

ESG REGULATORY DEVELOPMENTS & CHALLENGES IN THE CAPITAL MARKET

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ESG Background

- In 2019 ‘**The European Green Deal**’ has been published and important regulations are already in force or under development with the view of achieving the sustainability goals (E,S & G) and a climate- neutral Europe until 2050.
- The integration of the sustainability considerations into the EU financial policy framework are presented in the European Action Plan on Sustainable Finance and in the EU Renewed Sustainable Finance Strategy.
- Many studies have reported that there was strong evidence of **financial short - termism** (see e.g., ESMA Report on undue short- term pressure on corporations)
- Currently, ESG products show **growing trends in capital markets**. ESMA’s bi-annual Reports on Trends, Risks and Vulnerabilities provide illustrative statistics on this.
- At the same time the **risk of greenwashing**, i.e., to mislead the investing public on the sustainable characteristics of an investment, has become a concern for **investor protection**.
- The issue is **multidimensional** pertaining to nearly all categories of financial market participants while environmental considerations appear as an emergency for the planet, in a context of growing concerns with regard to the effects of the pandemic.

The new European legal framework

- The **Taxonomy Regulation** ([EU 2020/852](#))
- The **Sustainable Finance Disclosures Regulation (SFDR)** - ([EU 2019/2088](#)) as amended by the Taxonomy Regulation.
 - o Most articles of **SFDR** will apply from 10 March 2021 and the first Regulatory Technical Standards have already been delivered to the EC by the 3 ESAs (ESMA, EBA και EIOPA). Though these Standards (see [published](#) Joint ESA's Final Report on RTS /SFDR, 2021 03) have not yet taken the form of a formal legal EU text, it has been stressed by the EC that the SFDR applies as the core level 1 text and ESA's advice can serve as the basic guidance to market participants and competent authorities.
 - o Note that the complementing RTS is also under preparation through the ESA's Joint Committee. This RTS will complement the first RTS just mentioned, and will relate specifically to the Taxonomy Aligned products. It is expected that a consultation will open soon on this draft RTS.
- The **Regulation on sustainability benchmarks** (EU 2019/2089)
- Accompanying legal framework developments can be also followed through a) the [Platform on Sustainable Finance](#) which advises the European Commission on the development of technical screening criteria for the **Taxonomy Regulation** and b) on policy developments, through the [EU Member States expert group on sustainable finance](#).

The SFDR

- ▶ Lays down harmonised rules for **financial market participants and financial advisers** 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**.
- ▶ Among other provisions, the following central concepts are defined:
- ▶ - **sustainable investment**: an investment in an economic activity that contributes to an environmental objective, or an investment in an economic activity that contributes to a social objective, provided that such investments do not significantly harm any of those objectives and that the investee companies follow good governance practices.
- ▶ - **sustainability risk**: 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;
- ▶ - **sustainability factors**: environmental, social and employee matters, respect for human rights, anti-corruption and anti-bribery matters.

The Taxonomy Regulation (I)

The **Taxonomy Regulation** has introduced an additional, to the SFRD, framework for market participants and Taxonomy aligned products. It has also defined the following **6 environmental objectives**:

- ❖ climate change mitigation.
- ❖ Climate change adaptation.
- ❖ The sustainable use and protection of water and marine resources.
- ❖ The transition to a circular economy.
- ❖ Pollution prevention and control.
- ❖ The protection and restoration of biodiversity and ecosystems.

The Taxonomy Regulation (II)

- ▶ has also set the following cumulative criteria for an **environmentally sustainable economic activity** which would be one that:
 - **contributes substantially to one or more of the environmental objectives**
 - **does not significantly harm any of the environmental objectives (the DNSH principle)**
 - **is carried out in compliance with the minimum safeguards of the Regulation, and**
 - **complies with specific technical screening criteria established by the Commission.**

Improved disclosure of non-financial information

- Article 8 of the TAXONOMY Regulation obliges undertakings covered by Directive 2014/95/EU (the 'Non Financial Reporting Directive') to publish information on how and to what extent their activities are associated with economic activities that qualify as environmentally sustainable under the Taxonomy Regulation. To this end a Consultation run from 5 November 2020 and the final text is expected to be published soon.
- ▶ Furthermore,
- ▶ Following the European Green Deal, companies and financial institutions are also called to improve their disclosure of non-financial information since users of this information, mainly investors and civil society organisations, are demanding more and better information from companies about their social and environmental performance and impacts.
- ▶ To this end, the review of the **Non-Financial Reporting Directive** (NFRD) is **now under discussion** at EU level as part of the strategy to strengthen the foundations for sustainable investment. This also reflects global trends, with a wide variety of different organisations and stakeholders calling for a consideration of a new regulatory approach to non-financial reporting.
- ▶ Also, in autumn 2020, the European Commission (the Commission) launched **a public consultation** on a proposed sustainable corporate governance framework seeking views from a broad range of stakeholders and the consultations' feedback statement has been already published.

KEY CHALLENGES

- The extremely **pressing deadlines** for the preparation of the legal texts. Market Participants but also Regulators struggle to adapt to the Sustainable Finance prerequisites. To this end a Coordination Network on Sustainable under ESMA is a central point for policy alignment and HCMC participates to this work as well
- The difficult task of **defining S and G** per se and subsequently, in a uniform manner and through existing interlinkages with established frameworks for Shareholders Rights provisions, Corporate Governance, Corporate Social Responsibility, Ethics Codes. Together with the mandatory/voluntary basis discussion
- The challenge to **preserve proportionality and materiality** concerns. SMEs, Governments, sectoral legislation are all areas profoundly touched by the new provisions
- The trend to expand the **corporate purpose** and to revisit the meaning of “**creation of value**”
- The unregulated and unsupervised nature of the market for “**ESG**” ratings and **ESG assessment tools** and the need to match the growth in demand for these products with appropriate regulatory requirements to ensure their quality and reliability
- The issue, linked to the previous one, of **data quality** in the area of sustainable finance
- The, by definition, **global dimension** of Sustainability, especially concerning E

Thank you!