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The Green Deal vs. Geopolitics

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Introduction

Good morning, ladies and gentlemen, Guten Morgen meine Damen und Herren,

I would like to thank the Deutsche Schutzvereinigung für Wertpapierbesitz e.V. (DSW) and Better Finance for inviting me to speak today. As highlighted by the title of the conference, the current geopolitical context creates new challenges to the EU sustainability and sustainable finance agendas. However, in the face of the Russian invasion of Ukraine and of the resulting energy crisis, we should not waver in our commitment to the EU sustainability agenda. Tackling the environmental crisis and dealing with geopolitical challenges require two things - commitment to the long term and perseverance in our efforts to find international solutions. As Winston Churchill said: "Success is not final, failure is not fatal: it is the courage to continue that counts."

What can be the role of finance, or more precisely sustainable finance in these endeavours? While climate, energy and environmental policies and EU efforts for a Just Transition must continue to do the heavy lifting, the financial system must play its part. For the financial system to be able to facilitate our delivery of long-term sustainability objectives, the sustainable finance regulatory framework must be effectively and consistently developed and supervised. For the necessary capital flows to be channelled effectively towards sustainability objectives, investors must be able to make informed investment decisions in terms of sustainability.

Today, I would like to stress how transparency and comprehensibility of ESG disclosures, together with their effective supervision are key to protect investors. I will also stress how new obligations, under the forthcoming Corporate Sustainability Due Diligence Directive (CSDDD), may provide new levers for shareholders engagement. I will finally speak about the importance of international interoperability of corporate reporting standards to support a clear, comprehensive and decision-useful disclosure regime on ESG.

Before I dive into these topics, please let me highlight that our new ESMA Strategy 2023-2028 was published recently with Sustainable Finance being one of the 5 key areas that will fundamentally drive our work in the next 5 years. And, as reflected in the new strategy, given the novelty of this area and the urgency of the sustainability agenda, the development of a workable regulatory framework on one side, and effective and consistent supervision on the other, will have to progress in parallel, consistently and effectively.

Enhancing investors protection and participation

Let me start by addressing what ESMA is currently doing in order to enhance investor protection and safe participation in sustainable investing, before mentioning more specifically the role of shareholders.

ESMA has the important mandate of promoting investor protection. Promoting transparency and tackling greenwashing is therefore one of ESMA's priorities, as spelled out in the ESMA Sustainable Finance Roadmap and, more recently, in our 2023-28 Strategy. It is particularly important, as greenwashing may give rise to detriment for investors who wish to allocate resources to sustainable investments.

In a context of growing demand for sustainability-related products, rapidly evolving regulatory regimes and sustainability-related product offerings, and data scarcity, greenwashing concerns have been growing. We are very much looking at this with the investor's interest at heart. Ultimately, the objective is to enhance the transparency and quality of sustainability-related claims and to maintain trust in - and the integrity of - ESG markets.

This is why we are investigating greenwashing more closely. So how are we approaching the matter?

First, our objective is to clearly define greenwashing, and to do so in the context of the various segments of the investment value chain. More concretely, we would like to develop a more granular understanding of the potential issues at stake and to identify which topics, which market segments or financial products may be more prone to greenwashing risks.

That is why on 15 November, the three European Supervisory Authorities (EBA, EIOPA and ESMA – ESAs) published a Call for Evidence. The objective is to gather input from stakeholders on how to understand the key features, the drivers and the risks associated with greenwashing and to collect examples of what stakeholders consider as potential greenwashing practices. The Call covers potential sustainability-related claims across all aspects of the environment, social and governance (ESG) spectrum. We are seeking input from financial industry players, and from investors' associations. The consultation period closes on 10 January 2023. Please have a look and provide us with your feedback, which will help inform our future policy making and supervisory activities.

We would also like to leverage on this work to identify the challenges encountered by financial market participants and investors as well as by competent authorities in implementing the sustainable finance regulatory framework and possibly make recommendations for its improvement. ESMA is fully committed to enhancing the effectiveness and the consistency of both the regulatory framework and the supervisory response.

When it comes to investors the integration of ESG considerations adds new layers of complexity to an already complex field. This can be daunting - in particular for retail investors. Data shows that a vast majority of retail investors want their holdings to reflect sustainability preferences. [1, 2] However, as one of your [DSW] studies showed recently, sustainability-minded clients do not feel like they have the resources they need to follow up on these preferences: most would not follow the advice provided as they thought the advice did not match their expectations.[3] We collectively need to improve this situation.

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[1] According to a survey run by 2 Degrees Investing in six European countries (Denmark, Estonia, Germany, Greece, Ireland and Romania) in Q4 2021 about households' beliefs and preferences regarding sustainable finance: "60% of retail investors have mixed financial /sustainability goal, paying attention to maximizing financial returns but also to the alignment of savings with personal values and/or the real impact on the society or the environment."

[2] An AMF study showed that 76% of French people considered environmental impact of their holdings as important

[3] Anlageberatung zu nachhaltigen Produkten: Investoren zurückhaltend – wenig Klarheit in den Vorgaben– Seit dem 2. August 2022 sind Anlageberater aufgefordert, ihre Kunden nach ihren Nachhaltigkeits-Präferenzen zu fragen. Als Ergebnis der bisher erfolgten Beratung geben rund 36 Prozent der privaten Anleger an, dem Rat des

To ensure that retail investors trust the advice they are given, we need to ensure that distributors take into account investors' sustainability preferences properly. In this regard, I wish to highlight ESMA's recent revision of its Guidelines related to suitability requirements – with new requirements to inform clients about sustainability preferences, to collect information on their sustainability preferences and to assess which products fulfil those preferences as well as their other investment objectives. These revised Guidelines also create new obligations for investment firms to give staff appropriate training on sustainability topics.

ESMA is also taking action to support harmonised, comprehensible information for investors. We have just published a consultation paper with draft guidelines on the names of funds using ESG or sustainability-related terms. A fund's name is one of the most significant identifiers of investment funds for investors, especially retail investors, and a great marketing tool. We are concerned that some funds are using ESG or sustainability-related terms in their names without necessary living up to the corresponding sustainability features. This could potentially be misleading and imply greenwashing. Our draft guidelines propose some quantitative thresholds for the investments of such funds. We strongly encourage you to take part in this consultation because we need feedback from all stakeholders, and particularly from investors.

The shareholders' perspective

Let me now turn to the shareholders' perspective. The Shareholder Rights Directive (SRD), as amended by the SRD2, lays down a common regulatory framework and minimum standards for corporate governance and the exercise of shareholder rights in EU listed companies. By facilitating the involvement of shareholders in the corporate governance of investee companies, the SRD2 (introduced in 2017) sought to encourage shareholders long-term

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Beraters auch gefolgt zu sein; rund 64 Prozent verneinen dies. Mehr als die Hälfte der Befragten gab an, dass die Beratung eher nicht den eigenen Erwartungen entsprochen hat. Sofern private Anleger bereit sind, in nachhaltige Produkte zu investieren, hält annähernd die Hälfte (46,7 Prozent) einen Anteil am eigenen Portfolio von unter 20 Prozent für sinnvoll. Weitere rund 28 Prozent wollen mindestens zu 20 Prozent in „Grüne Werte" gehen, rund 13 Prozent mit mindestens 40, sieben Prozent mit mindestens 60 und lediglich rund 4 Prozent mit mindestens 80 Prozent. Dies sind Ergebnisse einer Befragung der DSW unter rund 150 privaten Anlagern, durchgeführt im Sommer 2022.

„Auf Anlageberater kommen mit der neuen Vorgabe erhebliche Herausforderungen zu. Sie müssen nicht nur entsprechende Produkte verfügbar haben, sondern auch die jeweiligen Präferenzen und Vorstellungen der Kunden zum Thema kennen. Zudem gibt es noch keine einheitlichen Standards für grüne Produkte oder ein entsprechendes, allgemein gültiges Label. Werden klassische Produkte schlicht umdeklariert, sind wir schnell beim Greenwashing", sagt Jella Benner-Heinacher, stellvertretende Hauptgeschäftsführerin der DSW.

engagement in EU companies and thereby to enhance sustainable long-term value creation in EU capital markets.

Five years down the road, following the receipt of a mandate by the European Commission, we recently published a Call for evidence (CfE), to collect input from market participants on the scope and the effectiveness of certain areas of the SRD2. The results of the CfE will feed into two reports regarding the voting chain and proxy advisors. ESMA's input will form the basis for the potential future review of the SRD2 by the European Commission.

Such a review could be an opportunity to see how the increasingly important ESG agenda can be supported through the exercise of shareholders' rights. It could reinforce the role of climate and the just transition as key shareholder engagement themes. In addition, the interplay with the forthcoming Directive on Corporate Sustainability Due Diligence (CSDDD) may also offer a new opportunity for shareholders to engage with companies' management with regard to ESG performance.

Implementation of the Sustainable Finance regulatory framework

Now let me take again the investors' perspective, to discuss the need for standardised, reliable, comprehensive corporate sustainability reporting and for interoperable international sustainability reporting standards.

Investor preferences have massively shifted towards sustainable investments – and with that the share of assets managed by ESG funds has grown, averaging 27 % in Q2 2022, up from less than 10% 2 years before. This growth of ESG markets has shown quite some resilience, even in the current context of general market turmoil, following the Russian invasion of Ukraine.[4] [5]

Tools created in the EU to help end-investors identify credible sustainable investment opportunities and potential sustainability risks have also been quite successful so far in terms of market uptake: EU Climate Benchmarks introduced in 2020 reached approximately EUR 65

[4] EU ESG bond issuance slowed in 1H22. This was mainly driven by lower sovereign and supranational issuance volumes (-49% compared to 1H21). Notably, corporate ESG bond issuance was more resilient (-5%) in particular compared to the overall EU corporate bond issuance (-32%). Additionally, EU ESG equity funds had net outflows in March 2022 for the first time in 2 years. However, fundamental factors driving the rise of ESG investing remain.
[5] ESMA, "Trends, Risks and Vulnerabilities: Risk Monitor (No. 2)" (*ESMA*, 1 September 2022), see here at page 26.

billion of assets under management in Q3 2022, 400% growth compared to EUR 15 billion at the beginning of 2021.

Despite these reasons for optimism, we have to acknowledge that there are challenges with the implementation of the regulatory framework. Let me highlight just two. Firstly, the timelines set by key acts such as the SFDR and the Taxonomy Regulation. Secondly, the lack of complete and comparable data sets. Still, as the various pieces of the puzzle come together, I am convinced that this transparency framework will become stronger and more effective over time.

In this context, the standardisation of corporate sustainability reporting, which the Corporate Sustainability Reporting Directive (CSRD) is introducing, is crucial. It will enhance the overall quality of information that is then available through the sustainable investment value chain. As this new Directive very clearly points out, these standardisation efforts should take account of the international developments to the greatest extent possible, without obviously contradicting or undermining the ambitious EU sustainability agenda.

The European Financial Reporting Advisory Group (EFRAG), as the body entrusted with developing the draft European Sustainability Reporting Standards (ESRS), has submitted the final draft standards to the Commission on 22 November.[6] This has been an impressive piece of work, done in record time.

ESMA, together with other EU public bodies[7], is an official observer to the EFRAG Board and, in this capacity, we have actively monitored the development of the ESRS. As we are required under the CSRD, we will be providing an opinion to the European Commission on the ESRS in January 2023.

A key axis in our assessment of the European standards, which also fed into our comments in the public consultation phase, is the international interoperability dimension. It is important for the integrity of financial markets globally that divergence between the European Sustainability Reporting Standards and international standards are reduced to a minimum. Ideally such

[6] The final set of ESRS covers a total of 12 standards: 2 cross-cutting standards (general requirements; strategy governance and materiality assessment), 5 environment-related standards (covering the 6 environmental objectives of the EU Taxonomy), 4 social-related standards (covering the 4 categories of: own workers, value-chain workers, communities and customers) and 1 governance standard (addressing business conduct)

[7] EBA, EIOPA, ECB, CEAOB, EEA, FRA, EU Platform on Sustainable Finance.

differences should be limited only to what is absolutely necessary to reflect the specificities of the EU *aquis* and the EU sustainability objectives.

A notable example of a “justified” area of divergence, in our view, is the need to reflect in the ESRS the disclosure requirements stemming from the SFDR. Another example is double materiality. The CSRD requires information on both sustainability-related impacts and risks/opportunities. Therefore, investors would understand divergence between ESRS and international standards, most notably ISSB standards, for disclosures concerning the “impact materiality”. However, investors would not understand differences for disclosures relating to the “financial materiality” perspective which both the ESRS and International Sustainability Standards Board (ISSB) have in common.

It has to be said that EFRAG and the ISSB have made extensive efforts to collaborate on eliminating, or at least narrowing down as far as possible, their respective differences. This was a challenge in the very constrained timeframe for both organisations. As also the work of the ISSB nears the final stages, we will have a clearer view of any remaining areas of divergence which we expect will be limited.

So far, what we can see from a first look the final drafts of the EFRAG standards is that in principle all the content of the future ISSB standards will be covered by the European standards, but we need to be cautious as our analysis is still on-going and because the ISSB deliberations are not completed yet.

International cooperation efforts

The UN COP27 has just closed and governments around the world have restated their commitment to foster the channelling of private finance towards sustainable investing. Faced with a growing energy crisis, record greenhouse gas concentrations, and increasing extreme weather events, COP27 sought renewed solidarity between countries, but fell short of reinforcing other commitments to deliver on the objectives of the Paris Agreement.[8]

As demonstrated by the annual cycle of Conference of Parties (COPs) of the United Nations Framework Convention on Climate Change, international cooperation requires perseverance. And perseverance will also be needed to build a globally comparable set of disclosure rules

[8] No new commitments regarding the phasing out of fossil fuels or the deployment of renewables. See FT article dated November 20, 2022: https://www.ft.com/content/03d7609b-decc-40fc-8029-a6cdebb11752

for sustainability reporting, through international cooperation, in a world where financial markets are global and economies are interdependent. A globally consistent approach is necessary to facilitate cross-border investments providing investors wherever they are based with the comparability needed to channel capital effectively towards a world economy that is environmentally sustainable. As Ban Ki-moon once said, "Given the nature and magnitude of the challenge, national action alone is insufficient. No nation can address this challenge on its own. No region can insulate itself from these climate changes. That is why we need to confront climate change within a global framework, one that guarantees the highest level of international cooperation."

In this context, and before opening the floor to questions, please let me mention one important international workstream. The International Organization of Securities Commissions (IOSCO) is conducting work on carbon markets, that ESMA is actually co-chairing. IOSCO has just launched a consultation on two reports, both of which fundamentally draw on the experience of financial markets' regulators in their role of overseeing securities, derivatives, and commodities markets. First, it is consulting on recommendations for establishing sound compliance carbon markets, aiming to build upon lessons learned from existing compliance markets. Second, it is consulting on key considerations for enhancing the resilience and integrity of voluntary carbon markets. The consultation is open until 10 February 2023.

The number of emissions trading systems around the world is increasing. Besides the EU emissions trading system, national or sub-national systems are already operating or under development in various jurisdictions. International trading of emission allowances can help achieve emissions reduction targets more efficiently, while increasing market liquidity – under the condition that sufficient levels of transparency and integrity, in particular environmental integrity, are achieved. In this context, carbon markets are another important area where international cooperation and international standards are key. ESMA will continue to contribute actively to the IOSCO workstream dedicated to carbon markets, upholding a commitment to international cooperation and long-term goals agreed upon by the international community – notably the Paris Agreement and the Sustainable Development Goals.

Thank for your attention and I wish you a fruitful conference!