the valuation of assets and liabilities, investment and underwriting practices, the calibration of market and natural catastrophe risks and the use of internal models. Regarding the valuation of assets of the insurance firms, EIOPA points out that further amendments in the availability and quality of information relevant to their valuation is needed. On the side of valuation of liabilities, despite the fact that there are no gaps in the regulatory framework, in practice many insurance firms do not take into account sustainability concerns. Moreover, EIOPA believes that insurance undertakings should take into consideration the impact of their investment activity or underwriting activity on ESG factors. EIOPA is of the opinion that insurance undertakings should evaluate their exposure to ESG risks which will increasingly impact the insurance sector over the coming decades. As an example, EIOPA mentions the transition risk of revaluation of assets which could impact long-term investments or increasing natural catastrophe risks[107].

5. The European Green Deal

On 11 December 2019 the EC adopted the European Green Deal. In its Communication[108] the EC presents its growth strategy in order to tackle climate change and transform the EU into a green, resource-efficient, just and competitive economy. To achieve these goals, the EC developed its roadmap in the form of the European Green Deal to make the EU's economy sustainable**.** This can only take place if environmental challenges become opportunities for every sector of the economy and this transformation happens in a just and inclusive way.

The aim of the European Green Deal is to take urgent action to ensure that the EU will become climate neutral in 2050, to facilitate the transition to a green, circular economy, to restore biodiversity and curb pollution. To reach that goal, it is imperative for the EU, the Member States and the private sector to mobilise significant amounts of investment in environmentally-friendly technologies, to support innovation and cleaner forms of private and public transport, to

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to mis-representation and mis-selling of financial products. As the number of products that claim to be linked to the sustainability performance of firms increases, driven by market demand, we need to be careful to ensure that investors do not end up buying products which are marketed as sustainable when in reality they are not.".

[105] In accordance with Art. 34 par. 1 of Regulation (EU) No 1094/2010.

[106] See **EIOPA (2019a)**.

[107] See ibid, pp. 11-16.

[108] COM (2019) 640 final

decarbonize the energy sector, to make new energy efficient buildings and to cooperate globally to address our common problems.

To help unlock the funds needed to ensure a smooth transition to a green economy, the EC announced on 14 January 2020 the adoption of the Sustainable Europe Investment Plan- European Green Deal Investment Plan[109]. This Investment plan is part of the European Green Deal and constitutes its investment pillar. According to EC estimates, additional investments of 260 billion euros per year are needed to achieve the 2030 climate and energy targets. The aim of the Sustainable Europe Investment Plan is to direct at least 1 trillion euros into public and private sustainable projects[110]. Moreover, it aspires to build a comprehensive framework for private investors and the public sector by providing them with appropriate tools to flag sustainable investments (especially the EU taxonomy). This framework will help identify ESG related investments.

The funding provided by the EU budget through guarantees aims also to contribute to a socially balanced and fair transition. To ensure that this transition will happen in a just way, the EC announced the creation of the Just Transition Mechanism (JTM), which will provide at least €100 billion funding to the regions most affected by the aspired transformation. The EC acknowledges that some European regions will have to bear a heavier burden in order to transform their carbon-intensive economies. This challenge means that the existing structure of many local economies needs to be fundamentally changed in terms of the resources used or the workers who might need to be fired or retrained to acquire new skills. Existing business models might have to be changed as well to reflect the new needs. An indicative example of a specific sector of the economy which will face tremendous problems is fossil fuel mining and other related activities which are harmful for the environment. To maintain social balance and address the various challenges associated with this transition, the EC proposed a three-pillar structure of the JTM: i) a Just Transition Fund, which will receive €7.5 billion of EU funds, ii) a dedicated just transition scheme under the programme InvestEU to mobilise up to €45 billion of investments and iii) a public sector loan facility with the European Investment Bank backed by the EU budget to mobilise between €25 and €30 billion of investments[111].

To ensure climate neutrality of the EU by 2050 and deliver on the second action set out in the European Green Deal, the EC proposed on 4 March 2020 the European Climate Law[112] in order to turn the political agreement into a legal obligation. The proposal establishes the relevant framework by providing a pathway to climate neutrality and promoting transparency and accountability. Art. 1 of the proposed Regulation provides that: "This Regulation sets out a binding objective of climate neutrality in the Union by 2050 in pursuit of the long-term temperature goal set out in Art. 2 of the Paris Agreement, and provides a framework for achieving progress in pursuit of the global adaptation goal established in Art. 7 of the Paris Agreement". The climate-neutrality objective is described in Art. 2 of the proposal: "Union-wide emissions and removals of greenhouse gases regulated in Union law shall be balanced at the latest by 2050, thus reducing emissions to net zero by that date". To achieve that goal, the EU institutions and the Member States are obliged to take urgent action in order to reach climate-neutrality by 2050. It also confers upon

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[109] COM (2020) 21 final
[110] See ibid, p. 1.
[111] See ibid, pp. 17-22.
[112] COM (2020) 80 final. On 23 October 2020, the Council reached agreement on large parts of the proposed European climate law.

the EC the power to adopt delegated acts to set out a trajectory at Union level to achieve the climate-neutrality objective. Lastly, it mandates the EC to assess periodically the progress made by the EU and the consistency of national measures of Member States with the above-mentioned objective.

6. The public consultation on the renewed sustainable finance strategy

On 8 April 2020, the EC launched a public consultation on its renewed sustainable finance strategy, available for 14 weeks (until 15 July 2020). All citizens, public authorities and private organisations within the EU and beyond were invited to give their views and opinions in order to inform the Commission's renewed strategy on sustainable finance. The new strategy (announced in the European Green Deal) was built upon the 10 actions described in the European Commission's initial 2018 Action Plan on Financing Sustainable Growth. It aims to provide an overview of the measures needed to mobilise private capital into sustainable investments, to support the different policy actions set out in the European Green Deal and to contribute to climate change mitigation.

The renewed sustainable finance strategy focuses primarily on three areas: i) strengthening the foundations for sustainable investment; ii) increasing opportunities to have a positive impact on sustainability for citizens, financial institutions and corporates; iii) climate and environmental risks management.

Chapter C. EU sustainable finance regulatory measures: an overview

1. The adopted Regulations

1.1.The EU Taxonomy Regulation

As previously mentioned, the EC published in March 2018 its Action Plan on Financing Sustainable Growth[113]. According to Action 1 of the Action Plan, the EC's objective was to table a legislative proposal that would pave the way for the progressive development of an EU taxonomy for environmentally and socially sustainable activities. The taxonomy will contribute to the growth of low-carbon economic sectors and to the decarbonisation of high-carbon ones, thus enabling the transition to a greener economy. Furthermore, the TR aims to play a crucial role in facilitating the EU Green Deal's sustainable economic policies. Morningstar DBRS[114] notes that the environmental objectives of the TR fully comply with the economic sectors that need to be reformed according to the Green Deal. Thus, the TR proves to be a useful tool for the EU in order to achieve the Paris Agreement's 2030 targets and become climate neutral by 2050.

This unified EU classification system clarifies which economic activities can be classified as sustainable with a view to gradually integrating this taxonomy in EU law by using it in different sectors of the economy. The establishment of an EU taxonomy constitutes the most important initiative envisaged in the Action Plan, because it serves concurrently two crucial goals: on the one hand it aspires to facilitate cross-border investment in sustainable activities across the EU by providing harmonised criteria on what can be defined as sustainable, while on the other hand aims to limit the practice of "greenwashing", where a market participant tries to maximise its profit by marketing a product or a service as environmentally friendly when in reality it does not meet basic environmental standards.

On 24 May 2018, the EC tabled a proposal for a Regulation of the European Parliament and of the Council on the establishment of a framework to facilitate sustainable investment[115]. Based on that proposal, on 17 December 2019, the Council and the European Parliament reached a political agreement on the Taxonomy Regulation (TR). Finally, the TR was published[116] on 22 June 2020 in the Official Journal of the EU. The legal basis of this Regulation is Art. 114 of the TFEU, since the criteria for determining whether an economic activity can be considered sustainable should be harmonised at EU level, in order to remove barriers to the functioning of the internal market in relation to raising capital for sustainable projects across the whole EU, to avoid market fragmentation and protect consumers and investors.

The TR[117] establishes "the criteria for determining whether an economic activity is environmentally sustainable for the purposes of establishing the degree of environmental sustainability of an investment"[118]. In other words, it establishes a general framework for the development of an EU-wide classification system for environmentally sustainable economic activities. However, that framework sets out only the general criteria to be considered, while the

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[113] On that see above, Chapter 2, Section 3.
[114] See **Morningstar DBRS (2020),** pp. 3-4
[115] COM (2018) 353 final
[116] OJ L 198, 22.6.2020, p. 13–43
[117] For a brief analysis of the TR see-inter alia- **Arnaud Van Caenegem (2020).**
[118] See Art. 1 par. 1 of the TR.

details of what constitutes an environmentally sustainable activity or product will be developed by the EC through delegated acts for each relevant environmental objective and sector respectively.

Regarding the scope of this Regulation, pursuant to Art. 1 par. 2 it applies to:

i. Measures adopted by Member States or by the EU setting out any requirements on financial market participants or issuers in respect of financial products or corporate bonds that are made available as environmentally sustainable. Art. 4 of the TR imposes upon the EU and the Member States the obligation to apply the criteria set out in Art. 3 of the TR to determine whether an economic activity qualifies as environmentally sustainable for the purposes of any measure setting out requirements for financial market participants or issuers in respect of financial products or corporate bonds that are made available as environmentally sustainable.

ii. Financial market participants making available financial products. The terms "financial market participants" and "financial products" are used in this Regulation with the same meaning as defined in the Sustainable Finance Disclosure Regulation[119]. These financial market participants will be obliged to disclose precontractually and in periodic reports information on how and to what extent the investments underlying the financial product are made in activities which can be considered sustainable economic activities under the criteria set out in Art. 3.

iii. Undertakings which are subject to the obligation to publish a non-financial statement or a consolidated non-financial statement pursuant to Art. 19a or 29a of Directive 2013/34/EU (as amended by the Non-Financial Reporting Directive).

The Regulation describes six[120] different types of environmental objectives[121]. Any economic activity qualifies as an environmentally sustainable activity for the purposes of this Regulation if it contributes to at least one of the following:

i. ***climate change mitigation***: an economic activity shall be considered to contribute substantially to climate change mitigation where that activity substantially contributes to the stabilization of greenhouse gas concentrations in the atmosphere at a level which prevents dangerous anthropogenic interference with the climate system by avoiding or reducing greenhouse gas emissions or enhancing greenhouse gas removals through various means described in Art. 10 par. 1, consistent with the long term temperature goal of the Paris Agreement.

ii. ***climate change adaptation***: the activity includes adaptation solutions that substantially reduce the adverse impact of the current and expected future climate on other people, nature or assets or on the economic activity itself, in each case without increasing the risk of an adverse impact on other people, nature and assets in accordance with Art. 11 of the TR.

iii. ***sustainable use and protection of water and marine resources***: the activity substantially contributes to achieving the good status of water bodies or marine resources, or to preventing their deterioration when they are already in good status, through various means described in Art. 12 of the TR.

iv. ***transition to a circular economy***: an economic activity shall be considered to contribute substantially to the transition to a circular economy, including waste prevention, re-use and recycling where that activity contributes substantially to that environmental objective through any of the means described in Art. 13.

v. ***pollution prevention and control***: an economic activity shall be considered to contribute

[119] On that Regulation see below.
[120] According to Recital 23 of the TR, this list of environmental objectives is exhaustive.
[121] See Art. 9 of the TR.

substantially to pollution prevention and control where that activity contributes substantially to environmental protection from pollution through any of the means described in Art. 14.

vi. ***protection and restoration of biodiversity and ecosystems***: an economic activity shall be considered to contribute substantially to the protection and restoration of biodiversity and ecosystems where that activity contributes substantially to protecting, conserving or restoring biodiversity and to achieving the good condition of ecosystems, or to protecting ecosystems that are already in good condition, through any of the means described in Art. 15.

In addition to substantially contributing to one of the six objectives described above, in order to qualify as an environmentally sustainable economic activity under the Taxonomy Regulation, an economic activity must also comply with each of the following criteria[122]:

i. ***no significant harm***: the economic activity does not significantly harm any of the above-mentioned environmental objectives set out in Art. 9 in accordance with Art 17.

ii. ***compliance with minimum safeguards***: the economic activity is carried out in compliance with the minimum safeguards laid down in Article 18. These safeguards refer to procedures implemented by the undertaking that is carrying out an economic activity to ensure the alignment with the OECD Guidelines for Multinational Enterprises and UN Guiding Principles on Business and Human Rights, including the principles and rights set out in the eight fundamental conventions identified in the International Labour Organisation's declaration on Fundamental Rights and Principles at Work and the International Bill of Human Rights.

iii. ***compliance with technical screening criteria***: the economic activity complies with technical screening criteria that have been established by the Commission in accordance with Art. 10 par. 3, 11 par. 3, 12 par. 2, 13 par. 2, 14 par. 2 and 15 par. 2.

In addition to the activities that in and of themselves contribute substantially to one of the six aforementioned environmental objectives, there are also two other types of environmentally sustainable economic activities: the transition and the enabling activities. Regarding the transition[123] activities, they refer to activities for which there are no technologically and economically feasible low-carbon alternatives, but that support the transition to a climate-neutral economy in a manner that is consistent with a pathway to limit the temperature increase to 1.5 degrees Celsius above pre-industrial levels, for example by phasing out greenhouse gas emissions. With respect to the enabling activities, they are defined in Art. 16 of the Taxonomy. According to that, "an economic activity shall be considered to contribute substantially to one or more of the environmental objectives set out in Article 9 by directly enabling other activities to make a substantial contribution to one or more of those objectives, and where that activity:

(a) does not lead to a lock-in in assets that undermine long-term environmental goals, considering the economic lifetime of those assets;

(b) has a substantial positive environmental impact on the basis of lifecycle considerations."

The TR also supplements the disclosure requirements laid down in Regulation (EU) 2019/2088

[122] These criteria are laid down in Art. 3 of the TR.

[123] Art. 10 par. 2 of the TR provides: "an economic activity for which there is no technologically and economically feasible low-carbon alternative shall qualify as contributing substantially to climate change mitigation where it supports the transition to a climate-neutral economy consistent with a pathway to limit the temperature increase to 1,5 0C above pre-industrial levels, including by phasing out greenhouse gas emissions, in particular emissions from solid fossil fuels, and where that activity:

(a) has greenhouse gas emission levels that correspond to the best performance in the sector or industry;
(b) does not hamper the development and deployment of low-carbon alternatives; and
(c) does not lead to a lock-in of carbon-intensive assets, considering the economic lifetime of those assets."

(the "SFDR") by imposing new transparency obligations upon "financial market participants"[124], meaning-inter alia- a UCITS management company, insurance undertakings making insurance-based investment products available, credit institutions and investment firms providing portfolio management. According to Art. 5 of the TR, when these financial market participants offer a financial product which invests in an economic activity that contributes to an environmental objective within the meaning of point (17) of Art. 2 of the SFDR, they have to inform investors about the compliance of these financial products with the TR. Their precontractual disclosures and periodic reports must include: (a) the information on the environmental objective or environmental objectives set out in Art. 9 of the TR to which the investment underlying the financial product contributes; and (b) a description of how and to what extent the investments underlying the financial product are in economic activities that qualify as environmentally sustainable under Art. 3 of the TR.

Under Art. 6 of the TR, the same information must be provided for financial products that do not qualify as "sustainable investment" as set out under the SFDR but nevertheless promote environmental characteristics. For this category of financial products, the above-mentioned information must be accompanied by the following statement: 'The "do no significant harm" principle applies only to those investments underlying the financial product that take into account the EU criteria for environmentally sustainable economic activities. The investments underlying the remaining portion of this financial product do not take into account the EU criteria for environmentally sustainable economic activities.' For all other financial products, Art. 7 of the TR provides that the information to be disclosed in accordance with the provisions of sectoral legislation referred to in Art. 6 par. 3 and 11 par. 2 of the SFDR shall be accompanied by the following statement: "The investments underlying this financial product do not take into account the EU criteria for environmentally sustainable economic activities."

Art. 8 of the TR introduces transparency obligations for undertakings that are required to publish non-financial information pursuant to Article 19a or Article 29a of Directive 2013/34/EU. These firms shall include in their non-financial statement or consolidated non-financial statement information on how and to what extent the undertaking's activities are associated with economic activities that qualify as environmentally sustainable under Art. 3 and 9 of the TR and in particular: (a) the proportion of their turnover derived from products or services associated with economic activities that qualify as environmentally sustainable under Art. 3 and 9 of the TR; and (b) the proportion of their capital expenditure and the proportion of their operating expenditure related to assets or processes associated with economic activities that qualify as environmentally sustainable under Art. 3 and 9.

As previously mentioned, the Taxonomy Regulation confers[125] upon the EC the power to adopt delegated acts which will specify the technical screening criteria for each environmental objective in accordance with Art. 19 of the TR. In this context, the EC asked TEG to provide guidance to the EC in the development of the delegated acts on climate change mitigation and climate change adaptation under the Taxonomy Regulation. On 9 March 2020, the TEG published its final report on EU Taxonomy[126]. This report contains recommendations on the overarching design of the Taxonomy, as well as guidance on how users of the Taxonomy can develop Taxonomy disclosures. It also includes a summary of the economic activities covered by the technical screening criteria.

[124] On the definition of this term under the SFDR see below.
[125] See Art. 23 of the TR.
[126] See **TEG (2020a)**

The report is supplemented by a Technical Annex containing a) a full list of revised or additional technical screening criteria for economic activities which can substantially contribute to climate change mitigation or adaptation (including assessment of significant harm to other environmental objectives) and b) a methodology section to support the above recommendations.

The TEG recommendations aim to assist the EC and serve as the first input to the Commission's work on developing the future delegated acts. Nevertheless, Art. 20 of the Taxonomy Regulation establishes a new body which shall be responsible for advising the Commission on the technical screening criteria and the possible need to update those criteria. The newly established Platform on Sustainable Finance will be composed of representatives from the European Environmental Agency, the ESAs, the European Investment Bank and the European Investment Fund and the European Union Agency for Fundamental Rights, along with private sector experts from the financial and non-financial market, civil society and academia. The Platform will also-inter alia-analyse the impact of the technical screening criteria in terms of potential costs and benefits of their application, assist the EC in analysing requests from stakeholders to develop or revise technical screening criteria for specific economic activities and advise the EC on the possible role of sustainability accounting and reporting standards in supporting the application of the technical screening criteria.

Art. 24 of the TR establishes a Member State Expert Group on Sustainable Finance. This Expert Group is mandated to advise the EC on the appropriateness of the technical screening criteria and the approach taken by the aforementioned Platform regarding the development of those criteria in accordance with Art. 19. This Group serves as a forum which aims to facilitate the exchange of views between Member States and the EC regarding new technical screening criteria or updates versions thereof or draft reports.

The TR confers upon the competent authorities designated in accordance with Regulation (EU) 2019/2088 the monitoring of compliance by financial market participants with this Regulation. According to Art. 21 par. 1 of the TR, Member States shall ensure that the competent authorities referred to in Art. 14 par. 1 of the SFDR monitor the compliance of financial market participants with the requirements laid down in Articles 5, 6 and 7 of the TR[127]. The same article equips the competent authorities of Member States with all the supervisory and investigatory tools necessary for the exercise of their functions under this Regulation and provides for the cooperation of the competent authorities with each other by providing each other with such information as is relevant for the purposes of carrying out their duties under the TR.

Art. 22 of the TR deals with the measures and penalties that can be imposed by the national competent authorities for violations of Art. 5, 6 and 7 of the TR. It mandates Member States to establish a system of effective, proportionate and dissuasive measures and sanctions which will be applicable to infringements of the aforementioned Articles. Regarding the powers available to the national competent authorities and the ESAs in order to enforce compliance, they can also exercise their product intervention powers laid down in Regulations (EU) 600/2014[128], (EU) No 1286/2014[129] and (EU) 2019/1238[130] of the European Parliament and of the Council regarding mis-selling practices or misleading disclosures of sustainability-related information, including the

[127] These Articles refer to transparency obligations in pre-contractual disclosures and in periodic reports.
[128] OJ L 173, 12.6.2014, p. 84-148
[129] OJ L 352, 9.12.2014, p. 1–23
[130] OJ L 198, 25.7.2019, p. 1–63

information required under the TR[131].

Pursuant to Art. 27 par. 1, the TR came into force 20 days after its publication in the Official Journal, namely on 12 July 2020. However, the Regulation will become fully operational only after the adoption of the delegated acts specifying the technical screening criteria for each environmental objective. These acts will be developed in two phases: the delegated act on the first two climate-related objectives (climate change mitigation and climate change adaptation) should be adopted by the Commission by 31 December 2020[132] with a view to ensure its entry into application on 1 January 2022. The delegated act on the other four environmental objectives should be adopted by the Commission by 31 December 2021 and will therefore apply from 1 January 2023. The rationale behind this timeline of actions is clearly stated in Recital 57 of the TR, according to which the relevant actors in the market should be given sufficient time (namely 12 months) to familiarise themselves with the newly established criteria for environmentally sustainable economic activities and to prepare for the application of the TR.

Art. 26 par. 2 point (b) of the TR provides that "the Commission shall publish a report describing the provisions that would be required to extend the scope of this Regulation beyond environmentally sustainable economic activities and describing the provisions that would be required to cover: activities that contribute to other sustainability objectives, including social objectives"[133]. In the same vein, Art. 20 par. 2 point (j) of the TR mandates the Platform on Sustainable Finance to advise the EC on other sustainability objectives, including social objectives. As is evident from these Articles, the TR prepares the ground for a Taxonomy of social objectives. Randazzo and Perozzi[134] point out that the global pandemic[135] caused by the outbreak of the COVID-19 disease has accelerated the need to establish a detailed EU classification system for sustainable activities with respect to the "S" of the ESG factors. Bearing that in mind, the TR can play a vital role in contributing to a sustainable economic recovery by bringing environmental and social values into the spotlight.

1.2. The EU Regulation on Sustainability-related Disclosures in the financial services sector (SFDR)

On 9 December 2019, the Regulation (EU) 2019/2088[136] of the European Parliament and of the Council of 27 November 2019 on sustainability-related disclosures in the financial services sector (commonly referred to as the Sustainable Finance Disclosure Regulation) was published in the Official Journal of the EU. This Regulation is primarily addressed to financial market participants and financial advisers and lays down the rules on transparency with regard to the integration of sustainability risks and the consideration of adverse sustainability impacts in their processes and the provision of sustainability-related information with respect to financial products[137].

The rationale behind the adoption of this Regulation is briefly described in recital (9). According

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[131] See Recital 55 of the TR.

[132] According to the information provided by the Register of delegated and implementing acts, the delegated Regulation on the objectives of climate change mitigation and adaptation will be adopted in December 2020.

[133] See also Recital 59 of the TR.

[134]See **Randazzo and Perozzi (2020),** pp. 4-5.

[135] On 11 March 2020, the rapid increase in the number of COVID-19 cases led WHO Director-General Dr Tedros Adhanom Ghebreyesus to announce that the outbreak of the disease caused by a new coronavirus (called SARS-CoV-2) could be characterized as a pandemic.

[136] OJ L 317, 9.12.2019, p. 1–16

[137] See Art. 1 of the SFDR.

to that, "divergent national measures and market-based approaches might cause significant distortions of competition because of significant differences in disclosure standards". Moreover, such divergencies make it very difficult to compare different financial products, create an uneven playing field for such products and for distribution channels and erect additional barriers within the internal market. Besides that, they could also prove confusing for end investors and could distort their investment decisions. The aim of the SFDR is clearly stated in recital (10): "This Regulation aims to reduce information asymmetries in principal-agent relationships with regard to the integration of sustainability risks, the consideration of adverse sustainability impacts, the promotion of environmental or social characteristics, and sustainable investment, by requiring financial market participants and financial advisers to make pre-contractual and ongoing disclosures to end investors when they act as agents of those end investors (principals)."

Art. 2 of the SFDR provides some key definitions. According to that, "financial market participant" means: a) an insurance undertaking which makes available an insurance-based investment product (IBIP), b) an investment firm which provides portfolio management, c) an institution for occupational retirement provision (IORP), d) a manufacturer of a pension product, e) an alternative investment fund manager (AIFM), f) a pan-European personal pension product (PEPP) provider, g) a manager of a qualifying venture capital fund registered in accordance with Article 14 of Regulation (EU) No 345/2013; h) a manager of a qualifying social entrepreneurship fund registered in accordance with Article 15 of Regulation (EU) No 346/2013, i) a management company of an undertaking for collective investment in transferable securities (UCITS management company) or j) a credit institution which provides portfolio management. "Financial adviser" means: a) an insurance intermediary which provides insurance advice with regard to IBIPs, b) an insurance undertaking which provides insurance advice with regard to IBIPs, c) a credit institution which provides investment advice, d) an investment firm which provides investment advice; e) an AIFM which provides investment advice in accordance with point (b)(i) of Article 6(4) of Directive 2011/61/EU or f) a UCITS management company which provides investment advice in accordance with point (b)(i) of Article 6(3) of Directive 2009/65/EC. It is also the first piece of EU legislation which provides a definition of the terms "sustainable investment"[138], "sustainability risk"[139], "sustainability factors"[140].

The TR amended the SFDR and inserted a new Article 2a which mandates the ESAs to develop ,through the Joint Committee, draft RTS in order to specify the details of the content and presentation of the information in relation to the principle of 'do no significant harm' referred to in point (17) of Article 2 of the SFDR consistent with the content, methodologies, and presentation in respect of the sustainability indicators in relation to the adverse impacts referred to in paragraphs

[138] See Art. 2 point (17): "Sustainable investment" means 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. For the six environmental objectives described in the Taxonomy Regulation see above under 1.1.

[139] See Art. 2 point (22): "Sustainability risk" means an environmental, social or governance event or condition that, if it occurs, could cause an actual or a potential material negative impact on the value of the investment.

[140] See Art. 2 point (24): "Sustainability factors" mean environmental, social and employee matters, respect for human rights, anti-corruption and anti-bribery matters.

6 and 7 of Art. 4 of the SFDR. The ESAs shall submit the draft RTS to the Commission by 30 December 2020.

The SFDR imposes multiple disclosure obligations in relation to sustainability risks. Firstly, it requires from financial market participants and financial advisers to publish on their websites information about their policies on the integration of sustainability risks in their investment decision-making process or in their investment or insurance advice respectively[141].

Moreover, it imposes disclosures of adverse sustainability impacts at entity level[142]. Financial market participants shall publish and maintain on their websites: where they consider principal adverse impacts[143] of investment decisions on sustainability factors, a statement on due diligence policies with respect to those impacts, taking due account of their size, the nature and scale of their activities and the types of financial products they make available. According to Art. 4 par. 3 and 4, from 30 June 2021, financial market participants exceeding on their balance sheet dates the criterion of the average number of 500 employees or parent companies of such an undertaking shall publish a statement on their website in relation to adverse sustainability impacts. In contrast to that, smaller firms can declare that they do not consider adverse impacts on sustainability risks in their investment decision-making process but must clearly explain why they do not do so, including, where relevant, information as to whether and when they intend to consider such adverse impacts[144]. As Chiu explains, smaller providers are generally obliged to integrate sustainability risks, but they are not subject to the mandatory disclosures of due diligence policies and information about their policies on the identification and prioritisation of principal adverse sustainability impacts and indicators, such as the ones imposed on larger firms[145]. However, as Professor Busch points out, unlike financial market participants exceeding a certain size, financial advisers always have the right not to consider adverse impacts of investment decisions on “sustainability factors” in their investment or insurance advice[146].

Pursuant to Art. 5 of the SFDR, financial market participants and financial advisers shall include in their remuneration policies information on how those policies are consistent with the integration of sustainability risks and shall publish that information on their websites.

At the precontractual level, financial market participants and financial advisers shall include descriptions of the following in pre-contractual disclosures: a) the manner in which sustainability risks are integrated into their investment decisions or into their investment/insurance advice respectively and b) the results of the assessment of the likely impacts of sustainability risks on the returns of the financial products they make available (or on the returns of the financial products they advise on in the case of financial advisers)[147].

At the financial product level, Art. 7 of the TR imposes upon financial market participants to include in the disclosures referred to in Art. 6 par. 3 the following: a) a clear and reasoned explanation of whether, and, if so, how a financial product considers principal adverse impacts on sustainability factors; b) a statement that information on principal adverse impacts on sustainability

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[141] See Art. 3 of the SFDR.
[142] See ibid, Art. 4.
[143] According to recital 20, “principal adverse impacts should be understood as those impacts of investment decisions and advice that result in negative effects on sustainability factors.”
[144] See ibid, Art. 4, par. 1 (b).
[145] See **Chiu, Iris H-Y (2020)**, pp 6-7. Chiu explains this exception by pointing to the principle of proportionality, meaning that the cost of compliance with the requirements of the Regulation for smaller firms would be too high, since they lack the necessary resources to measure their adverse sustainability impact.
[146] See **Busch, Danny (2020),** p. 15.
[147] See Art. 6 of the SFDR.

factors is available in the information to be disclosed pursuant to Art. 11 par. 2 of the SFDR.

The SFDR sets out precontractual disclosure obligations with regard to two types of financial products. In relation to products promoting environmental or social characteristics[148] or a combination of these characteristics, the information to be disclosed shall include: a) information on how those characteristics are met; b) if an index has been designated as a reference benchmark, information on whether and how this index is consistent with those characteristics. Regarding financial products which have sustainable investment[149] as their objective and an index has been designated as a reference benchmark, the information to be disclosed shall be accompanied by: a) information on how the designated index is aligned with that objective; (b) an explanation as to why and how the designated index aligned with that objective differs from a broad market index.

In accordance with Art. 10, financial market participants will need to publish on their websites the following information regarding products which promote environmental or social characteristics or a combination of these characteristics or financial products which have sustainable investment as their objective: a) a description of the environmental or social characteristics or the sustainable investment objective; b) information on the methodologies used to assess, measure and monitor the environmental or social characteristics or the impact of the sustainable investments selected for the financial product, including its data sources, screening criteria for the underlying assets and the relevant sustainability indicators used to measure the environmental or social characteristics or the overall sustainable impact of the financial product; c) the information referred to in Art. 8 and 9; d) the information referred to in Art. 11. This information needs to be clear, succinct and understandable to investors, as well as published in a way that is accurate, fair, clear, not misleading, simple and concise and in a prominent easily accessible area of the website.

The SFDR imposes also disclosure requirements in periodic reports[150]. For financial products that promote environmental or social characteristics, or a combination of those characteristics, financial market participants shall include in periodic reports a description on the extent to which environmental or social characteristics are met. In relation to financial products that have sustainable investment as their objective, the description will need to include the overall sustainability-related impact of the financial product by means of relevant sustainability indicators or, where an index has been designated as a reference benchmark, a comparison will be needed between the overall sustainability-related impact of the financial product with the impacts of the designated index and of a broad market index through sustainability indicators.

Pursuant to Art. 12 of the SFDR, financial market participants shall ensure that any information published in accordance with Art. 3, 5 or 10 is accurate. The financial market participants are also obliged to provide clear explanations of any amendments to the information that they are required to publish on their websites. The same applies to financial advisers regarding any information published in accordance with Art. 3 and 5 of the SFDR.

Both financial market participants and financial advisers shall ensure that their marketing communications do not contradict the information disclosed in accordance with the SFDR[151]. To specify this obligation, the ESAs may develop, through the Joint Committee, draft implementing technical standards to determine the standard presentation of information on the promotion of

[148] See Art. 8 of the SFDR.
[149] See Art. 9 of the SFDR.
[150] See Art. 11 of the SFDR.
[151] See Art. 13 par. 1 of the SFDR.

environmental or social characteristics and sustainable investments.

The monitoring of compliance of financial market participants and financial advisers with the requirements of this Regulation is conferred upon the competent authorities designated in accordance with sectoral legislation, in particular the sectoral legislation referred to in Art. 6 par. 3 of this Regulation, and in accordance with Directive 2013/36/EU (CRD)[152].

According to Art. 17, the SFDR shall neither apply to insurance intermediaries which provide insurance advice with regard to IBIPs nor to investment firms which provide investment advice provided that they employ fewer than three persons. Nevertheless, Member States may decide to apply this Regulation to insurance intermediaries which provide insurance advice with regard to IBIPs or investment firms which provide investment advice as well.

Pursuant to Art. 20 of the SFDR, this Regulation will apply from 10 March 2021. However, Art. 4 par. 6 and 7, Art. 8 par. 3, Art. 9 par. 5, Art. 10 par. 2, Art. 11 par. 4 and Art. 13 par. 2 shall apply from 29 December 2019. Art. 2a, 8 par. 4, 9 par. 6 and 11 par. 5 shall apply from 12 July 2020, namely the date of entry into force of the TR. Finally, in order to align the obligations arising from it with the SFDR, the TR amended Art. 20 of the SFDR providing that Art. 8 par. 2a and 9 par. 4a shall apply: (i) in respect of the environmental objectives referred to in points (a) and (b) of Article 9 of the TR, from 1 January 2022; and (ii) in respect of the environmental objectives referred to in points (c) to (f) of Article 9 of the TR, from 1 January 2023.

On 23 April 2020, the ESAs published a joint consultation paper setting out the proposed Regulatory Technical Standards (RTS) on content, methodologies and presentation of disclosures pursuant to Art. 2a, Art. 4 par 6 and 7, Art. 8 par. 3, Art. 9 par. 5, Art. 10 par. 2 and Art. 11 par. 4 of the SFDR.

The draft RTS refer to several disclosure obligations under the SFDR regarding the publication of:

i. the details of the presentation and content of the information in relation to the principle of 'do not significantly harm' as set out in Art. 2 point 17 of the SFDR consistent with the content, methodologies, and presentation of indicators in relation to adverse impacts referred to in Article 4 par. 6 and 7 SFDR.
ii. a statement on an entity's website on the due diligence policy in respect of the adverse impact of investment decisions on sustainability factors in relation to climate and other environment-related impacts (Art. 4 par. 6) and adverse impacts in the field of social and employee matters, respect for human rights, anti-corruption and anti-bribery matters (Art. 4 par. 7).
iii. pre-contractual information on how a product with environmental or social characteristics meet those characteristics and if an index has been designated as a reference benchmark, whether and how that index is consistent with those characteristics (Art. 8).
iv. pre-contractual information to show, where a product has sustainable investment objectives and a) has a designated index as a reference benchmark, how that index is aligned with the sustainable investment objective and an explanation as to why and how that designated index aligned with the objective differs from a broad market index (Art. 9 par. 1) SFDR); b) if no index has been designated as a reference benchmark, an explanation on how that objective is to be attained (Art. 9 par. 2 SFDR).
v. information on an entity's website to describe the environmental or social characteristics of financial products or the sustainable investment; the methodologies used; the pre-contractual

[152] See Art. 14 of the SFDR.

information referred to in Art. 8 and 9; and the periodic reports referred to in Art. 11.

vi. information in periodic reports according to sectoral legislation specifying (a) the extent to which products with environmental and/or social characteristics meet those characteristics, and (b) for products with sustainable investment objectives and products which objective is a reduction in carbon emissions: (i) the overall sustainability-related impact of the product by means of relevant sustainability indicators and (ii) where an index has been designated as a reference benchmark, a comparison between the overall impact of the financial product with the designated index and a broad market index through sustainability indicators (Art. 11 of the SFDR).

1.3.The Low Carbon Benchmarks Regulation

Regulation (EU) 2019/2089[153], commonly referred to as the Low Carbon Benchmarks Regulation, was published in the Official Journal on 9 December 2019 (the same day with the SFDR). This Regulation amends Regulation (EU) 2016/1011, known as the Benchmarks Regulation (BMR)[154], in order to increase transparency and uniformity in the use of low-carbon indices and introduces two new benchmark categories: EU Climate Transition Benchmarks and EU Paris-Aligned Benchmarks.

The BMR established uniform rules for benchmarks in the EU. As stated in recital 9 of the Regulation (EU) 2019/2089, "an increasing number of investors opt for low-carbon investment strategies and make use of low-carbon benchmarks to measure the performance of their investment portfolios." These two new benchmarks will be based on a methodology which will be linked to the obligations laid down in the Paris Agreement in relation to carbon emissions with the aim to contribute to increasing transparency and preventing the practice of greenwashing.

As previously mentioned, the new Regulation creates two new types of benchmarks. According to Art. 3 par. 1 point (23a) of the amended BMR, "EU Climate Transition Benchmark" means a benchmark which is labelled as an EU Climate Transition Benchmark and fulfills the following requirements: (a) its underlying assets are selected, weighted or excluded in such a manner that the resulting benchmark portfolio is on a decarbonisation trajectory; and (b) it is constructed in accordance with the minimum standards laid down in the delegated acts referred to in Art. 19a par. 2. On the other hand, the "EU Paris-aligned Benchmark"[155] is a benchmark which is labelled as an EU Paris-aligned Benchmark and fulfils the following requirements: (a) its underlying assets are selected, weighted or excluded in such a manner that the resulting benchmark portfolio's carbon emissions are aligned with the objectives of the Paris Agreement adopted under the United Nations Framework Convention on Climate Change; (b) it is constructed in accordance with the minimum standards laid down in the delegated acts referred to in Art. 19a par. 2; and (c) the activities relating to its underlying assets do not significantly harm other environmental, social and governance (ESG) objectives. The "decarbonisation trajectory"[156] refers to 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.

The amended BMR provides that benchmark administrators shall publish an explanation of how

[153] OJ L 317, 9.12.2019, p. 17–27
[154] OJ L 171, 29.6.2016, p. 1–65
[155] See ibid, Art. 3 par. 1 point 23b.
[156] See ibid, Art. 3 par. 1 point 23c.

the key elements of the benchmark methodology reflect ESG factors for each benchmark or family of benchmarks, with the exception of interest rate and foreign exchange benchmarks[157]. Benchmark administrators shall comply with this requirement by 30 April 2020. Additionally, the new Regulation requires from benchmark administrators to include in the benchmark statement by 30 April 2020 an explanation of how ESG factors are reflected in each benchmark or family of benchmarks. For those benchmarks or families of benchmarks that do not pursue ESG objectives, it shall be sufficient for benchmark administrators to clearly state in the benchmark statement that they do not pursue such objectives[158]. Furthermore, by 31 December 2021, benchmark administrators shall, for each benchmark or, where applicable, each family of benchmarks, with the exception of interest rate and foreign exchange benchmarks, include in their benchmark statement an explanation of how their methodology aligns with the target of carbon emission reductions or attains the objectives of the Paris Agreement[159].

The EC is also empowered by the Regulation to adopt delegated acts to supplement this Regulation by laying down the minimum standards for EU Climate Transition Benchmarks and EU Paris-aligned Benchmarks to specify: a) the criteria for the choice of the underlying assets, including, where applicable, any criteria for excluding assets; b) the criteria and method for the weighting of the underlying assets in the benchmark; c) the determination of the decarbonisation trajectory for EU Climate Transition Benchmarks[160].

Regulation (EU) 2019/2089 entered into force on the day following that of its publication in the Official Journal of the European Union, namely on 10 December 2019.

2. The ESA's mandates on sustainable finance

2.1. EBA's mandate on sustainable finance

The mandates conferred upon EBA are set out in various pieces of EU legislation and these different legal bases reflect various policy priorities.

Firstly, the EBA's founding Regulation[161] contains various provisions related to sustainability concerns. All these mandates have been added to the founding Regulation through the amendments made by the Regulation (EU) 2019/2175[162]. According to Art. 1 par. 3 of the EBA's founding Regulation, "The Authority shall act in the field of activities of credit institutions…. taking into account sustainable business models and the integration of environmental, social and governance related factors". Art. 8 par. 1 point (f) refers to one of the tasks of EBA which is "to monitor and assess market developments in the area of its competence ….and in innovative financial services duly considering developments relating to environmental, social and governance related factors", while par. 1a point (c) of the same article provides that "When carrying out its tasks in accordance with this Regulation, the Authority shall: take account of technological innovation, innovative and sustainable business models, and the integration of environmental, social and governance related factors." Art. 23 par. 1 provides that "The Authority shall, in consultation with the ESRB, develop criteria for the identification and measurement of systemic risk …including potential

[157] See ibid, Art. 13 par. 1 point d.
[158] See ibid, Art 27 par. 2a first subparagraph.
[159] See ibid, Art 27 par. 2a third subparagraph.
[160] See ibid, Art 19a.
[161] OJ L 331, 15.12.2010, p. 12–47
[162] OJ L 334, 27.12.2019, p. 1–145

environmental- related systemic risk." Furthermore, Art. 29 par. 1 point (f) states that the Authority should "put in place a monitoring system to assess material environmental, social and governance-related risks, taking into account the Paris Agreement to the United Nations Framework Convention on Climate Change." Pursuant to Art. 32. par. 2 points (a) and (e) the Authority "shall develop: a) common methodologies for assessing the effect of economic scenarios on a financial institution's financial position taking into account inter alia risks stemming from adverse environmental developments; and e) common methodologies for assessing the effect of environmental risks on the financial stability of financial institutions."

More mandates for EBA on sustainable finance are contained in the amended Capital Requirements Regulation[163] and Capital Requirements Directive[164]. Art. 98 par. 8 of CRD (as amended by the Directive (EU) 2019/878[165]) calls on the EBA "to assess the potential inclusion of ESG risks in the supervisory review and evaluation process performed by competent authorities. To that end, the EBA's assessment must comprise, inter alia: i) the development of a uniform definition of ESG risks including physical risks and transition risks; ii) the development of criteria for understanding the impact of ESG risks on the financial stability of institutions in the short, medium and long terms; iii) the arrangements, processes, mechanisms and strategies to be implemented by the institutions to identify, assess and manage these risks; and iv) the analysis methods and tools to assess the impact of ESG risks on lending and the financial intermediation activities of institutions." EBA shall submit a report on its findings to the Commission, the European Parliament and to the Council by 28 June 2021 and, on the basis of the outcome of its report, EBA may, if appropriate, issue guidelines, in accordance with Article 16 of Regulation (EU) No 1093/2010, regarding the uniform inclusion of ESG risks in the supervisory review and evaluation process performed by competent authorities.

Linked to the previous mandate is the one contained in the Art. 449a of CRR II[166], which obliges large institutions (applicable from 28 June 2022) which have issued securities that are admitted to trading on a regulated market of any Member State to disclose information on ESG risks, including physical risks and transition risks, as defined in the report referred to in Art. 98 par. 8 of Directive 2013/36/EU (CRD V). The above-mentioned information on ESG risks that needs to be disclosed shall be communicated via uniform disclosure formats. To that end, Art. 434a of CRR II tasks EBA with the responsibility to "develop draft implementing technical standards specifying uniform disclosure formats"[167]. EBA shall submit those draft implementing technical standards to the Commission by 28 June 2020.

Furthermore, Art. 501c of CRR requires the EBA "to assess whether a dedicated prudential treatment of exposures related to assets or activities associated substantially with environmental and/or social objectives would be justified. In particular, the EBA must assess: i) methodologies for the assessment of the effective riskiness of exposures related to assets and activities associated substantially with environmental and/or social objectives compared to the riskiness of other

[163] OJ L 176, 27.6.2013, p. 1–337
[164] OJ L 176, 27.6.2013, p. 338–436
[165] OJ L 150, 7.6.2019, p. 253–295
[166] OJ L 150, 7.6.2019, p. 1–225
[167] According to Art. 15 par. 1 of Regulation (EU) No 1093/2010, EBA develops implementing technical standards, which shall be technical, shall not imply strategic decisions or policy choices and their content shall be to determine the conditions of application of the legislative acts. After having developed these standards, the EBA shall submit its draft implementing technical standards to the Commission for endorsement. The draft implementing technical standards are being adopted by the Commission by means of implementing legal acts pursuant to Art. 291 par. 2 of the TFEU.

exposures; ii) the development of appropriate criteria for the assessment of physical risks and transition risks; and iii) the potential effects of a dedicated prudential treatment of exposures associated substantially with environmental and/or social objectives and activities on financial stability and bank lending in the Union." EBA shall submit a report on its findings to the European Parliament, to the Council and to the Commission by 28 June 2025.

On 5 December 2019 the Investment Firms Directive (IFD)[168] and the Investment Firms Regulation (IFR)[169] package was published in the Official Journal of the EU. Sustainability related mandates are also included in these two legislative acts. Pursuant to Art. 35 of the IFD, EBA shall prepare a report on the introduction of technical criteria related to exposures to activities associated substantially with environmental, social and governance (ESG) objectives (including definition of ESG risks, processes to manage them and relevant criteria and metrics for the purposes of supervisory review and evaluation process) with a view to assessing the possible sources and effects of risks on investment firms, taking into account applicable EU legal acts in the field of ESG taxonomy. EBA shall submit its report to the European Parliament, to the Council and to the Commission by 26 December 2021.

Art. 34 of the IFR confers upon EBA the competence to prepare another relevant report. According to the latter, EBA shall assess, after consulting the European Systemic Risk Board and on the basis of the findings of the Commission's HLEG on Sustainable Finance, whether dedicated prudential treatment of assets exposed to activities associated substantially with environmental or social objectives, in the form of adjusted K-factors or adjusted K-factor coefficients, would be justified from a prudential perspective (including specific risk profiles of assets exposed to ESG activities, risks related to the depreciation of assets due to regulatory changes such as climate change mitigation). EBA shall submit its report on its findings to the European Parliament, to the Council and to the Commission by 26 December 2021.

2.2. ESMA's mandate on sustainable finance

The founding Regulation[170] of the European Securities and Markets Authority contains the same mandates[171] on sustainability for ESMA as the EBA Regulation. This is not something unexpected or surprising, since all three ESA's have the same objective in accordance with Art. 1 par. 5 of their founding Regulations: "The objective of the Authority shall be to protect the public interest by contributing to the short, medium and long-term stability and effectiveness of the financial system, for the Union economy, its citizens and businesses."

A key priority for ESMA is the completion of the regulatory framework in relation to transparency obligations arising from the SFDR. ESMA will contribute to the development of the RTS as part of the Joint Committee of the ESAs, including those introduced through the amendment of the SFDR via the TR.

According to Art. 20 of the TR, ESMA is also a member of the Platform on Sustainable Finance. As previously mentioned, the Platform's main task is to advise the Commission on the technical screening criteria referred to in Art. 19 of the TR, as well as on the possible need to update those criteria. ESMA's advice is aimed at ensuring alignment and consistency with the financial

[168] OJ L 314, 5.12.2019, p. 64–114
[169] OJ L 314, 5.12.2019, p. 1–63
[170] OJ L 331, 15.12.2010, p. 84–119
[171] For the sake of brevity, reference is made here to section 2.1. of the present Chapter.

regulation.

Regarding the entities under ESMA's direct supervision, the most relevant task here is the implementation of ESMA's Guidelines on Disclosure Requirements applicable to credit ratings[172]. These Guidelines impose greater transparency obligations on CRA's in order to assess whether ESG factors are a key driver of a change to a credit rating. In the context of its direct supervision role under Art. 32 par. 6 and 7 of the BMR regarding third country administrators providing climate-related benchmarks and applying for recognition, ESMA aims to implement Regulation (EU) 2019/2089 as regards EU Climate Transition Benchmarks, EU Paris-aligned Benchmarks and sustainability-related disclosures for benchmarks and the related delegated acts.

Finally, developing common approaches for embedding ESG factors in the supervisory practices of NCAs is also a priority for ESMA. To achieve that goal, ESMA has to map out first the current domestic supervisory approaches in relation to ESG factors (including the relevant powers and competencies of the NCAs, their relevant experience and any particular national legal rules on ESG factors). After that, ESMA needs to raise the awareness of NCAs on ESG matters through training sessions, in order to promote common understanding of the ESG risks and the way to address them. Case studies are also an important tool for ESMA which can help NCAs share their experience with their peers, thus facilitating the development of a common supervisory language on ESG issues.

2.3. EIOPA's mandate on sustainable finance

EIOPA's founding Regulation[173] (which has identical structure and follows the same logic as the ones of the other two ESAs) contains the same legal provisions in relation to sustainable finance as EBA and ESMA founding Regulations.

EIOPA considers sustainable finance as a policy area of utmost importance and its goal is to contribute to the implementation of European Commission's Action Plan on Financing Sustainable Growth by providing technical advice on how to integrate ESG factors into the prudential and conduct framework for insurers, reinsurers, insurance distributors and pension funds. The main objective here is to incorporate sustainability in the delegated regulations under Solvency II Directive[174] and the Insurance Distribution Directive (IDD)[175] in order to ensure that insurers, reinsurers and insurance distributors operate in a sustainable manner through (among other measures) appropriate ESG risk management and mitigation procedures. Solvency II Directive lays down the rules concerning "the taking-up and pursuit, within the Community, of the self-employed activities of direct insurance and reinsurance; the supervision of insurance and reinsurance groups; the reorganisation and winding-up of direct insurance undertakings"[176], while IDD "lays down rules concerning the taking-up and pursuit of the activities of insurance and reinsurance distribution in the Union."[177]

As a response to the formal request from the EC on 24 July 2018, EIOPA published on 30 April 2019 its Technical Advice on the integration of sustainability risks and factors in the delegated

[172] See below under Section 4.
[173] OJ L 331, 15.12.2010, p. 48–83
[174] OJ L 335, 17.12.2009, p. 1–155
[175] OJ L 26, 2.2.2016, p. 19–59
[176] See Art. 1 of Solvency II.
[177] See Art. 1 par. 1 of IDD.

acts under Solvency II and IDD[178]. Regarding Solvency II, the technical advice focuses on organisational requirements and corporate governance mechanisms, operating conditions and risk management. It proposes amendments to various Articles of the Solvency II Delegated Regulation[179] including -among others- Art. 258 (General governance requirements), Art. 268 Specific provisions (Functions), Art. 273 (Fit and proper requirements), Art. 274 (Outsourcing), Art. 275 (Remuneration), Art. 259 (Risk management system), Art. 260 (Risk management areas), Art. 266 (Internal control system), Art. 270 (Actuarial function), Art. 271 (Internal audit function). In relation to IDD Delegated Regulation[180], EIOPA focuses on organisational requirements-conflicts of interest and product oversight and governance and proposes amendments to Art. 3 (Identification of conflicts of interest), Art. 4 (Conflicts of interest policy), Art. 5 (Procedures and measures under the conflicts of interest policy), Art. 6 (Disclosure), Art. 7 (Review and record keeping), Art. 8 (Distribution channels), Art. 10 (Product distribution arrangements), Art. 11 (Informing the manufacturer).

3. The Non-Financial Reporting Directive and the Commission Guidelines on reporting climate-related information

On 15 November 2014 the Directive 2014/95/EU[181] (commonly known as the Non-Financial Reporting Directive-NFRD) was published in the Official Journal of the EU. This Directive amended the accounting Directive 2013/34/EU[182] by imposing upon large public-interest companies with more than 500 employees (including listed companies, banks, insurance companies and other companies designated by national authorities as public-interest entities) the obligation to disclose specific information on the way they operate and manage ESG risks. In particular, "large undertakings which are public-interest entities exceeding on their balance sheet dates the criterion of the average number of 500 employees during the financial year shall include in the management report a non-financial statement containing information to the extent necessary for an understanding of the undertaking's development, performance, position and impact of its activity, relating to, as a minimum, environmental, social and employee matters, respect for human rights, anti-corruption and bribery matters"[183]. This statement shall include a description of the policies, outcomes and risks related to those matters and should be included in the management report of the undertaking concerned. The non-financial statement should also include information on the due diligence processes implemented by the undertaking, also regarding, where relevant and proportionate, its supply and subcontracting chains, in order to identify, prevent and mitigate existing and potential adverse impacts. In case that the undertaking does not pursue policies in relation to one or more of those matters, the non-financial statement shall provide a clear and reasoned explanation for not doing so. Companies concerned started applying the NFRD as of 2018, on information relating to the 2017 financial year[184].

Art. 2 of the NFRD is of great importance. It mandates the EC to prepare non-binding guidelines (after having consulted relevant stakeholders) on methodology for reporting non-financial

[178] See **EIOPA (2019b)**
[179] OJ L 12, 17.1.2015, p. 1–797
[180] OJ L 341, 20.12.2017, p. 8–18
[181] OJ L 330, 15.11.2014, p. 1–9
[182] OJ L 182, 29.6.2013, p. 19–76
[183] See Art. 19a and 29a of the amended Directive 2013/34/EU.
[184] See Art. 4 of the NFRD.

information, including non-financial key performance indicators, general and sectoral, with a view to facilitating relevant, useful and comparable disclosure of non-financial information by undertakings. On that basis, the EC published Guidelines on non-financial reporting[185] on 5 July 2017. The aim of these Guidelines is to "help companies disclose high quality, relevant, useful, consistent and more comparable non-financial (environmental, social and governance-related) information in a way that fosters resilient and sustainable growth and employment and promotes transparency"[186]. These Guidelines are non-binding and they are intended to help companies draw up relevant, useful concise non-financial statements according to the requirements of the amended Directive 2013/34/EU. They contain six key principles for good non-financial reporting, namely that disclosed information should be: (1) material; (2) fair, balanced and understandable; (3) comprehensive but concise; (4) strategic and forward-looking; (5) stakeholder oriented; and (6) consistent and coherent[187].

As a supplement to the existing Guidelines on non-financial reporting, the EC published Guidelines on reporting climate-related information[188] on 20 June 2019. These new Guidelines form part of the EC's Action Plan on Financing Sustainable Growth[189] and were developed in line with the Recommendations[190] of the Task Force on Climate-related Financial Disclosures (TCFD) which was established by the Financial Stability Board. The EC's Guidelines also build upon TEG's final report on climate-related disclosures[191] which was published in January 2019.

The Guidelines on reporting climate-related information have the same legal basis with the existing Guidelines on non-financial reporting, which is Art. 2 of the Non-Financial Reporting Directive (2014/95/EU). They are non-binding, like the existing non-binding guidelines published in 2017 to which they are a supplement, meaning that they do no create any new legal obligations. Companies may choose alternative approaches to the reporting of climate-related information, provided they meet legal requirements. The guidelines are intended for use by companies that fall under the scope of the NFRD, but they might also be useful for other companies that wish to disclose climate-related information.

The main contents of these Guidelines on climate-related reporting are: a) they provide explanations of important concepts in relation to reporting climate information under the NFRD, including materiality, climate-related risks and opportunities and natural capital dependencies. b) they make specific proposals for what to report regarding the climate under each of the reporting areas identified in the NFRD (business model, policies and due diligence, outcome of policies, principal risks and risk management and key performance indicators), c) they also contain an annex with further guidance for banks and insurance companies, with a view to addressing the particular issues that they face regarding the reporting of climate-related information. d) lastly, the provide an annex which explains how the reporting requirements of the NFRD can be combined with the recommendations of the TFCD.

The Guidelines appear to be linked with the TR. According to the NFRD, companies should disclose key performance indicators (KPIs) relevant to their particular business. As an example of a KPI linked with the TR, the new Guidelines propose that companies should disclose the

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[185] OJ C 215, 5.7.2017, p. 1–20
[186] See ibid, p. 4.
[187] See ibid, pp. 5-9.
[188] OJ C 209, 20.6.2019, p. 1–30
[189] See above, Chapter 2 Section 3 under point ix.
[190] See **TCFD (2017)**
[191] See **TEG (2019a)**

proportion of their turnover and/or capital expenditure and/or operational expenditure that meet the criteria for substantially contributing to mitigation of or adaptation to climate change as set out in the TR. The guidelines clearly state that companies should use this KPI upon the publication of the TR in the Official Journal of the EU. Regarding the timeframe of their application, companies should be able to use the new Guidelines for reports published in 2020, covering the financial year of 2019.

With a view to improving the disclosure of non-financial information and as part of its strategy to strengthen the foundations for sustainable investment, the EC launched on 20 February 2020 a public consultation, which aims to collect the views of stakeholders about possible amendments to the NFRD. The EC sought the views of preparers of reports containing non-financial information and of the end users of such published information, especially financial sector institutions, investors, civil society organisations and trade unions. The target group contains also other stakeholder groups, including academics, supervisors, national authorities, assurance providers, providers of ESG data and ratings or standards setting organisations.

4. The Credit Rating Agencies Regulation and the ESMA Guidelines on Disclosure Requirements Applicable to Credit Ratings

In recent years, Credit Rating Agencies (CRAs) have accelerated their efforts to evaluate firms' ESG scores and their risk management capacity in relation to climate-related risks. This type of evaluation motivates firms to mobilise more capital for sustainable projects and enhances the quality of information flow between issuers and investors. However, the current market practices used to evaluate companies' ESG performance are not broadly accepted, thus the transparency of the techniques employed by CRA's becomes even more crucial.

ESMA is responsible for the registration and supervision of credit rating agencies in the EU. Art. 21 par. 1 of Regulation (EC) No 1060/2009 (commonly known as the Credit Rating Agencies Regulation-CRAR)[192] confers upon ESMA the supervision of CRAs. The CRAR also assigns significant supervisory and enforcement powers to ESMA, including the power to request necessary information from CRAs, to conduct investigations and on-site inspections and to impose periodic penalty payments and fines.

The EC invited ESMA to include environmental and social sustainability information in its Guidelines on disclosure for credit rating agencies by Q2 2019. As a response to EC's Action Plan on Financing Sustainable Growth[193], ESMA published on 18 July 2019 its Guidelines on Disclosure Requirements applicable to credit ratings. These Guidelines apply to credit rating agencies (CRAs) established in the Union and registered with ESMA in accordance with the CRAR and refer to particular matters relating to the publication of credit ratings, rating outlooks and methodologies and models by EU Registered CRAs in accordance with Art. 10 par. 1, par. 2 and par. 5 and Annex I, Section D, I, points 1, 2, 4 and 5 and Annex I Section D, III, 1,2, 2a and 4 of the CRAR.

These Guidelines have been issued pursuant to Article 16 of the ESMA Regulation. Also, recital 12 of the CRAR states that in areas not covered by regulatory technical standards, ESMA should have the power to issue and update non-binding Guidelines on issues related to the application of the CRAR. In accordance with Article 16 par. 3 of the ESMA Regulation, CRAs must make every

[192] OJ L 302, 17.11.2009, p. 1–31
[193] See above, Chapter 2, Section 3 under point vi.

effort to comply with the Guidelines. The purpose of these Guidelines is to improve the consistency of the information that CRAs are required to disclose as part of certain rating actions and to ensure transparency around the credit rating actions in relation to ESG factors in order to enable the users of the credit rating to understand the main reasons for the credit rating. This information is typically included in the rating action press release or reports.

Particularly relevant for our analysis is section 3.2 of the Guidelines which contains specific requirements relating to Art. 10 par. 1 and par. 2 and Section D, Annex I, I, points 2a and 5 of the CRAR. Pursuant to that section, where ESG factors were a key driver behind a change to a credit rating or rating outlook that had been presented and disclosed in accordance with Article 10 par. 1 and par. 2 and Section D, Annex I, I, points 2a and 5, ESMA expects CRAs in the accompanying press release or report to: a) outline whether any of the key drivers behind the change to the credit rating or rating outlook correspond to that CRA's categorisation of ESG factors; b) identify the key driving factors that were considered by that CRA to be ESG factors; c) explain why these ESG factors were material to the credit rating or rating outlook; d) include a link to either the section of that CRA's website that includes guidance explaining how ESG factors are considered as part of that CRA's credit ratings or a document that explains how ESG factors are considered within that CRA's methodologies or associated models.

These Guidelines apply from 30 March 2020. ESMA aims to assess the application of these Guidelines by the CRAs through its ongoing supervision and monitoring of CRAs' periodic reporting to ESMA.

5. The unfinished agenda

5.1. The proposed Commission delegated Regulations under MiFID II and IDD

On 8 June 2020, the EC launched a public consultation for the following draft Delegated Regulations on how investment firms and insurance distributors should take sustainability issues into account when advising clients: a) Commission Delegated Regulation (EU) …/… of XXX amending Delegated Regulation (EU) 2017/565 as regards the integration of sustainability factors, risks and preferences into certain organisational requirements and operating conditions for investment firms; and b) Commission Delegated Regulation (EU) …/… of XXX amending Delegated Regulation (EU) 2017/2358 and Delegated Regulation (EU) 2017/2359 as regards the integration of sustainability factors and preferences into the product oversight and governance requirements for insurance undertakings and insurance distributors and into the rules on conduct of business and investment advice for insurance-based investment products. The draft Delegated Regulations constitute EC's response to Action 4[194] of its Action Plan on Financing Sustainable Growth and amend the delegated Regulations under MiFID II and the Insurance Distribution Directive respectively. These two draft acts aim at integrating ESG considerations into the investment and advisory process in a consistent manner across sectors. The goal is to ensure that all financial entities that receive a mandate from their clients to take investment decisions on their behalf would integrate ESG into their internal processes and inform their clients about it.

[194] On that see above, Chapter 2, Section 3 under point iv.

5.1.1. The proposed Commission delegated Regulation under MiFID II

MiFID II became applicable on 3 January 2018 and, together with Regulation (EU) No 600/2014[195] (MiFIR), replaced Directive 2004/39/EC. MiFID II and MiFIR create a harmonised legal framework governing the requirements applicable to investment firms, regulated markets, data reporting services providers and third country firms providing investment services or activities in the Union with the aim to enhance the efficiency and integrity of financial markets.

Under the existing MiFID II legislation, firms providing investment advice and portfolio management are required to obtain the necessary information about the client's knowledge and experience in the investment field, their ability to bear losses and objectives including the client's risk tolerance so as to enable the investment firm to recommend to the client or potential client the investment services and financial instruments that are suitable for him (suitability assessment)[196]. However, existing suitability assessments generally do not include questions on ESG preferences of clients. As a result, investment firms consistently do not give attention to ESG factors in the selection process. The proposed delegated Regulation aims at clarifying that ESG considerations and preferences should be taken into account in the investment and advisory process as part of the duties towards clients. The legal basis of the proposed delegated Commission Regulation is Art. 16 par. 12, Art. 24 par. 13 and 25 par. 8 of MiFID II.

The delegated Commission Regulation (EU) 2017/565[197] supplements Directive 2014/65/EU (MiFID II) by further specifying organisational requirements and operating conditions for investment firms. The proposed delegated Commission Regulation amends Regulation (EU) 2017/565 by introducing two main obligations.

Firstly, it aims at clarifying that investment firms providing investment advice and portfolio management should carry out a mandatory assessment of sustainability preferences of their clients. These investment firms should take these sustainability preferences into account in the selection process of the financial products that are offered to these clients. Further, it requires investment firms to prepare a report to the client that explains how the recommendation to this client meets his investment objectives, risk profile, capacity for loss bearing and sustainability preferences (ex-post information disclosure).

Secondly, it requires investment firms to consider sustainability risks when complying with the organisational requirements and to integrate sustainability risk into the risk management policies.

Art. 2 of the proposed Regulation sets out the date of its application which is twelve months after the date of its publication in the Official Journal of the EU.

5.1.2. The proposed Commission delegated Regulation under IDD

The IDD became applicable on 1 October 2018 and replaced Directive 2002/92/EC on insurance mediation. IDD established a harmonised legal framework governing the requirements applicable to the distribution of insurance-based investment products. Under the existing IDD framework, insurance intermediaries and insurance undertakings distributing insurance-based investment products are obliged to obtain the necessary information regarding the customer’s or potential customer’s knowledge and experience in the investment field relevant to the specific type of

[195] OJ L 173, 12.6.2014, p. 84–148
[196] See Art. 25 par. 2 of MiFID II.
[197] OJ L 87, 31.3.2017, p. 1–83

product or service, that person's financial situation including that person's ability to bear losses, and that person's investment objectives, including that person's risk tolerance, so as to enable the insurance intermediary or the insurance undertaking to recommend to the customer or potential customer the insurance-based investment products that are suitable for that person and that, in particular, are in accordance with that person's risk tolerance and ability to bear losses (suitability assessment)[198]. As described previously in relation to investment firms, these suitability assessments generally do not address ESG preferences of customers. That means that insurance intermediaries and insurance undertakings distributing insurance-based investment products tend to underestimate ESG factors in their selection process. The aim of the proposed delegated Commission Regulation is to make clear that ESG considerations and preferences should be taken into consideration as part of the advisory process. The legal basis of this Regulation is Art. 25 par. 2, Art. 28 par. 4 and Art. 30 par. 6 of IDD.

The proposed delegated Commission Regulation has a twofold aim. First, it aims at ensuring that insurance undertakings and insurance intermediaries consider the sustainability profile and preferences of the customers belonging to the target market in the product approval process and the product oversight and governance arrangements if a particular insurance product is intended to be distributed to customers looking for products with a sustainability-related profile.

Article 2 of the proposed Regulation aims at clarifying that insurance intermediaries and insurance undertakings distributing insurance-based investment products have to take into account possible conflicts of interest that may arise in relation to sustainability factors. Furthermore, when providing advice on insurance-based investment products, insurance intermediaries and insurance undertakings have to carry out a mandatory assessment of sustainability preferences of their customers and potential customers. They should take these sustainability preferences into account in the selection process of the insurance-based investment products that are offered to these customers.

The proposed Regulation will start to apply twelve months after the date of its publication[199] in the Official Journal of the EU, as in the case of the proposed delegated Commission Regulation under MiFID II.

5.2. The EU Green Bond Standard

As previously mentioned, the EC published in March 2018 its Action Plan on Financing Sustainable Growth, which sets out a comprehensive European strategy to mobilise finance for sustainable growth. In line with Action 2 of the Action Plan, the European Commission committed to create standards and labels for green financial products.

To assist the EC in its work, the TEG published an interim report on 6 March 2019 on an EU Green Bond Standard (EU-GBS) for public feedback. The interim report[200] presents the content of a draft EU-GBS (see Annex 1), explains its purpose and clarifies how such a standard should be developed and implemented in Europe with the aim to mobilise substantial financial flows to green projects. Over than 100 organisations provided feedback and supported the development of a voluntary EU-GBS. Most of the respondents acknowledged that green bonds play a crucial role in financing assets needed for the low-carbon transition. However, there is no uniform green bond

[198] See Art. 30 par. 1 of IDD.
[199] See Art. 3 of the proposed Commission Delegated Regulation.
[200] See **TEG (2019b).**

standard within the EU.

On 18 June 2019, the TEG published its final report[201] on EU-GBS. The TEG proposes that the Commission creates a voluntary, non-legislative EU Green Bond Standard to enhance the effectiveness, transparency, comparability and credibility of the green bond market and to encourage market participants to issue and invest in EU green bonds. This report is based upon the interim report that was published by TEG on 6 March 2019.

According to the final report, the TEG proposes that an EU Green Bond could be any type of listed or unlisted bond or capital market debt instrument issued by a European or international issuer that is aligned with the EU Green Bond Standard. TEG also recommends that the EU Green Bond Standard should incorporate four important elements[202]:

i. alignment with EU-taxonomy: proceeds from EU Green Bonds should finance activities that (a) contribute substantially to at least one of the six taxonomy environmental objectives, (b) do not significantly harm any of the other objectives and (c) comply with the minimum social safeguards. Where (d) technical screening criteria have been developed, financed projects or activities shall meet these criteria, allowing however for specific cases where these may not be directly applicable.

ii. publication of a Green Bond Framework, which confirms the voluntary alignment of green bonds issued with the EU GBS, explains how the issuer's strategy aligns with the environmental objectives, and provides details on all key aspects of the proposed use-of-proceeds, processes and reporting of the green bonds.

iii. mandatory reporting on use of proceeds (allocation report) and on environmental impact (impact report).

iv. mandatory verification of the Green Bond Framework and final allocation report by an external verifier. The TEG recommends that external verifiers are formally accredited and supervised. In TEG's view, the most suitable European authority to design and operate such an accreditation regime for verifiers should be the ESMA.

Based on the recommendations of the June 2019 report, TEG published on 9 March 2020 its usability guide[203] for the EU-GBS. This Guide provides recommendations from the TEG, with its views on the practical application of the EU GBS, as it was described by the TEG EU GBS report. This Guide's goal is to support issuers, verifiers and investors of EU Green Bonds. It provides guidance reflecting the latest changes in the draft model of the EU GBS. The Guide contains an updated draft model of a GBS (see Annex 1).

Along with its public consultation on the renewed sustainable finance strategy, the EC launched a targeted consultation on the establishment of an EU Green Bond Standard, that builds on the work of the TEG, and was running between 12 June and 2 October 2020. Based on the outcome of these two consultations, the Commission will take a decision in Q4 of 2020 on how to take the Green Bond Standard forward.

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[201] See **TEG (2019c).**

[202] See ibid, pp. 27-31.

[203] See **TEG (2020b)**

D. Conclusion

To accomplish the goals set in the Paris Agreement, a large amount of capital is required to flow towards sustainable economic activities at the global level. The EC has estimated that the European economy needs a mixture of public policies that will stimulate more than 180 billion euro to fund those projects that are necessary in order to maintain the global temperature increase to well below 2°C above pre-industrial levels. It is evident that the private sector should contribute to addressing this funding gap. In a bank-based European economy, banks should play a key role in the transition to a more sustainable financial system. The global nature of climate change, combined with increasing cross-border flows of capital through the financial markets, requires an international response and public-private partnerships. Therefore, the initiatives of the EU to be the first jurisdiction which attempts to coordinate and harmonise the European regulatory framework using various legal acts are praiseworthy. The establishment of a common language between the investors, the firms of the financial sector and the supervisory authorities constitutes a conditio sine qua non for a full integration of the EU financial markets.

The development of sustainable activities must take place throughout all sectors of the economy. The financial markets should reflect this need and contribute to the provision of capital for sustainable investments. Policymakers, both at the international, European Union and national level should support this transition by making it easier for businesses to raise funds from capital markets for environmentally sustainable projects and by reducing the regulatory burdens. However, companies themselves should also play a more active role in the transition to a low-carbon economy by embedding sustainability considerations into their corporate governance and strengthening climate-related disclosures.

The EC's Action Plan on Financing Sustainable Growth is an important step in setting up a regulatory framework in which banks, investments firms, insurance companies and investment funds can facilitate the decarbonisation of the economy by considering sustainability factors when providing investment or insurance advice, by integrating sustainability into institutional investors' and asset managers' duties and by incorporating ESG factors into prudential capital requirements. The EC, along with the ESAs which provide technical advice and their expertise in the area of sustainable finance, has made tremendous efforts to deliver on the Action Plan. This has a profound impact on the acceleration of the sustainability agenda across Europe and the whole world. Their unprecedented work covers a wide range of difficult issues that need to be addressed and this holistic approach provides the ground for a successful large-scale transformation of the EU economy.

However, we should not hesitate to address some key points of the relevant legal acts that were adopted by the EU, which might prove to be an impediment to the achievement of a genuinely harmonised legal framework. An attempt should be made to assess whether the EU TR and the SFDR (the two most important legal acts adopted to promote sustainability) are likely to succeed in establishing a uniform definition of "sustainable activities" and harmonising sustainability-related disclosure rules across Member States respectively.

Firstly, we have to acknowledge the fact that these two legal acts were adopted in the form of a Regulation (not a Directive) and that is clearly conducive to the harmonisation of the relevant framework. It is a basic principle of EU law that Regulations have direct legal effect across Member States, while a Directive is binding upon Member States, as to the result to be achieved, but leaves to the national authorities the choice of form and methods of implementation. The

adoption of the abovementioned legal acts in the form of a Directive would have entailed a risk of different implementing standards during the transposition into the legal order of the Member States.

However, we have to underline that the SFDR allows some financial market participants and financial advisers not to comply with certain sustainability disclosures at entity and product level, provided that they explain why they do not do so. This option could potentially have a negative impact on the harmonising effect of the SFDR in relation to financial products.

Moreover, both the TR and the SFDR delegate to the Commission the power to supplement these two Regulations by adopting several delegated acts based upon RTS developed by the ESAs. These RTS (contained in various articles of the TR and the SFDR) aim to specify the technical screening criteria for determining the conditions under which a specific economic activity qualifies as contributing substantially to one of the environmental objectives (under the TR) and the details of the presentation and content of the information to be disclosed (under the SFDR). As is evident, a large number of delegated acts will need to be issued by the EC creating a complex legal framework both for financial market participants and supervisors. This will not be an easy exercise for the Commission. The EC should be extremely cautious when adopting these acts since its decisions would have a profound impact on the functioning of the internal market. Both firms and supervisors need crystal clear rules that do not pose a challenge to the smooth functioning of the financial markets.

Another important element that is missing from the relevant legal framework is the lack of a single supervisory authority which would enforce the legal obligations stemming from the abovementioned legal acts. A single supervisor is a conditio sine qua non for achieving genuine harmonisation across member states. However, both the TR (Art. 21) and the SFDR (Art. 14) assign to the NCAs the monitoring of the compliance of financial market participants with the requirements laid down in the TR and the SFDR. Thus, it will not be an easy task to achieve supervisory convergence across Member States, since some national supervisory authorities tend to interpret and apply the same legal provisions in a stricter way than in other Member States.

Both legal acts aim to ensure that the NCAs have the supervisory and investigatory powers that are necessary for the exercise of their functions under TR and SFDR. According to art. 21 par. 2 of the TR and art. 14 par. 2 of the SFDR, they shall also cooperate with each other and provide each other with such information as is relevant for the purposes of carrying out their duties under both Regulations. Nevertheless, true harmonisation can be more efficiently achieved by delegating supervisory powers to a single supervisor in the EU. ESMA could be a possible candidate as it has the necessary experience and expertise in financial markets. However, this delegation of supervisory powers to ESMA could stumble upon some obstacles, the most important of which might be the reluctance of some Member States to give up the supervisory and investigatory powers of their NCAs, while also risking losing their influence on them.

It remains to be seen if the national supervisors will interpret and apply the provisions of the relevant legal framework in a way that promotes supervisory convergence across the EU or they will attempt to deviate from the decisions made by their peers at the expense of harmonisation.

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