

Chapter 2

ESMA identified its priorities in sustainable finance road map 2022-2024

This article aims to:

Summarise key points from the ESMA sustainable finance road map 2022-2024

Introduction

On 11 February 2022, the European Securities and Markets Authority (ESMA) published its Sustainable Finance Road map 2022-2024. In the road map, ESMA stated its priority areas and actions for 2022–2024.

ESMA has highlighted that beyond the activities in the road map, ESMA will continue to monitor major European Union (EU) and international developments and contribute as needed to the various initiatives in the sustainable finance area. These areas would include the EU Platform on Sustainable Finance, International Organisation of Securities Commission (IOSCO) as well as in relevant workstreams within the network for greening the financial system.

This will help ensure that all of ESMA's sustainable finance work is considered, and is compatible with, international initiatives.

Important elements of the road map

ESMA provided following two broad rationale for the development of the road map:

- Ensuring timely and coordinated action to fulfil its mandate in a rapidly evolving area on the basis of clear priorities that will direct ESMA's work both at the level of the individual sectors and transversally across the different sectors.
- Having a tool that enables the regular stock-taking on ESMA's progress towards fulfilling the identified priorities and, where needed, re-assessing/

adjusting the implementation actions envisaged or the priorities themselves, also in the light of developments at European or international level.

The sustainable finance road map is based on the ESMA's Strategy on Sustainable Finance 2020 and this is the first time it has developed this type of road map. The road map will help coordinate, prioritise and provide the sequence in which ESMA should respond to the supervisory needs emerging in the sustainable finance area over the next three years.

The Sustainable Finance Road map is structured as follows

Identification of priority areas: The two main building blocks of the road map are the identification of priority areas and the most impacted sectors. Additionally, it discusses the individual priorities and the reasoning underlying their identification in terms of challenges encountered by National Competent Authority (NCAs) and/or ESMA and the categories of follow-up actions that are envisaged under each priority.

List of actions: The road map provides a comprehensive list of planned actions and deliverables in the area of sustainable finance. The action plan covers eight areas and activities in the most impacted sectors (i.e. investment management, investment services, issuers' disclosure and governance, benchmarks, ratings, trading and post-trading, and financial innovation). The actions and deliverables are accompanied by an indicative timeline.

Challenges to the sustainable finance

The road map discussed following key challenges to the current sustainable finance:

- Fast-evolving regulatory framework that is unequally covering various parts of the sustainable investment value chain
- Diversity in the interpretation and application of sustainable finance legislation with the risk of inconsistent application across the EU and resulting detrimental consequences
- Growing demand for ESG investments not matched by adequate transparency and comparability on the real sustainability impact of the financial products available in the market
- The EU climate neutrality targets will imply that several economic activities will be on a transition path to becoming sustainable within a certain timeframe
- Need to further develop ESMA's and NCAs' expertise, experience and resources on sustainable finance and its implications for supervision
- Increasing risk of misalignment between investors' ESG preferences and products being offered to them, partly due to limited financial education on ESG-investing and lack of expertise on ESG matters
- Fast-evolving ESG markets requiring regular monitoring in a structured and coordinated way

Sustainable finance priorities

Actions to address these challenges relating to sustainable finance have been grouped into three main areas which constitute the three priorities for ESMA's sustainable finance work in the period 2022-2024. They are given below:

Tackling greenwashing and promoting transparency	Building NCAs' and ESMA's capacities	Monitoring, assessing and analysing ESG markets and risks
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The following section will explain the main key challenges surrounding the identified priorities and actions identified to address the priorities.

1. Tackling greenwashing and promoting transparency

ESMA discusses greenwashing as market practices, both intentional and unintentional, whereby the publicly disclosed sustainability profile of an issuer and the characteristics and/or objectives of a financial instrument or a financial product either by action or omission do not properly reflect the underlying sustainability risks and impacts associated to that issuer, financial instrument or financial product.

The combination of growing demand for ESG investments and rapidly evolving markets

creates room for greenwashing. Greenwashing is a complex and multifaceted issue which takes various forms, has different causes, and has potential to detrimentally impact investors looking to make sustainable investments. Regulatory arbitrage can also be one phenomenon that leads to greenwashing. A convergent understanding and application of legislative requirements is therefore crucial to ensure that the EU's sustainable finance framework has a real and profound impact.

ESMA states that investigating the complex issue of greenwashing, getting to defining its fundamental features and taking coordinated action in multiple sectors to find common solutions will be the key to investor protection.

ESMA observes that, in an ideal scenario, NCAs and ESMA would tackle greenwashing based on a complete and fully applicable legislative regime setting the boundaries of the type of market behaviour and practices that are and are not permissible.

ESMA proposes following categories of actions to address this priority:

- **Shared understanding on key concepts of greenwashing:** ESMA plans to organise case discussions among NCAs to establish a shared understanding of key concepts focussed on greenwashing. This will include identifying the key features of greenwashing practices, getting to a comprehensive definition of the

phenomenon and identifying related examples, also relying on existing literature (e.g., IOSCO Consultation Report on Sustainability-Related Practices, Policies, Procedures and Disclosure in Asset Management).

- **Issue guidance in relation to sustainable finance single rulebook:** ESMA plans to provide guidance to the market and NCAs on how to apply various rules in the sustainable finance single rulebook. This will help ensure consistent and effective application of the EU sustainable finance rulebook which will be the key to prevent greenwashing.
- **Develop a common understanding:** ESMA will help develop a common understanding of NCAs' supervisory role in the area of sustainable finance and specifically on greenwashing. It would be important to understand the extent to which NCAs should assess the degree of greenness of financial products and issuers' practices and how they may succeed in carrying out such assessments, considering their current supervisory toolkits.
- **Contribute to EU single rulebook on sustainable finance:** A complete, clear and consistent set of rules and supervisory and enforcement powers is a precondition for effective supervision and enforcement at national level and for supervisory convergence at EU level, both important building blocks in preventing greenwashing. ESMA will contribute

to the completion of the EU single rulebook on sustainable finance while promoting its consistency with international initiatives.

- **Collect and study evidence:** ESMA will collect and study evidence regarding the functioning of ESG markets and products as well as cases of greenwashing to better understand current and developing market practices.

2. Building NCAs' and ESMA's capacities

Sustainable finance requires going through a 'learning curve' in order to ensure that the supervisory implications of the new legislation as well as the basics of the sustainability transition are well understood and become mainstream in NCAs and ESMA. Sustainable finance requires NCAs to have a good handle not only of the relevant legislation but also a good understanding of the intersection between sustainability matters and finance. This complex skill set needs to be reinforced across most NCAs. Doing so will require training initiatives at both national and European level as well as sharing supervisory experiences among NCAs.

In the above background, ESMA proposes following actions to address this priority:

- **Sustainable finance training plan for staff of the NCAs and ESMA:** ESMA plans to facilitate exchange of knowledge and information on ESG-related initiatives between NCAs through the development and implementation of a 'Sustainable Finance Training Plan' for staff of

the NCAs and ESMA. The Sustainable Finance Training Plan would be built on a collective ESMA-NCA effort and provide a sequenced approach to developing, offering, and facilitating training activities. The intent is to leverage on existing materials developed by ESMA and NCAs but, as far as possible, also build on expertise of external organisations.

- **Case discussions:** ESMA would be organising regular supervisory and enforcement case discussions in relevant ESMA standing committees/networks and discussions with consultative working groups on sustainable finance-related topics. This will help ensure that NCAs can exchange experiences on real-life supervisory and enforcement cases, on the challenges they face and on solutions or initiatives adopted to address them will be a useful tool to build capabilities and a shared culture on these emerging topics.
- **Supervisory standards:** ESMA would develop common supervisory standards on key ESG-related matters.

3. Monitoring, assessing and analysing ESG-related markets and risks

The rapid evolution of ESG requirements creates new investment opportunities but it also creates new risks to investor protection, orderly markets and financial stability. Due to which ESG markets and products in particular sustainable investment vehicles and debt instruments such as ESG funds and green bonds should be closely monitored.

In addition, climate change is expected to have a growing impact on global financial markets in coming years. Therefore, tools such as stress testing and scenario analysis are needed to enable the assessment of climate transition and physical risks. However, risk monitoring and assessment is hampered by issues such as data availability and data quality. The situation is particularly challenging for entities facing disclosure requirements in the short to medium term, such as asset managers.

ESMA proposes following actions to address this priority:

- **Clear set of rules and powers:** By supporting single rulebook and convergence initiatives ESMA will contribute to a complete and clear set of rules and powers. Its policy work relies on collecting and studying empirical evidence grounded in analytical work that monitors ESG markets, ESG products as well as cases of greenwashing.
- **Climate change stress tests:** ESMA will continue the work on climate change scenario analysis and further mediate on this with the other ESAs¹, the ECB and the European Environment Agency, including on EU-wide stress testing of the financial system. This exercise entails providing guidance for bottom-up climate change stress tests to be used by supervisors and supervised entities, conducting EU-wide climate stress tests to assess the resilience of the financial sector.

- **Assess data availability and quality issues:** ESMA will assess issues with data availability and quality affecting market participants' reporting obligations as well as the users of this data. These issues will be considered when amending existing reporting obligations or proposing new ones to reflect the specificities of ESG data.
- **Digital innovation and sustainability:** ESMA will work towards better understanding the interaction between digital innovation and sustainability. This will be done by exploring use cases of innovative technologies that help channel investments into sustainable objectives and assist transition to a greener economy through the European Forum of Innovation Facilitators (EFIF) and organising workshops and trainings.
- **Synergy and global consistent approach:** ESMA will be engaging with the relevant international fora to benefit from synergies and promote globally consistent approaches.



1. European Supervisory Authority

Other considerations

The road map recognises that the three priorities are intertwined with each other in certain respects. For example, the work to address greenwashing needs to be backed by a robust knowledge of sustainable finance-related matters and a sound understanding of ESG markets.

Further, ESMA also identified sectors where ESG-related risks and problems are currently perceived as having the highest potential impact on investor protection, orderly markets and financial stability. These are the sectors for which the challenges and the three priorities identified are most impactful and/or those in which key pillars of the EU sustainable finance architecture are established.

The Sustainable Finance Road map primarily concerns the following sectors:

- Investment management
- Investment services
- Issuers' disclosure and governance
- Benchmarks
- Ratings (credit ratings and ESG ratings)
- Trading and post-trading, and
- Financial innovation.

The sectoral classification of actions would help ESMA to better coordinate and ensure that different pieces of EU sustainable finance legislation within ESMA's remit are built, applied and supervised consistently.

Next steps

ESMA has embarked on the first road map and activities to ensure successful achievement of its plans. ESMA will keep the road map, including the identified priorities and the sectors of focus, under review during the entire implementation period of 2022 to 2024. This will ensure that it continues to address the most significant challenges related to ESMA's sustainable finance mandate, as this important field continues to evolve.