EBI European Banking Institute

EBI Working Paper Series

2021 – no. 90

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The EU's "green" finance. Can "exit", "voice" and "coercion" be enlisted to aid sustainability goals?

12/04/2021

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THE EU'S "GREEN" FINANCE.

CAN "EXIT", "VOICE" AND "COERCION" BE ENLISTED TO AID SUSTAINABILITY GOALS?

David Ramos Muñoz; Elia Cerrato García; Marco Lamandini*

Abstract: Climate change is humanity's defining problem for this century, and policymakers are trying to reform finance to aid in that goal. The flurry of activity is substantial, but is it enough? In this paper we assess the strength of the means chosen to make finance sustainable, by considering sustainability a "promise", like the financial promise to pay a sum of money, or maximize profits, and comparing the means used to protect one and another promise, using the categories of "Exit", "Voice" and "Coercion" to classify different legal tools. Current proposals are primarily based on transparency, and thus rely primarily on "Exit" mechanisms, and only for some instruments. Since progress is generally slow and hesitant on mechanisms relying on "Voice" and "Coercion", and almost absent in relation to some instruments, we conclude that the current strategy is adequate for creating a market niche for green finance, but as it stands now it is not credible, as such, for the broader goal of greening financial markets as a whole.

I. INTRODUCTION

"*Adaptation means anticipating the adverse effects of climate change and taking appropriate action to prevent or minimise the damage they can cause, or taking advantage of opportunities that may arise. Early adaptation action saves money.*"[1]

1.While 2020 will be the "year of Covid-19", the XXIst will be the century of climate change and of a totally new environmental approach to reality. There is no other more defining problem for humanity. Following in the footsteps of the Paris Agreement[2] the European Commission adopted the decarbonization objectives for 2050,[3] a pledge that has been reinforced by the "European Green Deal" of the new Commission.[4] And yet, since markets are slow to take the hint, the Commission has found itself limited in its room for manoeuvre in fiscal and energy policy, both of which fall mostly with Member States, and show uneven progress.

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[1] EU ACTION ADAPTATION TO CLIMATE CHANGE,: https://ec.europa.eu/clima/policies/adaptation_en (last visited May 21, 2020).

[2] UNITED NATIONS FRAMEWORK CONVENTION ON CLIMATE CHANGE (UNFCCC), THE PARIS AGREEMENT (2015) https://unfccc.int/process-and-meetings/the-paris-agreement/the-paris-agreement (last visited May 21, 2020).

[3] *See* Communication from the Commission to the European Parliament, the European Council, the Council, the European Economic and Social Committee, the Committee of the Regions and the European Investment Bank, A Clean Planet for all A European strategic long-term vision for a prosperous, modern, competitive and climate neutral economy, COM(2018) 773 final (Nov. 28, 2018), https://eur-lex.europa.eu/legal-content/EN/ALL/?uri=CELEX%3A52018DC0773.

[4] *See* Communication from the Commission to the European Parliament, the European Council, the Council, the European Economic and Social Committee, the Committee of the Regions, The European Green Deal, COM(2019) 640 final (Dec. 11, 2019), https://eur-lex.europa.eu/legal-content/EN/TXT/?uri=COM%3A2019%3A640%3AFIN [hereinafter Green Deal Communication].

2.It was only a matter of time until policymakers set their sights on finance. Here specialist bodies can rely on science and expertise without an uphill battle with special interests and squabbling parliamentary factions. Hence the Financial Stability Board (FSB), the Task Force on Climate-related Financial Disclosures (TCFD),[5] the Network for the Greening of the Financial System (NGFS) of central banks and prudential supervisors,[6] and industry bodies, such as the International Capital Markets Association (ICMA) Green Bond Principles (GBP[7]), or the Transition Pathway Initiative (TPI) sponsored by asset owners-and-managers to track the quality of companies' management of greenhouse gas emission against international benchmarks.[8]

3.European policymakers' aspiration is to lead the process. Europe is particularly receptive to sustainability arguments, and finance has become the linchpin of integration with the Banking and Capital Markets Union. Thus, the EU Commission Action Plan on Sustainable Finance[9] signalled an ambitious program of reforms, including a Technical Expert Group (TEG), a unified green taxonomy, reporting requirements, benchmarks and a vast array of other measures.[10] The plan's policy ambition is remarkable. The question is, is it enough?

4.The first doubts arise if, instead of focusing on "green" instruments' growth (impressive), we compare them with the total market volume (puny).[11] Since carving out a market niche is not enough, the Commission Action Plan also refers to the "mainstreaming" of sustainability.[12] Yet, if

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[5] TASK FORCE ON CLIMATE-RELATED FINANCIAL DISCLOSURES (TFCFD), https://www.fsb-tcfd.org/ (last visited May 21, 2020).

[6] NETWORK FOR THE GREENING OF THE FINANCIAL SYSTEM (NGFS): https://www.ngfs.net/en/about-us/governance/origin-and-purpose. (last visited May 21, 2020).

[7] GREEN BOND PRINCIPLES (GBP): https://www.icmagroup.org/green-social-and-sustainability-bonds/green-bond-principles-gbp/. (last visited May 21, 2020).

[8] TRANSITION PATHWAY INITIATIVE (TPI): http://www.lse.ac.uk/GranthamInstitute/tpi/ (last visited May 21, 2020).

[9] *See* Communication from the Commission to the European Parliament, the European Council, the Council, the European Central Bank, the European Economic and Social Committee, the Committee of the Regions on an Action Plan: Financing Sustainable Growth, (COM 2018) 97 final (March 8, 2018) [hereinafter EU Commission Action Plan 2018].

[10] Some of these initiatives were reiterated (albeit more generally). *See* the Green Deal Communication, *supra* note 4, at 16-17. *See also infra* n. 67. The ECB has set in motion a new initiative that encourage banks to disclose climate-related risks transparently. The initiative is still at an early stage, since the ECB launched a public consultation on its guide on May 20, 2020. This guide aims to integrate climate-related risks and enhance transparency regarding the ECB's understanding of the prudent management of environmental risks under the current prudential framework. *See* EUROPEAN CENTRAL BANK (ECB), GUIDE ON CLIMATE-RELATED AND ENVIRONMENTAL RISKS RISK MANAGEMENT AND DISCLOSURE (2020), https://www.bankingsupervision.europa.eu/legalframework/publiccons/pdf/climate-related_risks/ssm.202005_draft_guide_on_climate-related_and_environmental_risks.en.pdf [hereinafter ECB guide on climate-related risks]. In the same vein, see BANQUE DE FRANCE, The role of central banks in the greening of the economy (2021), https://www.banque-france.fr/en/intervention/role-central-banks-greening-economy.

[11] *See* EUROPEAN COMMISSION, STUDY ON THE POTENTIAL OF GREEN BOND FINANCE FOR RESOURCE-EFFICIENT INVESTMENTS (2016), at 22, https://ec.europa.eu/environment/enveco/pdf/potential-green-bond.pdf (In 2016, green bonds only represented 0.13% of the bond market according to the European Commission). *See also* EU TECHNICAL EXPERT GROUP ON SUSTAINABLE FINANCE, REPORT ON EU GREEN BOND STANDARD (2019), at 19, https://ec.europa.eu/info/sites/info/files/business_economy_euro/banking_and_finance/documents/190618-sustainable-finance-teg-report-green-bond-standard_en.pdf (In 2017 and 2018, green bond issuances represented approximately the 2% of global bond issuances) [hereinafter Report on EU Green Bond Standard].

[12] *See* EU Commission Action Plan 2018, *supra* note 9, at 4, 8. (The word is used in relation to "risk management").

the goal is not just to make it easier to find green investments for those who are convinced, but to "green" the whole market, another problem becomes evident: the law needs to deal not only with the "engaged" person who will behave in accordance with the new goals out of conviction, but also with the recalcitrant who will not, and will exploit every opportunity to serve their own interest. This is the proverbial selfishness of the "bad man" of Oliver Wendell Holmes, and, in Holmes' vision, the law is what the bad man fears.[13] Although this may not fully capture the phenomenon of the "law" in its entirety, it is useful to filter the excessive buzz and talk about an issue, and it will be our guiding idea to assess the credibility of the Commission's Sustainable Finance strategy and its associated measures.

5.Under this premise, and stripped to its bare conceptual bones, the "sustainability" of a financial instrument is a "promise", a "green promise", by which an issuer or offeror commits to do certain things (e.g. earmark funds for certain projects), or achieve certain goals (e.g. comply with targets). At a basic level, this is not different from the promise to pay 6% interest, reimburse the principal, or maximize company value. This comparison allows all the nuances and specialties, but also helps to assess the mechanisms enlisted by the "law" to secure the fulfilment of the promise in a cold, objective light, by comparing "green" promises with "conventional" (or "financial") promises.

6.From that perspective, the "bad man" who has made a promise, in the financial markets at least, is afraid that (i) disappointed investors will sell the instrument, and funds will flow elsewhere; (ii) opponents will start challenging his decisions; and (iii) he will be penalized for going against the law, or coerced into compliant behaviour. In this article we will develop this idea into a general framework (Section 2), then use the next sections to explore the substance of the tools, proposed, considered, or not considered but available if we draw from the experience with financial promises, namely "exit" (Section 3), "voice" (Section 4), and "coercion" (Section 5), to finally draw some conclusions (Section 6).

II. A TOOLKIT FOR ALL (INCLUDING "GREEN") PROMISES: "EXIT", "VOICE" AND "COERCION", AND THE INSTRUMENTS SUBJECT TO THEM.

7.Once we have laid out our "mission" (to compare "green" and "financial" promises based on the legal tools available to ensure their fulfilment) we need a roadmap, a framework that helps compare the two kinds of promises. Our initial inspiration is Alfred O. Hirschman's observation that, whereas economics emphasized competition, political science emphasized participation, and that, while both were partly right, both were wrong in neglecting the importance of the other, hence his distinction of "Exit" and "Voice", i.e. mechanisms that facilitate a person's (the investor) exit from the relationship, and mechanisms that help the disappointed party have a say in the decision.[14]

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[13] Oliver Wendell Holmes, *The Path of the Law*, 1 BOSTON L. SCHOOL MAG. 1 (1896-1897), at 3:

> If you want to know the law and nothing else you must look at it as a bad man, who cares only for the material consequences which such knowledge enables him to predict, not as a good one, who finds his reasons for conduct, whether inside the law or outside of it, in the vaguer sanctions of conscience.

[14] ALBERT O. HIRSCHMAN, EXIT, VOICE, AND LOYATY: RESPONSES TO DECLINE IN FIRMS, ORGANIZATIONS, AND STATES (1ND ED. 1970).

8.Thus, if an issuer's business sells to the public "green securities", i.e. securities that promise to use the proceeds to fulfil certain sustainable goals, as soon as it is reliably reported that proceeds are being used in non-compliant ways, or if a recalcitrant company refuses to mend its ways, and internalize a part of the externality it is creating, investors have at least two options. Some investors will be in favour of "getting out", and putting their money elsewhere.[15] Others, however, may prefer to stay and correct the unsatisfactory performance by exerting influence.[16] From a legal perspective, though, in addition to "Exit" and "Voice" it is also essential to consider "Coercion" mechanisms, i.e. those that force the promisor by penalizing non-performers, asking him to compensate the promisee, or ostracizing the former from the market (i.e. extreme versions of "exit").

9.A second step is to identify the different financial instruments that are susceptible of "greening", because they have a "green" promise embedded in them, or because their issuer or offeror has pledged to make its overall activity more sustainable. This encompasses bonds (distinguishing between corporate and securitized or structured bonds), shares or equity instruments, and sovereign debt. Combining the taxonomy of tools and instruments leaves the following table:

INSTRUMENT	**EXIT**	**VOICE**	**COERCION**
Bonds (corporate debt) Securitization/structured debt			
Shares & equity instrument			
Sovereign debt			

10.The idea in the following sections is to fill in the table, in light of the feasibility of each strategy, and to do so using a visual "color-coding". In so doing, we will fall on the side of optimism, not cynicism. This means that (i) as long as the specific tool is being proposed, it will be coloured in green ("light" for those being proposed, "dark", for those implemented or close to implementation). Yet, (ii) there may be other mechanisms that would be equivalent to those that exist to secure financial promises, but are not being discussed for green promises, and/or face important practical or conceptual obstacles, which will be coloured in "yellow". Finally, (iii) for those mechanisms that, although constituting a mere extrapolation from financial promises, face obstacles so formidable that their implementation is very unlikely, we reserve the colour "red".

11. Someone may object here that our comparison is unfair, that "green promises" are different from financial promises and should have different accountability mechanisms. Our reply is "yes and no". We do not say that "financial promises" and "green promises" are the same, only that financial promises are the bedrock of deep and sophisticated capital markets because they are credible, and they are credible because their fulfilment is protected by many different tools. If the final table offers a relatively green landscape, we will conclude that we are walking towards the greening of financial markets (at least in the EU). If patches of green sit together with cast areas of yellow and red, we will conclude that the "bad man" can feel safe, and that green promises mostly

[15] Exit consists of terminating the one's relationship with a corporation following the unsatisfactory performance (e.g., a shareholder sells her interest, a supplier ceases delivery). *See* HIRSCHMAN, *supra* note 14 at 10-15. *See also* Ronald J. Gilson & Reinier Kraakman, *The Mechanisms of Market Efficiency*, 70 VA. L. REV. 565 (2003), at 594-595.

[16] "Voice" is an attempt to correct an objectionable state of affairs. *See* HIRSCHMAN, *supra* note 14.

depend on the people who already believe in them. Even if there are reasons why certain tools used for financial promises cannot be used for green promises (other than sheer lack of credibility) at least that will be the beginning of a sincere discussion.

III. THE REALITY: A FRAMEWORK BASED ON TRANSPARENCY AND "EXIT". PROPOSALS FOR INCREMENTAL IMPROVEMENT

INSTRUMENT	EXIT	
Bonds (corporate debt)	Standards (Green Bonds)	Using the existing institutional architecture of the European Environmental Agency (EEA) to enhance transparency.
	Taxonomy	
	Financial institutions' disclosures	
Structured debt	Green Securitised Bonds	
Shares & equity instruments	Benchmarks	
	Non-Financial Disclosures	
Sovereign debt & public finance	Green Sovereign Bonds	
	European Investment Bank	

12.Corporate bonds are debt securities issued by corporations and sold to investors. "Green bonds" are corporate bonds whose proceeds "shall be exclusively used to finance or re-finance in part or in full new and/or existing Green Projects" as defined by a specific standard and verified by accredited verifiers.[17] This transparency-based effort is supplemented by the development of a "Taxonomy" of environmentally sustainable activities where green funds may be allocated. In light of their saliency as the more visible project of financial sustainability, it is logical to start there (3.1). One criticism is the risk of "greenwashing", i.e. of gaining an unfair competitive advantage by marketing financial products as environmentally friendly, when they are not so.[18] Yet, since our goal is to focus on the availability of legal mechanisms, rather than their actual use, we will take the official statements at face value, leaving empirical claims aside.

13.Instead, in our view the main problem is that green bonds still represent just around 1% of the whole bond market,[19] which looks quite meagre in light of the task ahead. Thus, in addition to a standard for "green bonds", i.e. instruments where the proceeds shall be exclusively used to meet

[17] See Report on EU Green Bond Standard, *supra* note 11, at Annex 1.

[18] *See* Lyon and Montgomery did a comprehensive literature review of the studies devoted to the term and practice. *See* Thomas P. Lyon; A. Wren Montgomery, *The Means and End of Greenwash*, 28 ORG. & ENV'T 223 (2015), at 223-247. (Although their approach is broader, i.e. they include the greenwashing of consumer products, and throw in the greenwashing of bonds together with other products as "corporate" greenwashing, their definition of "greenwashing" as "misleading communication" is in line with the transparency-exit basis used here). *See* Proposal for a Regulation of the European Parliament and of the Council on the establishment of a framework to facilitate sustainable investment, COM (2018) 353 (May 24, 2018), (approval of the final compromise text), EUR. PARL. & EUCO DOC. ST 14970 2019 COR 1, https://eur-lex.europa.eu/legal-content/EN/TXT/?uri=CELEX%3A52018PC035 [hereinafter Proposal for a Taxonomy Regulation – Compromise text]. (It is designed to combat greenwashing, to which we will refer below. Recital (9) states that "Greenwashing refers to the practice of gaining an unfair competitive advantage by marketing a financial product as environmentally friendly, when in fact it does not meet basic environmental standards.")

[19] See Commission Action Plan, *supra* note 9, at. 5 with reference to G20 GREEN FINANCE STUDY GROUP, G20 GREEN FINANCE SYNTHESIS REPORT (2016), http://unepinquiry.org/wp-content/uploads/2016/09/Synthesis_Report_Full_EN.pdf [hereinafter G20 Green Finance Study Group Report].

green goals, we ask ourselves how the rules promote the "greening" of all financial products, using the same "exit-based" tools, i.e. where the firm informs about its environmental performance, and investors decide whether to stay or walk away. As we transcend the 'niche' market of green instruments and encompass the whole debt market progress is hesitant and sketchy (3.2.) Conversely, important progress is taking place in equity markets, through benchmarks and non-financial information (NFI) (3.3.) Some progress is also present in public fund markets, thanks to the leadership of the European Investment Bank (EIB) a re-channelling of flows that may nudge sovereigns towards greening their investments (3.4.) Finally, to close the section we analyse the convenience of enlisting the independent expertise of the European Environment Agency (EEA) in the efforts to increase transparency and facilitate exit by environmentally conscious investors (3.5.).

1. Standardisation. Green bonds and taxonomy and transparency.

14.The activities carried out by the TEG to promote transparency include:

15. **The Green Bond Standard.** These are voluntary recommendations proposed as a basis for defining the environmental criteria of green bonds with the aim at encouraging the market participants to issue and invest in EU green bonds.[20] The Standard will also propose the establishment of a mandatory reporting on use of proceeds (allocation report) an environmental impact report, and a mandatory verification of the Green Bond Framework and final allocation report by an external reviewer.[21]

16.**The EU Green Taxonomy.** The Technical Expert Group (TEG) set up by the European Commission is working on the promotion of more transparency, such us a disclosure framework. This would be based on a set of conditions for financial market participants in order to gradually increase the transparency and create a unified classification system ("Taxonomy") on what can be considered an environmentally sustainable economic activity (the Taxonomy's official label is that of a "framework to facilitate" sustainable investment[22]).

17.All these elements are important steps forward, but all of them focus on the same logic: by enhancing transparency on environmental (and other ESG goals) they facilitate investors' decision to invest and disinvest, and by making an express assessment of clients' preferences investment firms and insurance companies also signal to their clients that ESG goals are a relevant factor in

[20] *See* Report on EU Green Bond Standard, *supra* note 11.

[21] *See Id*. at 13 (for a summary of the key features). *See also Id*. at 9-12 (The TEG Report recommendations include creating a *voluntary* standard, align the projects funded by green bonds with the EU Taxonomy (to avoid greenwashing), ensure accreditation by external verifiers, which would, themselves, be subject to registration, encourage institutional investors to take sustainability factors into consideration for their investment policies, and enhance disclosure of green bond holdings, and other kinds of incentives).

[22] EU Commission Proposal for a Regulation on the establishment of a framework to facilitate sustainable investment, COM (2018) 353 final (May 24, 2018) [hereinafter Proposal for a Taxonomy Regulation]. *See also* the EU TECHNICAL EXPERT GROUP, FINAL REPORT ON SUSTAINABLE FINANCE, (2020), https://ec.europa.eu/info/sites/info/files/business_economy_euro/banking_and_finance/documents/200309-sustainable-finance-teg-final-report-taxonomy_en.pdf [hereinafter TEG Taxonomy Technical Report].

the investment decision, and that they can "vote with their feet" when ESG policies are not satisfactory.

2. *Transparency beyond green bonds: securitisation and sovereign instruments, and… what about the rest of the market?*

18. The initiatives analysed above show a pattern: the "green bond" standard is more specific and targeted, helping structure instruments whose goal is to foster "green investment", while the "taxonomy" initiative is broader in scope, as it intends to provide uniform criteria for determining whether an economic activity is environmentally sustainable. Both try to enhance certainty, but the taxonomy has the potential for "greening" the market, as issuers see the advantage of presenting their activities as economically sustainable.

19.In principle, if sustainability factors are relevant for investment decisions, it would be logical to expand disclosure and reporting duties (with the necessary adaptations) to all financial instruments. This is in line with the Prospectus Regulation, which provides that the prospectus shall include necessary information for the investor to make an informed assessment of the financial condition of the issuer's business and the risk of profitability associated with the corporate bond.[23]

20.Yet, although the taxonomy of "green" instruments is quite comprehensive, and the "green bond standard" is, in principle, expansive in its definition, neither encompasses all kinds of financial instruments, or debt instruments for that matter. Given that some of those instruments represent the largest part of the market in debt instruments, it is worth analysing the reasons and implications of such differentiated treatment.

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[23] See Regulation (EU) 2017/1129 of the European Parliament and of the Council of 14 June 2017 on the prospectus to be published when securities are offered to the public or admitted to trading on a regulated market, and repealing Directive 2003/71/EC (Text with EEA relevance), 2017 O.J. (L168) [hereinafter Prospectus Regulation] (Art. 6.1 of Prospectus Regulation provides that:

> a prospectus shall contain the necessary information which is material to an investor for making an informed assessment of: (a) the assets and liabilities, profits and losses, financial position, and prospects of the issuer and of any guarantor; (b) the rights attaching to the securities; and (c)the reasons for the issuance and its impact on the issuer. That information may vary depending on any of the following: (a) the nature of the issuer; (b) the type of securities; (c) the circumstances of the issuer…

Art. 16 of Prospectus Regulation establishes that the risk factors included in a prospectus "a prospectus shall be limited to risks which are specific to the issuer and/or to the securities and which are material for taking an informed investment decision.")

Nonetheless, see Recital (7) of the legislative resolution of 11 February 2021 on the proposal for a regulation of the European Parliament and of the Council amending Regulation (EU) 2017/1129 as regards the EU Recovery prospectus and targeted adjustments for financial intermediaries to help the recovery from the COVID-19 pandemic, https://www.europarl.europa.eu/doceo/document/TA-9-2021-0047_EN.html. In the European Parliament's view, "the Commission should, in the context of the [Prospectus Regulation] assess whether it is appropriate to integrate sustainability-related information… and assess whether it is appropriate to make a legislative proposal in order to ensure coherence with sustainability objectives and the comparability of sustainability-related information across Union financial services law".

21.First, the taxonomy's scope of application encompasses "financial products", as defined in the regulation on disclosures relating to sustainable investments;[24] which does not encompass securitisation instruments. The taxonomy is based on a logic of reporting for collective investment products, and thus what is reported as "sustainable" is a fund, pension scheme or portfolio. Thus, securitisation funds (like, e.g. private equity funds) are not included in this definition, but would be if, say, they were to be marketed as "green".[25] Yet, a fund of securitisation instruments can hardly be marketed as "green" if there is no standard of what can be considered a "green securitisation" bond. The Report on the Green Bond Standard (GBS) by the Technical Expert Group includes practically no references to securitisation instruments.[26] This is despite the fact that, by the TEG's own admission, bank loans are still the largest source of financing for the corporate sector in Europe, while corporate bond markets are dominated by investment grade issuers and the issuances are concentrated in a few countries.[27]

22.Furthermore, the Loan Market Association (LMA) and the Asia-Pacific Loan Markets Association (APLMA), with ICMA's support, have already elaborated a Green Loan Standard,[28] which could be used as a basis for a market in securitized green bonds. Yet, the Report only makes a general reference to the potential for "synergies" between EU-GBS with the Green Loans Market.[29]

23.It is understandable that the more urgent aim is to put in place a standard that helps to "green" the plainer vanilla bonds, but there is not even a mention to the need to explore further the necessary adjustments for securitised bonds. This is surprising for several reasons. First, the TEG declares as its goal that "[t]he EU-GBS should be open to existing green bond transactions and to all types of issuers"[30] and securitisation is practically the only way small and medium enterprises (SMEs) can access capital markets, and benefit from a pro-green tide sweeping those markets.[31] SMEs can hardly benefit from an initiative conceived for larger issuers, which need a rating, not to mention

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[24] *See* Art. 2 (c) of the Proposal for a Taxonomy Regulation, *supra* note 22 with reference to Art. 2 (12) of the Regulation (EU) 2019/2088 of the European Parliament and of the Council of 27 November 2019 on sustainability-related disclosures in the financial services sector (Text with EEA relevance), 2019 O.J. (L317) [hereafter Regulation on Sustainability Disclosures] (which includes within the definition of "financial product" a "portfolio managed" in accordance with the definition of portfolio management, "an alternative investment fund (AIF)", "an IBIP", a "pension product", a "pension scheme", "a UCITS", or "a PEPP").

[25] *See* TEG Taxonomy Technical Report, *supra* note 22, at 58.

[26] *See Id.*, *supra* note 25, at 40 (includes a reference to the regime of registration of external verifiers for Simple Transparent, Standardised (STS) Securitisation as a model for the centralized system of registration for external verifiers that is proposed for the GBS, and page 51 refers to the preferential prudential treatment of securitization products (among others) as an example for possible ways forward for green bonds).

[27] *See Id.*, *supra* note 25, at 51.

[28] *See* LOAN MARKET ASSOCIATION. ASIAN PACIFIC LOAN MARKET ASSOCIATION, GREEN LOAN PRINCIPLES (2018), https://www.lma.eu.com/application/files/9115/4452/5458/741_LM_Green_Loan_Principles_Booklet_V8.pdf (last visited May 21, 2020).

[29] *See* TEG Taxonomy Technical Report, *supra* note 25, at 51.

[30] *Id.*, *supra* note 29, at 24.

[31] *See* SEAN KIDNEY et. al, *Stimulating private market development in green securitisation in Europe : the public sector agenda* (2017), https://www.cccep.ac.uk/wp-content/uploads/2017/02/Kidney-et-al_policy-paper_Feb-2017.pdf.

the ability to place bonds in the market. Second, securitisation is a key focus of the Capital Markets Union (CMU),[32] which should make it salient for anyone trying to develop initiatives concerning debt instruments. Third, the rationale for GBS financing is to have an asset-based or project-based targeted financing, with funds separated from the sponsor's main activities, subject to enhanced reporting and external (expert) verification.[33] Do these aspects sound familiar? They should. They are at the core of securitisation, and its regulatory framework.[34] Thus, considering how much the rationale of securitization and the rationale for GBS have in common, it is strange that no one has put the two together.

24.This "silo" approach reaches unintended inconsistencies if one looks, e.g. at the EBA Work Programme 2020.[35] Activity 17 is defined as "Banking markets, securitisation, covered bonds and sustainable finance", i.e. *both* securitization and sustainable finance form part of *the same* activity. And yet, when one sees the detail of the ongoing work, both lines of work are completely disconnected.[36]

25. A second type of debt instrument are sovereign bonds. They do not receive an explicit mention in the Taxonomy documents. Yet, unlike securitised instruments, sovereign bonds are often mentioned in the GBS.[37] No mention is made, however, of the potential challenges that they pose, and unofficial documents discussing the issue also tend to overlook (or sidestep) the issue of the structural and unavoidable conflict of interest that arises in a situation where the State is engaged both as a debtor-issuer, but also as regulator.

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[32] *See* Communication from the Commission to the European Parliament, the Council, the European Economic and Social Committee and the Committee of the Regions on an Action Plan on Building a Capital Markets Union, COM(2015) 468 final (Sept. 30, 2015) [hereinafter Action Plan on Building Capital Markets Union].

[33] *Id.*, *supra* note 32, at 27, 28, 29, 31.

[34] Regulation (EU) 2017/2402 of the European Parliament and of the Council of 12 December 2017 laying down a general framework for securitisation and creating a specific framework for simple, transparent and standardised securitisation, and amending Directives 2009/65/EC, 2009/138/EC and 2011/61/EU and Regulations (EC) No 1060/2009 and (EU) No 648/2012, 2017 O.J. (L347) (Arts. 7 (transparency), 9 (credit granting), or 28 (third-party verifying STS compliance).

[35] *See* EUROPEAN BANKING AUTHORITY (EBA), THE EBA 2020 WORK PROGRAMME (2019), at 22, https://eba.europa.eu/sites/default/documents/files/documents/10180/2970032/4c85f578-fe16-4cd7-920a-bbe0ac54b9eb/EBA%202020%20Work%20Programme.pdf [hereinafter the EBA 2020 Work Programme].

[36] *Id.*, *supra* note 35, at 22 (this is, at least, the impression that we drew when reading the description of Activity 17. To avoid being unfair towards the EBA, which generally does a remarkable job, we include the actual text:

> The new European framework for the simple, transparent and standardised securitisations regulation (the STS Regulation), which came into force in January 2019, sets out a large number of mandates for the EBA. The EBA's work on the STS Regulation will focus on TS, GL and reports for the new STS Regulation. There will also be follow-up work conducted related to the new directive on covered bonds. <u>In addition, the EBA will contribute to the Commission's work on sustainable finance</u>, particularly regarding the taxonomy for sustainable finance and the green bonds standards, as well as the work required by the specific mandate for the EBA included in the CRD, the CRR, the IFD and the IFR, and in the Commission action action plan for sustainable finance.) (underlined added).

[37] *See* Report on EU Green Bond Standard, *supra* note 11, at 17, 23, 26, 28, 47, 48, 58.

26.If the steps involved in the issuance include engaging stakeholders, establishing the green bond framework, identifying eligible green investments, arrange independent review, issue the green bond and monitor and report,[38] engagement of stakeholders, identification of investments and issuance involve debtor-like behaviour, while creating the framework and monitoring and reporting involve regulatory-like behaviour. Of all the steps only the independent verification is external, and thus non-conflicted, and typically takes place before the issuance.[39] The small size of the market makes the issuances currently outstanding appear more salient, and this can be a deterrent against abuse, or "green washing" for the moment, but as issuances grow in size, it is unclear whether the safeguards in place will be enough to overcome the intrinsic conflict posed by these instruments.

27. Another important consideration is that all these initiatives seem to be "niche-based", i.e. their aim is to help enhance certainty and clarity for the market in "green" debt instruments, to boost its growth from the current below 1% of the debt market[40] to help it become larger. Yet, the obvious question is what happens with the remaining 99% of the debt market. Considering that one of the stated aims of the Commission Action Plan is to help sustainability become "mainstream",[41] this compartmentalized approach to "green investment" does not seem fully aligned with it.

28.Financial advice is another matter for policy-making attention (in the transparency-oriented approach). The Commission's effort of mainstreaming sustainability is related to "risk management".[42] To this aim belong the initiatives consisting in introducing sustainability in ratings and market research.[43] As per the mainstreaming of sustainability in investment decision-making, i.e. the fostering of the consideration of sustainability factors by investors in their investment decisions, the TEG also suggested amending Markets in Financial Instruments Directive II (MiFID II)[44] and Insurance Distribution Directive (IDD),[45] or adopting new delegated acts under the same Directives[46] in order to integrate ESG considerations as part of the duties applicable under those

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[38] *See* CLIMATE BOND INITIATIVE (CBI), *Sovereign Green Bonds Briefing* (2017), at 4, https://www.climatebonds.net/files/files/Sovereign_Briefing2017.pdf [hereinafter Climate Bonds Initiative Briefing].

[39] In the case studies of Poland, The Netherlands, Belgium and Fiji, Sustainalytics was engaged, while France engaged Vigeo Eiris, Nigeria engaged DNV GL and Indonesia engaged CICERO. *See* Climate Bonds Initiative Briefing, *supra* note 37, at 6- 11.

[40] *See* EU Commission Action Plan 2018, *supra* note 9, at 5, with reference to G20 Green Finance Study Group Report, *supra* note 19.

[41] See EU Commission Action Plan 2018, *supra* note 9, at 4, 7.

[42] *Id. supra* note 41.

[43] *See infra* § 4.1.

[44] Directive 2014/65/EU of the European Parliament and of the Council of 15 May 2014 on markets in financial instruments and amending Directive 2002/92/EC and Directive 2011/61/EU (Text with EEA relevance), 2014 D.O. (L173), https://eur-lex.europa.eu/legal-content/EN/TXT/?uri=celex%3A32014L0065.

[45] Directive (EU) 2016/97 of the European Parliament and of the Council of 20 January 2016 on insurance distribution (recast) (Text with EEA relevance), 2016 D.O. (L26), https://eur-lex.europa.eu/legal-content/en/TXT/?uri=CELEX%3A32016L0097.

[46] Perhaps the most important MiFID II delegated act is the Commission Delegated Regulation (EU) 2017/565 of 25 April 2016 supplementing Directive 2014/65/EU of the European Parliament and of the Council as regards organisational requirements and operating conditions for investment firms and defined terms for the purposes of that Directive, (Text with EEA relevance), 2017 D.O. (L87), https://eur-lex.europa.eu/legal-content/EN/TXT/?uri=CELEX%3A32017R0565 [hereafter MiFID II Delegated Regulation]. The most important

regulations. This amends the transparency requirements towards investors of ESG factors, in order to ensure that investors' preferences with regard to these factors are duly considered in the disclosures to investors,[47] and in providing investment advice.[48] We will discuss in a next session how effective and far-reaching these considerations can be.[49]

3. Transparency and signalling beyond debt instruments: benchmarks and non-financial information (NFI)

29.In the context of green finance, tensions can arise beyond the debtor-creditor relationship. The roles performed by shareholders, directors, managers and stakeholders within the company can give rise to conflicts of interest (principal/agent relations[50]). Changing from short-term to long-term goals (value creation[51]) can create tensions, and the same can happen with decisions to reorient capital flows towards sustainable investments. Transparency is essential also in this context.

30.**Low-carbon benchmarks.** This includes the Regulation (EU) 2019/2089 on low carbon benchmarks and positive carbon impact benchmarks,[52] a Regulation for the creation of two

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delegated act related to the IDD is Commission Delegated Regulation (EU) 2017/2359 of 21 September 2017 supplementing Directive (EU) 2016/97 of the European Parliament and of the Council with regard to information requirements and conduct of business rules applicable to the distribution of insurance-based investment products (Text with EEA relevance), 2017 D.O. (L341), https://eur-lex.europa.eu/legal-content/EN/TXT/?uri=CELEX%3A32017R2359 [hereafter IDD Delegated Regulation].

[47] Regulatory Technical Standard (RTS). *See* proposed regulation amending Regulation (EU) 2017/565 supplementing Directive 2014/65/EU of the European Parliament and of the Council as regards organisational requirements and operating conditions for investment firms and defined terms for the purposes of that Directive, EUR. PARL. & EUCO DOC. Ares (2018)2681500, https://eur-lex.europa.eu/legal-content/ES/PIN/?uri=PI_COM%3AAres%282018%292681500.

[48] Regulatory Technical Standard (RTS). *See* proposed regulation amending Delegated Regulation (EU) 2017/565 as regards the integration of Environmental, Social and Governance (ESG) considerations and preferences into the investment advice and portfolio management, (2018) EUR. COM. DOC. (Explanatory Memorandum), https://ec.europa.eu/finance/docs/level-2-measures/mifid-delegated-act-2018_en.pdf.

[49] *See infra* § 4.

[50] The "canonical" version of the conflict between ownership and control was formulated in Michael C Jensen & William H Meckling, *Theory of the firm: Managerial behavior, agency costs and ownership structure*, 3 JOURNAL OF FINANCIAL ECONOMICS 305(1976), at 305–360. The extension of its logic to other agency conflicts, such as the one between majority and minority shareholders, or firm and creditors, is discussed in JOHN ARMOUR ET AL., *Agency Problems, Legal Strategies, and Enforcement* (2009). (which was integrated as chapter 2 of REINIER KRAAKMAN et al., THE ANATOMY OF CORPORATE LAW (2ND ed. 2009).

[51] Note that we are still focusing on "exit" strategies, i.e. those whose goal is to make it easier for environmentally conscious investors to "vote with their feet" (including enhancing disclosure to facilitate investment and dis-investment choices). This is different from "voice" strategies, that, e.g. try to shape the conduct of gatekeepers and intermediaries so that they can channel the preferences of those investors in a constructive way (*see infra* §§ 4.1-4.4). Those voice-based strategies are, in turn, different from coercion-based strategies that may consist in repurposing directors' duties, and which pose formidable challenges (*see infra* § 5.2.)

[52] Regulation (EU) 2019/2089 of the European Parliament and of the Council of 27 November 2019 amending Regulation (EU) 2016/1011 as regards EU Climate Transition Benchmarks, EU Paris-aligned Benchmarks and sustainability-related disclosures for benchmarks (Text with EEA relevance), 2019 O.J. (L317), https://eur-lex.europa.eu/eli/reg/2019/2089/oj#d1e529-17-1 [hereinafter Benchmarks Regulation]. Pursuant to Art. 19a of Benchmarks Regulation, benchmark administrators "which provide an EU Climate Transition Benchmark or an EU Paris-aligned Benchmark shall comply with this Regulation by 30 April 2020."

categories of low-carbon benchmarks (voluntary labels): a EU Climate-Transition benchmark, which will offer a low-carbon alternative to the commonly used benchmarks, and the Paris-aligned benchmark, which will only comprise investment portfolios in line with a 1.5˚ target.

31.Administrators of benchmarks shall disclose first whether or not they offer one of the two cited benchmarks; and second, whether or not their benchmarks pursue ESG objectives[53] in order to enable market participants to make well-informed choices. Thus, when weighting underlying assets, the administrator of an EU Climate Transition Benchmark should (1) explain how the benchmark contributes to ESG objectives, and (2) take into account companies that have an objective to reduce their carbon emissions. The publicity of such information would enable asset managers to choose the most appropriate benchmark for their investment strategy. Accordingly, many investors who wish to adopt a climate-conscious investment strategy would choose companies that use EU Climate-Transition Benchmark or the Paris-aligned benchmark to invest in their low-carbon investments portfolios.[54]

32.**Guidelines for non-financial (especially climate-related) disclosures.** The above efforts to increase transparency must be related as well to the rules requiring large firms to disclose information related to environmental impact, such as "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".[55] This is the EU response to global initiatives such as the UN Global Compact, the Guiding Principles on Business and Human Rights implementing the UN 'Protect, Respect and Remedy' Framework,[56] the Organisation for Economic Co-operation and Development (OECD) Guidelines for Multinational Enterprises,[57] the International Organisation for Standardisation's

[53] *See* Benchmarks Regulation, *supra* note 52, at Recital (20), which states that: "…the benchmark administrator should disclose how the carbon emissions of the underlying assets were measured, their respective values, including the total carbon footprint of the benchmark, and the type and source of data used... The published information should also include details on the frequency of reviews and the procedure followed."

[54] *See* Benchmarks Regulation, *supra* note 52, at Recital (14) which states that:

In order to maintain the proper functioning of the internal market for the benefit of the end investor, to further improve the functioning of the internal market, and to ensure a high level of consumer and investor protection, it is appropriate to amend Regulation (EU) 2016/1011 by introducing a regulatory framework which lays down minimum requirements for EU Climate Transition and EU Paris-aligned Benchmarks at Union level...

[55] *See* Recital (7) Directive 2014/95/EU of 22 October 2014 amending Directive 2013/34/EU as regards disclosure of non-financial and diversity information by certain large undertakings and groups (Text with EEA relevance), 2014 O.J. (L330), https://eur-lex.europa.eu/legal-content/EN/TXT/?uri=CELEX%3A32014L0095 [hereinafter NFI Directive].

[56] *See* Stéphanie Bijlmakers & Stéphanie Bijlmakers, *The UN Guiding Principles on business and human rights*, CORPORATE SOCIAL RESPONSIBILITY, HUMAN RIGHTS, AND THE LAW 45 (2018), at 45–63.

[57] These include the ORGANISATION FOR ECONOMIC CO-OPERATION AND DEVELOPMENT (OECD) GUIDELINES FOR MULTINATIONAL ENTERPRISES 2011 EDITION (CHINESE VERSION), (2013) (and specific guidelines by sector, including minerals, extractive, garment and footwear, agriculture, etc.).

ISO,[58] or the Global Reporting Initiative.[59] The frameworks elaborated under the aegis of these global initiatives can be used for reporting purposes under EU rules.[60]

33. To this we must add the measures to enhance the disclosure by financial market participants of climate-related risks, and their impact in specified reporting areas (e.g., business model, policies and due diligence processes),[61] which specifically concern financial institutions.

34. Yet, although the above initiatives show evident progress in attitudes towards the relevance of sustainability goals, we must note that they are, primarily, "exit-based" strategies, i.e. their goal is to enhance the information available to investors to help them direct or reorient their choices towards companies that have an objective to reduce their carbon emissions. The incorporation of the two above-mentioned measures could ensure a higher level of investor protection, considering that market participants follow the requirements demanded by the benchmarks. Yet, the full extent of the mechanisms' effectiveness cannot be appraised unless their combined effect is assessed beyond the mere decision to buy or sell, i.e. their true measure as accountability-inducing mechanisms requires a further analysis of "voice", or "governance" mechanisms (infra 4), as well as "coercion" for non-compliance (infra 5).

4. Sovereigns, public funding and the greening of the European Investment Bank (EIB).

35.The basis of the "exit" strategy is the competition mechanism.[62] In our case, if different projects are competing for funds, and a large volume of funds ceases to be available, this is likely to lead the managers to correct whatever faults have led to exit. Under this very basic logic, sovereign states and their governments need not be considered differently from private firms and can thus be persuaded to become greener if that leads to better access to funding.

36. Yet, since public funds are grounded on the principles applicable to fiscal policy, e.g. sovereignty, or democratic accountability, changes in the framework that may shift funds away from some States must be treated with prudence and caution. Any change will always be easier if it affects funds that a State is not expecting, but may suddenly become available, rather than funds a State has come to rely upon. This may make the "exit" less salient, and thus less pressing, but will definitely facilitate the change.

37.By that account, development banks are the more suitable institutions to pioneer the transition. The European Investment Bank (EIB) has a mandate that seems perfectly designed for this, as it is committed "to the balanced and steady development of the internal market in the interest of the Union", facilitating the financing of projects "for developing less-developed regions",

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[58] *See* the *ISO 2600 ON CORPORATE SOCIAL RESPONSIBILITY (CSR)*, ISO STANDARD 2600, https://www.iso.org/obp/ui#iso:std:iso:26000:ed-1:v1:en.

[59] See, e.g. GLOBAL REPORTING INITIATIVE, GRI STANDARDS FOR SUSTAINABILITY REPORTING (CONSOLIDATED VERSION), https://www.globalreporting.org/standards (last visited 21 May 2020).

[60] See Recital (9) of NFI Directive, *supra* note 55.

[61] *See* Art. 4 of Regulation on Sustainability Disclosures, *supra* note 24.

[62] HIRSCHMAN, *supra* note 14, at 1-3.

"modernising or converting undertakings or for developing fresh activities", or "projects of common interest to several Member States".[63]Nowadays, what can be more in line with this message than the modernisation of infrastructure and/or production mechanisms to align them with sustainability goals?

38. It is not surprising that the EIB has become the "green bank" as of late, having announced an ambitious set of targets,[64] accompanied by a new Lending Policy,[65] which identifies the existence of a funding gap and market externalities,[66] and outlines an ambitious four-pronged strategy, of funding directed to unlocking energy efficiency, decarbonising energy supply, supporting innovative technologies, and securing enabling infrastructure.[67]

5. *Enlisting the institutional architecture of the European Environment Agency (EEA) to enhance transparency.*

39.The implementation of mechanisms that promote transparency facilitates the re-orientation of flows and re-allocation of resources and ultimately affects the design of financial markets. Yet, there is a risk of multiple initiatives developing in parallel, without giving rise to a coordinated "transparency infrastructure", that puts sustainability goals on a level with financial goals, and green promises with financial promises. In this regard, one question is whether the existing institutional architecture for the environment, especially the European Environment Agency (EEA) could be enlisted to increase of transparency and build a common approach to incorporate sustainability into supervisory practices.[68]

40.The EEA is an independent EU agency that provides Member States and other EU institutions with information on the environment. The main objective of the EEA and Eionet is to report objective, reliable and comparable information with a twofold objective: first, to inform Member States to take appropriate environmental measures, and second, to inform the public about the state of the environment and the effectiveness of environmental policies[69] To this end, the EEA staff

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[63] Art. 309 TREATY OF FUNCTIONING OF THE EUROPEAN UNION [TFEU] [hereinafter TFEU], https://eur-lex.europa.eu/legal-content/EN/TXT/?uri=CELEX%3A12012E%2FTXT.

[64] The EIB Board of Directors approved a new set of targets ahead of the November 2019 UN climate change conference in Madrid. *See* EUROPEAN INVESTMENT BANK (EIB), EU BANK LAUNCHES AMBITIOUS NEW CLIMATE STRATEGY AND ENERGY LENDING POLICY (2019), https://www.eib.org/en/press/all/2019-313-eu-bank-launches-ambitious-new-climate-strategy-and-energy-lending-policy.htm (last visited May 21, 2020). *See also* San Fleming and Leslie Hook, *EIB to Phase Out Lending to Fossil Fuel Projects by 2021*, FINANCIAL TIMES, Nov. 2019.

[65] See EUROPEAN INVESTMENT BANK (EIB), EIB ENERGY LENDING POLICY (2019). [hereinafter EIB Energy Lending Policy].

[66] EIB Energy Lending Policy, *supra* note 65, at 7, 12, 14, 15.

[67] *Id.*, *supra* note 65, at 18-26. The ECB is willing to accept high supervisory standards be applied consistently across the Eurozone. Thus, our proposal would be in line with the supervisory expectations of the ECB in relation to climate-related risk management framework. *See* ECB guide on climate-related risks, *supra* note 10.

[68] See EUROPEAN ENVIRONMENT AGENCY (EEA), *Europe's state of the environment 2020: change of direction urgently needed to face climate change challenges, reverse degradation and ensure future prosperity* 8 (2019)., https://www.eea.europa.eu/highlights/soer2020-europes-environment-state-and-outlook-report.

[69] Art. 1.2 of Regulation (EC) No 401/2009 of the European Parliament and of the Council of 23 April 2009 on the European Environment Agency and the European Environment Information and Observation Network (Codified

includes experts on environment and sustainable development and communication, while the European environment information and observation network (Eionet) brings together hundreds of specialized institutions.[70]

41.The activities carried out by EEA are predetermined in a five-year work programme, and they can be divided into three categories: (1) reporting on policy implementation, objectives and targets of the EU policy; (2) supporting the EU's Sustainable Action Plan by assessing systemic challenges across sectors; and (3) coordinating the networks of institutions in participating countries.[71] This role tries to help Member States integrate environmental considerations into economic policies. However, insofar as the EEA's mandate is limited to data collection on the quality, pressures and sensitivity of the environment,[72] its reports have no "teeth", and its conclusions not operational.

42. The norm that should help create a Taxonomy on sustainable investment suggests that the EEA should be part of a public-private platform on sustainable finance to assist the European Commission with issues related to EU sustainability taxonomy.[73] This Platform would be formed by representatives of the EEA, the European Supervisory Authorities (ESAs), the European Investment Bank (EIB) and the European Union Agency for Fundamental Rights (EU - FRA),[74] and focus on ascertaining whether an economic activity is environmentally sustainable, carrying out tasks, such as: (1) assessing environmental footprint, (2) taking into account the potential risks of both creating inconsistent incentives and of certain assets becoming stranded after losing value due to the transition to a more sustainable economy; (3) identifying the long-term impacts of the economic activity; and (4) reporting periodically to the Commission on capital flows towards sustainable investments.[75] Thus, although the platform is ambitious in the number of agencies included, it is not ambitious in the role it may play, and it does not alter the EEA's mandate, nor puts it in a predominant position: the EEA would continue to collect data and communicate its outcomes to their collaborators, and advice the Commission through the platform.[76]

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version), 2009 O.J. (L126), https://eur-lex.europa.eu/legal-content/EN/ALL/?uri=CELEX%3A32009R0401 [hereinafter Regulation on the EEA].

[70] *See* EUROPEAN ENVIRONMENT AGENCY (EEA), https://europa.eu/european-union/about-eu/agencies/eea_en (last visited May 21, 2020). (The EEA and the national contact points of participating countries coordinate Eionet activities on their territories, including data collection to assess environmental policies to elaborate reports that provide information on environmental policy).

[71] *Id.*, *supra* note 70.

[72] Art. 3.1 of Regulation on the EEA, *supra* note 69. Art. 3.2 states that socioeconomic dimension shall be taken into account" when furnishing information regarding the areas of work within the EEA's scope of action.

[73] *See* the Proposal for a Taxonomy Regulation, *supra* note 22. *See also* Andreas Barkman et. al, *Investing for sustainability*, ELECTRICITY REFORM IN EUROPE: TOWARDS A SINGLE ENERGY MARKET 142 (2009), at 142–171. *Id.*https://www.eea.europa.eu/articles/investing-for-sustainability.

[74] The original proposal included the European Investment Fund (EIF) and did not include the EU-FRA, these were, respectively, excluded and included in the current compromise text with the Parliament. *See* Art. 15.1 of Proposal for a Taxonomy Regulation – Compromise Text, *supra* note 18.

[75] *See* Art. 14.1 of the Proposal for a Taxonomy Regulation, *supra* note 22 defines the requirements for technical screening criteria, which in broad terms refers to economic activities that can have an impact on the environment with the aim at avoiding significant harm to the "relevant environmental objectives".

[76] *See* Art. 15 of the Proposal for a Taxonomy Regulation, *supra* note 22.

43.And yet, some features of the system suggest that the EEA may be well-placed to play a more important role to improve the transparency and monitoring the fulfilment of green promises. Sustainable finance's nature, operational features, financial and environmental outcomes are heterogeneous; thus, building a "coherent financial system that supports sustainable solutions"[77] requires a consistent approach, which needs the expertise from many disciplines. The EEA could work closely with the TEG on harmonising the EU taxonomy on green finance, and have a more prominent role given the agency's expertise in climate change adaptation and mitigation.[78] Moreover, the EEA is in a good position to become a specialized environmental agency in charge of checking the core content of "green" transparency (e.g., green bond standards and green benchmarks cited above) measured against the necessary EU green taxonomy.[79]

44. As regards the monitoring of sustainable investments, ESMA has recently pointed out that supervisors' mission is influenced by the investors preferences, given that they are shifting towards investments that integrate ESG factors.[80] According to ESMA, this situation, in turn, creates new challenges to promote the stability of financial markets. For example, in relation to Supervisory Convergence, ESMA notices that sustainability is a pervasive factor across different regulatory domains, which makes the creation of a common approach for incorporating sustainability risks a priority.[81] It suggests that ESMA and NCAs work together to develop supervisory practices and requirements in relation to sustainability factors.[82] This includes the creation of a training plan for NCAs in order to enable them to foster supervisory practices regarding sustainability, especially in those areas where sustainable finance has not been addressed yet. However, the EEA, as a specialized environmental agency, can be the entity that (1) promotes supervisory convergence regarding green promises by improving financial supervisors' understanding on how they should take into consideration sustainability; (2) supports ESMA and NCAs with technical advice that draws on its experience of environmental policy analysis and research; and (3) identifies risks related to sustainable finance; particularly, in green promises.[83]

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[77] *See* the Green Deal Communication, *supra* note 4.

[78] *See* EEA, CLIMATE CHANGE ADAPTATION, https://www.eea.europa.eu/themes/climate-change-adaptation (last visited May 21, 2020). On climate change mitigation, *see* EEA, CLIMATE CHANGE MITIGATION, https://www.eea.europa.eu/themes/climate (last visited May 21, 2020).

[79] In fact, the Commission has announced the launching of a new environmental action programme to complement the European Green Deal, which integrated a new monitoring mechanism to ensure that Member States meet their environmental objectives. The EEA could help enforce this new mechanism. *See* the Green Deal Communication, *supra* note 4, at 23.

[80] According to ESMA, sustainable finance impacts on a wide range of activities: Supervisory Convergence, Single Rulebook and Direct Supervision. *See* EUROPEAN SECURITIES AND MARKETS AUTHORITY (ESMA), *Strategy on Sustainable Finance* 13 (2020). at 4, https://www.esma.europa.eu/sites/default/files/library/esma22-105-1052_sustainable_finance_strategy.pdf.

[81] *Id.*, *supra* note 30.

[82] *Id.*, *supra* note 30.

[83] ESMA suggests implementing guidelines or supervisory briefings on disclosure practices for credit ratings to foster transparency in the reporting of non-financial information, a task that could also be assumed by the EEA. In this sense, ESMA's proposal include the development of harmonized local supervisory practices to assess market participants, risks and transaction that are of relevance in sustainable finance, so NCAs can understand how to integrate sustainability in their supervisory roles. See 33-9-320 EUROPEAN SECURITIES AND MARKETS AUTHORITY (ESMA),

45.The adjustment of the EEA as a specialised environmental agency would instil a market-design component into the transparency tool. This would not displace market instruments like market standards, market ratings and exit mechanisms from their valuable nodes into the green ecosystem of the law of finance but would dramatically enhance transparency credibility and thus would make the green promise embedded in the marked based transparency tools performative and operational.

46.Furthermore, the EEA can act as a joint supervisor together with ESMA and other ESAs and help implement voice mechanisms.[84] To this end, we should reshape the EEA's role, but this change does certainly not have to disrupt or overlook its current assignments, i.e., providing Member States and the Community with reliable and precise environmental information. Our suggestion would entail a minor but worthwhile shift. We emphasize that promoting the integration of environmental information into monitoring programs is within the scope of action of the agency just as much as reporting technical knowledge on environmental policy is.[85] The Regulation on the EEA already states that, to achieve the goals of environmental protection and improvement laid down by Community environmental action programmes and the Treaty, the agency shall provide the Community and Member States with "the necessary technical and scientific support".[86] The regulation does not elaborate on what constitutes "technical and scientific support", however it stresses that the EEA shall actively seek the cooperation of other Community bodies and programmes.[87]

47.The regulation even grants the possibility for cooperation between the EEA and institutions in third countries in areas of common interest.[88] This, in turn, leads to believe that if the EEA shall cooperate with institutions in third countries, a fortiori it would be optimal that the EEA can liaise with ESMA and other ESAs in order to address the challenges posed by green promises. Moreover, sustainable finance is an area of mutual interest for both financial supervisors and the EEA.[89] By acting as a joint supervisor for green financial intermediaries committed to ESG policies and risks

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Final Report Guidelines on Disclosure Requirements Applicable to Credit Ratings (2019), https://www.esma.europa.eu/sites/default/files/library/esma33-9-320_final_report_guidelines_on_disclosure_requirements_applicable_to_credit_rating_agencies.pdf.

[84] *See infra* Section 4.

[85] *See* Art. 2 (g) of Regulation on the EEA, *supra* note 69, states that the agency state that European environmental information should be incorporated into international environment monitoring programmes by comparison with the monitoring programmes developed by United Nations and its specialized agencies.

[86] *See* Art. 1.2 (b) of Regulation on the EEA, *supra* note 69.

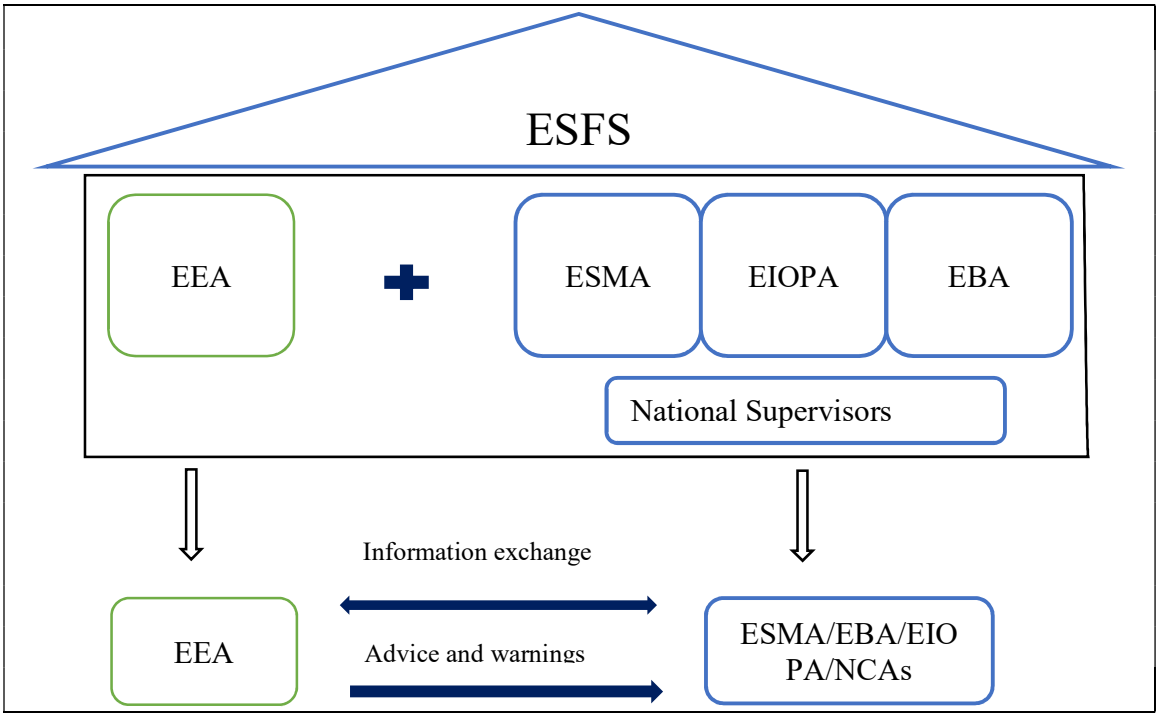
[87] *See* Art. 15 of Regulation on the EEA, *supra* note 69. (It names some institutions with whom the EEA should cooperate although the list seems to be open to whichever institution that may need EEA's support. Paragraph 15.2 provides that the "[a]gency shall also cooperate actively with other bodies such as the European Space Agency, the Organisation for Economic Cooperation and Development (OECD), the Council of Europe and the International Energy Agency as well as the United Nations and its specialised agencies, particularly …").

[88] *See* Art. 15.3 of Regulation on the EEA, *supra* notes 69, 87. (It integrates the possibility for cooperation with "those institutions in countries which are not members of the Community which can provide data, information and expertise, methodologies of data collection, analysis and assessment which are of mutual interest and which are necessary for the successful completion of the Agency's work").

[89] *Id., supra* note 88.

management techniques, the EEA can provide technical knowledge or scientific support as to the "green" substantive content. By doing so, the EEA would contribute the substance to the monitoring exercise, whilst financial supervisors would contribute the form. The conception of "green", once objectivized, can be transformed to an operational rule or standard, capable of being enforced under the law of finance.

48.An example of our suggestion of micro-supervision of green promises would be the following:



49.Since the EEA can assume a greater role for the technical assessment of the merit of sustainability factors and, accordingly, it might accept supervisory mandates (e.g., in relation to green benchmarks or green bonds), once infringement is technically detected by the EEA, enforcement action would then be taken by the competent financial supervisor (ESMA, EBA and EIOPA, and/or and National Competent Authorities (NCAs)). Therefore, the EEA's analysis would be used as an external verification mechanism that would help streamline decision-making processes and enhance accountability and would strengthen financial supervision's credibility in respect to green promises. The European System of Financial Supervision (ESFS), the current network centred around the European Supervisory Authorities (ESAs), and through it, national financial supervisors would thereby be reinforced to ensure consistent supervision of green promises through the EU, with full understanding of the merit of such promises (and of their real-world fulfilments). In this way, partially re-shaping the EEA role as a specialised environmental agency could immensely contribute to the implementation, and credibility, of the EU Commission green taxonomy and the strengthening of non-financial disclosures.

IV. THE DESIRABLE NEXT STEP: "VOICE"-BASED MECHANISMS, OR "GREENNESS AND GOVERNANCE".

INSTRUMENT	VOICE
Bonds (corporate debt)	Ratings, Advice
	Intermediaries organizational rules
Structured (securitised) debt	Fiduciary duties and engagement
	"Green trustee"
Shares & equity instruments	Proxy advisors
	Intermediaries' fiduciary duties and engagement
	Corporate governance and duties
Sovereign debt and public finances	A "Sustainable" Stability and Growth Pact

50.The measures analysed in the previous section should help create a framework where improvements in transparency help investors direct their choices towards suitable investments, by "voting with their feet". Nonetheless, the strategy can be greatly amplified if completed with mechanisms that help investors channel their "voice" and contribute to decision-making. This involves rules concerning intermediaries and specialized parties, as well as corporate governance. Alas, evidence of progress on this front is mixed. Here we discuss the tools that are on the table, e.g. those related to ratings and financial advice or the inclusion of sustainability factors in organizational rules (4.1 and 4.2), and those that are not, e.g. a re-orientation of financial advisors' fiduciary duties, or a "green trustee" for bond offerings (4.3 and 4.4).

1. Gatekeeper-based strategies: ratings and financial advice

51.Ratings and financial advice enhance transparency, and thus their basic functioning appeals to "exit" dynamics. Yet, the addition of expert judgment put them within gatekeeping mechanisms, one of the bedrocks of modern corporate governance.[90] If gatekeepers, or trusted third parties, churn out a steady flow of information that helps to assess an instrument (or company) sustainability credentials, not only environmentally-conscious investors will use them to vote with their feet: managers and company boards will also pay attention, and integrate these goals into their strategy. Furthermore, financial advisors in particular also have direct contact with clients and adding a sustainability perspective can make investors' more conscious of its importance.

52.Current proposals hint in that direction: building on a transparency-based core, they try to effect a change the framework in a way that embeds sustainability goals more deeply into corporate governance and decision-making. Initiatives on disclosures relating to sustainable investments and sustainability risks stated that a lack of regulatory framework made more difficult and costly for investors to make informed investment choices, and could give rise to divergent outcomes and market fragmentation, which makes it necessary to integrate "mandatory disclosures at the level of the financial market participants and financial advisors on how ESG risks are integrated in the investment decision and advisory process", to achieve the objectives of transparency and reducing

[90] *See* John C. Coffee, *Gatekeeper Failure and Reform: The Challenge of Fashioning Relevant Reforms*, 84 CORPORATE GOVERNANCE IN CONTEXT: CORPORATIONS, STATES, AND MARKETS IN EUROPE, JAPAN, AND THE US (2012). B.U.L. REV. 237 (2004), at 301-364.

investors' search costs.[91] Yet, the proposals also suggest that, beyond helping investors vote with their feet, ratings and financial analysis can be used as an external verification that helps streamline decision-making process and enhance accountability. Financial advice, for its part, is formulated in relatively broad terms, which may include going beyond mere disclosure, and encompass a better engagement with the offering companies.[92]

53.An example of this is the European Commission's Sustainable Action Plan proposal that MiFID II and IDD firms should ask their clients about their ESG preferences and take them into account when assessing the range of financial instruments and insurance products to be recommended.93 This suggestion, which is part of the European Commission's aim to amend delegated acts under MiFID II and IDD,[94] would enable clients to "voice" their preferences and ensure that they are sufficiently taken into consideration when providing portfolio management services or advice under MiFID II and IDD. However, proposals are still in a very initial stage (e.g. the comprehensive study on sustainability in ratings and research promised for 2019[95] will be available only in 2020, and this is only a first step towards regulatory action) which is why we label them with a light green.

54.Even assuming that these meritorious proposals become law, it is important to be aware at their challenges and limitations. Agencies' ratings, and advisors' labels may help improve bond offerors' sustainability governance through more transparency.[96] However, for that to work the new rules need to be clear about what they mean for gatekeepers' internal procedures, and external relations.

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[91] *See* Proposal for a Regulation of the European Parliament and of the Council on disclosures relating to sustainable investments and sustainability risks and amending Directive (EU) 2016/2341, COM (2018) 354 (final) (May 24, 2018) §§ 2-3, https://eur-lex.europa.eu/legal-content/EN/TXT/?uri=CELEX%3A52018PC0354. This resulted in Regulation on Sustainability Disclosures, *supra* note 24.

[92] The Proposal for a Taxonomy Regulation – Compromise text, *supra* note 18, in its Recital (11) states that:

> Member States should be required to use a common concept of environmentally sustainable investment when setting up requirements for market actors for the purpose of labelling financial products or corporate bonds marketed as environmentally sustainable at national level", i.e. focusing on transparency and labelling. However, it also adds that "For the same reasons, fund managers and institutional investors that hold themselves out as pursuing environmental objectives should use the same concept of environmentally sustainable investment when disclosing <u>how they pursue those objectives</u> (underlining added).

A more ample formulation, which suggests that financial advisors may not only indicate which "green" labels they use, but also how they act towards the companies they invest in to make them "greener".

[93] The aim of the consultation launched by the European Commission in this regard is to amend delegated acts under IDD and MiFID II. *See* EUROPEAN INSURANCE AND OCCUPATIONAL PENSIONS AUTHORITY (EIOPA), *Technical Advice on the Integration of Sustainability Risks and Factors in the delegated acts under Solvency II and IDD* (2019), https://www.eiopa.europa.eu/content/technical-advice-integration-sustainability-risks-and-factors-solvency-ii-and-insurance_en.

[94] *See Supra* §3.2.

[95] *See* Commission Action Plan 2018, *supra* note 9, at 8. (The tender for the study was closed in August 2019, *see* https://etendering.ted.europa.eu/cft/cft-display.html?cftId=5281). *See* SUSTAINABILITY, SUSTAINABILITY APPOINTED BY EUROPEAN COMMISSION TO CONDUCT SUSTAINABILITY RATINGS AND RESEARCH STUDY (2020) https://sustainability.com/who-we-are/in-the-media/sustainability-appointed-by-european-commission-to-conduct-sustainability-ratings-and-research-study/.

[96] *See* EU Commission Action Plan 2018, *supra* note 9.

2. *Financial intermediaries' fiduciary duties (I): internal perspective.*

55. Among gatekeepers, financial intermediaries have the crucial role: they are the primary bridge between investors' preferences and issuers of instruments. If financial intermediaries assimilate sustainability's importance, they will signal its presence to investors, some of whom might not have been aware that they can decide upon these parameters and will use it to convey investors' shift in emphasis to the companies issuing the instruments.

56. For that to occur, however, sustainability needs to be incorporated top-to-bottom. In a 2019 speech, Andrea Enria, head of the SSM point at the relevance of "culture and governance" for good banking and risk management.[97] His insights are as true for "conventional" variables, such as financial risk, as they are for less conventional ones, like sustainability or environmental risk: a proper risk "culture" is nurtured through consciousness about the "three lines of defence": business areas, compliance and risk management, and the board itself.[98] Only if firms perceive that they need to change these will "sustainability" be truly incorporated into firms' culture, and financial intermediaries' will act like a bridge between issuers and investors conveying not only messages about financial, but also environmental risks and returns. Yet, to achieve this feat, to go beyond mere formalistic compliance and change firms' culture in the already crowded environment of financial regulation and its myriad provisions, apart from rules' pure "regulatory" dimension, i.e. their mandates, prohibitions and incentives, we need to consider their "expressive" function,[99] i.e. their ability to convey a broader, clear, more profound message about the necessity that the firm and its actors "think" in sustainability terms.

57.The Commission Action Plan included the measures on disclosure towards investors (outlined before) in a broader project to adapt advisors' "fiduciary duties", because "current EU rules on the duty of institutional investors and asset managers to consider sustainability factors and risks in the investment decision process are neither sufficiently clear nor consistent across sectors".[100] Thus, the Commission's rationale was twofold: first, "institutional investors and asset managers still do not systematically consider sustainability factors and risks in the investment process", and, second, they "do not sufficiently disclose to their clients if and how they consider these sustainability factors in their decision-making".[101] Thus, disclosure to investors is more the outcome of a deeper process, and may be perfunctory in nature, and ineffective in practice, unless sustainability is prioritized also within a firm's internal processes.

58. Yet, as we move from the Commission's broader goals set in its Action Plan to ESMA's more concrete Consultation Paper on the integration of sustainability risks and factors into MiFID II, the

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[97] *See* Andrea Enria, *Just a few bad apples? The importance of culture and governance for good banking*, (speech), Conference of the Federation of International Banks in Ireland, (2019), https://www.bankingsupervision.europa.eu/press/speeches/date/2019/html/ssm.sp190620~f9149fe258.en.html

[98] *Id.*, *supra* note 97.

[99] Cass R. Sunstein, *On the Expressive Function of Law*, 144 U. PA. L.REV. 2021 (1996), at 2021-2053.

[100] *See* EU Commission Action Plan, 2018, *supra* note 9, at. 8.

[101] *Id.*, *supra* note 100.

agency takes a more hesitant view towards any comprehensive change in firms' organizational requirements to adjust them to the needs of sustainability. Yes, the idea should be to ensure that firms "incorporate ESG considerations within their processes, systems and controls in order to ensure the investment and advisory process correctly takes them into account",[102] but at the same time comprehensive changes in the MiFID framework should be avoided.[103]

59.To be fair, ESMA's proposals are well directed, structurally based, and touch upon the "three lines of defence". They discuss intermediaries' duties when assessing an investment's suitability for a client[104] (front line); they accompany these points about the firm-client relationships with proposals to change "product governance",[105] and top these up with proposals of structural changes in general organizational requirements of investment firms, their risk management, and a new perspective on conflicts of interest to ensure that ESG goals are taken into consideration.[106] The approach of ESMA's Consultation Paper was maintained in ESMA's Final Report.[107]

60.The approach's rationale is correct: proposals try to incorporate sustainability goals not only as relational tools shaping the rapport with investors, but also as structural tools, shaping the internal organization of firms, to effect top-to-bottom (or bottom-to-top) change. Still, from the perspective of law's "expressive" function, the message is not always as clear-cut. ESMA has expressed the need to change specific provisions, but balked at the prospect of effecting comprehensive change, and include sustainability as a key factor across organizational provisions.[108] This impression of ambivalence is reinforced if we consider ESMA's advice from the perspective of the "bad man".

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[102] See 35-43-1210 ESMA, *Consultation Paper. On integrating sustainability risks and factors in MiFID II* (2018) §2 (*Organisational requirements*), at 6, https://www.esma.europa.eu/press-news/consultations/consultation-integrating-sustainability-risks-and-factors-in-mifid-ii [hereafter: ESMA Consultation Paper MiFID II and Sustainability Risks].

[103] *Id.*, *supra* note 102, at 8.

[104] *Id.*, *supra* note 103, at §4 (*Suitability*).

[105] *Id.*, *supra* note 104, at § 3 (*Product Governance*).

[106] *Id.*, *supra* note 105, at 5, 8 and 12, and p. 11, with references to the proposed changes in Arts. 21, 23 and new Recital (59*bis*) of Commission Delegated Regulation (EU) 2017/565 of 25 April 2016 supplementing Directive 2014/65/EU of the European Parliament and of the Council as regards organisational requirements and operating conditions for investment firms and defined terms for the purposes of that Directive (Text with EEA relevance), 2017 O.J. (L87) [hereinafter MiFID II Delegated Regulation].

[107] *See* 35-43-1737 EUROPEAN SECURITIES AND MARKETS AUTHORITY (ESMA), *ESMA's technical advice to the European Commission on integrating sustainability risks and factors in MiFID II* (2019), https://service.betterregulation.com/document/385225 [hereinafter ESMA Final Report MiFID II and Sustainability Risks].

[108] *See* ESMA Consultation Paper MiFID II and Sustainability Risks, *supra* note 102:

> ESMA considers that the suggested change to Article 23 of the MiFID II Delegated Regulation meets the objectives set out in the Commission's request for advice, in terms of organisational requirements. However, introducing sustainability risks in other articles of the organisational requirements section does not appear appropriate. In other articles of this section, the concept of 'risk' is only referred to very broadly or not mentioned at all. Therefore, singling out sustainability risks (amongst the various risks that are relevant for firms) is unnecessary to achieve the Commission's objectives and would be disproportionate. This approach does not preclude the possibility for ESMA to provide investment firms with further guidance in the future on this matter if need be (for example, through new Q&As).

61.Consider *risk management*, where ESMA proposed to amend the homonymous article 23 of MiFID II Delegated Regulation,[109] by including at the end of the provision regulating firms' duty to establish adequate risk policies the need that those firms "take into account" sustainability risk.[110] A new recital would stress this point by involving different bodies and decision levels within the firm,[111] while another recital should stress that firms should take into consideration conflicts of interest arising from "the distribution of sustainable investments" to avoid using this "as an excuse to sell own-products or more costly ones, or to generate churning of clients' portfolios, or to misrepresent products or strategies as fulfilling ESG preferences where they do not".[112] Then, proposals on product governance would require that a product "meets the identified needs, characteristics and objectives of the target market, including by examining the following elements: […] (b) the financial instrument's ESG characteristics (where relevant) are consistent with the target market;" an idea that is reinforced by the duties imposed to manufacturers and distributors of financial products to ensure that these are consistent with "the needs, characteristics and objectives, and ESG preferences (where relevant)".[113] What is the combined message conveyed by these proposed changes? How are they likely to be perceived by their addressees, and how would they be perceived by a bad man?

62.Considering that ESMA seemed to confirm participants' views that its approach was principles-based, and that it was not trying to tell firms how to weigh sustainability factors in risk management or product governance,[114] the above measures can be interpreted in at least three different ways: (i) sustainability factors should pervade risk assessment and product design and distribution as a whole; (ii) sustainability factors should influence risk assessment and product design and distribution only for instruments affected by climate-based risks (e.g. instruments issued by companies in exposed sectors); or (iii) sustainability factors should influence a firm's assessment only for investors who have expressed sustainability-related preferences.

63. Far from mere semantic differences, approach (i) would result in top-to-bottom adjustment and influence how all products are presented to investors; approach (ii) would force a more careful analysis, but only of industries exposed to climate risk, which would introduce a bias towards climate-adaptation, but not climate-mitigation, i.e. it would discount firms exposed to climate risk,

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[109] *See* ESMA Final Report MiFID II and Sustainability Risks, *supra* note 107, at 16.

[110] *See* Article 23 (1) (a) of MiFID II Delegated Regulation, *supra* note 106 (currently reads:

Investment firms shall take the following actions relating to risk management: (a) establish, implement and maintain adequate risk management policies and procedures which identify the risks relating to the firm's activities, processes and systems, and where appropriate, set the level of risk tolerated by the firm". The proposal would add the following: "<u>In doing so, investment firms shall take into account sustainability risk</u> (underlined added).

[111] *See* ESMA Final Report MiFID II and Sustainability Risks, *supra* note 109, at 16: "compliance function, internal audit function, management body and senior management should also consider aspects related to sustainability risk in their respective duties."

[112] *See* ESMA Final Report MiFID II and Sustainability Risks, *supra* note 109, at 16.

[113] *Id.*, *supra* note 112, at 21, (reformed Arts 9(14), 10(2) and 10(5) of MiFID II Delegated Regulation, *supra* note 106).

[114] *See* ESMA Final Report MiFID II and Sustainability Risks, *supra* note 107, at 5, 18 and 19.

but not to the firms causing the problem in the first place; and approach (iii) would segregate clients, and shape decisions on product manufacturing and distribution, and risk assessment only for the market niche of ESG-conscious investors.

64.These hypothetical understandings would reflect different views about the meaning of "voice": under one view investors should be given "voice" when they have expressly asked for it. Under another, sustainability would be considered relevant enough in and of itself to be incorporated into the internal processes of the firm. This, in turn, would result in making the issue "salient" to investors, and possibly "nudge" them to consciously evaluate their preferences.[115] The intermediate option (option (ii)) would simply expand the intermediary's time horizon of risk assessment. A "pure rationality" perspective would consider all the views to be equivalent. A behavioural approach would consider them radically different. If we believe that choices are more meaningful when the chooser is aware of the different options, the contrast between options would be tantamount to comparing a solution that tackles the full market of financial instruments, or a marginal part of it.

65. Unfortunately, the proposals do not clarify what kind of vision is being enacted. The same textuality in regulatory rules can give rise to very different implementations, depending on how supervisors (and firms) interpret the meaning of the rules, a process in which the rules' expressive function is crucial. The proposed approach consists in targeted reforms of very specific rules, without a clear statement about the need to accompany those by deeper, more comprehensive and consequential change. This does not send a clear message and can hinder the rules' efficacy in changing financial firms' overall culture.

3. *Financial intermediaries' fiduciary duties (II): external perspective.*

66. The internal perspective of firms' processes needs to be accompanied by an analysis of their "external" interplay with investors and firms. These are shaped by firms' "fiduciary duties", and their interplay with regulatory duties contained in MiFID II or IDD rules. "Fiduciary" duties', such as the duty of care, duty to look after clients' interests, or conflicts of interests, are anchored in private law,[116] and follow a "principal-agent" logic: special duties or checks-and-balances on decision-making are needed, or otherwise the asymmetry of information will be too great, and investors' interests will not be served.[117] Yet, the tendency of MiFID II or IDD rules is to use the principal-agent logic for inspiration, but use a market-design logic for implementation, and

[115] RICHARD H. THALER & CASS R SUNSTEIN, NUDGE: IMPROVING DECISIONS ABOUT HEALTH, WEALTH AND HAPPINESS (2009).

[116] *See*, e.g. Veerle Colaert & Maartin Peters, *Is There a Case for a Cross-Sectoral Duty of Care for the Financial Sector? in* FINANCIAL REGULATION. LEVELLING THE CROSS-SECTORAL PLAYING FIELD 245(Veerle Colaert et al. eds., 2019), at 319-341 and, in that same volume, Danny Busch et. Al., *An 'Assist-Your-Customer Obligation' for the Financial Sector? In* FINANCIAL REGULATION. LEVELLING THE CROSS-SECTORAL PLAYING FIELD 343(Veerle Colaert et al. eds., 2019), at 343-375. See also DANNY BUSCH & GUIDO FERRARINI, REGULATION OF THE EU FINANCIAL MARKETS: MIFID II AND MIFIR (2017).

[117] M. LAMANDINI & D. RAMOS, EU FINANCIAL LAW. (2016), at 511-530, 647-663.

concentrate on mandatory rules that dictate firms' structures and procedures.[118] This may enhance certainty about internal changes, but makes it hard to visualize how firms will actually behave externally i.e. vis-à-vis their investors. It is more difficult to surmise how fiduciary duties can be expanded to encompass sustainability[119] absent a clear message. When it comes to the incorporation of sustainability goals to firms' behaviour, policymakers' attitudes seem hesitant.

67.There is, in the first place, the traditional trade-off between short- versus long-termism. While green finance is on top of the agenda, it will have to face down market pressure to be effectively implemented:[120] maximization of short-term goals can result in unsustainable investments, while investment in ESG goals require a long-term orientation.[121] Unless long-termism is effectively incorporated in the decision-making feedback loop sustainable investments stand little chance. To correct short-termism in the financial sector the European Commission requested European Supervisory Authorities (ESAs) to develop an action plan intended to be used as a basis for considering potential future policy options.[122] In particular, the ESAs are expected to (1) investigate sources of market pressure on the financial sector; (2) assess to what extent short-termism can be considered a disruptive effect; and (3) provide advice in those areas where regulators can address the issue.

68.**Engagement.** Shareholder engagement should be a key part of this process. Excessive short-termism can only be corrected (and sustainability incorporated across the board) if channels are open for shareholders to communicate concerns and influence senior management and company boards,[123] or directly dictate policy by proxy voting, if guided by comprehensive ESG guidelines.

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[118] *Id.*, *supra* note 117, at 733-742. (For the distinction between "market-reliant", "principal-agent" and "market design"). *See also Id., Preface*, at XXXI-XL.

[119] *See* ORGANISATION FOR ECONOMIC CO-OPERATION AND DEVELOPMENT (OECD), *Investment governance and the integration of environmental, social and governance factors*, (2017), at 45-50, https://www.oecd.org/cgfi/Investment-Governance-Integration-ESG-Factors.pdf. (According to the OECD, in common law jurisdictions, many asset owners consider fiduciary duties as an obstacle to ESG integration (narrow interpretation of fiduciary duty). Nonetheless, the OECD also posits that: "narrow interpretation of fiduciary duty, which excludes non-financial factors from both portfolio management and from the assessment of beneficiaries' interests, is out of step with legal opinion and regulation, which no longer aim to exclude the possibility of integrating ESG factors into investment governance").

[120] ESMA has already been identified market pressure as an obstacle to green finance's development. *See* EUROPEAN SECURITIES AND MARKETS AUTHORITY (ESMA), *Survey on undue short-term pressure on corporations from the financial sector*, (2019), at 1, https://www.esma.europa.eu/press-news/consultations/collection-evidence-undue-short-term-pressure-financial-sector-corporations [hereinafter ESMA Survey Explanatory Note].

[121] *See* ESMA Survey Explanatory Note, *supra* note 120, at 1. (Responses of asset managers to the ESMA's questionnaire that reject the definition of short/termism gave by ESMA are available at: https://www.esma.europa.eu/press-news/consultations/collection-evidence-undue-short-term-pressure-financial-sector-corporations.)

[122] *See* EUROPEAN COMMISSION, CALL FOR ADVICE TO THE EUROPEAN SUPERVISORY AUTHORITIES TO COLLECT EVIDENCE OF UNDUE SHORT-TERM PRESSURE FROM THE FINANCIAL SECTOR ON CORPORATIONS, https://eiopa.europa.eu/Publications/Advices/190201-call-for-advice-to-esas-short-term-pressure_en.pdf (last visited May 22, 2020).

[123] According to ESMA, "*engagement is defined as any monitoring and interaction by institutional investors with investee companies, including the exercise of voting rights and other activities to influence the investee company such as activist strategies.*" *See* ESMA Survey Explanatory Note, *supra* note 120, at 4. Directive 2017/828 of 17 May 2017 amending Directive 2007/36/EC as regards the encouragement of long-term shareholder engagement, 2017 O.J.

69.Yet, some concerns remain. Many investors tend to be rationally apathetic. Activist investors can aid long-term goals, but also hinder them, if their preferences are short-term, and not sustainability oriented. Boards have great discretion to interpret shareholder resolutions or weigh their relevance and can decide that they do not address a "significant policy issue" for a company.

70.In this sense, the problem is not in what the current initiatives say, which is good, but what they do not say. First, no mention is made to a possible link between ESG goals and investment managers' fiduciary duties.[124] Second, there is no clear framework by which institutional investors can integrate ESG factors into their self-perceived duties, despite those investors' are a major influence in corporate governance, and corporate governance is what ultimately determines the success or failure of strategic changes, (including shifts toward sustainable investments).[125]

71.A "green fiduciary standard" would not need new specific duties; only an expanded, more enlightened understanding of the meaning of the duties of care and loyalty. Financial firms, including institutional investors, investment managers and advisors of different kinds form the links of the investment chain that connect issuing firms with the public. Only if these entities perceive that their fiduciary duties comprise the obligation to ensure that end-investors are aware of the risks, and can communicate their ESG preferences and expectations in the advisory process,[126]and that issuers are made aware of end-investors concerns, and financial firms' own perspective, will reforms give rise to a better, more constructive, engagement process. This perception, however, cannot be nurtured unless the law sends a clear message of comprehensive change. As we saw in the previous section, a piecemeal approach, based on targeted amendments of specific rules, does not suffice.

(L132) [hereinafter Revised Shareholder Rights Directive] (adopted by the EU in 2017, strengthens shareholders' rights and encourages more long-term shareholder engagement).

[124] *Id.*, *supra* note 123, at 7. (The Commission received eight responses to the inception impact assessment on institutional investors and asset managers' duties regarding sustainability (13 November 2017 to 11 December 2017). All of them supported the Commission's work to ensure that sustainability factors are assessed, consistently taken into account and disclosed by institutional investors and asset managers. Moreover, they all referred to issues such as transparency and disclosure, supervision of ESG integration, clarity of investors' duties in the existing EU legislation, comparability and reliability of available data or risk management and governance arrangements.)

[125] "It is clear that the universe of board rules with which listed companies must comply has been significantly extended by the corporate governance rules." *See* P. Davies, *The Board of Directors: Composition, Structure, Duties and Powers, Company Law Reform in OECD Countries. A Comparative Outlook of Current Trends*, (speech), (Nov. 7-8, 2000), at 29,: https://www.oecd.org/daf/ca/corporategovernanceprinciples/1857291.pdf.

[126] Moreover, since institutional investors and asset managers shall act in the best interest of their clients and, in doing so, they undertake to assess which investment products are more suitable for final investors. The Commission conducted targeted interviews with stakeholders (January to February 2018). 23 entities were interviewed. The vast majority of interviewed entities confirmed the need to clarify at EU level whether institutional investors' and asset managers' duties involve assessing ESG-related risks and taking them into account if they are relevant. *See* Committee on Economic and Monetary Affairs, Proposal for a Regulation of the European Parliament and of the Council on disclosures relating to sustainable investments and sustainability risks and amending Directive (EU) 2016/2341, (Nov. 2018), § 3, (*Stakeholder consultation*), https://eur-lex.europa.eu/legal-content/EN/TXT/?uri=CELEX%3A52018PC0354. See *supra* note 91.

72. The conflict between the clear awareness that a narrowness of decision-making perspective in each of the individual links can, once combined, cause massive problems in the aggregate, and the struggle to tackle the problem by re-allocating responsibilities across the investment chain is not something new. After the financial crisis an inquiry in the United Kingdom exposed the risks of short-termism and compartmentalization across the investment chain, and the resulting Kay Review advocated for fiduciary duties that enhanced regulatory standards, were not contractually overridden, and applied across the investment *chain*.[127] Yet, the Law Commission's Report that followed[128] concluded that fiduciary duties as they stood did not follow this pattern, nor were they likely to do so: courts were reluctant to impose fiduciary duties beyond regulatory duties, e.g. in contracts with professional clients, allowed fiduciary duties to be contractually overridden, and configured by the contract, and did not apply them beyond the specific relationship.[129]

73. Legislators are cautious even when what is at stake are shareholders' (i.e. not bondholders') rights, which are the linchpin of directors' fiduciary duties, and should thus be a top priority when regulating how financial intermediaries make directors accountable for the exercise of those duties. The Shareholders' Rights Directive, which was reformed in 2017 to favour shareholder engagement, included rules on institutional investors and asset managers "engagement policies".[130] However, these (1) are primarily transparency duties, i.e. institutional investors and asset managers have to "develop and publicly disclose an engagement policy that describes how they integrate shareholder engagement in their investment strategy"; and (2) based on a comply-or-explain logic, i.e. investors/managers can develop and disclose the policy, or explain why they choose not to.[131]

74. Legislative attitudes (cautious or bold), and institutional investors' incentives will ultimately decide whether changes in company culture will take place. Institutional investors are the main bridge between companies and the public, and differently perceived fiduciary duties could push them towards deeper, more constructive engagement: emphasizing "voice" over "exit" would also help effect granular change, since institutional investors work with data and precise and objective information, rather than subjective perception.

75. And yet, the Kay Review already suggested that "[t]he structure of the industry favours exit over voice, and gives minimal incentives to analysis and engagement", even though all asset managers accepted that engagement was part of the duties of institutional investors.[132] If this was

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[127] *See* JOHN KAY, *The Kay review of UK equity markets and long-term decision making*, (JULY) (2012). [hereinafter Kay Review].

[128] 350 LAW COMMISSION, FIDUCIARY DUTIES OF INVESTMENT INTERMEDIARIES, 30 (2014).

[129] For a summary of the comparison, *see* M. LAMANDINI & D. RAMOS, *supra* note 117, at 674-675.

[130] "[I]ncluding strategy, financial and non-financial performance and risk, capital structure, social and environmental impact and corporate governance, conduct dialogues with investee companies". *See* Art. 3g (1) (a) of Revised Shareholder Rights Directive, *supra* note 123.

[131] *See* Article 3(g) of Shareholders Revised Rights Directive, *supra* note 123.

[132] *See* Kay Review, *supra* note 127, at 5.34.

Many respondents clearly regarded engagement with companies as a cost. One of the largest UK asset managers, with both active and passive funds under management, told us that "engagement with investor companies requires

the situation when pure financial risk was involved, what are the chances of a more constructive engagement on sustainability? O.W. Holmes' "bad man" would not hesitate in his answer.

4. Sustainability and coordination problems: "green" trustees and proxy advisors?

76.Perhaps, if asset managers and conventional financial intermediaries do not see their role in a different light, the answer might be in entrusting specialized parties with that task. After all, one can see the investment public's problem as a combination of (i) an information problem (of information availability, and, more important, saliency); and (ii) a coordination problem to make their voice heard. Financial intermediaries can tackle both, but if we focus on the latter, it is possible to draw useful lessons from the example of parties that specialize in addressing coordination problems for "conventional" financial promises: trustees (for debt instruments) and proxy advisors (for equity instruments).

77.In regular bond offerings the indenture/debenture/bond trustee (hereafter: bond trustee) helps overcome the coordination problem between multiple investors, especially upon the enforcement of their interests upon default.[133] The underpinning problem is that the function of the trustee, which is relevant and comprehensive (i.e., to represent investors' interests), often contrasts with the contractual stipulations that regulate that role, which are narrow and formalistic.[134] Courts have tried to solve this dilemma by focusing on the trustees' implied duties, and distinguishing between a pre-default stage (where duties are more ministerial) and post-default stage (where duties are more expansive).[135] Scholars have concentrated on courts' standard of review; some have argued that bond trustees should be subject to the "business judgment rule" to promote a more managerial approach,[136] while some of us are more reluctant and prefer a case-by-case approach, based on the trustee's function in the bond offering.[137]

78.In this light, one clear inference is that sustainability goals would require a more engaged role by the trustee during the lifetime of the offering. The trustee would have to promote steady

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investment of time and resource which can be seen as an encumbrance in a situation where mandates are being awarded based on fees.

[133] *See* ICMA & NAFMII, *International Practices of Bond Trustee Arrangements* (2018).

[134] D. Ramos Muñoz, *In Praise of Small Things: Securitization and Governance Structure*, 5 CAP. MKT. L. J. 363 (2010), at 370.

[135] In the United States some courts have considered bond trustees contract-based, and only pseudo-fiduciary in nature (*see* Hazzard v Chase National Bank, 159 Misc 57, 287 N.Y.S. 541 (S Ct 1936), or, more recently, AG Capital Funding Partners, L.P., et al. v. Street Bank and Trust Company, N.Y. 3d WL 2510628 (2008)) while others have considered their role as more imbued of fiduciary duties than that of "normal" trustees (see Dabney v Chase National Bank, 196 F2d 668 (2d Cir 1952), appeal dismissed, 346 U.S. 863, 74 S. at 102, 103, 98 L Ed 374 (1953), or, more recently, Beck v. Manufacturers Hanover Trust Co., 650 F. Supp. 48 (S.D.N.Y. 1986)). What seems to be accepted is that pre- and post-default stages is the main distinction. In the United Kingdom, some courts have discussed whether duties and liability can be excluded by contract, with some courts reaching an affirmative conclusion (Citibank v MBIA Citibank NA v MBIA Assurance SA & Ors [2006] EWHC 3215 (Ch) (Eng)) while some statutory rules seem to exclude it (see, e.g. UK COMPANIES ACT, §750 (2006) (Eng)). D. Ramos Muñoz, *supra* note 134, at 393-396.

[136] S. L. Schwarcz, *Bond Defaults and the Dilemma of the Indenture Trustee*, 59 ALA. L. REV. 1037 (2007-2008), at 1037–1073.

[137] D. Ramos Muñoz, *supra* note 134, at 386.

information flows to acquaint investors with the ways in which an issuer plans to give effect to its "green promises", and, conversely, to help them voice their concerns. All this would ensure that bondholders have a "voice", and that issuers can provide more granular information to enhance reliability and trust. This, in turn, would require some re-conceptualization of the trustee's role into an effective monitoring trustee, like those used by the European Commission to verify the fulfilment of engagement taken by private parties in the form of remedies under State aids or competition rules. Unlike financial promises, "green" promises are less binary, the notion of "default" more elusive, and thus the distinction between "pre- and post-default" duties more fluid, also because default may not automatically lead to acceleration, but to a careful weighing of options. This would influence the duties, but also other aspects, notably the fees.

79.The possibility of a "green trustee" would be even more important in the context of securitized or other structured debt, where what is monitored is not a single debtor, but a pool of loans, which may need more expertise. Securitization specialties were considered relevant enough by some rating agencies in the past to advocate a stronger role for the trustee in normal securitizations, despite the main promise was a financial promise, and default was more easily identifiable. In securitised "green debt" it would be difficult to resist the need towards a specialized role that could address bondholders' coordination problem in a definitely more complex context.

80.And yet, the Sustainable Finance Action Plan does make any mention of the possibility to use "green trustees", or similar mechanisms to address bondholders' coordination problem.

81.Another promising avenue seems that of proxy advisors, for equity instruments. Their role is precisely to advise shareholders, or institutional investors on voting policies.[138] EU rules on proxy advisors only require them to adhere to a code of conduct, or explain why they do not do so, and to disclose information concerning their information, methodology, procedures, dialogue with the companies, management of conflicts of interest.[139] Different proxy advisors are already adhering to codes that promote sustainability,[140] which means that they can put pressure on others to do the same. How much institutional investors will heed their advice,[141] and how much company directors will heed institutional investors' views remains to be seen, but at least this represents an open channel to voice shareholders' sustainability concerns. It is however critical, in this perspective, that proxy advisors base their views on a thorough and rational understanding of the true green impact of company's decisions, and not just on a complacent, only declaratory adherence to green promises if we want to achieve a knowledge-based transition to a credible green new paradigm, and not just a green rhetoric in and for the boardrooms.

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[138] Art. 2(g) of the Revised Shareholders Rights Directive, *supra* note 123, defines a "proxy advisor" as *"a legal person that analyses, on a professional and commercial basis, the corporate disclosure and, where relevant, other information of listed companies with a view to informing investors' voting decisions by providing research, advice or voting recommendations that relate to the exercise of voting rights;"*

[139] Art. 3(j) of the Revised Shareholders Rights Directive, *supra* note. 123,138.

[140] *See* INSTITUTIONAL SHAREHOLDER SERVICES (ISS), *International Sustainability Proxy Voting Guidelines*, (2019).

[141] Some authors suggest that their influence may be overestimated. *See* Gaia Balp, *Regulating Proxy Advisors Through Transparency: Pros and Cons of the EU Approach*, 14 EUR. COMP & FIN. L. REV. 1 (2017), at 1-36.

82.The re-shaping of the EEA's role in the terms we cited above[142] could also immensely help in this, by including the possibility for the EEA to act as appointing, or certifying, authority of green trustees and a joint supervisor of proxy advisors. This mandate would be governed by the Regulation of the EEA, in particular, by the provision establishing that the EAA shall provide "the necessary technical and scientific support".[143] Therefore, the EEA could provide ESMA with technical support by acting as a joint supervisor of green gatekeepers (e.g., green rating agencies) and of proxy advisors.

83.First, the EEA (i) is an independent agency which (ii) collects environment data and uses it to stimulate the development of techniques to implement adequate environmental protection and restoration policies (preventive measures).[144] Second, whereas trustees represent bondholders' interests green trustees should ensure that investors get access to proper sustainable information and heed investors' concerns. For that reason, the EEA is an adequate institution to align issuers and bondholders' positions in order to address the coordination problem cited.

84.The same logic would apply for proxy advisors. The EEA collects and process relevant data in order to provide complete, reliable and comparable information on environmental matters. The EEA's technical knowledge on environmental matters contribute the creation of a uniform code of conduct for green promises which proxy advisors should adhere to. Likewise, the EEA can monitor and report on the suitability of the information disclosed by proxy advisors by monitoring the information that proxy advisors disclose and analyse whether it is suitable for further uses aimed at facilitating sustainable investments.

5. Sovereigns, public finances and environmental sustainability: from "exit" to "voice"?

85. If the peculiarities of public finances make "exit" mechanisms more difficult, the challenge is even greater with "voice" based mechanisms. After all, sovereignty means that states cannot meddle in each other's affairs, and the democratic principle means that a state is accountable to its citizens, and not to other states.

86.And yet, we cannot ignore the precedents that allow EU institutions to have a "voice" in the fiscal policies of other states. This occurs in the case of the Eurozone Stability and Growth Pact.[145] This includes a framework for strengthening coordination and surveillance of budgetary discipline,[146] including a preventive arm,[147] and a corrective arm, in the form of an institutional

[142] *See supra* §3.5.

[143] *See* Art. 1.2 (b) of Regulation on the EEA, *supra* note 69.

[144] *See* Art. (i)-(k) of Regulation on the EEA, *supra* note 69.

[145] *See* Arts. 121, 126 and 136, and Protocol 12 TFEU.

[146] Art. 136 TFEU.

[147] *See*, e.g. Council Regulation (EC) No 1466/97 of 7 July 1997 on the strengthening of the surveillance of budgetary positions and the surveillance and coordination of economic policies, 1997 O.J. (L209).

structure for "excessive deficit procedures".[148] The latter includes quite intrusive rules, which allow the surveillance by the European Commission and Council in the budgetary process.[149]

87.This structure is based on a series of rules inspired on the goal of "sound" budgetary policy, and debt "sustainability".[150] It appears that, if the objective is sufficiently important so as to compromise the stability of the countries concerned, they are ready to accept the monitoring of a core part of their sovereignty.

88.If environmental sustainability is truly "this generation's defining task",[151] which means that there is hardly any goal more important, there should be room to build on existing monitoring structures, to use "voice" mechanisms, such as monitoring by Commission and Council, to ensure that, at least in closely integrated areas, such as the Eurozone, fiscal spending is oriented towards fulfilling the Paris Climate goals. As a matter of principle, this would only require re-interpreting the references to "fiscal sustainability" in a broader sense, which also encompasses environmental sustainability. Considering the nature that environmental shocks can have in finances, both private and public, the link between environmental risk, financial risk, and fiscal sustainability should not be hard to establish.

89. As a matter of policy… and politics, though, this would be a drastic "cultural" change, not due to the link between climate risk and fiscal/financial risk (which is solid) but to states' mutual trust to openly discuss their tax-and-spend policies' environmental impact (which is weak).

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[148] Art. 126 and Protocol 12 TFEU. *See also* Council Regulation (EC) No 1467/97 of 7 July 1997 on speeding up and clarifying the implementation of the excessive deficit procedure, 1997 O.J. (L209), or Council Regulation (EC) No 479/2009 of 25 May 2009 on the application of the Protocol on the excessive deficit procedure annexed to the Treaty establishing the European Community, 2009 O.J. (L145).

[149] *See* for example Council Directive 2011/85/EU of 8 November 2011 on requirements for budgetary frameworks of the Member States, 2011 D.O (L306). *See also* Regulation 472/2013 of 21 May 2013 on the strengthening of economic and budgetary surveillance of Member States in the euro area experiencing or threatened with serious difficulties with respect to their financial stability, 2013 D.O. (L140), and Regulation 473/2013 of 21 May 2013 on common provisions for monitoring and assessing draft budgetary plans and ensuring the correction of excessive deficit of the Member States in the euro area, 2013 D.O. (L140) [hereinafter Regulation 472/2013 and Regulation 473/2013 are the Two-Pack Regulation].

[150] Sustainability is already the key concept in both Two-Pack regulations, *supra* note 149. *See* e.g. Art. 1 (1) (a), 2(1) or 6 of Regulation 472/2013, or Recitals (17), (24), (27), (32), or Arts. 5 (2) (c) 7 (4) or 9 (2) Regulation 473/2013. Art. 6 of Regulation 472/2013, *supra* note 149, already indicates that "[t]he assessment of the sustainability of the government debt shall be based on the most likely macroeconomic scenario […] using the most up-to-date information […] The Commission shall also assess the impact of <u>macroeconomic and financial shocks</u> and <u>adverse developments</u> on the <u>sustainability of government debt</u>" (underlined added), while Art. 7 (4) of Regulation 473/2013 provides, for the assessment of the draft budgetary plan, that "The overall assessment shall include <u>sensitivity analyses</u> that provide an <u>indication of the risks to public finance sustainability</u> in the event of <u>adverse economic, financial or budgetary developments</u>" (underlined added) and Art. 9 (2) of the same Regulation provides that the economic partnership programme, "shall identify and select a number of specific priorities" to address "structural weaknesses in the Member State concerned".

[151] *See* the Green Deal Communication, *supra* note 4.

V. THE BIG QUESTION MARK: "COERCION-BASED MECHANISMS", ENFORCEMENT AND PRUDENTIAL RULES.

INSTRUMENT	COERCION
Bonds (corporate debt) Structured (securitised) debt	Prospectus liability
	Prudential rules. "Brown penalising factor"
	Central banks & sustainability
Shares & equity instruments	Business judgment rule Duty of loyalty and company interest
Sovereign debt	Sovereign stability mechanisms & sustainability
	Prudential rules. "Brown penalising factor"

90. "Exit" and "Voice" are the two mechanisms identified by Alfred Hirschman as the possible reactions to discontent with organizations. As already noted, he emphasized that economists, with their emphasis on competition, neglected the role of "voice", while political scientists, with their interest in political participation, neglected the role of "exit".[152] Yet, following this logic, economists, political scientists and Hirshman himself would be neglecting the role of enforcement and other coercion mechanisms that are lawyers' bread-and-butter. We offer a preliminary (and thus brief) analysis on the difficulties associated to coercion-based mechanisms, both direct and indirect, which explains the preponderance of "red" and "yellow". Among "direct" coercion mechanisms we include the liability arising from falsehoods contained in a prospectus, or other public information (for debt instruments) (5.1.) as well as from a breach of (reshaped) duties of care and loyalty (for equity instruments) (5.2.) In this section, however, we also discuss the potential of "indirect" coercive mechanisms, such as the application a "brown penalizing factor" under prudential rules or in central bank (bond purchase) policies (5.3.) or in sovereign debt markets (5.4.)

1. Direct coercion (I). Green default and liability for misstatements.

91. When we approach the issue of liability resulting from a failure to comply with the "green promise" we need to differentiate between the liability resulting from "default", as contemplated by the bond instrument, and the liability arising from false information contained in the prospectus, or the information periodically disclosed to the market.

92.Liability resulting from a "green default" is primarily contractual, and, as such, will be articulated in the offering documents themselves. These must determine how to assess a specific default, i.e. whether it is serious enough to result in an increase in the cost of debt, or in the acceleration of payments. Yet, preliminary evidence is not encouraging. Although some have highlighted the possibility of investors seeking damages for a "green default",[153]others point out that, since use of proceeds, ongoing maintenance or withdrawal of second-opinion reviews and

[152] *See* HIRSCHMAN, *supra* note 14, at 90.

[153] KPMG, *Sustainable Insight Gearing up for green bonds.* KEY CONSIDERATIONS FOR BOND ISSUERS (2015); ORGANISATION FOR ECONOMIC CO-OPERATION AND DEVELOPMENT (OECD), GREEN BONDS. MOBILISING THE DEBT CAPITAL MARKETS FOR A LOW-CARBON TRANSITION, (2015), at 12.

annual reporting are not included as direct covenants in the terms and conditions of the bonds, failure to use bond proceeds for green projects (even deliberate mis-use), inadequate (or non-existent) reporting are not events of default, or events that allow acceleration or early redemption, nor are they step-up events, which trigger an increase in payable coupons.[154] It is hard to overemphasize the importance of this: if the final sanction is unavailable, this affects the credibility of any "voice-based" mechanism (e.g. trustee, financial intermediaries' pressure) that ultimately rests upon the enforceability of the basic "green promise".

93.The impact of sustainability on prospectus liability is even more uncertain. The Prospectus Regulation requires the inclusion of "material" information or risk factors that could have affected the investment decision of the beneficiary or investor,[155] and attaches liability to the issuer, offeror or person responsible for drawing up the prospectus when that information is false or makes omissions likely to affect its import.[156]

94.However, whether a risk is material or not is a matter of interpretation that would depend on the information published by the issuer and the preferences demanded by the investor. This creates a double problem, in relation with the disclosure duties for "green instruments", and in relation to climate-related, or sustainability risks in general.

95. In relation to green instruments, the Prospectus Regulation makes no mention of the need that the issuer, offeror or similar party includes information of the extent to which the offering serves a green purpose in the prospectus. The "green" use of the proceeds may be the key feature of green bonds offerings, but absent a clear legal obligation, the issuers/offerors will have a strong incentive to include as much information as possible outside the prospectus, e.g. during road shows, and to relax the application of "green" verification and reporting standards on an ongoing basis.[157]

96. This also raises important doubts on a liability scenario. Aspects such as what makes a bond "green", or how proceeds may be used, will likely be key information for investors when weighing investment options, but to what extent is less clear. For instance, if only the 80% of the proceeds are allocated in strict accordance with the pre-defined criteria, that percentage might not satisfy the investment criteria for some green bond investors but might do so for others. What would happen if an investor who purchased a green bond argued that the issuer's disclosure was misleading with respect to what made the bond "green"? The only available source in the current Prospectus Regulation is the civil liability regime, whose application depends on the national regulation of

[154] Michael Doran & James Tanner, *Critical challenges facing the green bond market*, INT'L FIN. L. REV. (2019), https://www.iflr.com/Article/3893838/Critical-challenges-facing-the-green-bond-market.html.

[155] *See* Prospectus Regulation, *supra* note 23, (Recitals (41), (54), (66), and Art. 6(1).)

[156] *See* Art. 11 of Prospectus Regulation, *supra* note 23.

[157] Cenzi Gargaro et al., *EU Sustainable Finance Regulation*, WHITE&CASE CLIENT ALERT (2019), https://www.whitecase.com/sites/default/files/2019-06/eu-sustainable-finance-regulation.pdf.

each Member State[158] and which applies to the persons responsible for the information given in a prospectus in case of omitting material information (misleading).

97. Another problem would concern the sustainability risk associated to instruments that are not "green bonds", but have a strong sustainability link because (i) the company makes assurances in that respect, even if it does not wish to categorize the instrument as a "green bond", or (ii) because the company itself has pledged a strong commitment to sustainability; or simply (iii) because the company itself is exposed to sustainability risk. One can argue that climate-conscious investors would like to receive information not only about the business' financial condition, but also about the underlying activity. Yet, it is unclear whether the failure to disclose green goals would attach civil responsibility on the basis of omitting material information or providing inaccurate or inconsistent information.[159] Existing guidelines on non-financial information do not provide a sufficiently clear basis.[160] Terms such as "material", "inaccurate" or "inconsistent" should be interpreted on a case by case basis given that they are not defined in those rules.

98. Even if the falsity or omission is considered "material" another relevant question is what damage may be requested, and the cause-and-effect relationship with the falsity. In conventional, plain-vanilla bonds the expected returns are financial, and thus there will be a direct relationship between, say, a falsity that affects the financial performance of the bonds, and the market price of those bonds, so that there will be some objective elements to assess the damage. In the case of "green bonds", or instruments where the investment decision is partly motivated by the use of proceeds, the harm resulting from relevant falsities or omissions cannot, in purity, be assessed by reference to the decrease in market price, or any other market-imposed penalties. It is an opportunity cost, in the sense that the investor would have been better investing her money someplace else. Yet, this automatically raises the question of what should be the source of comparison: some market measure? the investor's average portfolio of non-green assets? This causation requirement may be even more elusive in relation to instruments that are not expressly

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[158] *See* Art. 11(2) of the Prospectus Regulation, *supra* note 23. (It establishes that "Member States shall ensure that their laws, regulations and administrative provisions on civil liability apply to those persons responsible for the information given in a prospectus.")

[159] The formal answer to the question of whether sustainability can be a source of "material" falsities or omissions is "yes". Recital (54) of the Prospectus Regulation, *supra* note 23. (It states that:

> Among others, environmental, social and governance circumstances can also constitute specific and material risks for the issuer and its securities and, in that case, should be disclosed. To help investors identify the most material risks, the issuer should adequately describe and present each risk factor in the prospectus. A limited number of risk factors selected by the issuer should be included in the summary.

Yet, there are no further indications as to what constitutes a "material" omission, e.g. whether this would concern solely situations where the firm directly suffers environmental risk (e.g. a company affected by food prices, or a construction company affected by the risk of drought or floods), or also comprise cases where the company contributes to climate change, and is subsequently penalized by sanctions or punitive regulation, or even by worsening market perception.)

[160] The non-financial guidelines lay down some instructions as to the companies that should disclose non-financial information; what information should be disclosed, including ESG factors; and how companies can report the non-financial information. Nonetheless, since the guidelines are not binding, they do not provide a liability scheme for breaching the guidelines. *See* NFI Directive, NFI Directive, *supra* note 55 (as regards disclosure of non-financial and diversity information by certain large undertakings and groups.)

"green" but suffer a financial hit as a result of sustainability factors. The provision of specific liquidated damages clauses or penalty clauses in the prospectus to ""ensure"" the green promise would partly solve the enforcement problem, adding to the credibility of the promise. However, this is not an established practice, and for obvious reasons, because it unlikely that issuers may take the initiative spontaneously to commit to pay damages if they fail to abide by their promises. Failing this, the damage may be well established, and even the connection with sustainability or ESG factors, but such connection will be hindsight-based, and that may not satisfy the threshold to argue that the issuer/offeror should have taken these factors into consideration on an ex ante basis.

99.These difficulties make us necessarily cautious when assessing the effectiveness of initiatives such as GBS. At the end of the day, they rely on transparency and better information to assess when investments are sustainable, but "green bonds" ultimately rely on investors' ability to enforce their rights against the "bad man". Thus, if we believe that a chain is as strong as its weakest link, this one is a very weak chain indeed.

2. Direct coercion (II). "Greening", duties of care and loyalty, and company interest?

100. A large part of the credibility of a pivot towards sustainability goals across the whole financial system ultimately rests upon the susceptibility of the fiduciary duties of company directors to be interpreted in a way that encompasses those goals.[161] Mandatory rules are the red lines that cannot be crossed, but directors' fiduciary duties are the compass that sets the course once all red lines have been complied with, which is why they have such prescriptive and expressive force. Consider, for example, the case of a company that publishes a comprehensive strategy on sustainable finance. The company's commitment to fulfil sustainable objectives would apply constantly, unless it infringes any mandatory rule. Whether such pervasive duties apply depend on whether they can be considered as determinative of the appropriate course of action in the best interest of the company for the benefit of its members as a whole.

101.The question is whether it is possible to understand that the "company interest" of "for-profit" corporations goes beyond the economic interest of a hypothetical shareholder in short-term returns. Since taking into account sustainable, social or "non-shareholder" interests can sometimes be congruent with shareholder interests, and sometimes not, the board of directors is the authority that decides whether the company interest is consistent with the beneficiaries of the investment.[162] Some

[161] In previous sections we have discussed the fiduciary duties of financial intermediaries such as investment advisors and portfolio managers as "voice" mechanisms, in the understanding that a reassessment of those duties ultimately translates into changes in the way they interact with their clients, and the companies they invest in. Unlike those, here our focus is on the duties directly applicable to company boards. In both cases the assumption is that (non-financial) companies are the ones making decisions with a direct impact on climate-related issues. From that vantage point, financial intermediaries can persuade the companies, while their own fiduciary duties are a direct source of coercion.

[162] In Associated Students v. Oregon, 82 Or. App. 145, 728 P.2d 30 (Or. App. 1987), (the court held that the trustees of a charitable trust do not need to meet the University's resolution directing divestments (three million dollars) in companies doing business in South Africa, if the divestment resolution breached the prudent investor rule. The court held that despite the plaintiffs had "a particular interest in the allotment of scholarships" from a charitable endowment, their allegations did "not relate to that interest" and so they had no standing). Conversely, *see* Board of Trustees v. Baltimore, 317 Md. 72, 562 A.2d 720 (Md. App. 1989), (the City of Baltimore passed ordinance requiring the city's public pension funds to divest from companies doing business in South Africa. The plaintiffs (trustees) sued the City

US/UK courts have exhorted directors to use their best efforts to maximize shareholders' value or wealth; whilst others have held forth on the importance of socially responsible conduct.[163] Under either approach, the standard of review has been the business judgement rule, which ultimately shows a tension between directors' authority and their accountability.[164]

102.From the perspective of maximization of shareholder wealth, managers would be accountable to maximize shareholders' value. From a "stakeholder" theory maximization includes social concerns and the need to pursue objectives towards society, where the latter objective goes beyond the simple maximization of shareholders' value.[165] According to the first view, even if the concept of "company interest" is not clearly defined by company laws, corporations should seek to maximize profits or return on capital; whilst in accordance with the second view, if a company publishes an explicit interest in promoting low-carbon investment portfolios, the interest of stakeholders and collective long-term developments should be taken into account by the directors in order to suitably promote the company interest.[166]

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arguing that the ordinance reduced their investment universe and this was against the duty of prudence. The Court held that "by considering the social consequences of investment decisions", a trustee does "not necessarily violate the duty of loyalty", and as a consequence some divestment is acceptable with the bounds of prudence.)

[163] In Long v. Norwood Hills Corp., 380 S.W.2d 451, 476 (Mo. App. 1964). (The court held:

> Plaintiff cites many precedents to show that the ultimate object of every ordinary trading corporation is the pecuniary gain of its stockholders and that it is for this purpose the capital has been advanced.". The court further established that it had "no quarrel with plaintiff insofar as the rules of law stated therein govern the actions of majority stockholders and the boards of directors of corporations.)

In A. P. Smith Mfg. Co. v. Barlow, 13 N.J. 145, 98 A.2d 581, 1953 N.J. LEXIS 186, 39 A.L.R.2d 1179 (N.J. 1953), (the claimant usually donated sums of money to a range of charities. There is a state statute that allows the corporation to donate to charities, but the defendants allege that the corporation's certificate of incorporation, which was incorporated prior to the statute, does not allow the gift-giving and the claimant cannot donate money without authorization from stockholders. Claimant argues that company gift-giving increases the goodwill of the corporation. The court does not accept defendants' reasoning arguing that the potentially infinite operational life of corporations would lead them to live under various sets of laws.)

[164] See Robert Barlett & Eric Talley, *Law and Corporate Governance*, *in* 1 THE HANDBOOK OF THE ECONOMICS OF CORPORATE GOVERNANCE 760 (Benjamin Hermalin & Michael Weisbach, eds., 2017).

[165] For a discussion on Benefit Corporations see Katherine Hunt et. al, *Nudging Inclusive Banking and Micro Finance towards Self-Sustainability (The Ethical Role of Regulation and Self-Regulation)*, *in* RESEARCH HANDBOOK ON LAW AND ETHICS IN BANKING AND FINANCE 448 (Constanza Russo et. al eds. 2019), at 102-106.

[166] In U.S. Workers v. U.S. Steel Corp., 631 F.2d 1264, 1280-82 (6th Cir.1980) (the Court held that the board of directors had no duty to take into account stakeholder interests). On the contrary, Shlensky v. Wrigley, 95 Ill. App. 2d 173, 237 N.E.2d 776, 1968 Ill. App. LEXIS 1107 (Ill. App 1st Dist. 1968), (Shlensky, a minority shareholder in the Chicago Cubs, challenges the decision by Wrigley, the majority shareholder, not to install lights at Wrigley Field. Shlensky claims that the team was money loser because of the board's refusal to install lights and play night baseball. The majority shareholder argues that Wrigley was motivated by his beliefs that night baseball might have a deteriorating effect on the neighborhood surrounding Wrigley Field. The court observed that the decision to "not to install lights at Wrigley Field" because of the "deteriorating effect on the surrounding neighborhood…might well be considered by a director." The court added that "the long run interest" of the corporation "might demand protection of the neighborhood." Accordingly, Shlensky's case was dismissed for failure to state a claim upon which relief could be granted. In this vein, some scholars hold that stakeholder interests are to be taken into account when promoting the company member's interest. The success of the company will lead to the success for the benefit of its members. Directors shall promote the success of the company for the benefit of its members as a whole, which means to have regard to the impact of the company's operations on the environment and the community, maintaining a reputation for high standards of business conduct.) *See* Paul Davies & Jonathan Rickford, *An Introduction to the New UK Companies*

103.The existing regulation does not impose a legal obligation for the directors/managers to consider ESG factors, but it only provides recommendations. However, when the objective of a company is, say, to reduce its carbon emissions towards an overall alignment with the target of the Paris Climate Agreement, one can argue that the directors should have regard not only to the maximization of profits but also to the impact of the company's operation to the environment.[167] Negative externalities are in this way incorporated into the company's costs. Thus, the directors' liability would depend, first, on the provisions contained in the bylaws of the company and, second, on the potential regulatory change where sustainability can be made part of the company's interest.

104.As regards the second consideration, a solution that may be half way between maximization of profits and compliance with social objectives is the converge approach proposed by the EU Economic and Social Committee (EESC).[168] The EESC has highlighted that EU law should provide for the existence of entities such as Social Economy Enterprises (SEE), whose particularities are not reflected in the law yet. SEEs are neither capitalist-type for-profit corporations nor financially altruistic entities, but their purpose is to meet objectives according to principles such as the primacy of social goals over capital, and democratic governance.[169] This does not mean that managers of SEEs do not serve the economic interests of shareholders, but these companies, by definition, pursue also objectives related to environmental or social protection. Instead of profit maximisation, fair return on capital profitability is the key difference between SEEs and capitalist-type enterprises. This is what we call a "New Testament" view for corporate governance, one concerned not just with setting limits but also with nudging companies to do a simple but not so obvious positive action: doing good. Lynn Stout called it the culture of a corporate governance for a privately-ordered public policy[170] by driving positive societal change. Yet, also in this context, no real change can credibly be expected absent any structured channels by which culture can turn into 'law', or at least 'law of the sort'. In this regard, the constraints as to the "company's interest" to maximize profits can be formalised in the company's bylaws, and in addition the EESC proposes that EU law

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Act, 5 EUR. COM. & FIN. L. REV. 48 (2008), at 65-66, https://www.degruyter.com/view/journals/ecfr/5/1/article-p48.xml.

[167] *See* Opinion of the European Economic and Social Committee (EESC), *Towards an appropriate European legal framework for social economy enterprises*, 544th Plenary Session (2018), (own-initiative opinion)) ¶ 2.2.12, https://eur-lex.europa.eu/legal-content/EN/TXT/HTML/?uri=CELEX:52019IE0346&from=ES [hereinafter EESC Opinion on social economy enterprises]. (The EESC states that:

> [The]Union law does not impinge on any decision to adopt either a capitalist-type for-profit structure for a company, where power depends on the amount of shares (or equity) held, or a social economy structure under which power is distributed on the basis of people rather than capital." See Opinion of the European Economic and Social Committee, Towards an appropriate European legal framework for social economy.)

[168] Social objectives are connected to sustainability at some level since sustainable development and social economy are currently undergoing a process of convergence.

[169] SEEs make profit but they do not intend to distribute the entire profit or part of it to their owners, as their purpose is based on social objectives. Hence, sustainability can be considered a "social objective", too. According to the EESC, the neutrality principles should make it possible to unlock the potential of all types of entrerprise by avoiding a situation where only one single model develops: "[neutrality] leads to non-recognition of whole swathes of the economy and allows a certain type of enterprise to be imposed as the reference standard or model for law-making". *See* EESC Opinion on social economy enterprises, *supra* note 167.

[170] LYNN STOUT et. al, CITIZEN CAPITALISM (2019).

integrates the possibility to qualify an entity as a limited profit company in order to make profitability a means instead of the main objective of its operations.[171] The integration of SEEs or similar types of companies may encourage directors to use their best efforts to both maximize shareholders' wealth whilst achieving sustainable objectives.

105.If the directors rather focus on promote the success of personal shareholders wealth over promoting the ESG objectives, they could face liability under their fiduciary duties if they voluntarily decided to bind themselves.[172] However, the answer to this question seems cumbersome in the current framework.

3. Indirect coercion (I). A "brown" penalizing factor in prudential rules and central bank purchases of corporate debt?

106.Prudential rules would, in purity, be considered either "exit-based", or "voice-based", as they would induce banks to either disinvest (by limiting credit) in sustainability-risky companies or convey their concerns to those companies' boards. The same goes for central banks' bond purchases, which are purely "exit-based". Yet, given their status as prescripts-setters of what is considered risky or not, we include them among coercion mechanisms: the threat of being ostracized from the credit market is as coercive a tool as one can imagine.

107.The current debate is focused on whether or not introducing a "green supporting factor" to boost green investments. This measure would consist of lowering capital requirements for certain carbon-low investments with the aim at making green investment appealing to a higher number of investors.[173] However, some voices argue that, there is no empirical evidence that low-carbon loans are less risky than carbon-intensive loans.[174]

108.Other voices argue that in parallel with the green taxonomy, a "brown penalizing factor" that imposes higher capital requirements for brown assets would be a stronger approach.[175] The "green supporting factor" can help increase "purely green" investment above 1% of the bond market; but the "brown penalizing factor" is better if the goal is to make sustainability part of "mainstream" finance and risk management, as the Commission Action Plan purportedly tries to do.[176]

109.The argument is reasonable. Increasing the risks that banks need to weigh when making carbon-intensive investments could reflect the systemic risk of investing in those investments and deter further investments that contributes to climate change. However, there is still considerable

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[171] *See* EESC Opinion on social economy enterprises, *supra* note 167, § 3.1.

[172] For a more detailed explanation on self-regulation, *see* HUNT, s*upra* note 165, at 37-106.

[173] The green supporting factor was an initiative raised by the TEG in 2018. *See* TECHNICAL EXPERT GROUP (TEG), ALL EXPERT WEBINAR (2019), https://www.epma.com/dm-industry-news/814-eu-taxonomy-webinar/file.

[174] *See* Sini Matikainen, *Green doesn't mean risk-free: why we should be cautious about a green supporting factor in the EU*, GRANTHAM RESEARCH INSTITUTE ON CLIMATE CHANGE AND THE ENVIRONMENT (2017), http://www.lse.ac.uk/GranthamInstitute/news/eu-green-supporting-factor-bank-risk/.

[175] *See* DIRK SCHOENMAKER & WILLEM SCHRAMADE, PRINCIPLES OF SUSTAINABLE FINANCE 432 (2019), at 68.

[176] *See* EU Commission Action Plan 2018, *supra* note 9, at 6- 7.

debate about what policy tools would be better suited to addressing the risk or how risky these assets are,[177] and how to "apportion" the systemic risk created by carbon-intensive activities across the instruments issued by the companies that engage in such activities.

110.Even more difficult would be to convince central banks to consider sustainability goals as part of their mandate and deter them from purchasing bonds from issuers in polluting industries. Some recent research suggests that the presence of environmental protection goals as a sort of overarching goal would be supported by its recognition in articles 3 and 11 TEU, and the ratification of the Paris Accord by the EU, which would contradict the ECB's approach, which suggests that environmental goals irrelevant for its monetary mandate.[178] However, even admitting that environmental protection is a relevant legal factor for the ECB's mandate would not answer the question about what the avenues would be to ensure that it is actually taken into consideration, because the justiciability of the issue could endanger central bank independence.

4. Indirect coercion (II). Sovereigns and public finances: can someone bell the cat?

111.If instilling sustainability goals into prudential supervision and central bank mandates looks complicated, moving the levers of public to coerce sovereign states to shift their finances towards sustainability goals looks remote. As we moved from "exit" tools (based on the reorientation of public investment flows towards "green projects") to "voice" mechanisms (based on re-purposing existing structures for "fiscal" sustainability to encompass sustainability in a broader sense) the options became more limited. As we move from "voice" to "coercion", the question is whether there are any options available. Considering that states are sovereign in the way they manage their finances, any constrain that may result in coercion needs to have been pre-agreed.

112.Any solution would have to build on the existing institutional infrastructure to enforce financial promises and extrapolate it to "green" promises. For the moment, any possibility linked to the market in sovereign debt looks remote. In previous sections we discussed the possibility of expanding the Eurozone Stability and Growth Pact to monitor environmental sustainability, albeit pointing the enormous challenge that this would entail[179] Moving from "voice" to "coercion" would require a similar step as a matter of principle (i.e. espousing a broader concept of "sustainability"), but an even more difficult step as a matter of policy and politics.

113.As a matter of principle current Eurozone rules contemplate a procedure for the detection and correction of macroeconomic imbalances,[180] which includes the possibility of imposing sanctions

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[177] *See* Frank Van Lerven & Josh Ryan-Collins, *Central Banks, Climate Change and The Transition to a Low-Carbon Economy*, NEW ECONOMICS FOUNDATION (2017), http://neweconomics.org/wp-content/uploads/2017/09/NEF_BRIEFING_CENTRAL-BANKS-CLIMATE_E.pdf.

[178] Javier Solana, *The Power of the Eurosystem to Promote Environmental Protection*, 30 *Euro. Bus. L. J.*, 548 (2019), at 547-575.

[179] *See supra* §§3.4. and 4.5.

[180] Regulation 1176/2011 of 16 November 2011 on the prevention and correction of macroeconomic imbalances, 2011 D.O. (L306), https://eur-lex.europa.eu/legal-content/en/TXT/?uri=celex%3A32011R1176.

in case of non-compliance.[181] None of the relevant rules would require major adjustments to account for climate-related factors, as they are formulated in relatively broad, and all-encompassing terms.[182] Sustainability-related factors could also be used to calibrate forbearance in the imposition of sanctions, which is permitted in case of "exceptional economic circumstances", or "following a reasoned request of a Member State".[183]

114.Sustainability factors could also be incorporated into last-resort financial assistance tools, such as the ESM. The ESM grants financial assistance under strict conditionality,[184] and it is involved in setting the policy conditions of adjustment programs.[185] It grants stability support following an assessment by the European Commission and the ECB of a risk to financial stability, and debt sustainability,[186] under conditions set forth in a Memorandum of Understanding (MoU) agreed with the state recipient.[187]

115. The legal challenge to adapt this to sustainability goals does not seem formidable. To the extent that one accepts the link between environmental risk and financial stability, concepts such as "stability", "sustainability", "conditionality" or "adjustment" are sufficiently flexible, and the MoU, having a contractual logic, seems even more so. Furthermore, the ESM has become a signatory of the UN Principles of Responsible Investment,[188]which should account for something.

116.Thus, it is the political challenge that looks formidable. Even if climate-related shocks and financial (in)stability are related in general, establishing a direct link between a State's contribution, and climate shocks is more difficult, and the greatest contributor need not be the state in need of financing, while the imposition of climate-related adjustments under threat of financial duress may

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[181] Regulation 1174/2011, of 16 November 2011 on enforcement measures to correct excessive macroeconomic imbalances in the euro area, 2011 D.O. (L306), https://eur-lex.europa.eu/legal-content/EN/ALL/?uri=CELEX%3A32011R1174 [hereinafter Regulation on measures to correct excessive macroeconomic imbalances].

[182] The key concept in Regulation 1176/2011 are "macroeconomic imbalances", which are defined in article 2 (1) as *"*<u>any trend giving rise to macroeconomic developments</u> which are adversely affecting, or <u>have the potential adversely to affect</u>, the <u>proper functioning</u> of the economy of a Member State or <u>of the economic and monetary union, or of the Union as a whole</u>*;"* that are measured by a "Scoreboard" (article 4).

[183] *See* Art. 3 (6) of Regulation on measures to correct excessive macroeconomic imbalances, *supra* note 181.

[184] *See* Arts. 3 (1), 13 (1) European Stability Mechanism (ESM) Treaty, between the Kingdom of Belgium, the Federal Republic of Germany, the Republic of Estonia, Ireland, the Hellenic Republic, the Kingdom of Spain, the French Republic, the Italian Republic, the Republic of Cyprus, the Republic of Latvia, the Republic of Lithuania, the Grand Duchy of Luxembourg, Malta, the Kingdom of The Netherlands, the Republic of Austria, the Portuguese Republic, the Republic of Slovenia, the Slovak Republic and the Republic of Finland, (Feb. 2, 2012), https://www.esm.europa.eu/sites/default/files/20150203_-_esm_treaty_-_en.pdf [hereinafter ESM Treaty].

[185] Although outside the EU legal framework, *see* Art. 7(12) (3), and Recitals (12) and (18) of Regulation (EU) No 472/2013, *supra* note 149, (they permit to infer such involvement.)

[186] Art. 13 of ESM Treaty, *supra* note 184.

[187] Art. 13 (3) of ESM Treaty, *supra* note 184.

[188] ESM, ESM BECOMES SIGNATORY OF UNITED NATIONS PRINCIPLES FOR RESPONSIBLE INVESTMENT, https://www.esm.europa.eu/press-releases/esm-becomes-signatory-united-nations-principles-responsible-investment (last visited May 22, 2020).

not be a popular option. The fact that we look at this scenario with some disbelief is proof that, as far as "green promises" go, they are less credible than financial promises.

117. The challenge seems even more difficult if we think about "greening" central bank or commercial banks purchases of sovereign debt, by adjusting central bank frameworks or prudential frameworks. Central banks cannot (or should not) provide financial assistance to sovereigns, unless there is a threat to financial and monetary stability,[189] in which case refusing to purchase a state's bonds because it is not climate-friendly does not sound credible. "Greening" prudential rules applicable to sovereign exposures seems equally hard. Since sovereign exposures receive preferential prudential treatment,[190] and regulators have been unable to correct this in the name of financial risk, penalizing them in the name of environmental risk sounds even less feasible.

VI. CONCLUSIONS

INSTRUMENT	EXIT		VOICE	COERCION
Bonds (corporate debt)	Standards (Green Bonds)	Using the European Environmental Agency (EEA) to enhance transparency.	Ratings, Advice	Prospectus liability
	Taxonomy		Intermediaries organizational rules	"Brown factor" in prudential rules
Securitization/structured debt	Fin. Inst. disclosures		Intermediaries fiduciary duties &engagement	Sustainability & central bank purchases
	Green securitised bonds		Green trustee	
Equity/shares	Non-financial disclosures		Proxy advisors	Bus. judg. rule, loyalty, company interest
			Intermediaries fiduciary duties & engagement	
			Sustainable corporate governance & duties	
Sovereign debt/public funds	Green sovereign bonds		A sustainable Stability and Growth Pact	"Sustainable" sovereign stability mechanisms
	European Investment Bank			"Brown factor" prud. rules for sovereigns

118.The Paris Agreement was the starting point to develop policies to tackle climate change. The EU Action Plan 2018 shows the Commission's will to make the EU a leading actor in sustainable finance, and contains clear steps to achieve its objectives: creating a unified green taxonomy, encouraging reliable disclosures of taxonomy-related information, benchmarks, and policy initiatives regarding intermediaries and institutional investors, or prudential regulation and

[189] E.g. by affecting the monetary policy transmission mechanism. *See* C-62/14, Peter Gauweiler v Deutsche Bundestag [June 16, 2015], ECLI:EU:C:2015:400.

[190] D. Nouy *Is sovereign risk properly addressed by financial regulation?*, 16 FIN. STABILITY REV., 95 (2012), at 95-106; V. Acharya & S. Steffen, *The "greatest" carry trade ever? Understanding eurozone bank risks*, 115 J. FIN. ECON. 2 215 (2015) at 215-236; NICCOLÒ BATTISTINI et. al, *Systemic Risk and Home Bias in the Euro Area*, 494 ECONOMIC PAPERS 1 (2013), at 1-50.

supervision rules integrating ESG factors. The UN Climate Change Conference COP 25[191] showed collaborative initiatives,[192] calls to allocate more capital to low carbon investments and put a price on carbon-intensive activities, or proposals to foster synergies among climate finance actors, including finance regulators and the private sector, by building on the enhancement of climate-related risk disclosure to strengthen mitigation and adaptation.[193]

119. More than one year after the EU Action Plan has been prepared, there is (some) progress on many fronts, and a myriad of initiatives dispersed across different policy areas. Thus, it is useful to ask whether the EU initiatives on climate-related finance convey a general message about the preferred means to effect change, and what does this message say about the likelihood that the ultimate goal (using finance's muscle to enhance sustainability across the board) will be achieved.

120. To answer this question, we have used a simple idea: stripped to its bare bones, "sustainability" is a "promise", which, like financial promises (on risk and returns) consists in meeting certain goals. Unlike financial promises, it offers extra complications (notably on measurement), but it is safe to assume that, to be credible, the "green promise" should be backed by mechanisms that ensure the effectiveness of the commitment, like financial promises are. The underpinning logic is that the proverbial "bad man" of O.W. Holmes only cares about the negative consequences of his actions.

121. What we propose is to use the available tools to secure their effectiveness as a proxy of the credibility of "green promises", exactly like it is done for financial promises. To make sure that the comparison is fair, we use relatively ample concepts, not tailored to financial promises. In this aim, we find Alfred Hirschman's distinction between "Exit" and "Voice" particularly enlightening, although, as lawyers, we also add a "Coercion" dimension. These three concepts help us to set up sufficiently broad categories to compare what mechanisms are available to ensure compliance with green promises, and how well these fare when compared with financial promises.

122.Once adopt this methodology, and instead of analysing measure by measure we decide to group them together according to their logic, a clear pattern emerges: current initiatives are overwhelmingly based on an "exit" logic, i.e. most of the new rules, and proposed rules simply try to improve the information available, to let investors "vote with their feet". Moreover, a large part of those rules is concentrated on identifying a "niche" of "green" or "sustainable" investments that can cater to the needs of sustainability-concerned investors.

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[191] See the information on the UNFCC, UN CLIMATE CHANGE CONFERENCE –DECEMBER 2019 (2019): https://unfccc.int/cop25 (last visited May 22, 2020).

[192] Global Investor Statement to Governments on Climate Change urge national governments to strengthen their contributions to achieve the goals of the Paris Agreement. *See* INVESTOR AGENDA, GLOBAL INVESTOR STATEMENT TO GOVERNMENTS ON CLIMATE CHANGE, (2019), http://theinvestoragenda.org/wp-content/uploads/2019/12/December-9-2019_-PressRelease_Global-Investor-Statement-to-Governments-on-Climate-Change.pdf. *See also* the Press released by THE INVESTOR AGENDA, INSTITUTIONAL INVESTORS MANAGING MORE THAN USD 37 TRILLION IN ASSETS URGE GOVERNMENTS TO STEP UP, (2019), https://unfccc.int/news/631-institutional-investors-managing-more-than-usd-37-trillion-in-assets-urge-governments-to-step-up.

[193] UNITED NATIONS FRAMEWORK CONVENTION ON CLIMATE CHANGE (UNFCC), IN-SESSION WORKSHOP ON LONG-TERM CLIMATE FINANCE IN 2019, 25th Session (2019), at 6, 9: https://unfccc.int/sites/default/files/resource/cp2019_04E.pdf.

123.These efforts, worthy of praise as they are, are simply not what the Paris Agreement and UN Conferences have in mind when they outline the need for drastic changes. Impressive as the growth of "sustainable investments" is, it still represents 1-2% of the whole market, which makes it legitimate to ask whether something should be done about the remaining 98-99%. This may be more difficult to change if reforms and their implementation rests on the shoulders of authorities that, like the ESAs, are used to look at the market in a compartmentalized way (i.e. distinguishing between banking, securities and insurance). To make up for this "silo" approach we suggest adding to the equation the European Environmental Agency (EEA) which may look at the problem less from the lens of the particular instrument, and more about a general sustainability viewpoint.

124.That current initiatives are "niche" based can be seen in the fact that the Technical Expert Group (TEG) taxonomy and standards are limited to some instruments (bonds, pension or funds) while disregarding others (e.g., securitisation instruments), and not even considering some (e.g., sovereign bonds). That they are exit-based can be seen in the fact that, as one moves from measures aimed at improving the information available, towards measures aimed at improving the internal decision-making within financial intermediaries, and their external interactions with clients and companies alike, proposals are less detailed, and are accompanied by more tepid messages.

125. Some prudence is understandable. Climate-related risk is still hard to gauge, and regulators are not in a position to dictate the use of specific methodologies. Yet, "voice-based" mechanisms can only prosper if the expressive function of the law is used to send a clear message, i.e. that sustainability is not a marginal consideration for certain types of investments, but an overarching concern across the board. Only then will financial intermediaries commit the necessary share of resources and attention (already spread thin across a myriad of rules) to ensure that their internal structures are adapted to process climate-related risk, and that their external relations are adapted to signal to investors that they can express their sustainability preferences, and to constructively engage with companies to convey the message that sustainability is an key part of the discussion.

126.From this perspective, the evidence is not encouraging. Proposed rules requiring financial intermediaries to incorporate sustainability risks as a structural tool are not clear about the duty's meaning and scope, fiduciary duties, despite their flexibility, tend to be quite rigid when it comes to incorporating goals that pervade the whole investment chain, and proposals to strengthen the role of specialized parties, such as "green trustees" (for debt instruments) and proxy advisors (for equity instruments) are not decisively developed, or not even considered. In line with our views on "exit-based" mechanisms, we would propose to not only seriously consider these roles, but to also consider the involvement of the EEA as a certification, or even appointing authority.

127.Finally, despite exit- and voice-based mechanisms are key steps towards a low-carbon economy, "coercion-based" tools are still crucial, as a "closure" mechanism, and an expression of the legislator's seriousness of commitment towards the issue. For market participants as a whole, they convey that the rules' underpinning principles have decidedly shifted to embrace a broader notion of "sustainability" (which comprises a financial and a climate-related perspective). For the

“bad man” there is no clearer message than the prospect of financial ruin if it does not fulfil its promise.

128.Come to this point, however, the picture is dismal. There has been no clear reflection on the need to back up increased transparency with the threat of damages in case statements are not followed by deeds (direct coercion), while the decisive intention to consider climate-related risk to introduce a “brown penalizing factor” under prudential rules or central banks policies, which could be a good approach to make sustainability part of the mainstream finance and risk management, has not been followed by equally decisive reforms.

129.In conclusion, rules delineate the boundaries of permissible activity, but also the legislative intent about the goals, the tools to meet them, and their credibility. Financial promises are credible because they are backed by “exit”, “voice” and “coercion” mechanisms. By that yardstick, sustainability is, simply, not credible as a promise. Current reforms are suitable to encourage sustainable investment as a niche choice, and vastly insufficient for any other goal. To these objections one can answer that, in any legislative reform, the safer choice is to create a firm basis of clear criteria, and then gradually and prudently build from there. In general, we tend to align with this way of thinking. On the issue of finance and climate change, though, we cannot help but wonder whether time is on our side.

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