REDUCTION OF GREENWASHING

EVERT VAN WALSUM
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EU supervisors are taking action against greenwashing risks

Sustainability-related financial products and markets have experienced remarkable growth in the EU and an important share of retail investors want to invest sustainably. However, professional investors and consumers alike have expressed concerns about greenwashing risks. In a survey EIOPA conducted in 2023, 51% of consumers replied they do not trust sustainability claims made by insurance and pension providers. While the figure signals improvements compared to 2022, when 63% of consumers expressed such distrust, this situation is not satisfactory for EU authorities. In its Progress report on greenwashing, ESMA found greenwashing risk to be material across all key segments of the sustainable investment value chain and to be the result of both conduct issues and structural problems.

To maintain trusted markets for sustainability-related financial products and services, an effective regulatory framework is critical. ESMA and the other ESAs will continue to advise the European Commission on ways to further facilitate the investor journey towards sustainable investments. In parallel, with the sustainable finance regulatory framework now closer to completion, the focus of ESMA and national authorities is shifting to providing guidance and to effective and consistent supervision and enforcement. In January 2023 ESMA launched a Union Strategic Supervisory Priority focused on ESG disclosures. Concretely, ESMA and national authorities agreed to take common supervisory actions (CSAs) and have been dedicating important attention and resources to preventing and tackling greenwashing notably focusing (1) on corporate sustainability reporting and (2) on the application of SFDR and the integration of sustainability aspects by investment service providers, as described below.

High-quality corporate sustainability reporting is critical for a well-functioning value chain and it is best supported through convergent supervision in the EU. This area is therefore a priority for ESMA. The new Corporate Sustainability Reporting Directive requires standardised and audited sustainability statements for about 50,000 companies active in the EU. These disclosures will include science-based data on sustainable activities along the lines of the EU Taxonomy. In parallel with these EU measures, international standardisation is also necessary to promote sustainable investment globally. ESMA therefore encourages interoperability between EU and international standards and supports IOSCO's endorsement of the ISSB standards for global adoption in jurisdictions where no sustainability reporting standards are in place.

As laid out in ESMA's Progress report on greenwashing, further down the value chain, areas of concern for investment management comprise product-level claims about impact, ESG performance, and broader aspects of ESG strategy and governance as well as practices regarding naming of products. For investment services, areas of concern comprise the personalised advice provided to investors when presenting the sustainability features of products. Mitigating greenwashing risks in these areas is particularly important to support informed retail investor decisions and hence participation in financing the transition.

> **The focus of ESMA and national authorities is shifting to effective and consistent supervision.**

To tackle these issues, ESMA is committed to provide the market with regulatory clarity and consistency. Regulatory clarification can help prevent greenwashing, especially when it fosters more precise clearer and appropriately substantiated sustainability claims. One of ESMA's priorities in the funds industry is to address misleading naming practices. Funds' names are a powerful marking tool, central to retail investors' decisions. That is why the use of ESG, sustainability and transition-related terms in fund names should be reflected in funds' investments. ESMA recently consulted on Guidelines addressing this area of concern and plans to adopt these Guidelines shortly after the revised UCITS and AIFM Directives enter into force. ESMA also updated its MiFID II guidelines on suitability and product governance to help firms with incorporating sustainability aspects in the provision of investment services.

ESMA has been promoting common approaches to supervision in these sectors. In a concerted manner, NCAs are assessing (1) marketing material of financial products, including potential greenwashing practices and (2) compliance of the funds industry with provisions related to sustainability disclosures and risks. In 2024, ESMA will launch a CSA to assess the implementation of the new requirements on the integration of sustainability into suitability assessment and product governance. Finally, the ESAs published in November a Financial Education factsheet on sustainable finance, to help improve retail investors' ability to understand ESG markets.

The sustainable finance regulatory framework is close to completion and its various components coming into application. In coming years, the priority for ESMA and national authorities will be on supervising the application of these rules.

MARK T. UYEDA

Commissioner - U.S. Securities and Exchange Commission (SEC)

A Q&A with SEC Commissioner Mark Uyeda

In 2023, greenwashing seems to have been less in the headlines than before. Do you think that the importance of this issue has diminished?

In the asset management space, "greenwashing" generally refers to funds or asset managers that exaggerate their environmental, social, and/or governance (ESG) investment strategies or the extent to which their investment process integrates these ESG factors. Similarly, public companies that greenwash attempt to mislead investors about how environmentally friendly their products or practices are, among other things.

The impact of greenwashing may ultimately depend on the success of ESG-focused products. According to the Investment Company Institute, the number of ESG-oriented funds has grown since 2019, from 489 to 991 funds in 2022. The assets under management have also grown since 2019, from $276 to $460 billion in 2022. Since 2022, however, the number of new ESG funds has dropped significantly and net redemptions from ESG funds has increased. In short, are these products are themselves "sustainable?"

There is debate as to whether ESG strategies are more costly and underperform other investment strategies, and if so, whether investors will accept that tradeoff for a "greener" investment. Investors that prioritize ESG strategies are faced with complex questions as to whether the investment meets their personal values. For example, some investors may prioritize investments that seek to achieve a particular social good, notwithstanding the environmental impact. Others may face difficult choices, such as whether to invest in companies that mine metals used in "green" technology, where the mining raises environmental, worker safety, and other questions.

What is the situation regarding greenwashing in the USA and what is the policy of the SEC against greenwashing?

U.S. federal securities laws are generally focused on disclosure for securities and financial products. Essentially, it is a "truth in securities" law. Purposefully misleading investors about material aspects of their product or services – such as how "green" these products or services are – can violate the antifraud provisions of our laws. The SEC's Enforcement Division has brought actions for greenwashing, such as funds that claimed to integrate ESG factors into their investment process but did not, or a mining company that made materially misleading statements about the safety of its dam, which later failed catastrophically.

Given the existing antifraud laws and our ability to enforce them, I have questioned whether additional rules to address greenwashing are needed to protect investors. To the extent that new rules are intended to achieve environment or social objectives, this approach may not only ineffective and inefficient, but also outside the Commission's statutory authority and expertise. Such concerns are best addressed by our legislature.

What are for you the priorities in the United States for greenwashing in the coming years?

The SEC's current regulatory agenda has two proposals that implicate ESG and greenwashing. One proposal relates to new climate change disclosure rules for domestic and foreign companies, including requiring certain climate-related governance, strategy, risk management and metrics and goals, and information about greenhouse gas emissions. We received over 5,000 comments on this proposal. The other proposal relates to prospectus and other disclosures for funds and investment managers that use ESG. Interestingly, some commenters thought that this proposal could lead to more greenwashing, as the disclosures could elevate ESG factors above others. However, others noted that the proposal's standardized disclosures could provide transparency.

The ultimate impact of greenwashing depends on whether ESG-themed products are a short-term trend.

Greenwashing and ESG are important topics subject to vigorous debate. Our public consultation process provides valuable insights into the different perspectives about our proposals' costs and benefits. I also appreciate learning about how regulators, investors, and industry around the world, including Europe, approach these issues.

JOS HEUVELMAN

Member of the Executive Board - Dutch Authority for the Financial Markets (AFM)

Towards a functional sustainability framework for investors and suppliers

Sustainability is playing an increasingly important role in choices made by investors. Accordingly, suppliers of financial products are also increasingly promoting and differentiating their products in terms of sustainability. To maintain trust in sustainable products it is of great importance that there exists a common system to assess the sustainable characteristics of financial products that is clear, meaningful, and feasible for both investors and suppliers.

For investors to make informed sustainable investment decisions that match their sustainability preferences, they need to be enabled to clearly and easily assess the sustainability features and claims associated with financial products. Convergently, suppliers need to be given more clarity as how to market, promote, and inform the market about the sustainability aspects of their products. Currently, investors and suppliers lack this clarity; as a result, investors are not always able to make clear and targeted sustainable investment decisions and suppliers are not able to effectively position and inform investors about their product offering. At the AFM, we have identified two ways by which clarity surrounding sustainability features could be improved.

Firstly, sustainability claims made in marketing communications, in prominent website information, or in the naming of products do not always conform to the existing requirements that information needs to be fair, clear, and not misleading. This is problematic as we found that investors are primarily guided by this kind of information over mandatory disclosures such as SFDR information. To support suppliers in adhering to the requirements that information needs to be fair, clear, and not misleading, we published guidelines on sustainability claims. These guidelines provide guidance by means of principles to market participants on how to correctly implement the information requirements. The principles state that sustainability claims need to be (i) accurate, representative, and up to date, (ii) specific and substantiated, and (iii) understandable, appropriate, and easy to find.

Secondly, the SFDR – which plays an important role in mandatory sustainability disclosures – faces several issues that make it difficult for investors to assess the actual degree of sustainability of a financial product. The information that is disclosed based on the SFDR is not always easy to understand and compare. Additionally, the categorisation of financial products along the lines of SFDR Articles 8 and 9 has led to their incorrect use as sustainability labels in the market.
Now that the is SFDR is being reviewed, we propose to move away from the current SFDR distinction between products with “sustainable characteristics” and “sustainable investment objectives” as this does not correspond to the objectives and expectations of investors. Current market practices regarding SFDR Articles 8 and 9, however, do demonstrate a clear desire for consumer-friendly sustainability product classifications. To ensure alignment of disclosure and categorisation with investor expectations and objectives, we propose to introduce three distinct sustainable product categories that investors can understand: “transition”, “sustainable” and “sustainable impact”.

Transition products invest in companies that are not yet sustainable (but plan to become so) and aim to create impact through active management of the investments. Sustainable products do not necessarily make measurable, active impact through the investment but are intended to cater to investors that demand investments in sustainable assets only. Sustainable impact products seek to make direct and measurable impact through investments, by financing underserved markets or companies that have a tangible positive impact on sustainability factors. These categories, coupled with minimum quality requirements and additional disclosure requirements, can guide financial market participants, distributors, and investors through the complexity of sustainable investment decisions.

For a well-functioning sustainable finance market, investors and product suppliers need clarity.

To have a well-functioning sustainable finance market, both investors and suppliers of financial products need clarity. We believe that by providing guidance as to (voluntary) sustainability claims based on existing general disclosure requirements and by altering the SFDR framework, suppliers will be able to effectively meet the information needs of investors, allowing them to make well-informed sustainable investment decisions.

DAVID HENRY DOYLE

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Scaling EU sustainable finance: from market disruption to efficient marketplace?

The revolutionary reforms of the EU Sustainable Finance Agenda have disrupted norms in the global financial system. A new financial system is emerging in Europe which features ground-breaking reporting, measurement, and screening tools to target genuine sustainability outcomes. However, despite early progress, the EU's new system can be optimised to improve its efficiency and maximise its potential output. Given the scale of the sustainability challenges and increasing global competition for investment, European policy makers and market participants must intensify their work to calibrate, clarify, and – if necessary – correct key aspects of the EU's sustainable finance framework.

The scale of the sustainable investment challenge

The scale of investment needed to tackle the global climate, biodiversity, and sustainability emergencies is immense. The financial system can - and must - play a leading role in addressing these crises. Yet, to understand the necessary investment expected from financial markets it is useful to make a comparison to existing markets. The United Nations global stocktake at COP28 estimates that €4 trillion per year needs to be invested in clean energy up until 2030 to align with net zero targets. From 2030 to 2050 global investment to achieve net zero needs to rise to €4.6 trillion per year. For perspective, according to the Bank of International Settlements, the entire outstanding value of the French bond market in 2022 was €4 trillion.

The European context is equally daunting. According to the European Commission, every year from 2021 to 2030 the EU will need to invest €700 billion more than it invested from 2011 to 2020 to decarbonise its economy. For context, €700 billion is roughly the value of the entire bond market of Belgium, our current Eurofi hosts.

In short, the green investment gap at global level and European level requires the development of new sustainable markets the size of the French and Belgian bond markets every year from now until 2050. Every annual target missed increases next year's gap. Moreover, there will be increasingly intense competition for these markets.

Efficient rules create efficient systems

How can the EU sustainable finance system reach the scale needed at the necessary pace? In a word, efficiency. Efficiency is a critical factor in the success of any system. An efficient system ensures that inputs are optimised to produce the desired output. Efficient systems also enable maximum productivity with limited resources. However, the final output of any system is always less than the input due to friction. Unwanted friction drains the system of energy and lowers overall output.

It is no secret that there is friction in some of the EU's sustainable finance regulations. Interpretative, informational, and conduct concerns have emerged when applying the new rulebook. The ability of the EU's new system to deliver on its full range of objectives at scale and in a competitive international environment will depend on its ability to resolve this friction.

Europe will have a competitive advantage if its capital markets are efficient at producing sustainable results. For markets to be efficient the rulebook governing them must be optimised. The efficiency reforms under the Capital Markets Union project are equally important for the success of the Sustainable Finance Agenda.

Positive momentum

The EU's Sustainable Finance Platform's latest report notes positive momentum. EU Green bond issuance reached 6.5% of total EU corporate bond issuance in 2023. Investment funds that track the EU climate transition benchmarks and EU Paris aligned benchmarks are reported to have grown considerably and have a current value of €110 billion. In 2022, EU governments issued €266 billion of green bonds, compared with €85 billion in 2019, equal to 1.7% of EU GDP.

For markets to be efficient the rulebook governing them must be optimised.

These results demonstrate that equipped with the right tools, financial markets can be a powerful and efficient force to transform potential investment into sustainable projects. This heralds the promise of even greater output if refinements to market practices are accompanied by streamlining of complex regulations like the SFDR and Taxonomy.

Looking forward

In the next mandate, the focus should be on calibrating the design of the EU's new sustainable finance system to maximise its efficiency. This may mean embracing tough political choices to focus on technical adjustments rather than sweeping new initiatives. The trade-off between optimising the existing system and pursuing additional disruption should be carefully weighed.

Meaningful technical adjustments in the short term which reduce unnecessary friction within the EU financial system will mobilise more input, generate more output, and yield more efficient allocation of capital to sustainable investments in the long term. By contrast, if inefficiencies and friction are not addressed Europe risks losing its head start in sustainable finance.

STÉPHANE JANIN
Head of Global Regulatory Developments and Public Affairs - AXA Investment Managers

Does the EU want to be consistent in reducing the Greenwashing Risk?

Up to now, the EU has been at the international political forefront in promoting ESG. Through the 2018 Sustainable Finance Action Plan, the EU revealed a very high ambition in orientating the financing of EU real economy towards sustainable activities.

In particular, the Action Plan aimed at setting a series of requirements for various types of players involved in the EU sustainability value chain, such as issuers, banks, insurers and asset managers. More recently, EU institutions have wondered if that official orientation in favor of ESG was not going to lead to risks of misleading information or false claims of ESG investments by such players – the "Greenwashing Risk".

What is the reality today of greenwashing risk and how to reduce it?

First of all, let's recall that in practice the specific risk of greenwashing may be captured by more general rules applicable to the financial sector. For instance, in the US, even without federal legislation dedicated to ESG, the US SEC was able to capture instances of suspected greenwashing by listed issuers through more general regulations applicable to misleading statements. That approach was interesting to observe, to wonder if a regulatory framework dedicated to greenwashing as such is really needed to prosecute players disclosing misleading information in the area of ESG or sustainability.

But if a political decision were made to introduce a specific framework on greenwashing risk, which approach should be followed? The answer seems to be obvious: to reduce the greenwashing risk, all the ESG value chain should be covered. In particular, when professional investors have to comply with sustainability reportings (e.g. EU Sustainable Finance Disclosure Regulation) or make sustainable investments (e.g. based on the EU Taxonomy), it is key that they can rely on the quality of information they receive from issuers or external providers.

At the level of issuers themselves, disclosure of reliable information is currently being tackled at EU and international levels, in particular in the EU with the Corporate Sustainability Reporting Directive (CSRD) and more widely at global level through the International Sustainability Standards Board (ISSB).

But regarding ESG Data Product Providers, their commercial provision of re-disseminated issuers' data or own ESG data estimates has not been captured at EU level yet. While the European Commission (EC) published a draft Regulation before the summer 2023, it included ESG Ratings but not ESG Data products from providers.

The fact that the EC does not intend to manage ESG data product providers within the EU sustainability value chain soon is very difficult to understand. On a regular basis, EU (and non-EU) based investors identify wrong ESG data among those sold to them by global ESG data providers. If those providers are not tackled by any framework, it will remain a missing link in the value chain, leading to unintended use by investors of wrong data impacting their own sustainability reportings or investments.

It would mean that at the end of the day, regulated professional investors might be prosecuted by regulators or clients for greenwashing, although due to providers out of the regulatory framework.

As long as major ESG data product providers are not identified within any framework while being central for reducing the greenwashing risk, they will not feel responsible in the quality of ESG data they sell (being issuers' re-disseminated data or their own estimates). This missing piece in the overall sustainability value chain framework does not make sense from an EU standpoint.

EU lack of action and compliance with IOSCO on ESG Data Product Providers is difficult to understand.

In addition, at global level in November 2021, the International Organization of Securities Commissions (IOSCO) asked national securities regulators to act on ESG data product providers, precisely to reduce greenwashing risk. Since then, many Asian jurisdictions have started complying with the IOSCO's Recommendations including major jurisdictions such as Japan, Singapore and Hong Kong.

And in the European region, at the end of 2022 the UK FCA took the initiative to launch an industry-led working group aimed at building a UK Code of Conduct applicable to ESG Data Product Providers, based on IOSCO Recommendations. While the UK approach is voluntary to allow for ESG Data Product Providers to sign it or not, the peer pressure on the UK marketplace will lead to get the major providers signing in. And ultimately, it will significantly reduce the risk of greenwashing for investors in the UK.

Two main regions have not taken action on ESG Data Product Providers yet: the USA and the EU.

In the USA, we may understand that for the time being at political level there is no clear majority in favor of any ESG framework more widely.

But in the EU, that lack of action and compliance with IOSCO standards on ESG Data Product Providers is difficult to understand.

It should therefore be fixed urgently. Now.

THOMAS BEHAR

Chief Financial Officer - CNP Assurances

Towards sustainable, green and ESG savings products

In March 2018, the European Commission adopts a strategy on sustainable finance after realizing that the achievement of the objectives of the 2015 Paris Agreement, requires the contribution of private investments. In parallel with the "European Green Deal" of 2019, a new complex regulatory corpus that affects all insurance professions is emerging. The three objectives of the European regulations can be summarized in increasing product transparency on sustainability at company level, designing and distributing sustainable products, integrating sustainability into all levels of governance and key corporate functions. The various components of the European Union's sustainable finance strategy were intended to help savers better navigate the jungle of sustainable, green, ESG, SDGs, climate, and transition products.

According to an EU-wide survey[1] carried out by EIOPA in June 2022, 62% of EU consumers do not trust the sustainability claims made by insurance undertakings or distributors, while a similar percentage (63%) says that sustainability claims about insurance products are often misleading... 75% of EU consumers think also that it is difficult to really know if a product is sustainable as the documentation provided is too complex to understand...

Customers and policyholders still need a clear vision of the sustainable and green nature of their savings products. The EIOPA's report[2] on Greenwashing in June 2023, provides a very accurate and eye-opening list of gaps, inconsistencies, and issues in the current EU sustainable finance legislative framework which don't help to lead to a better vision:

- The assessment of whether insurance products are indeed sustainable is challenging due to the unclear, inconsistent, and changing regulatory framework. Skipping the current RTS revision to go directly to the SFDR level 1 review could move int the right way.
- The divergent interpretation of sustainable finance regulatory requirements and the lack of consistency of the terminology used by the various EU regulations does not help the overall understanding.
- The Taxonomy Regulation DNSH 'Do no significant harm' is not applied in the same way as the SFDR DNSH.
- SFDR does not further specify what promoting environmental or social characteristics entails.
- SFDR does not set threshold regarding the minimum share of sustainable investments that a product needs to make to fall under Article 9 To avoid greenwashing, the European Commission needs to urgently tackle these gaps and inconsistencies.
- The use of numbers "SFDR 8" or "SFDR 9" is clearly only suitable for a well-informed public and doesn't speak to a wide audience. Going to the use of very precise defined European labels could make a great step forward.

Furthermore, the main limitation of the Taxonomy is that it does not apply to sovereign debts, which constitute a significant part of insurers' asset allocation. It is urgent for Europe to define the technical criteria that a State should respect to be aligned with the Taxonomy, even if we can anticipate lively political debates to reach a consensus. On a same way, it is important that SFDR applies to all components of a life-saving insurance contracts and not only the unit linked component. Multi-Options products should be fully covered, and a methodology developed for that.

It is crucial for the client, to understand the ESG characteristics of a fund and compare the sustainability of different funds/products with each other. Of course, we support the use of labels as simple communication tools, and we encourage the creation of European sustainable finance labels inspired by existing national labels by harmonizing them. The review of the ISR label is an improvement but raises the problem of the 'shelf life' of a label compared to the 'shelf life' of a product, very complex for a customer.

Clarifying the EU regulation to better inform customers and avoid a greenwashing suspicion.

This double materiality is at the heart of the CSRD regulation. The companies must consider both the impact of society and the environment on the financial performance of their company but also the impact of their activities on society and the environment. A 'freeze frame' without implementing new RTS standards, seems to be interesting to take advantage of the work already done and to converge to more consistency between reports (SFDR/CSRD/Taxonomy), less complexity of data and a harmonization of indicators. The review of the SFDR regulation seems interesting to achieve these objectives.

1. *Consumer Trends Report 2022 – EIOPA.*
2. *Advice to the European Commission on Greenwashing – Progress report - EIOPA-BoS-23/157 - 01 June 2023.*

FIONA MELROSE
Head of Group Strategy and ESG - UniCredit

Sustainability regulation and corporate finance: the impacts and the way forward

At this stage, the framework continues to be somewhat unclear, so individual investors may well still find themselves confused. While regulation is in place for both lenders and investors, some areas remain unclear and uncovered, and more consistency is needed among the various regulations.

In particular, it is important to clarify the most important definitions and concepts that we are working with as an industry, i.e., identifying precisely what can be included in targets, not to double count overlapping perimeters and how to identify social categories. Additional regulations at this stage risk increasing complexity, whereas what the market needs is to clarify the existing framework.

With ESG ratings becoming more and more used and increasingly influencing investor decisions, we see the new regulation as a necessary improvement that will help investors make more informed decisions when it comes to ESG related investments.

Banks too will have the opportunity to be fairly evaluated. The regulation is designed to enhance the governance and transparency of ESG rating activities, driving higher quality of service and higher levels of consumer and investor protection. All of this contributes to preventing greenwashing, social washing and other types of misinformation.

We welcome limitations and controls around market entry, as it may prevent the proliferation of substandard raters, ensuring higher-quality ratings. On top of this, the transparency afforded by the regulation will help foster reliability and empower informed decision-making in the market, while helping the banking system as a whole to understand which areas need more effort to improve.

We also support AFME's position on the exemption for ESG ratings incorporated in products of regulated financial undertakings which are already subject to regulation. This may add uncertainty and bring within scope already highly regulated products, different in nature to ESG ratings produced by specialized ESG ratings providers.

New regulation on ESG ratings should focus on maximizing benefits by ensuring greater transparency of methodologies and making it easier to compare ratings and rated companies and not introducing new requirements for products that are already regulated.

Certainly, taxonomy and CSRD regulation represents a positive first step in increasing transparency: the first clarifies what counts as green, and second enlarges the perimeter of application for mandatory disclosure. However, they do not yet cover the full spectrum of issues, and small companies are still struggling in finding guidance for their application.

And while the EU Taxonomy is a key element in sustainable finance and essential to preventing greenwashing, applying it is a complex exercise. Banks are expected to verify technical aspects with their clients that go beyond their traditional area of expertise, and this makes the taxonomy less effective. Even the European Banking Association (EBA) in December 2023, suggested that the European Commission support banks with a voluntary EU label for green loans based on a common definition, introducing more flexibility.

For this reason, we have adopted an internal policy to ensure consistency in our activities across our geographies. This includes guidance on how to apply regulations, coverage of grey areas, and a specific focus on the topic of marketing and comms. We have also defined a very clear set of ESG commitments and targets, that we constantly keep monitored.

Overall, the CSRD aims to create a more robust, transparent, and standardised framework for sustainability reporting, providing numerous benefits for companies, investors, and society at large, such as enhanced transparency, improved stakeholder trust and comparability across organisations.

Interoperability between different sustainability reporting standards (i.e. ESRS developed by EFRAG for CSRD and IFRS S1 and S2 developed by ISSB for IFRS) is crucial for providing a comprehensive view of a company's performance. Despite these efforts towards standardisation, achieving complete interoperability is an ongoing challenge due to differences in focus, methodologies, and stakeholders involved in financial and sustainability reporting. Ongoing collaboration between standard-setting bodies, regulatory bodies, and companies is essential to develop a more unified and cohesive reporting framework.

For sure, the priorities in Europe in the fight against greenwashing for the coming years are a clear and consistent legislation is the first priority – ensuring regulation requires the same level of disclosure and provides the same definitions to all actors, also considering the European Supervisory Authorities' report issued last year. Continuing to push for transparency from banks without making it easier to access reliable data puts the industry at risk in many cases.

This to be extended also to social definition, we need standardisation of social definitions.

We are adopting internal processes and rules to make sure we are coherent and consistent, but this is not a standardised approach across the whole industry, which makes it impossible to compare firms fairly.

PATRICIA TORRES

Global Head of Sustainable Finance Solutions - Bloomberg

Global coordination is key for ESG regulation to drive real change

A key question societies and financial companies are asking is 'how can we deliver real-world impact?'. Governments around the world are setting ambitious sustainability objectives, while regulators are implementing rules aimed at promoting transparency and credibility in the market. But how can regulation serve as a positive force for real-world change?

First and foremost, regulation provides much-needed transparency. For transparency to lead to the far-reaching structural changes required, at the ambitious pace needed, regulation needs to focus on the problem, be accessible and have international ambitions. There also needs to be coordination across regulators to promote standardisation to ensure market comparability and consistency, while recognising nuances and differences across industries and market participants. When regulation creates burden and complexity without creating opportunity, there is a risk that only few companies will be able to move beyond a 'tick-box' approach, which will reduce its ability to drive real change in business and investment practices.

The Corporate Sustainability Reporting Directive (CSRD) is a critical piece of legislation, which should significantly improve the availability and quality of ESG data. To ensure its success, it is fundamental that the CSRD complements and remedies existing data gaps around reporting for other EU sustainable finance regulations, such as the Taxonomy Regulation and Sustainable Finance Disclosure Regulation (SFDR). Reporting under the CSRD will be complex, as companies grapple with over 1000 data points (176 of those mandatory, 647 subject to materiality assessments, and an additional 279 voluntary). Clarification and guidance on how sectors should report on double materiality will therefore be key to supporting effective implementation by the market.

Outside the EU, the International Sustainability Standards Board (ISSB) is working with jurisdictions to implement IFRS S1 and S2; these efforts are vital to improving the quality of ESG data at the global level. However, it will be imperative for jurisdictions to keep any changes to the core of IFRS S1 and S2 to a minimum. Otherwise, there is a risk we will see divergent local ISSB regimes emerge, causing additional complexities for the global financial market.

Regulation can also help provide clarity on what is considered 'environmentally sustainable'. This is where taxonomies play a valuable role. In the EU, the Taxonomy Regulation provides transparency around how companies perform against EU environmental objectives. Globally, over 40 public sector-led taxonomies have emerged. As more taxonomies are developed, it will be important for policymakers to coordinate and consider how to improve interoperability between jurisdictions.

Regulatory efforts to establish criteria and/or labeling regimes for financial products claiming to be sustainable are also welcome, because they help build trust and credibility in the market. In the US, the SEC amended its Names Rule to include new criteria as part of efforts to prevent misleading investment fund names. In the UK, the FCA set out criteria for UK asset managers using sustainability-related terms and introduced four new labels through the new Sustainability Disclosure Requirements regime. It will be important for the EU to consider these developments in its review of the SFDR, as consistent regulatory approaches to ESG fund labeling will help ensure clarity and interoperability for the global investment community.

There is a risk for regulatory fragmentation in the market in the absence of global coordination.

There has also been increased momentum to regulate ESG ratings, as concerns are raised around the risks they may pose to investor protection and capital allocation. The EU's efforts to address these concerns are an important step to improving transparency and credibility in this nascent industry. Other jurisdictions are also considering their own approaches to enhance ESG ratings through Codes of Conduct. However, it is essential to understand that there are a wide range of products that may resemble 'ESG ratings'; these are constructed in different ways and used for varying purposes by different users. Therefore, it is key that regulators do not pursue a 'one-size-fits-all' approach and instead, focus on protecting transparent eco-systems where users benefit from product diversity, and are ultimately better equipped to navigate their sustainability strategies. Regulation of ESG rating providers should not, however, replace users' due diligence.

Ultimately, there is a risk for regulatory fragmentation in the market in the absence of global coordination, posing significant challenges for global market participants operating in multiple jurisdictions. The greater the complexity and divergence between regulatory regimes, the greater the cost associated with compliance, the slower the adoption, and the lower the real-world impact. Regulation has the power, but does it have the will to build inter-connected bridges that facilitate convergence and drive real-world impact?