UNIMORE
UNIVERSITÀ DEGLI STUDI DI MODENA E REGGIO EMILIA

Dipartimento di Giurisprudenza

The European pro-sustainability policies

Alessio Bartolacelli

Associate Professor of Italian and European Business Law

Sustainability

Difficult definition, blurred concept

The currently most convincing idea: “securing **social foundations** within **planetary boundaries**” (Sjåfjell & Bruner, 2020)

Dimensions:

- **E**nvironmental (planetary boundaries)
    - pollution
    - climate change
    - biodiversity preservation
    - waste of water
    - ocean acidification
    - …

Sustainability

- **S**ocial (social foundations)
  - gender equality
  - social equality
  - peace and justice
  - healthcare
  - food, housing
  - energy
  - education, work, transportation
  - …

[- **G**overnance (*how?*)]
  - both private (corporate), and public

ESG ▶ **SDGs** (UN Agenda 2030)

It usually implies…

… a **long-term approach**, as the consequences only can be appreciated in the long run

- let's consider this from the firm's point of view

Long-term also deals with **replicability** by future generations

- impact on the environment (not only)
- possibility for future development (social)

Firms and enterprises are **encouraged** (not bound, or at least not necessarily) to act sustainably by

- **reputation**
- **public policies** (awarding regulation)
- specific shareholders/investors **beliefs**

How to deal with sustainability?

A holistic approach is needed: the EU roadmap

- **Substantive rules at national level**
- **European rules for the development of a sustainable single market**
    - **Definitions: taxonomy**
    - **Companies: activities, capital and debt**
    - **Finance**
    - **Disclosure**
    - **Due diligence in the value chain**

Therefore…

Integration of sustainability into the global financial system* in order to promote *sustainable development

- Sustainable Development Goals (UN Agenda 2030 as a driver)

Key issue: ***integration***, **not replacement**. Sustainable finance is intended to **balance** financial returns with public interest goals, not just promote the latter

- financial sustainability matters, as well
- balance is left to the issuer (and assessment to the market)
- in general, and popular terms: “doing well, by doing good”

The key problems

Define

- when green is green?
- when social is social?

Easier with environmental issues, more difficult for social ones

- objective and material data, more than personal beliefs

Measure

– basically: **impact**

– “non-financial”?

– actually, they do have a financial impact!

Why? Avoiding big risks

Greenwashing…
…and **social-washing**

Impact and **reporting** are fundamental

But also: reports addressed to… **whom**?
- **investors**
  - not just directly: also, **credit agencies**
- **banks**
- **general public** ▶ reputation

Fallouts on technical profiles in the drafting (e.g., machine readability improves also international investments)

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

More from the EU?

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

- **EU Taxonomy Climate Delegated Act**

- Proposal for the **reform of the Non-Financial Reporting Directive** (eventually: **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 (adopted)**
- **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) that had 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 eco-sustainability system: we need to 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 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 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

2. Including sustainability into risk management

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

3. Boosting transparency and long-termism

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**

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

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

The EU Taxonomy

The backbone of European sustainability strategy

The only instrument of **hard law** we have been discussing so far

- Implementing the principles of the Action Plan, and of the EU Green Deal
- But also **serving as guiding principles** for the delegated acts

Basically, it's the answer to the question: **"How green green should be in order to be considered green?"**

Green projects must contribute to **at least one** of its six environmental objectives

Regulation (EU) 2020/852

Aims at establishing "a framework to facilitate sustainable investment", besides amending a further EU Regulation (2019/2088)

The key purpose

Art. 1.1

“This **Regulation establishes the criteria** for determining whether an economic activity qualifies as environmentally sustainable for the purposes of establishing the degree to which an investment is environmentally sustainable”

The **criteria only**: the actual determination is made under the **delegated acts** for the relevant areas of interest (see below)

And is applicable to

- **The MSs and the EU** itself
- **Financial markets participants** that make available financial products
- **Enterprises that are obliged to publish non-financial statements** pursuant to the Directive 2013/34/EU

And applicable for:

- **Bonds**, of course
- **Other financial products** (art. 4)
- ***Reasonably, not shares…***

The definitions (art. 2)…

…show very clearly the *acquis communautaire* in the field of environment, due to the many cross references

- e.g.: ‘greenhouse gas’, ‘waste hierarchy’, ‘pollution’, ‘good environmental status’…

- Note worth: ***‘Circular economy’*** *means an economic system whereby the value of products, materials and other resources in the economy is maintained for as long as possible, enhancing their efficient use in production and consumption, thereby reducing the environmental impact of their use, minimising waste and the release of hazardous substances at all stages of their life cycle, including through the application of the waste hierarchy*

Environmentally sustainable economic activities

Criteria: the sustainable economic activity

(a) contributes substantially to one or more of the environmental objectives set out by the regulation;

(b) does not significantly harm any of the **environmental** objectives set out in Article 9;

(c) is **carried out in compliance with the minimum safeguards** laid down in Article 18;

(d) complies with **technical screening criteria** that have been established by the Commission

N.B.: all the four criteria must be met **jointly**…

Specific disclosure duties

Pre-contractual and **periodic** reports

Basically: **prospectus**

The key idea is to have a disclosure of the

- **Environmental objectives** the financial products contributes to; and
- ‘a **description of how and to what extent** the investments underlying the financial product **are in economic activities that qualify as environmentally sustainable**’, with a specific reference to the ***proportion*** *of environmentally sustainable economic activities as a* ***percentage*** *of all investments selected for the financial product*

N.B.: just **each financial product**, *not* the issuer as a whole

A couple of principles and six objectives

Principle 1:

“**Do no significant harm**” [Reg. (EU) 2019/2088, whereas 17 and art. 2 (17)]:

‘To ensure the coherent and consistent application of this Regulation, it is necessary to lay down a **harmonised definition of ‘sustainable investment’** which provides that the investee companies follow good governance practices and the precautionary principle of ‘do no significant harm’ is ensured, so that neither the environmental nor the social objective is significantly harmed.’

Minimum safeguards (OECD and ILO principles)

Principle 2:

No significant harm to **environmental** objectives: it is not possible promoting one, while damaging others. That activity is not deemed to be sustainable

- Also considering not just the activity but its products’ lifecycle

A couple of principles and six objectives

The objectives (to be achieved by means of economic activities):

(a) climate change mitigation;

(b) climate change adaptation;

(c) the sustainable **use and protection of water** and marine resources;

(d) the transition to a **circular economy**;

(e) pollution prevention and control;

(f) the protection and restoration of **biodiversity** and **ecosystems**.

Each of them is carefully described an arts 10 to 15. Here just a few examples

Contribution to climate change mitigation

- Substantial contribution…

- Stabilisation of **greenhouse gas concentrations** in the atmosphere by, i.a.,
    - Improving **energy efficiency**
    - Increasing climate-neutral mobility
    - Producing clean and efficient fuels
    - …

Contribution to climate change adaptation

- Substantially, again…

- The economic activity:
  - ‘(a) includes **adaptation solutions that either *substantially reduce the risk of the adverse impact of the current climate and the expected future climate* on that economic activity** *or* ***substantially reduce that adverse impact***, *without increasing the risk of an adverse impact on people, nature or assets*; or
  - (b) provides adaptation solutions that, in addition to satisfying the conditions set out in Article 16, contribute substantially to preventing or reducing the risk of the adverse impact of the current climate and the expected future climate on people, nature or assets, without increasing the risk of an adverse impact on other people, nature or assets.’

Substantial contribution to the sustainable use and protection of water and marine resources

The activity contributes to achieving the good status of bodies of water, by, i.a.:

- Protecting the environment from **wastewater discharges**
- Protecting human health from the adverse impact of **contaminations of water**
- Improving water management and efficiency
- …

Substantial contribution to the transition to a circular economy

The activity contributes to the **transition to a circular economy**, by, i.a.:

- Increasing the **efficiency in the use of natural resources**, also reducing the use of primary raw materials or increasing the use of by-products and secondary raw materials
- Increasing **durability, reparability, upgradability**… of products
- Increasing **recyclability of products and materials**
- Developing high-quality recycling of waste
- Reducing waste generation…

Substantial contribution to pollution prevention and control

The activity contributes to achieving the pollution prevention and control, by, i.a.:

- **Reducing pollutant emissions** into air
- **Preventing or minimising any adverse impact** on human health and the environment of the production, use or disposal of chemicals
- Cleaning up litter and other pollution
- …

Substantial contribution to the protection and restoration of biodiversity and ecosystems

The activity contributes to the protection, the conservation or the restoration of the **biodiversity** or to the achievement of a **good condition of the ecosystems**, by means of, i.a.:

- Sustainable **agricultural** practices,
- Sustainable **land use** and management
- Sustainable **forest management**…

And, in addition…

- **All the enabling activities**, leading to the abovementioned objectives, are to be considered sustainable if they contribute substantially to one or more among those objectives

- Provided that they **do not undermine long-term environmental goals**, and have a positive environmental impact

Green Bond Standards Regulation

Regulation (EU) 2023/2631

The point is: where does the company take the money it needs from?

- Members
- Banks
- Debt Investors

Bonds are for Banks and Debt Investors: money is to be returned…

…but in the meanwhile, it is used for some specific activities: environment-friendly, hence “green”

Green Bonds: peculiarities

Need to identify the proper activities -> Taxonomy

Need of reliability

Third-party external assessment

Supervision by ESMA

Besides green bonds: Sustainability-linked bonds

Proceeds are not used for a green project, but for an enhancement of the level of sustainability of the company itself

If the company does not meet the Key Performance Indicator originally disclosed, has some penalties

Problem: the taxonomy is available only for environmental activities, so far…

These bonds are nevertheless hugely relevant: common European Framework for debt

Corporate Sustainability Due Diligence Directive

Directive (EU) 2024/1760

Nice example on how the European lawmaking activity takes place

The idea:

"foster sustainable and responsible corporate behaviour in companies' operations and across their global value chains. The new rules will ensure that companies in scope identify and address adverse human rights and environmental impacts of their actions inside and outside Europe."

Due diligence?

identifying and addressing…

…potential and actual…

…adverse human rights…

…and environmental impacts…

…in the large company's own operations,…

…their subsidiaries…

and, where related to their chain(s) of activities, those of their business partners.

The initial scope of application is rather little…

…but there is a huge cascade effect!

Due diligence?

All of this is to be made considering obligations coming from International Treaties listed in the Annexes of the Directive

The approach is integration of policies (organization: risk-based), identification (and prioritization), prevention, mitigation, bringing to an end or minimisation, establishment of notification and complaint procedure, monitor the effectiveness, and… disclosure

Then there is a close connection with the area of disclosure (CSRD)

What's the difference? The CSRD is *ex post*; the CSDDD is *ex ante*! And there are specific managerial duties on the company's directors

Criticalities?

Oh, yes, there are always criticalities!

- Costs for enterprises (to establish the due diligence procedure)
    - Even higher for SMEs
- Extra-European scope of application
- Actual scope of the directors’ liability (left to the Member States)
- Direct application of international Treaties (legally debatable)
- …

Non-Financial Reporting Directive & CSRD

See the next presentations!

… and so the Sustainability Disclosure in the Financial Services Sector

Thank you very much for your attention!

alessio.bartolacelli@unimore.it