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BLEUSE CATTEDRA JEAN MONNET
BUSINESS LAW IN THE EUROPEAN UNION AND SUSTAINABLE ECONOMY

Regulatory Framework on Sustainable Bonds and Green Bonds, including financial markets participants and sustainability reporting

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The scenario and the EU commitment

Paris Agreement on climate change (2015)

UN 2030 Agenda for sustainable development and 17 Sustainable Development Goals (2015)

- Many SDGs involved

EU High Level Experts Group on sustainable finance (2016-2020)

- Final report in January 2018

European Commission's Action Plan: Financing Sustainable Growth (8.3.2018)

A general EU green commitment

Long-term perspective: **The European Green Deal** (11.12.2019)

- It deals with sustainable (and namely also Eco sustainable) finance
- Includes references to the Action Plan

In order to implement: **EU Taxonomy** (classification tool)

- Principles in Regulation (EU) 2020/852 of 18.6.2020 on the establishment of a framework to facilitate sustainable investment
- Many **further implementing acts** (delegated acts), in order to take thoroughly care of the specific chapters of the Taxonomy
  - The EU Taxonomy Climate Delegated Act approved on 4.6.2021

More from the EU?

So-called **Sustainable finance package**, by the European Commission (21.4.2021)

- **EU Taxonomy Climate Delegated Act** (see above)
- Proposal for the **reform of the Non-Financial Reporting Directive** (eventually called **Corporate Sustainability Reporting Directive**)
- **Amendments of Delegated Acts in the field of financial services**, to ensure the inclusion of sustainability in the procedures and advices to the customers
  - Sustainability risks and factors to be taken into account for Undertakings for Collective Investment in Transferable Securities, and by Alternative Investment Funds Managers
  - The same for insurance-based investment products, for insurance and reinsurance undertakings, for product governance obligations, in general for investment firms (organisational requirements and operating conditions)

More from the EU?

Strategy for financing the transition to a sustainable economy (6.7.2021)

- EU Commission Communication
- Proposal for a **standard for European green bonds**
- **Delegated act supplementing the Taxonomy Regulation**
  - For **financial and non-financial undertakings**, concerning the **proportion of environmentally sustainable economic activities** in their business (preventing greenwashing by disclosure)
    - Linked to the Corporate Sustainability Reporting Directive
    - Key Performance Indicators related to turnover, capital expenditure (capex) and operational expenditure (opex) that non-financial undertakings must disclose

The EU strategy to promote Eco-S

Regulatory based

- Reforms in corporate governance
- EU green deal

Market based

- Taxonomy
- Disclosure

The Action Plan

The key question: how to use finance in order to create a more sustainable world?

More sustainable in terms of

- Environmental
- Social
- Governance

profiles.

The current state of the art at a European level is mainly focused on the environmental sustainability

The Action Plan

Includes **proposals for initiatives** (legislative and non-legislative) to be taken **between 2018 and 2020**

Three main streams:

1. Reorienting **capital flows towards a more sustainable economy**
2. Including **sustainability in the common companies' risk management**
3. **Boosting disclosure**/transparency and a **long-term** vision
   - The idea of the long-term as a sort of panacea, which is at least debatable

For each of such streams, the Action Plan proposes specific actions to be taken, and a timetable

1. Reorienting capital flows towards sustainability

1. **Action 1: Classification (Taxonomy)**

Establishing a classification system for sustainable activities:

- Needed to **select** the activities which can be considered sustainable
- The **cornerstone** of the entire sustainability system: no green bonds, if we do not know what does 'green' mean

Setting up a technical expert group on sustainable finance, in order to elaborate reports, on which the delegated acts to implement the taxonomy are based

2. Action 2: Labels

Creating **specific labels** for green securities…

…or adapting existing labels (e.g. the EU Ecolabel Regulation; or the SRI of social investments)

Mainly for the **benefit of retail investors**, and with specific prospectus duties

1. Reorienting capital flows towards sustainability

3. Action 3: Boosting investment in sustainable projects

By means of **specific funding for sustainable infrastructure**, through the European Fund for Strategic Investments 2.0 (at least 40% of financing for infrastructure and innovation to support climate action projects) in the EU, and the EU External Investment Plan in partner third countries.

4. Action 4: Considering Sustainability in financial advice

Ensuring that **customers' sustainability preferences are taken into account** in the suitability assessment (amendment to MiFID II and IDD delegated acts)

5. Action 5: Setting up sustainability benchmarks

Investors are allowed by this way to **assess the sustainability performances** of the issuers

2. Including sustainability into risk management

6. Action 6: Rating and market research

- Moral suasion to include sustainability in **credit ratings**
- Amend ESMA's guidelines on disclosure for credit rating agencies (including sustainability)
- Develop a study on **sustainability ratings**

7. Action 7: Clarifying institutional investors' and asset managers' sustainability duties

- Legislative proposal to clarify such duties, integrating sustainability considerations in the decision-making process, and increasing transparency on sustainability policies and risks

8. Action 8: Incorporating sustainability in prudential requirements

- Amending accordingly CRR and CRD (banks and credit institutions), including climate and environmental factors in institutions' risk management policies

3. Boosting transparency and long-termism

9. Action 9: strengthening sustainability disclosure

- Amending NFRD -> **sustainability reporting directive**
- Revising the NFRD guidelines
- Establishing the European Corporate Reporting Law, as a part of European Reporting Advisory Group
- Asset managers and institutional investors will be required to disclose how they consider sustainability in their decision-making process and in their strategies
- The EFRAG should assess **the impact of IFRSs on sustainable investments**, and if adjustments in IFRSs in terms of sustainability are possible

10. Action 10: Fostering sustainable corporate governance and attenuating short-termism in capital markets

- Exploring the need to require corporate boards to develop and disclose a sustainability strategy
    - Including due diligence in supply chain...
- Monitoring markets' short-termism

The European Green Deal

EU's effort towards a sustainable and inclusive growth

Perfectly **in line with the Action Plan**…

…but **not limited to the financial** prospective

Again, included in the EU **response to UN Agenda 2030**

All the chapters are relevant for Green Bonds as they include activities likely to be financed by such securities

The EGD's main chapters

1. Increasing the EU's climate ambition for 2030 and 2050

- Key elements: EU candidates to be the world leader in terms of sustainability
- Proposal for EU Climate Law
- Achieving climate neutrality by 2050, transforming the economy
- Reduction of greenhouse gas emissions target for 2030 to 50-55% compared with 1990 levels

2. Supplying clean, affordable and secure energy

- Further decarbonisation
- Revision of MSs energy and climate plans
- Transition towards clean energy with benefits for consumers
- Address the risk of energy poverty
- Smart infrastructure to support climate neutrality

The EGD's main chapters

3. Mobilising industry for a clean and circular economy

- The industry is needed for achieving a climate neutral and circular economy
- Expansion of sustainable and job-intensive economic activity
- **New EU circular economy action plan**
  - Including strengthening the extended producer responsibility and a 'sustainable products' policy
  - Considering resource-intensive sectors as well, with specific action
  - Encourage 'Right to repair'
- Modernisation of energy-intensive industrial sectors
- Fighting the greenwashing by means of increased (and reliable) disclosure
- Reducing unnecessary waste
- A new way to secure resources and raw materials
- Cooperation with industry and investments in essential value chains
  - E.g. batteries
- Digital technologies, and improved energy efficiency

The EGD's main chapters

4. Building and renovating in an energy and resource efficient way

- Building sector
- 'Renovation wave' in both public and private buildings
- Enforcing the legislation on energy performance
- New initiatives on renovation in 2020

5. Accelerating the shift to sustainable and smart mobility

- Boosting multimodal transport
- Automated and connected mobility
- Linking the price of transport with the impact on the environment
- Fostering the development of sustainable alternative transport fuels
- Specific focus on cities

The EGD's main chapters

6. From farm to fork strategy

- Fair, healthy and environmentally-friendly food system
- New opportunities in the food value chain
- Specific attention to European farmers and fishermen
- Reducing chemicals pesticides, fertilisers and antibiotics
- Farm to fork and circular economy
- Stimulating sustainable food consumption

The EGD's main chapters

7. Preserving and restoring ecosystems and biodiversity

- EU biodiversity strategy
- EU forest strategy
- **Promoting a central role for a 'blue economy'**

8. Zero pollution ambition for a toxic-free environment

- Revision of the measures to address pollution from large industries
- Reduce hazardous chemicals and support the development of sustainable alternatives

More in general

Key role for **private sector**: renewed **sustainable financial strategy** to be developed at EU level

- **Taxonomy** (seen yesterday)
- Embedding sustainability in **corporate governance**
  - Promoting long-termism
- **Disclosure**, to inform fully the investors
- Developing **natural capital accounting practices**
- **Labelling** and **Green Bond Standards**
- **Integrating climate and environmental risks in the financial system**
  - Prudential framework
  - Capital requirements for green assets

NF and Sustainability Reporting Directive

- Need to **improve undertakings' disclosure of social and environmental information** (Commission's Communication 2011)
- Importance of **businesses divulging information on sustainability** such as **social** and **environmental** factors, with a view to identifying sustainability risks and increasing investor and consumer trust (EU Parliament Resolutions 2013)
- **Non-Financial Reporting Directive (NFRD): Directive 2014/95/EU**
- Provides for amendments to **Directive 2013/34/EU on auditing**
  - Formally, the **provisions are provisions of Directive 2013/34/EU**

NF and Sustainability Reporting Directive

- Disclosure of non-financial information helps the measuring, monitoring and managing of undertakings' performance and their impact on society (Recital 3, NFRD)
- Importance of corporate sustainability reporting and encourages undertakings, where appropriate, to consider integrating sustainability information into their reporting cycle (also with a view to development of best practices) (Paragraph 47 of the outcome document of the United Nations Rio+20 conference, entitled 'The Future We Want', Recital 11)
- **New Directive (Corporate Sustainability Reporting Directive - CSRD) Directive (EU) 2022/2464, applicable from 2025 (financial year 2024) on**

Basic principles (i)

- **Coordination of national provisions**
- Coordination **limited to large enterprises** (default rule) ["This should not lead to undue additional administrative burdens for small and medium-sized undertakings": Recital 8 + Recital 13: "think small first" to reduce overall regulatory burden for SMEs]
  - Currently: around 11,700
  - **With the CSRD: around 50,000**
- **Minimum legal requirements for the extent of the information**
- Large undertakings must prepare non-financial statements regarding, at least:
  - **Environmental** matters
  - **Social** and **employee-related** matters
  - **Respect for human rights**
  - **Anti-corruption and bribery matters**

Basic principles (ii)

- Information on the **due diligence** adopted
- **Supply and subcontracting** chain approach
- **Comply or explain** if Member States allow this

In general: here the whole company is considered, **not just the financial products** issued

Environmental issues

- **details** of the **current and foreseeable impacts** of the undertaking's operations on the environment, and, as appropriate, on health and safety;
- the **use of renewable and/or non-renewable energy**;
- **greenhouse gas** emissions;
- **water use**;
- **and air pollution**.

Social and employee-related matters

- **actions** taken to ensure gender equality;
- implementation of **fundamental conventions** of the International Labour Organisation;
- **working conditions**, social dialogue, respect for the right of workers to be informed and consulted, respect for trade union rights;
- **health and safety** at work;
- and the **dialogue** with local communities, and/or the **actions** taken to ensure the **protection** and the **development** of those communities

Other issues

- Human rights and anti corruption and bribery
  - **information** on the prevention of human rights abuses
  - and/or on **instruments** in place to fight corruption and bribery

Information to be disclosed (i)

Matters that stand out as being **most likely** to bring about the **materialisation of principal risks of severe impacts**, along with those that have **already materialised**. The severity of such impacts should be judged by their scale and gravity. The risks of adverse impact may stem from the **undertaking's own activities** or may be linked to its **operations**, and, where relevant and proportionate, its **products**, services and business relationships, including its **supply** and **subcontracting chains** (Recital 8)

Information to be disclosed (ii)

- **Double materiality principle** (outside-in: incorporating sustainability; and inside-out: externalising good impact)

- According to **national**, **European**, or **international standards** (Recital 9)
  - **With the CSRD also specific Sustainability Reporting Standards**
- **MS** shall ensure **adequate and effective disclosure** (compliance and enforcement)

Scope of application

- Defined by reference to the **average number of employees**, **balance sheet total** and **net turnover**. [T]he obligation to disclose a non-financial statement should apply only to those **large undertakings** which are **public-interest entities** and to those **public-interest entities** which are **parent undertakings of a large group**, in each case having an average number of employees in excess of 500, in the case of a group on a consolidated basis. (Recital 14)
  - Art. 19a(1):

  "Large undertakings which are public-interest entities exceeding on their balance sheet dates the criterion of the average number of 500 employees during the financial year"
- Just a **default rule**: "This should not prevent Member States from requiring disclosure of non-financial information from undertakings and groups other than undertakings which are subject to this Directive."
- **Consolidated management reports** in the case of groups of companies (harmonization needed)

Reliability of the information

- Statutory auditors and audit firms **only check** that the non-financial statement or the separate report **has been provided**.
- MS **may** "require that the information included in the non-financial statement or in the separate report [is] **verified** by an **independent assurance services provider**". (Recital 16 + Art. 19a.5 and .6)

- **N.B.: with the CSRD the assessment becomes mandatory!**

Corporate governance issues

- (18) **Diversity of competences** and **views** of the members of **administrative**, **management** and **supervisory bodies** of undertakings facilitates a **good understanding** of the **business organisation** and **affairs** of the undertaking concerned. It enables members of those bodies to constructively **challenge** the management decisions and to be more open to innovative ideas, addressing the similarity of views of members, also known as the 'group-think' phenomenon. It contributes thus to **effective oversight** of the **management** and to **successful governance** of the undertaking. It is therefore important to enhance transparency regarding the diversity policy applied. This would inform the **market of corporate governance practices** and thus put **indirect pressure** on undertakings to have **more diversified boards**.

Corporate governance issues

- (19) The obligation to **disclose diversity policies** in relation to the administrative, management and supervisory bodies with regard to aspects such as, for instance, age, gender or educational and professional backgrounds should apply only to certain large undertakings. **Disclosure of the diversity policy should be part of the corporate governance statement**, as laid down by Article 20 of Directive 2013/34/EU. **If no diversity policy is applied there should not be any obligation to put one in place, but the corporate governance statement should include a clear explanation as to why this is the case.**

The statement

Art. 19a.1

- In the Management Report
- "Containing information to the **extent necessary for an understanding** of the undertaking's **development**, **performance**, **position** and **impact of its activity**, relating to, as a minimum, **environmental**, **social** and **employee matters**, respect for **human rights**, **anti-corruption and bribery** matters, including:
  - (a) a brief description of the undertaking's business model;
  - (b) a description of the policies pursued by the undertaking in relation to those matters, including due diligence processes implemented;
  - (c) the outcome of those policies;
  - (d) the principal risks related to those matters linked to the undertaking's operations including, where relevant and proportionate, its business relationships, products or services which are likely to cause adverse impacts in those areas, and how the undertaking manages those risks;
  - (e) non-financial key performance indicators relevant to the particular business.

  Where the undertaking does not pursue policies in relation to one or more of those matters, the non-financial statement shall provide a clear and reasoned explanation for not doing so."

Minimum European requirements

- Environmental, social and employee matters, respect for human rights, anti-corruption and bribery matters
- Description of policies (but not obligation to establish policies)
- Non-financial key performance indicators relevant to the particular business (who decides if they are relevant?)
- **Comply or explain policy**
    - **Much less relevant with the new Directive**
- Links to the **financial** statements ("The non-financial statement referred to in the first subparagraph shall also, where appropriate, include references to, and additional explanations of, amounts reported in the annual financial statements")
- Subsidiary undertakings exempted from the reporting obligation if included in consolidated management report (Art. 19.3)

Exceptions (i)

- MS may allow **some information to be omitted in exceptional cases**, where, "in the duly justified opinion of the members of the administrative, management and supervisory bodies (…), the **disclosure of such information would be seriously prejudicial to the commercial position of the undertaking**, provided that **such omission does not prevent a fair and balanced understanding** of the undertaking's development, performance, position and impact of its activity." (Art. 19a.1, **now 19a.3**)

Exceptions (ii)

- "Where an undertaking prepares a **separate report** corresponding to the same financial year whether or not relying on national, Union-based or international frameworks and covering the information required for the non-financial statement as provided for in paragraph 1, **Member States may exempt** that undertaking from the **obligation to prepare the non-financial statement** laid down in paragraph 1, provided that such separate report:
    - is published together with the management report in accordance with Article 30; or
    - is made publicly available within a reasonable period of time, not exceeding six months after the balance sheet date, on the undertaking's website, and is referred to in the management report." (art. 19a.4)
- **With the CSRD: to be mandatorily included in the management report (art. 19a.1)**
    - And no general exemption, but "lighter" reports for "small and non-complex institutions" (art. 19a.6)

Consolidated statements

- **Public-interest entities** which are parent undertakings of a large group exceeding on its balance sheet dates, on a consolidated basis, the criterion of the average number of 500 employees during the financial year
- **Same information as the single-entity** statement, and equally linked to the financial statements
- Always **comply or explain**
  - **See above**
- Same rules for exceptions and reliability/assessment (Art. 29a)

Corporate governance

- In the corporate governance statement of the Management report the **diversity policy** must be stated:
  - in relation to the undertaking's administrative, management and supervisory bodies
  - age, gender, or educational and professional backgrounds, the objectives of that diversity policy, how it has been implemented and the results in the reporting period
- **Comply or explain**
- Assessed by the Statutory auditor or audit firm (Art. 20.3)
- Possible MS exemption for those companies "which have only issued securities other than shares admitted to trading on a regulated market", unless they have issued shares traded in a multilateral trading facility (Art. 20.4)
- **General exemption for SMEs** (Art. 20.5)

Liability for compliance

- **Member States** shall ensure that the **members of the administrative**, **management** and **supervisory** bodies of an undertaking, acting within the competences assigned to them by national law, have **collective responsibility** for ensuring that:
  - (a) the **annual financial statements**, the management report, the corporate governance statement when provided separately and **the report referred to in Article 19a(4)**; and
  - (b) the **consolidated financial statements**, the consolidated management reports, the consolidated corporate governance statement when provided separately and **the report referred to in Article 29a(4)**,

are **drawn up and published in accordance with the requirements of this Directive** and, where applicable, with the international accounting standards adopted in accordance with Regulation (EC) No 1606/2002. (art. 33.1)

With the new Directive, art. 33.1 mentions also the Sustainability Reporting Standards

News from the Taxonomy Regulation

- The **Taxonomy Regulation** included **further obligations** in terms of **disclosure** (art. 8)
- Inclusion of information on ***how* and *to what extent*** the undertaking's activities are **associated with economic activities covered by the Taxonomy regulation**, and in particular:
  - Proportion of turnover derived from sustainable activities (products and services)
  - Proportion of capital expenditure and operating expenditure related to assets or processes associated with sustainable economic activities
- **Delegated act**, specifying content and presentation of the information, and defining the methodology to be used, is expected

The CSRD – major news

- More involved companies (around 50,000)
- Less room for comply or explain
- The assessment becomes mandatory
- The report is not "non-financial" any longer…
- …and it must come with the Management Report
- Specific sustainability reporting standards to be elaborated
- Single electronic reporting format

Financial services sector

- Regulation (EU) 2019/2088 (+ Reg. 2019/2089 on climate transition Paris-aligned benchmarks)

- Addressed to "financial market participants" (e.g.: pension fund, alternative investment fund, insurances, investment undertakings…)
- Definition of "sustainable investment" (art. 2.17)

"an **investment in an economic activity** that **contributes to an environmental objective**, as **measured**, for example, **by key resource efficiency indicators on the use of energy, renewable energy, raw materials, water and land, on the production of waste**, and greenhouse gas emissions, or on its **impact on biodiversity** and the **circular economy**, or an investment in an economic activity that contributes to a social objective, in particular an investment that contributes to **tackling inequality or that fosters social cohesion, social integration and labour relations**, or an **investment in human capital or economically or socially disadvantaged communities**, provided that such investments do not significantly harm any of those objectives and that the investee companies follow good governance practices, in particular with respect to sound management structures, employee relations, remuneration of staff and tax compliance"

Disclosure

1. Policies on sustainability risks in investment decision-making (and advisors in their advice) – websites (art. 3)
2. Transparency of adverse sustainability impacts *for the entity*: statement on due diligence (information on policies, actions, engagement, adopted business conduct codes) – just if they have 500+ employees; comply or explain; similar rules for financial advisors - websites (art. 4)
3. Remuneration policy (linked with sustainability) (art. 5)
4. Information in pre-contractual disclosure on integration of sustainability risks (integrated with many disclosure provisions) (art. 6)

Disclosure

5. Transparency of adverse sustainability impacts *for the financial product* (art. 7) (linked to art. 6: to be included in the pre-contractual disclosure)
6. Transparency of *promotion* of environmental or social characteristics in pre-contractual (art. 8; linked to art. 6) (technical standards to be adopted by ESAs)
7. Transparency of sustainable investments in pre-contractual disclosure (art. 9) (linked to art. 6) (information on benchmarks and indexes)
8. Transparency of ESG promotion on websites and periodic reports (arts 10 and 11)