Greening the financial markets: challenges and opportunities at the current juncture

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Ladies and Gentlemen,

Guten Tag, good afternoon. I am delighted to attend this year's ICMA Annual General Meeting and Conference. It is an honour and a pleasure to address such a big audience, and – even more so – to be able to be here in person. I would like to thank ICMA for the opportunity to share my perspective as ESMA Chair with you, this afternoon.

The conference covers a wide range of important topics, such as the future of capital markets in the wake of the pandemic, the geopolitical crisis, and the future of sustainable finance. I take the liberty of leveraging on those panels – hopefully without pre-empting their conclusions – to consider how the current context provides us with an opportunity for further greening financial markets. I will focus on the relevance of associated regulatory action, including the challenges facing us as regulators and supervisors, as well as the important role international cooperation has to play.

Current juncture

Over the past years, the EU has been taking bold steps to tackle climate change. This has included unprecedented initiatives to build the foundations for finance to play its role in the sustainability transition. Sustainability has been also a pivotal feature of the EU's recovery from the COVID-19 pandemic, with the financial sector increasingly channelling resources in a way that will help meeting the targets of the European Green Deal.

The EU market for green, social and sustainability bonds stood at €1.2 trillion at the end of March 2022, a 50% increase from a year earlier. The assets managed by EU-domiciled ESG funds grew by 20% over the same period, to €2.1 trillion[1]. These figures indicate significant market growth for these products.

Nevertheless, it is also true that the environment we now live in has been changing, and it is one of soaring prices and new inflationary pressures. A number of EU Member States have experienced double-digit inflation, with energy accounting for more than half of the overall rise in eurozone inflation. The Russian invasion of Ukraine has compounded supply-side disruptions, which will amplify inflation. The role of Russia and Ukraine in global commodity supply has furthermore led to high volatility of commodity prices such as for energy, metals and food.

This has resulted also in short-term risks in commodity related financial markets. By way of example, margin calls on commodity derivatives have created liquidity strains for counterparties. Other reactions have also been observed in the market, including participants reducing their exposures to the energy derivatives market.

To my mind, these recent events however also provide an opportunity to reconsider Europe’s dependency on fossil fuels across our economies, and the financial markets. These events underscore the importance of greening financial markets even further.

[1] ESMA calculation based on data provided by Climate Bonds Initiative, Refinitiv EIKON and Morningstar.

The benefits and business opportunities brought by sustainable finance are well known at this point. We have seen investor preferences shifting and issuers looking into ways to finance their transition into more sustainable activities. The private sector has had – and still has – an important role to play in catalysing this process through initiatives to promote voluntary codes of practice, such as the ICMA Green Bond Principle, which informed the issue of NextGenerationEU bonds by the Commission. Now, the geopolitical context we face amplifies the significance of sustainable finance as a way to speed up the transition away from environmentally harmful and problematic energy sources. We should seize this opportunity!

So far, a great deal of work has been done by the official sector to assess risks and provide the regulatory building blocks to make this transition possible. Yet, important challenges lie ahead of regulators and market participants as the design of the associated framework unfolds.

ESMA and sustainable finance

Sustainable finance has been part of ESMA's work for some years now and was formally integrated into our mandate following the 2019 review of our founding regulation. Accordingly, sustainability assessments and disclosures, and the integration of ESG factors are an essential part of ESMA's strategy and work plan.

ESMA's approach to sustainable finance, which follows our 2022-2024 Sustainable Finance Roadmap, is focused on promoting transparency and tackling greenwashing; building regulatory capacities at EU and national level; and monitoring, assessing and analysing ESG markets and risks.

This year, ESMA is working on a number of cross-sectoral, as well as sector-specific actions. This includes the development of a disclosure framework under the Sustainable Finance Disclosures Regulation (SFDR) and the Taxonomy Regulation, to clarify disclosure obligations for sustainability products. We have recently published a briefing for national supervisors to drive convergence in the supervision of investment funds with sustainability features. We are further deepening the understanding of the greenwashing phenomenon and working with national supervisors to fight it. Finally, we are supporting the Commission to develop its views in relation to ESG ratings and ESG factors in credit ratings.

These are just a few examples, and I invite you to consult the sustainable finance section of our website for additional information on past and ongoing work.

Greenwashing and disclosures

Evidence produced by the industry[2] shows that between May 2005 and May 2018, 'ESG' was mentioned in less than 1 per cent of earnings calls of global companies. By May 2021, the use of the acronym saw a dramatic increase, with almost a fifth of earnings calls referring to it. While this may indicate an important interest in ESG investment, transparency is essential to ensure that associated investments do account for the purpose for which they are marketed, and that a rush for the 'ESG gold' does not lead to greenwashing.

Tackling this phenomenon and improving transparency is one of the three priorities of our Sustainable Finance Roadmap, as I have just mentioned. Consistent with this approach, we will be investigating greenwashing more closely, getting to define its fundamental features and take coordinated action in multiple sectors to find common solutions – both in our supervisory convergence activity and in our single rulebook work. Together with the national supervisory authorities, we need to combat the detrimental effects that greenwashing may pose to investors, and ultimately to investors' trust in financial markets.

The EU has introduced a set of sustainable finance legislation and policies, gradually putting in place disclosure requirements for companies, manufacturers of financial products and financial advisers. As part of this effort, ESMA has been working hard to increase transparency and comparability of the sustainability characteristics of financial products, for example in the context of our joint work with the other ESAs on the Sustainable Finance Disclosures Regulation.

[2] PIMCO analysis of earnings call transcripts of approximately 10,000 global companies through May 2021.

ESMA is also taking an active role in the ongoing implementation of these and other regulatory requirements. We are working closely with the national authorities as they start supervising the various financial market players and their conduct in this area – aiming to ensure convergence in supervisory outcomes. We trust that market uptake and the bedding down of the framework will significantly improve transparency and comparability over the next few years, helping end-investors to make appropriate judgements, identify risks and find credible investment opportunities.

We – both official and private sectors – face a steep learning curve. Market feedback is essential for us, and so is the need to continue to provide and, where necessary refine, guidance to market participants. Following a recent call for experts, ESMA is about to establish a Consultative Working Group (CWG) of the Coordination Network on Sustainability (CNS). This will provide an opportunity for ESMA to enhance the important exchanges with the private sector and allow us collectively to learn and build capacity and knowledge.

Another important topic worth briefly touching on is corporate sustainability disclosure and reporting. This part of the regulatory framework should have ideally and logically come first, prior to product disclosure, but has in reality taken a bit longer to come to fruition.

It is good to see that there is now significant progress – at the EU side through the final negotiations on the Corporate Sustainability Disclosure Regulation and through the work by EFRAG on the draft European Sustainability Reporting Standards. [Regulators elsewhere have also been taking similar actions. Some notable examples are the UK FCA 2021 Roadmap for Sustainability Disclosure Requirements and the US proposed rules on *The Enhancement and Standardization of Climate-Related Disclosures for Investors*].

At the international level, important initiatives on sustainability have been launched, under the auspices of IOSCO and, more recently, with the establishment of the International Sustainability Standards Board (ISSB) and the first exposure drafts on sustainability related reporting standards coming out for consultation. Given the global nature of the challenges we face, I firmly believe that there is sufficient common ground between all of us on ESG-reporting to make all possible efforts to converge in building a common baseline of reporting requirements that can be internationally accepted. This would help us as regulators and supervisors to tackle, in an internationally coordinated fashion, the challenges underlying the sustainable finance transition.

We consider it as essential that the European and the global reporting standards are interoperable, both to ensure helpful disclosure to investors internationally and to limit unnecessary burdens on companies who operate both within and outside the EU.

ESMA has therefore a strong interest in associated international work. We actively support the work of the IOSCO Sustainable Finance Task Force and its corporate reporting workstream, which will assess the ISSB's Exposure Drafts and may eventually endorse the standards if they meet certain pre-defined criteria.

ESG ratings

Another important piece of work that benefited from international regulatory cooperation is the IOSCO work on ESG ratings and data providers, which was co-chaired by ESMA. A report, that set out recommendations applicable to ESG ratings and data providers, was published in November last year. The IOSCO recommendations aim to promote measures to improve the independence, transparency and reliability of ESG ratings and data products. If you are familiar with this paper, you will note that it pushes for comparability of ESG ratings, as opposed to consistency. Our view here is that different ESG ratings can have different measurement objectives, and these can be helpful in view of the various purposes and needs users may have. What is important, is that whatever the objective, this is clear to the user, and the methodology followed is transparent.

Closer to home, ESMA recently conducted a call for evidence concerning the ESG rating providers market structure in the EU. The aim is to support the Commission's work on ESG ratings. I should note that in ESMA's view, the currently unregulated nature of ESG ratings and data assessments could pose potential risks to investor protection. The importance of this topic seems to be widely recognised, as – I am pleased to say – we had a good response rate to this consultation and will provide our feedback to the Commission shortly.

[An important challenge for ESMA is the mismatch between the demand for ESG investments and the transparency and comparability on the real sustainability impact of the financial products available in the market. This is a concern, as this could lead to misrepresentation and wrongful disclosure and mis-selling of what appear to be ESG products to final investors. Ultimately, this can result in reputational and financial risks for the actors involved. More importantly, it can lead to a loss of trust of investors and the public at large and have a detrimental impact upon the whole sustainable finance project.]

In ESMA's supervision of CRAs, ESG factors will remain one of the focus areas in 2022. As part of this, we have recently assessed the implementation of ESMA's Guidelines on Disclosures, to whether CRA's are complying with the Guidelines requirements' for CRAs to disclose the relevance of ESG factors to credit rating actions. Beyond the level of disclosures, we have also just recently finalised a workstream looking into the extent to which the consideration of ESG factors have been integrated in CRA's credit rating methodologies. We hope that the findings here will provide valuable insights to support the Commission in their role and responsibilities under the Renewed Sustainable Finance Strategy.

Carbon markets

Let me come to one final example of ESMA's engagement on the broad range of sustainability related work. At the global level the IOSCO workstream on carbon markets that commenced this year, under the joint chairmanship of Russ Benham of the CFTC and myself.

This is another workstream under the IOSCO Sustainability Task Force. It is dedicated to assessing the functioning, and potential risks, of global carbon markets. These markets – including compliance and voluntary markets – regained attention since the COP 26.

Given the increasing size of these markets and their important role in the fight against climate change, securities regulators want to positively support this, while mitigating associated risks. We will be working to establish a set of good practices and essential features that support the sound, safe and transparent functioning of these markets.

I hope that ESMA will be able to contribute through its recent expertise in this area. We published an in-depth analysis of the functioning and surveillance of the EU carbon market, in March this year. Our final report unveiled important findings and policy recommendations, notably to further improve transparency and monitoring of the EU carbon market.

A few challenges were also identified, such as having a comprehensive view of this market and an in-depth understanding of its developments, amid fragmented data sources that do not make it easy to establish a clear picture.

I hope that the report and its recommendations will contribute to the continuous quest for further developing market mechanisms that give CO2 a price and create incentives to reduce emissions.

Conclusion

Ladies and Gentlemen, Yale Professor Robert J. Shiller once said that '*finance is not merely about making money. (…) It's about stewardship and, therefore, about achieving a good society'*. Today, these thoughts resonate across the world more than ever in view of the current geopolitical and economic context we experience. They also validate the need for shifting away from non-sustainable sources of energy, and the important role that the financial services sector and markets can and need to play in the sustainable transition process.

So far, we have come some way in the process of greening financial markets, but further work needs to be done as the European and global sustainable finance agendas move ahead with further concrete steps. This will not be an easy road to travel and will require tackling significant challenges and road bumps. Effective international cooperation will be important to facilitate this process. As will be continued exchanges between the official sector and the industry. I trust that together we can seize the opportunities to accelerate the transition to a low-carbon, more resource-efficient and sustainable economy.

I look forward to continuing our engagement and I welcome your input to the work that lies ahead.

Thank you very much indeed.