



EUROFI MAGAZINE: Sustainability reporting: moving forward, but not plain sailing

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Septiembre de 2022

Several years have gone by since the conversation about sustainable finance started. Throughout this time, Europe has strongly supported the transition to a more sustainable economy and has been at the forefront of efforts to build a financial system that supports sustainable growth.

Looking back, it is impressive how much we have advanced in the development of a new sustainable finance regulation. One of the main drivers of this change has been the establishment of a transparency framework based on disclosures at product and entity level in the financial sector.

Firstly, the EU-wide classification system introduced by the Taxonomy Regulation has provided clarity for investors on environmentally sustainable economic activities. Additionally, the Sustainable Finance Disclosure Regulation (SFDR) has implied a great change for asset managers and asset owners setting disclosure obligations of an entity's investment decisions and requirements on how to present the characteristics of products. Lastly, the Corporate Sustainability Reporting Directive (CSRD) will be a game changer in enhancing comparability and increasing transparency on sustainability corporate performance.

However, despite all the effort made so far, the challenges ahead are still huge, partly due to the intensity and velocity of this regulatory wave. These changes will take time to digest. I would like to underline three of these challenges: risk of greenwashing, a lack of criteria for market participants and regulators, and possible inconsistencies across regulatory requirements.

First, greenwashing. One of the main objectives of the new sustainable finance regulation is precisely to crack down on so-called greenwashing. Regulators should play an essential role in identifying, preventing, and remediating greenwashing but they can not do this alone. Greenwashing is a complex and multifaceted issue which takes many forms. There is a clear role here for the European authorities to develop a cross-cutting definition of greenwashing and consider further sector-specific adaptations if needed.

Secondly, despite efforts made, the lack of enough data and criteria has led to some misalignment in the interpretation of key regulation concepts and possible inconsistencies in their EU-wide application.

For instance, SFDR was not intended to be used as a labelling regime, but it is becoming one, and some areas remain open to a wide spectrum of interpretation. More work needs to be done on specifying minimum sustainability criteria, mainly for Article 8 funds, to reduce the current confusion in the market.

Furthermore, reliable and comparable corporate reporting is still lacking. The first EU Sustainability Reporting Standards (ESRS) will not be due until early 2025 since companies will need time to adjust. Additionally, the proposed ESRS bring their own challenges, such as the possible information overload and the need to ensure convergence with international initiatives without compromising the EU's sustainability ambitions.

Finally, another key challenge of this evolving regulatory framework is that it could lead to inconsistencies across regulatory requirements. The sustainable finance rulebook is complex, and it is important that all market participants understand how various texts are interlinked. I will just mention two examples: do no significant harm (DNSH) definition and differences between sustainable investment and activities in SFDR and the Taxonomy.

But, does this mean that we have to slow down the implementation and development of regulation?

Some may argue that legislators are going too far, too fast. It is true that some of the regulation may have too much detail, but I do not think the answer is to slow down, at least not regarding transparency and reporting. It is precisely the lack of a completed regulatory framework that increases the risks of greenwashing and the problems of lack of comparability, both between products and companies, as well as between jurisdictions. That is why it is more important than ever to increase efforts to ensure rules are comparable and consistently applied across jurisdictions.

To that end, regulators should apply the necessary flexibility so that market participants can adapt to the new requirements and navigate this new domain. But this is not enough. First, legislators should also understand the challenges that companies are facing and take this into account while completing the framework. Secondly, we all should increase coordination and cooperation. ESMA has a prominent role to play in ensuring supervisory convergence and offering guidance in achieving the desired level of transparency and comparability of financial products across EU jurisdictions.