

## GREAT FUND INSIGHTS

# New ESMA sustainable finance roadmap – What you need to know

### 1. Speed Read

ESMA has published a new “Sustainable Finance Roadmap 2022-2024” setting out its strategic priorities and key planned actions for the next three years. This includes a focus on tackling greenwashing, promoting transparency and more consistent/reliable disclosures, and monitoring, assessing and analysing ESG markets and risks.

This briefing gives further detail on the new roadmap.

### 2. New Roadmap

On 11 February 2022, the European Securities and Markets Authority (ESMA) published its new “Sustainable Finance Roadmap 2022-2024”.<sup>1</sup> This has identified the main priorities for ESMA in its sustainable finance work over the next three years, together with a list of key actions and timings (although positioned as indicative only and subject to change). The three main priorities are:

- tackling greenwashing and promoting transparency;
- building the capacities of regulators in individual member states, plus ESMA itself, in relation to sustainable finance; and
- monitoring, assessing and analysing ESG markets and risks.

### 3. Key takeaway points from the roadmap

Some key takeaway points that may be drawn from the very helpful roadmap are as follows:

#### Fragmentation

ESMA gives a “nod” to the international arena, indicating it will monitor international developments and contribute as needed to initiatives, including those of the International Organization of Securities Commissions (IOSCO). It states that: “This has the important purpose of ensuring that all of ESMA’s sustainable finance work takes into account, and is compatible with, international initiatives”.

Although the sentiment here is welcome, it is difficult to believe the EU position is to take a coordinated approach internationally to ESG, or compromise its positions (or slow down its timelines) to reach an international consensus.

Later in the roadmap it also says the following (emphasis added): “it will be important to ensure that the reporting standards developed in the EU ... do not unnecessarily depart from global sustainability reporting standards, as investors operating in the EU should be able to reconcile, at least to some extent, the sustainability disclosures of investee entities placed outside the EU. In this regard, international cooperation within IOSCO and with the International Sustainability Standards Board will be essential to ensure that the EU reporting regime is adequate to meet the information needs of investors that operate at global level.”

<sup>1</sup> See <https://www.esma.europa.eu/press-news/esma-news/esma-prioritises-fight-against-greenwashing-in-its-new-sustainable-finance>. See also the list of actions at [https://www.esma.europa.eu/sites/default/files/library/esma71-99-1848\\_esma\\_sustainable\\_finance\\_roadmap\\_areas\\_of\\_focus.pdf](https://www.esma.europa.eu/sites/default/files/library/esma71-99-1848_esma_sustainable_finance_roadmap_areas_of_focus.pdf).

Although it is helpful that ESMA has acknowledged this point, they fail to highlight a related key issue: namely, the operational difficulties that firms that operate globally/cross border must navigate, if (as manufacturers and distributors) they are forced to comply with multiple/differing disclosure regimes in different countries and regions. This is likely to only increase over time, as EU-type initiatives are replicated elsewhere, with local nuances and amendments.

### Timing and interpretation issues

ESMA recognises a number of problems on the legislative side in relation to ESG – this includes timing issues, such as the delay to the Level 2 requirements for SFDR<sup>2</sup> and the Taxonomy Regulation<sup>3</sup>, the “misalignment” between the dates for the Level 1 and Level 2 requirements coming into force, and product level disclosure requirements coming into force before investee companies are required to report under CSRD<sup>4</sup>. In fact, ESMA notes: *“the new requirements – if and when finalised – will kick in for the 2024 reporting season at the earliest”*.

It also states that: *“Investors and supervisors in the EU therefore have to cope with the current sub-optimal status of sustainability reporting still for some years.”* It is hoped, however, that the problem is time-limited, and there is regulatory forbearance in the interim.

ESMA also recognises the different interpretations taken of SFDR, which is a more “solvable” problem. With this in mind, it suggests work to ensure a *“consistent application of the EU rulebook through convergence tools such as Q&As and Guidelines”*. It also suggests work on *“clarifying definitions and disclosure obligations for sustainability products”*, among other things.

This would be much welcomed by the market, which has suffered of a lack of regulatory guidance as to the meaning of key concepts and issues of scope (eg the application of SFDR to non-EU AIFMs).

### Building expertise

To ESMA’s credit, the roadmap discusses in some detail the “learning curve” of ESMA and local regulators: *“The capacity building will have a crucial derivative effect which is to establish a common supervisory culture in this nascent area.”* It is possible that low levels of confidence with the underlying subject matter have contributed to the lack of Q&A and other guidance issued to date on SFDR, the taxonomy and other subjects. In any case, the focus on building expertise is likely to be welcomed by the market.

### Greenwashing

It is clear that greenwashing will not drift off the EU “regulatory radar” anytime soon. Judging from the roadmap, we can expect that it will be one of the most significant priorities of ESMA for the coming three years, including *“taking coordinated action in multiple sectors to find common solutions – both in the supervisory convergence area and in the single rulebook work”*.

Two other takeaway points for firms “in the weeds” on SFDR; ESMA notes the following as potential instances of greenwashing: *“For instance, the marketing documentation focuses on exclusion policies [ie negative screening] which do not per se result in selecting a fully sustainable eligible investment universe, or an ESG integration strategy is presented but no commitment is made to use ESG considerations in the investment decision-making. This is a problem affecting both institutional investors and retail investors. The latter increases the risk of misinformation, mis-pricing and mis-selling ... ”*

<sup>2</sup> Regulation (EU) 2019/2088 of the European Parliament and of the Council of 27 November 2019 on sustainability-related disclosures in the financial services sector.

<sup>3</sup> Regulation (EU) 2020/852 of the European Parliament and of the Council of 18 June 2020 on the establishment of a framework to facilitate sustainable investment, and amending Regulation (EU) 2019/2088.

<sup>4</sup> This refers to the Proposal for a Directive of the European Parliament and of the Council amending Directive 2013/34/EU, Directive 2004/109/EC, Directive 2006/43/EC and Regulation (EU) No 537/2014, as regards corporate sustainability reporting.

## 4. ESG-related risks in the market

Some of the key risks and issues identified by ESMA include the following:

- The fact that ESG markets and products are evolving at a rapid pace, creating new investment opportunities but also risks in terms of investor protection, orderly markets and financial stability. ESMA flags that ESG markets and products, “including in particular sustainable investment vehicles and debt instruments such as ESG funds and green bonds”, need to be closely monitored.
- Climate change is expected to have a growing impact on global financial markets.
- Carbon prices are expected to play a central role in the transition to a low-carbon economy, and ESMA states that it will closely monitor potential risks in the EU carbon markets.
- ESMA notes the severe issues that exist with data availability and quality, including the limited number of companies disclosing ESG-related information, the insufficient granularity of the disclosures, the lack of standardisation, and poor reliability. It also notes that “non-financial statements are currently not systematically subject to third party assurance”, although it believes that issues with data standardisation and reliability are expected to be addressed through the CSRD, together with standard-setting initiatives in Europe (eg the European Financial Reporting Advisory Group) and worldwide (eg the International Sustainability Standards Board).

It acknowledges this raises particular issues for asset managers in the short to medium term: “Due to the sequencing of the ESG disclosure requirements applicable across the sustainable investment value chain, [their] data needs are currently not fulfilled by the data disclosed by companies.”

- ESMA notes its view that the “methodologies, limitations and assumptions” of ESG ratings providers “need to become more transparent”.

To address these risks and issues, ESMA proposes various actions, including the following:

- **Supporting single rulebook and convergence initiatives to develop a complete and clear set of rules.** A cluster of specific actions are included here, such as the following:
  - support efforts to develop EU-wide labels, including the EU Green Bond Standard (**EU GBS**),<sup>5</sup> and labels for financial instruments (eg sustainability-linked bonds) and investment products;
  - a study on disclosure requirements under Articles 8 and 9 of SFDR; and
  - a project to collect data on the distribution of ESG products.
- **Continuing the work on climate change scenario analysis and further structuring the dialogue in this area, including on EU-wide stress testing of the financial system.** This includes various actions, including the following:
  - performing regular climate stress tests or scenario analyses of entities within ESMA’s remit.
- **Assessing issues with data availability and quality affecting firms’ reporting obligations as well as the users of this data.**
- **Better understanding the interaction between digital innovation and sustainability.**
- **Engaging with relevant international fora to benefit from synergies and promote globally consistent approaches.** This includes ESMA’s participation in work being conducted by IOSCO, the Financial Stability Board (**FSB**) and the Network for Greening the Financial System (**NGFS**). In particular, ESMA seems to welcome the opportunity to draw on expertise available elsewhere (eg in the context of climate scenario analysis), while promoting the EU’s rulemaking approach in areas where it has taken the lead “with a view to reducing the risk of global fragmentation”.

<sup>5</sup> See [https://ec.europa.eu/info/business-economy-euro/banking-and-finance/sustainable-finance/european-green-bond-standard\\_en](https://ec.europa.eu/info/business-economy-euro/banking-and-finance/sustainable-finance/european-green-bond-standard_en).

## 5. Contact us

There is a lot of material to digest in the new roadmap, which is laudable in terms of scale and levels of ambition. We hope this bulletin has been helpful, and if you have any questions on the initiatives mentioned above or ESG generally, please get in touch with your usual A&O contact.

## Annex | Specific Proposed Actions

Some of the key actions proposed by ESMA in the roadmap are as follows (emphasis added), although for a complete list, see the Annex to the roadmap.

Sector	Key actions	Timings
<b>Cross-sectoral or horizontal actions</b>	Assess/contribute to consistency of Sustainable Finance legislation across sectors (CSRD, Benchmarks Regulation, SFDR, Taxonomy Regulation, etc.) and convergence in their application/supervision	2022-2023
	Assess greenwashing market practices	2022-2023
	Establish Consultative Working Group ( <b>CWG</b> ) for Coordination Network on Sustainability ( <b>CNS</b> )	2022-2023
	Contribute to EC's efforts to develop EU-wide labels for sustainable finance products	2022-2024
<b>Investment management</b>	Contribute to EC's work on <b>minimum sustainability criteria</b> for SFDR Article 8 products, or a combination of criteria for financial products that disclose under Article 8 of the SFDR	2022
	Review the SFDR regulatory technical standards ( <b>RTSs</b> ) to clarify: <ul style="list-style-type: none"> <li>– Indicators for climate and environment related Principal Adverse Impacts (<b>PAI</b>)</li> <li>– PAI on social and employee matters, respect for human rights, anti-corruption and anti-bribery matters</li> </ul>	2022
	Contribute to the EC's work on possible further changes to the UCITS Directive and AIFMD to enable fund managers to systematically consider positive and negative sustainability impacts of their investment decisions	2024
	<b>Flag to the EC any need to amend/clarify/interpret Level 1 and Level 2 such as for SFDR, Taxonomy Regulation, UCITS Directive or AIFMD</b>	2022-2024
	Contribute to consistent implementation of new requirements applicable to asset managers (eg SFDR/Taxonomy Regulations): <ul style="list-style-type: none"> <li>– National Conduct Authorities (NCAs) to share supervisory cases to promote effective and consistent supervision</li> <li>– <b>Develop ESMA guidance to NCAs and/or the market to ensure effective and consistent application of rules as needed</b></li> <li>– Maintain up to date/develop new supervisory briefings</li> </ul>	2022-2024

Sector	Key actions	Timings
<b>Investment management</b> <b>... continued</b>	Survey landscape of EU/national ecolabels	2022-2024
	Undertake a Coordinated Supervisory Action (CSA) on sustainability disclosures	2023-2024
	Analyse disclosures under Articles 8 and 9 of SFDR in the investment management sector to support supervisory convergence efforts and the identification of greenwashing cases	2022-2024
	Undertake work on climate change scenario analysis: – Develop methods, parameters and scenarios for bottom-up climate change stress testing to be used by supervisors and supervised entities (in coordination with the EBA and EIOPA) – <b>As a one-off exercise, conduct climate change stress test to assess the resilience of investment funds in line with the Fit-for 55 package</b> – <b>Perform regular climate change stress tests or scenario analyses of entities within ESMA's remit.</b>	2022-2024
	Assess data availability and quality for asset managers	2022-2024
<b>Investment services</b>	Contribute to the EC's work on the ESG changes to MiFID	2024
	II to enable firms to systematically consider positive and negative sustainability impacts of the products they advise on and of their investment decisions	2022-2024
	Flag to the EC any need to amend/clarify/interpret Level 1 and Level 2	2022-2024
	<b>Assess added value/conduct a Coordinated Supervisory Action (CSA) on ESG factors in suitability assessments</b>	2023-2024
	Contribute to consistent implementation of new requirements: – Discuss and agree on how the new/existing ESG related rules (ie those related to manufacturing and design of ESG products, information provided on ESG products as well as their marketing and distribution) should be effectively and consistently applied and supervised <b>notably updating the Guidelines on product governance and suitability assessments</b> – <b>Develop further ESMA guidance</b> to NCAs and/or to the market (such as Q&As), as needed – NCAs to share supervisory cases to promote effective and consistent supervision	2022-2024
Collect data on distribution of ESG products	2022-2024	

Sector	Key actions	Timings
<b>Issuers' disclosure and governance</b>	Contribute to EU and international sustainability reporting standards	2022
	Contribute to development of a framework for European Green Bonds	2023-2024
	Provide input to the EC on adjustments to the Prospectus Regulation to create minimum requirements for the comparability, transparency and harmonisation of information available for green, social and sustainable securities	2022-2023
	Contribute to legislative process on sustainable corporate governance and SRD II	2022-2023
	Contribute to developing further guidance in the area of stewardship and engagement to ensure acting in concert does not impede collaborative engagement by investors around common sustainability goals	2022-2023
	Contribute to assessment of how IFRS reflect sustainability risks	2022
	Contribute to EC work on a label for sustainability-linked bonds	2022-2024
	Develop guidance to NCAs/market participants on Taxonomy Regulation Article 8 and on the related Level 2 provisions in view of effective and consistent application and supervision of the rules	2022
	Prepare for supervisory powers over external reviewers for green bonds issuances	2022-2023
	Flag to the EC any need to amend/clarify/interpret Level 1 and Level 2 including possible need to amend future reporting standards to fulfil needs from other sectors (eg, asset management, benchmarks, etc.)	2022-2024
Contribute to EC's efforts to develop EU-wide labels, including the EU Green Bond Standard, and in the future as requested ESG labels for instruments (eg, sustainability-linked bonds) and investment products	2022-2024	
<b>Credit ratings and ESG ratings</b>	Support the EC in improving reliability and comparability of ESG ratings	2022
	Assess how CRAs incorporate ESG factors in their methodologies	2022
<b>Trading and post-trading</b>	Undertake work to consider impact of climate change in CCP stress testing	2022-2024
	Build analytical tools for monitoring EU carbon markets	2022-2024

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