Università di Genova | DIGI DIPARTIMENTO DI GIURISPRUDENZA

ESMA’s mandate in sustainable finance

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ESMA and sustainable finance

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- Key challenges and ESMA priorities
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ESMA and sustainable finance

A crucial role to:

1. ensure that the financial markets support and promote this shift by integrating environmental, social and governance (ESG) factors across its core activities

2. support the Commission's initiatives as presented in the Action Plan on Financing Sustainable Growth and the Renewed Sustainable Finance Strategy

3. enhance investor protection and promote stable and orderly markets

ESMA Strategy on Sustainable Finance

To this end, in February 2020 ESMA adopted its first Strategy on Sustainable Finance. The Strategy sets out key objectives which can be summarised as follows:

a. **Integrating sustainability in the development of the single rulebook**

b. **Building common approaches for incorporating Environmental, Social and Governance (ESG) factors in the supervisory practices of NCAs**

c. **Monitoring market developments and identifying risks related to sustainable finance**

d. **Improving transparency on the role of ESG factors in the credit rating process.**

Key challenges:

1. Fast-evolving regulatory framework
2. Diversity in the interpretation and application of sustainable finance legislation
3. Growing demand for ESG investments not matched by adequate transparency and comparability
4. Need to further develop ESMA's and NCAs' expertise, experience and resources
5. Increasing risk of misalignment between investors' ESG preferences and products

ESMA priorities:

1. Tackling greenwashing and promoting transparency
2. Building NCAs' and ESMA's capacities
3. Monitoring, assessing and analysing ESG markets and risks

These priorities are intertwined with each other in certain respects.

Tackling greenwashing and promoting transparency

The misalignment between demands for investments that can make a sustainability impact and the available investing opportunities marketed as sustainable.

As such, greenwashing typically gives rise to potential detriment to investors who are looking to allocate resources to sustainable investments.

How greenwashing differs from other types of mis-selling?

What type of marketing communication can be regarded as faithful with respect to the sustainability nature of certain financial products and what are the different types of sustainable products?

Tackling greenwashing and promoting transparency

Regulatory arbitrage can also be one phenomenon that leads to greenwashing.

Diverging applications of the rules on what constitutes a ‘green’ financial product across the Union.

Lack of comparability, transparency when products with a similar or even the same naming convention do not share the same underlying characteristics.

ESMA tripartite approach to a sustainable finance single rulebook

1. Ensuring the consistent and effective application of the EU sustainable finance rulebook is key to preventing greenwashing.

2. Developing a common understanding of NCAs’ supervisory role in the area of sustainable finance and specifically on greenwashing.

3. Contributing to further completing the EU single rulebook on sustainable finance while promoting its consistency with international initiatives.

ESMA Supervisory Briefing

Sustainability risks and disclosures in the area of investment management

The supervisory briefing is designed around a risk-based approach to supervision, meaning that the intensity and frequency of the sustainability related supervision of investment funds are determined based on the assessment of the risks affecting these funds.

This refers to the whole set of procedures, processes, mechanisms and practicalities allowing competent authorities to exercise their supervisory powers in a way that is commensurate with the identified risks.

The supervisory briefing is issued under Article 29(2) of the ESMA Regulation which enables ESMA to develop new practical instruments and convergence tools such as supervisory briefings.

Carbon markets

Voluntary carbon markets are widely considered to have an important role to play in achieving greenhouse gas (GHG) emissions goals.

High-quality voluntary carbon credits (VCCs) are essential to the future development of the voluntary carbon market.

At the global level, the IOSCO workstream on carbon markets commenced this year under the joint chairmanship of the CFTC and ESMA.

It is dedicated to assessing the functioning, and potential risks, of global carbon markets.

Analysis of Regulatory Oversight in the US

As VCC derivatives are considered commodity derivatives, the CFTC and SROs could apply the same oversight tools they use in commodity markets to ensure the integrity of VCCs.

The increased role of established exchanges (and, by extension, the CFTC) in ensuring the integrity of registries will likely increase confidence in VCC markets.

This would translate into better and more reliable pricing for spot and OTC derivatives markets.

Analysis of Regulatory Oversight in the US

On June 2, 2022, the Commodity Futures Trading Commission convened for the first time market participants to discuss the state and the challenges of the U.S. voluntary carbon credit markets and, at the end of the meeting, published a Request for Information on Climate-Related Financial Risk.

CFTC has only a limited enforcement jurisdiction over ESG commodities and specifically carbon credits, allowing the CFTC to prosecute for fraud and manipulation.

European carbon markets

At the European level ESMA will be working to establish a set of good practices and essential features that support the sound, safe and transparent functioning of these markets.

ESMA published an in-depth analysis of the functioning and surveillance of the EU carbon market, in March this year.

ESMA final report unveiled important findings and policy recommendations, notably to further improve transparency and monitoring of the EU carbon market.

European carbon markets

ESMA has also looked at two other possible courses of action on which it does not express policy recommendations but which it would like to raise to the Commission's attention for further consideration.

Those include the introduction of position limits on derivatives on emission allowances and the setting up of a centralised market monitoring of the EU carbon market.

In each case, there are arguments in favour and against any such initiative.

Are position limits on derivatives on emission allowances be necessary?

***Is a centralised market monitoring of the EU carbon market desirable*?**

Is a centralised market monitoring of the EU carbon market desirable?

ESMA experienced difficulties when assembling the data necessary for drafting its report, because the available data on the EU carbon market appears quite fragmented.

Currently, no example exists in the EU of a financial instrument within the remit of ESMA being centrally monitored at European level.

However, wholesale energy markets are centrally monitored by the Agency for the Cooperation of Energy Regulators (ACER).

Is a centralised market monitoring of the EU carbon market desirable?

PRO: emission allowances are very distinct, unique financial instruments created by EU law. The EU carbon market is a very European one by nature.

CONS: the setting up of a centralised monitoring of the EU carbon market would be a major change to the current organisation of market monitoring in the EU.

Is a centralised market monitoring of the EU carbon market desirable?

A final remark …

a more in-depth analysis is required.

Ultimately, a centralised market monitoring at EU level

will raise standards and mitigate the risk of manipulation.

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