

ESMA's role in enabling the transition to a low carbon economy

Keynote Speech

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Thank you very much for the opportunity to speak at this AFME conference dedicated to sustainable finance. It is quite timely given all the initiatives under way. In previous sessions, you have already touched upon a wide array of topics, and I am sure had lively debates. What I would like to do in my remarks today is to explain what we, at ESMA, the European Securities and Markets Authority, are trying to do to contribute to enable an orderly transition to a low carbon economy. We are only one part of the system of course and much depends on the political level as well as the concrete actions taken by companies and market participants on the ground. But ESMA is committed to doing its part to support the EU's transition to a more sustainable economy by helping preserve trust in the financial system, ensuring adequate information is available for investors to make informed investment decisions and that proper safeguards are in place to protect the integrity of our markets and prevent the risk of greenwashing.

Let us first take a step back and remind ourselves when this journey to adapt our financial regulation to the transition started in the EU. The main pillar was the [Action Plan to finance sustainable growth](#) that the European Commission launched in March 2018. It contained an ambitious package of legislative measures to drive how the financial sector could support the transition to a more sustainable economy. Key legislative actions stemming from that plan were the Taxonomy Regulation, the Sustainable Finance Disclosure Regulation (SFDR) and the revisions to the Benchmarks Regulation (BMR). In addition, requirements around the distribution of investment products were amended (through MiFID II Level 2), and other

initiatives were initiated, e.g., the EU Green Bond standard. ESMA has actively contributed to these legislative developments since the Action Plan was published.

Since 2018, other flagship initiatives have followed such as the European Green Deal, the Commission's Renewed Strategy on Sustainable Finance or the Fit for 55 Package.

While initiatives such as the **European Green Deal** go well beyond the remit of financial regulation and cover actions across all sectors of the real economy to foster a just and an inclusive transition, **financial regulators have a major role to play**, which is to **provide a sound framework to enable and facilitate the financing of the transition**.

In addition, to structure our contribution and help focus our efforts on high priority areas, ESMA has developed its own Sustainable Finance Roadmap which sets out three priorities:

- Promoting transparency and tackling greenwashing.
- Capacity building, i.e., increasing the knowledge and expertise of ESMA staff and National Competent Authorities.
- Monitoring and assessing ESG markets and risks.

Ultimately these actions should help maintain trust in the financial system and are in line with ESMA's strategic priorities of fostering effective markets and financial stability and enhancing protection of retail investors.

Today I would like to focus mainly on the first objective and all the work that has been done to support the provision to the market of high-quality information (i) by corporates on the environmental and social risks they face as well as on how their activities impact on the environment and other stakeholders, (ii) by financial market participants on their sustainability profile and the ESG features of investment products. Finally, I would like to discuss what more can be done to facilitate informed investment decisions and the sound channelling of funds to support an orderly transition while preventing greenwashing.

Enhanced corporate sustainability reporting is the cornerstone of the Sustainable finance framework

Let me start with the disclosure obligations for companies. Corporate sustainability reporting is the cornerstone of the entire sustainable finance framework and is expected to provide much awaited data to be used across the whole sustainable investment value chain.

In this regard, ESMA has contributed to the preparatory work for the **Corporate Sustainability Reporting Directive (CSRD)** by highlighting, in its response to the Commission's 2020 public consultation, the shortcomings of the Non-Financial Reporting Directive and the limitation it imposes on the ability of national supervisors to exercise their mandates to the full extent possible when dealing with sustainability information. The new Directive empowers ESMA to develop guidelines for the supervision and enforcement of the new requirements and we expect to have these guidelines ready on time for the first publications pursuant to the CSRD in 2025.

ESMA also actively contributes to the critical work led by the European Financial Reporting Advisory Group (EFRAG) with the development of the **European Sustainability Reporting Standards (ESRS)** by exercising an active role as official observer as well as, more formally, by providing its views in the relevant public consultations on the draft standards and providing its opinion to the European Commission prior to adoption of the standards in EU law.

Finally, ESMA also provided technical advice to the European Commission on the development of the disclosures supporting the EU Taxonomy.

Importantly, the new rules set out in the CSRD, impose an obligation for companies to disclose their **transition plans**, i.e., any plans that they may have to ensure that their business model and strategy are compatible with the transition to a sustainable economy, with the objectives of limiting global warming to 1.5°C in line with the Paris Agreement and achieving climate neutrality by 2050.

In its [2022 European Common Enforcement Priorities](#), ESMA provided a number of recommendations on the quality of the disclosures relating to transition plans, stressing the importance of providing transparency on the assumptions used, on the targets disclosed and their credibility vis-à-vis the headline ambition set out by the company as well as on the resources – both financial and human – needed to give effect to the planned actions. We also

emphasised the importance of being transparent and fair when putting forward carbon neutrality claims, with particular attention to the role that in these claims, carbon credits and emission removal mechanisms play in overall emission reduction measures.

One important feature of the CSRD is that it establishes a disclosure regime that is meant to complement traditional financial reporting. An entity business model and strategy, its targets and actions, its impacts and risks will be affected to a varying degree by its transition trajectory towards a more sustainable business. It is, therefore, important that entities use these disclosure points not only as means of external communication, but also as internal checkpoints to assess the extent to which they have equipped themselves with a strong and consistent strategy and operational structure to face the transition.

All this information is expected to offer a comprehensive and clear image of a company's efforts towards the transition, as well as the progress it has accomplished in an objective and evidence-based manner. Clear targets and common metrics will be of paramount importance not only to assess a given company's efforts, but also to compare companies. Here, the sectoral standards that EFRAG is developing will support the ability to compare companies within a specific sector.

Improving the disclosure framework for financial entities and investment products

Let me now turn to the substantial work that ESMA has done with the European Banking Authority and the European Insurance and Occupational Pensions Authority in relation to the Sustainable Finance Disclosure Regulation (SFDR). Recognising the complex and evolving framework, the three European Supervisory Authorities have put significant efforts to provide clarity around the new disclosure obligations for different actors in the investment chain, to provide practical guidance on how to fulfil these disclosure obligations and how to make them understandable for the end investors.

The joint ESAs' work on the SFDR draft regulatory technical standards, currently under [consultation](#), is meant to enhance transparency and allow investors to better assess the sustainability characteristics and objectives of investment products. The adjustments and amendments suggested by the ESAs in the ongoing consultation are meant, in part, to provide

better information on how financial products (and the companies they invest in) are contributing to the transition, for instance, by means of their decarbonisation targets.

- In order to address **net-zero commitments and pledges** that sometimes lack sufficient substantiation, the consultation proposes enhanced disclosures on decarbonisation targets. To bring about enhanced transparency of these commitments, in particular for funds that have a specific GHG emissions reduction target, the ESAs consider that high-quality disclosures of GHG emissions, and the progress made in achieving those targets, are needed to allow investors to compare products and to make informed investment decisions.
- The consultation also proposes changes to the “**Do no significant harm**” clause and associated disclosures. It seeks input on how best to address the lack of comparability across products and the lack of consistency with the criteria and elements of the Taxonomy Regulation DNSH test for environmentally sustainable economic activities.
- The ESAs are also proposing to enhance transparency on the **social adverse impacts** of investment decisions, which are an important part of the transition objective to a just and inclusive society. The ESAs propose to expand and enhance the list of social indicators of the principal adverse impacts (PAIs) with four more mandatory indicators and six additional opt-in indicators
- Last but not least, the ESAs are consulting on simplified financial product **templates** in order to make them more user friendly and to facilitate the understanding of the sustainability profile and characteristics of a product by the investor.
- All the changes proposed are aimed at providing clearer and more accessible information that will help investors to understand the products and assess if they match his / her sustainability preferences. Your views are most welcome on each of these points to help us improve the applicable standards.

Notwithstanding all the work mentioned above, ESMA believes that there would be merit in complementing the framework with elements supporting explicitly the transition. Here we look forward to contributing to the work led by the **Platform on Sustainable Finance** on the EU Taxonomy to improve the usability of the Taxonomy disclosures and to make the taxonomy a stronger tool in support of the transition.

Despite all the efforts I have described until now, **the framework remains complex and difficult to navigate for investors**. Against that background there is a **clear need to step up our efforts to combat the risk of greenwashing**. In parallel there could be merit in **exploring whether labels could help better channel savings** according to investors needs and preferences and therefore support an orderly transition.

Labels, advice and the prevention of greenwashing

Labels:

- One key legislative proposal in support of that approach is the **Ecolabel for green products and services**, which is meant to apply to products targeting retail investors. This project has unfortunately seen little progress so far probably as a result of its ambitious criteria, one of which is that the investments must be at least 50% taxonomy aligned. In an article published in the ESMA Trends, Risks and Vulnerabilities in December 2022, ESMA noted that only 16 funds (0.5 % of the sample that ESMA took) met the proposed minimum portfolio greenness threshold of 50 % and the additional exclusion requirements.
- Nevertheless, we believe that **labels for sustainable financial products are a useful tool** to channel resources to finance the necessary shift of our economies. The interest in labels is evidenced by the fact that the market is using Article 8 and Article 9 of SFDR, which were designed for disclosure purposes only, as actual marketing labels. A credible European labelling regime with robust common criteria would provide more clarity on the investment options for investors to decide if and how to contribute to financing the transition.
- Other labels are in the pipeline and should come to fruition later this year. One of them is the label for **green bonds** that will set out a voluntary standard regime, aligned with the EU Taxonomy, that companies and public authorities can use to raise funds on capital markets to finance large-scale investments.
- To support the quality of the information, bond disclosures would need to be reviewed by an external third party, which in the framework that the European Commission is proposing, would be supervised by ESMA.

Additional requirements for investment firms

- As a complement to the disclosure requirements introduced by SFDR, it is important to highlight the changes introduced in the existing regulatory framework, namely the MiFID II delegated regulation to integrate sustainability factors, risks and preferences into organisational requirements and operating conditions for investment firms. In that context, allow me to mention the work done by ESMA when it amended its **Guidelines on the Suitability Assessment** last year in September.
 - The assessment of suitability is one of the most important requirements for investor protection in the MiFID framework. The main amendments introduced to the MiFID II Delegated Regulation and reflected in the guidelines on the topic of sustainability are key to raise awareness among investors of sustainable products and to allow them to take part in the transition, should they wish to do so. The guidelines describe the new obligations that firms have to adhere to when offering financial advice to their clients notably to collect information from clients on sustainability preferences.
- Another ESMA's piece of work directly linked to this one is the recent publication of the **Guidelines on Product Governance** that have been updated to incorporate, among others, the sustainability-related amendments to the MiFID II Delegated Directive. One of the objectives of the guidelines is to reduce the risks of greenwashing in the manufacturing and distribution of products.
- The new requirements also have an impact on the information exchange between manufacturers and distributors, which now have to include information on products' sustainability features.

Combatting greenwashing

As the framework gradually develops, demand for sustainable investment products and supply of E/S/G or sustainable investment opportunities have increased significantly and rapidly, creating an increased risk of misalignment between the actual product offering and the investors' expectations. This mismatch between the sustainability claim and what the investor expects has generally been qualified as greenwashing risk. In the fund space, with the general misuse of the SFDR article 8 and article 9 provisions as marketing classifications the concern

is particularly high. In that context, until there can be further clarity on potential changes to the SFDR or the introduction of labels, **ESMA believes that some criteria should be required when naming funds that claim to have sustainability characteristics or goals.**

This is particularly important in the context of the SFDR that contains no rules in this regard. The need to enhance investor protection is particularly evident when dealing with funds that use terms in their name which suggest an investment focus in companies that meet certain ESG standards such as “sustainable”, “impact”, “climate change”. The name of a fund is an important marketing tool. Even if there is an expectation on investors to look beyond the name itself and check the fund’s documentation, the name can have a significant impact on their investment decisions.

That is the reason why ESMA launched a consultation on Guidelines that considered specific thresholds and other requirements to be able to use sustainability-related terms to name funds. At the moment, we are assessing and analysing the responses. What I can disclose at this point in time is that there appears to be a common agreement on the need to have specific rules that address fund naming. Views however differ on how to address this challenge. We will communicate on next steps in due course.

While the fund space has been a primary focus for ESMA in its effort to combat greenwashing, it is more broadly a challenge that supervisors and all market participants need to face. ESMA, in coordination with the other two ESAs, is carrying out a thorough **analysis of the greenwashing phenomenon**. In accordance with the mandate received by the European Commission, the objective is to reach a better understanding of what may constitute greenwashing and its occurrence, the risks it poses to financial markets, the supervisory response and whether the legal framework needs to be modified or if it is adequate to tackle greenwashing. **ESMA will deliver a Progress Report at the end of May 2023 and a Final Report in May 2024** where we will be presenting the results of our findings regarding greenwashing risks and their drivers, and the associated financial risks.

To strengthen supervision of ESG disclosures, ESMA is focusing one of its current **Union Strategic Supervisory Priority on ESG Disclosures**. USSPs are an important tool through which ESMA coordinates supervisory action with National Competent Authorities and provides an EU structured and comprehensive response to address specific risks.

Concretely, through this USSP, ESMA wishes to gradually promote increased and consistent scrutiny on ESG disclosures across the sustainable investment value chain through a number of supervisory actions which will be carried out by NCAs in parallel across the EU.

Concluding remarks

The urgency of the situation commands swift action. The amounts of capital required to finance the transition are significant: The European Commission estimated the average annual investment needs to achieve the 55% reduction in greenhouse gas emissions compared to the 1990s level at EUR 400 to 440 billion per annum between 2021-2030¹. At the same time, we recognise that the regulatory framework is still evolving and needs to be completed notably to further tackle the transition. In that context, it is essential that we ensure the right information is available and understandable for investors to make informed decisions, to protect market integrity and trust in our financial system and prevent the risk of greenwashing. ESMA has been working very hard with the other ESAs, the NCAs, the European Commission and European legislators, and has engaged extensively with stakeholders to provide guidance on the implementation of the existing framework and where appropriate to advise on how to further improve and/or complement it.

The ultimate objective is to support the channelling of the necessary capital flows to meet the EU's decarbonization targets as well as its environmental and social objectives. ESMA stands ready to contribute to further legislative changes and respond to new market developments.

The journey continues and ESMA is fully mobilised to play its part and contribute to the achievement of the ambitious goals the EU has set for itself in support of an effective and orderly transition to a more sustainable economy.

Thank you for your attention.

¹ 2021 [Fit-for-55 package](#) impact assessment.