Are EU policymakers going down the right path on the sustainable finance policy agenda?

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1. **Do you think the current EU legislative framework on sustainable finance is fit for purpose? What is your assessment of current progress and what else can be done?**

Before addressing what else can be done, I want to put things into perspective and acknowledge the massive progress made so far by the EU and European authorities. Over a very short period, European authorities have developed a framework in which sustainable finance was given space to flourish.

Indeed, we now have new tools, as well as several directives and regulations, in addition to many other documents (guidelines, Q&As, public statements, regulatory technical standards). I am aware that the regulatory effort cannot be measured by the number of pages, but just to provide some perspective, the delegated regulation that supplements the Taxonomy, establishing the technical screening criteria, has more than 350 pages.

Thanks to this legislative effort, the EU has become more ambitious and has put Europe at the forefront of the international arena in developing a framework for sustainable finance. All this is essential for finance to play its role in the sustainable transition and to tackle the risk of climate change.

However, there are still many areas and challenges that need to be addressed. Problems are bound to appear when a new regulatory framework is developed from scratch in such a short period of time. There are some inconsistencies among the different elements of the framework. The framework is excessively complex and could be further simplified. And transparency requirements have been imposed while there is not enough data available and, where this is the case, quality can be questioned. As the saying goes, we are putting the cart before the horse.

As a supervisor, I would like to share the three most pressing challenges ahead.

- First, we need to finalise the legislative framework as soon as possible, and with this I am referring to all the elements relating to ensuring high quality data (such as the Corporate Sustainability Reporting Directive, and the regulation of ESG ratings and ESG data providers). Sustainability standards are still being discussed. We should use proportionality if needed, but without delay.

- Second, we must help consumers and investors to find their way in this new world, particularly retail investors. This means simplifying the framework as much as possible.
- Lastly, we must work on enhancing supervisory convergence and enforcement across jurisdictions and sectors to ensure that there is no greenwashing and that we keep trust in the system.

A lot has been done so far, massive progress has been made, but we must keep working to finalise the legislative framework as soon as possible.

2. **As supervisor, how have you built your approach to identifying greenwashing risks, and in this context could you tell us about the ongoing work at ESMA level to respond to the European Commission request for input on greenwashing mandate?**

Tackling greenwashing is one of our main priorities. ESMA has also identified greenwashing as one of the three priorities of its Sustainable Finance Road Map 2022-24, published in February 2022.

Nevertheless, it is not an easy task. Greenwashing is a broad and transversal concept since it could appear at any point of the investment value chain, and it may affect all types of products and services. Thus, first we need a common understanding of what greenwashing is to then identify the triggers of its risks. This is where the role of European supervisory authorities is key.

When we think about greenwashing, we typically think about mis-selling. And that is correct, but this is just the tip of the iceberg. There are also many other elements across the investment value chain that could trigger these types of risks and spread them across the system. Therefore, we cannot be limited to examining the very last step of the process, the selling process. Greenwashing risks could be originate from the quality of the data disclosed by companies, the information provided by third parties, the claims made by undertaking, or the way an investment fund or a product is classified. Furthermore, greenwashing could also stem from the lack of clarity of the regulatory framework. That means that it could likewise be an unintended consequence of the incomplete regulatory framework and the lack of clarity on how to apply the requirements, which could lead to different interpretations.

So, how can we approach this issue? Taking a broad and horizontal approach, incorporating this analysis in each area of supervision, and acting from a double perspective: ex-ante (with a prevention mode) and ex-post (making use of the enforcement powers that financial supervisors have).

Regarding the ex-ante approach (prevention from happening), a lot has been done so far: publishing guidelines, Q&A, and keeping a close dialogue with all market participants to understand the dynamics of the market and to offer guidance and clarification. We have also been active with investors, engaging with them and providing them with tools to better understand the new disclosures. Regarding the ex-post approach, the Sustainable Finance Disclosure Regulation (SFDR) came into force 18 months ago and now is the time to assess the implementation of the new requirements.

At this point, I very much welcome the work of ESMA and the other two ESAs following the European Commission request for advice on greenwashing risks.

ESMA is working to address this complex issue from three main areas. First, by clearly defining greenwashing and better understanding the phenomenon, identifying potential risk factors. Second, taking stock of the implementation of relevant legislation aimed at addressing greenwashing risks. And third, assessing the supervisory response to the risk of greenwashing and issuing recommendations if needed.

The objective of ESMA is to deliver a first project report around May 2023 and a final report in May 2024. At some point ESMA will probably launch a call for evidence to gather views from various stakeholders on how to understand greenwashing and what the main drivers of greenwashing might be, asking for concrete examples of potential greenwashing practices. This is a learning process for us all, and we appreciate contributions from investors and market participants. We are also working very closely and in a coordinated way with the other ESAs and colleagues.
Greenwashing risk is at the top of the supervisors and regulators agenda for the years to come. Properly addressing this risk is of utmost importance to maintaining trust in the system.

3. **Would the introduction of labels help improve investors understanding of sustainable products and prevent greenwashing? Do you see any risks from the potential introduction of a labelling regime?**

We aim to help investors to better understand the sustainability characteristics of a product, by simplifying the complexity of the information that they receive. And by doing so, avoiding misleading disclosures about the greenness of the product, and reducing the risk of greenwashing.

Introducing sustainability labels could be a good solution. Labels can simplify the selection process for investors, offering a clearer message and simplifying the information on the sustainability of a product. Additionally, labels would help bridge the information asymmetry between providers of financial products, such as asset managers, and final investors.

However, labels also come with some challenges or risks that need to be addressed. Nowadays, many sustainable labels have been developed in different European countries, each of them following a different approach such as some being more restrictive than others. A proliferation of unstandardised labels could lead to confusion, as they increase the noise in the market, potentially creating confusion and deteriorating confidence. This is not to mention the risk of market fragmentation due to the different labels at national level. On the other hand, introducing just one label or a reduced set of them could be too simplistic and it could reduce the eligible investment opportunities.

Nevertheless, I would highlight the risk of misselling coming from the use of ESG terms to name funds that do not match with their investment policy.

The Sustainable Finance Disclosure Regulation (SFDR) is widely used as a label (Art. 8 funds, Art. 9 funds), when it should not be the case since it is just a disclosure regulation. The lack of a clear understanding of the underlying characteristics of Art 8 products are a potential source of greenwashing risk.

It is essential to ensure that funds names are not misleading. The use of terms such as "ESG", "green", "sustainable", "social", "ethical", "impact," or any other ESG-related should be used only if the underlying characteristics of the fund support the latter. Funds shouldn´t market themselves as "green" or "sustainable" while investing in economic activities that significantly harm our environment. This is a role for supervisors, to question and challenge the use of such terms.

There is an important role for ESMA as well, offering guidance on how to approach this risk from a common position. To that end, I very much welcome the guidance published by ESMA last May. The use of term "sustainable" or "sustainability" should be used only by funds disclosing under Art. 9 or under Art. 8 which partly invest in economic activities that contribute to environmental or social objectives. This is a first step to help to avoid confusion for investors, and at the same time enhance supervisory convergence across jurisdictions. So, much to do on this front yet.

4. **What kind of supervisory challenges will national competent authorities face following the application of the new sustainability requirements introduced in MiFID II.**

The integration of sustainability preferences from suitability test is a crucial step forward in fulfilling the European Commission's ultimate purpose: reorienting capital flows towards more sustainable investments. This should be done in an orderly and appropriate manner, so as not to undermine investor protection.

Firms are incorporating sustainability preferences of investors for the first time. Investors are used to being asked about their financial knowledge and their target in terms of financial investments. Now, they will also be asked about what percentage of their portfolio shall be invested in sustainable activities, and in which activities they do not want to invest in, among others sustainability factors.

From a supervisory point of view, it's too early to arrive at any conclusions. MiFID II requirements became applicable on 2 August, just two months ago. And ESMA guidelines on how to integrate those preferences will be published shortly.

However, we can spot some challenges ahead. First and foremost is to ensure that investors understand the new concepts and that they are able to navigate this new world. And this is not straightforward. We know that the legislative framework is quite complex, both for market participants and for us as supervisors. So, it goes without saying, it is complex for investors too. It is extremely relevant to contribute towards investor knowledge, publishing informational materials and reinforcing financial education. We do not want investors to shy away from the market because of their complexity. Companies and firms should help and contribute by explaining in plain, understandable language, the different aspects queried regarding their preferences. It is essential to reduce any expectation gap between what the investor perceives as being green and the actual characteristics of the product. To that end, it is crucial to ensure that investment firms and their personnel have the appropriate knowledge to explain complex concepts in an accessible way.

We are in a process of learning by doing. We want investors to participate in this flourishing market while being protected and properly informed. This is a mutual learning process, which involves all market participants, along with investors and other supervisors.