



EBI STUDIES IN
BANKING AND CAPITAL MARKETS LAW

Sustainable Finance in Europe

Corporate Governance,
Financial Stability and Financial Markets

Edited by Danny Busch · Guido Ferrarini
Seraina Grünewald



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EBI Studies in Banking and Capital Markets Law

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SERIES EDITORS' PREFACE

The European Union (EU) has set ambitious climate-related and environmental goals. In this respect, and according to the recent (2018) European Commission's Action Plan on Financing Sustainable Growth, the financial sector should play a key role in this 'green' transition by bringing together supply and demand for 'green' capital, supporting thus sustainable finance.

The aim of this book on *Sustainable Finance in Europe* is to collect views of expert academics and practitioners on the latest regulatory developments in sustainable finance in the EU. The volume deliberately includes a wide range of cutting-edge aspects. Although it mainly focuses on the green transition and environmental sustainability, it also addresses social and governance issues, i.e. all so-called ESG issues. The individual contributions deploy different methods of analysis, including theoretical contributions on the *status quo* of macro-financial research, as well as law and economics approaches, encouraging thus interdisciplinary readership.

The book chapters are grouped in a thematic way, covering the following areas: (i) General Aspects, including the impact of the current COVID-19 crisis on the sustainability agenda (Part I); (ii) Sustainable Finance and Corporate Governance (Part II); (iii) Sustainable Finance and Systemic Risk (Part III); and (iv) Sustainable Finance and Financial Markets (Part IV).

Some of the chapters included in this book are based on presentations made at the 2020 Global Annual Conference of the European Banking

Institute (EBI), which took place in Frankfurt on 20 & 21 February. The conference was jointly organised with the Goethe University, the Institute for Monetary and Financial Stability (IMFS) and benefited from the kind support of the Foundation Project Capital Markets Union.

The book serves as the first volume in the newly established EBI Book Series on Banking and Capital Markets Law.

Danny Busch
Christos V. Gortsos
Antonella Sciarrone Alibrandi

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PART I

General Aspects



Sustainable Finance in Europe: Setting the Scene

Danny Busch, Guido Ferrarini, and Seraina Grünewald

1.1 INTRODUCTION

The European Union (EU) has launched ambitious climate plans. According to the European Commission's Sustainable Finance Action Plan, the financial sector must play a key role in this green transition by bringing together supply and demand for green capital.¹

¹See the Green Deal presented by the European Commission on 10 December 2019 (COM (2019) 640 final) and the proposal dated 4 March 2020 for a 'European Climate Law' (COM(2020) 80 final), amended on 17 September 2020 to include a revised EU emission reduction target of at least 55% by 2030 (COM(2020) 563 final). The Sustainable Finance Action Plan was launched by the previous European Commission on 8 March 2018 (COM (2018) 97 final); for the present position, see https://ec.europa.eu/info/business-economy-euro/banking-and-finance/sustainable-finance_nl.

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The aim of this book is to collect the views of expert academics and practitioners on the latest regulatory developments in sustainable finance in the EU. The volume deliberately includes a wide range of cutting-edge issues. Although it focuses on the green transition, it also addresses social and governance issues. The individual contributions deploy different methods of analysis, including theoretical contributions on the status quo of macrofinancial research as well as law and economics approaches, encouraging interdisciplinary readership.

The book chapters are grouped in a thematic way, covering the following areas: (i) general aspects (Part I); (ii) sustainable finance and corporate governance (Part II); (iii) sustainable finance and systemic risk (Part III); and (iv) sustainable finance and the financial markets (Part IV). This chapter provides a summary and overview of the chapters. But before doing so we will discuss the impact of the COVID-19 crisis on the sustainability agenda.

1.2 SUSTAINABLE FINANCE AND COVID-19

In the blink of an eye, COVID-19 paralysed the world economy. Restaurants, hotels, bars, theatres, cinemas and concert halls closed their doors, and their income dried up. Events were cancelled, and the aviation and tourism industries came to an almost complete standstill. Demand for oil largely dried up. As businesses in the directly affected sectors suddenly ceased to generate income, they are no longer able to pay their employees, banks, landlords and suppliers, throwing the economy into a downward spiral. This in turn is reducing tax revenue, putting extra pressure on government finances. The consequent uncertainty has caused extreme volatility in the financial markets. While a successful rollout of vaccination programmes internationally may induce governments to lift lockdown

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restrictions in the short to medium term, the economic impact will be felt for a long time to come. A deep global recession seems inevitable.

Investors and the business community are being hit hard. As the current crisis has reduced the amount of capital available generally, less private sector capital is also available for the transition to a greener economy. Implementation of the climate plans is likely to be delayed by the COVID-19 crisis. This is particularly tragic since a link may exist between climate change and the outbreak of pandemics.² A delay in the realisation of the climate plans would therefore be unacceptable.

However, three more positive observations may perhaps be made. First, the COVID-19 crisis may help us to realise that a video link, despite all its limitations, works quite well and that flying around the world for face-to-face meetings is often not really necessary. Second, the massive state aid provided by governments to their corporate sector (e.g. KLM-Air France) gives them the opportunity to impose green conditions.³

And last but not least, the Member States and the EU themselves can act as providers of green or social funding. The interest rate is historically low so they can borrow cheaply on the capital markets and transfer the money to the market parties as a loan, as equity or even as a gift.⁴ Moreover, in cooperation with the national central banks of the eurozone, the European Central Bank (ECB) will likely continue to buy government bonds on a massive scale via the secondary markets for the time being.

In fact, the EU *is* already acting as provider of social and green funding. First of all, there is the EU programme for Support to mitigate Unemployment Risks in an Emergency (SURE). SURE is funded by raising a total of EUR 100 billion through social bonds issued by the EU itself. By 26 January 2021, the European Commission had raised EUR 53.5 billion through the issuance of social bonds in four rounds

²That link is in any event assumed by the European Commission in the ‘Consultation on the renewed sustainable finance strategy’ dated 8 April 2020 (p. 3) (https://ec.europa.eu/info/consultations/finance-2020-sustainable-finance-strategy_en).

³See also D. Schoenmaker: <https://www.bruegel.org/2020/04/a-green-recovery/> (6 April 2020).

⁴Always subject to state aid restrictions of course. To ensure that national governments can act swiftly and know what is allowed during the COVID-19 crisis, the European Commission published a specific temporary state aid framework. The Commission is currently handling applications under state aid rules with unprecedented speed and applying the rules in a generous spirit. See: https://ec.europa.eu/competition/state_aid/what_is_new/covid_19.html.

under the EU SURE instrument to help protect jobs and keep people in work. The issuings consisted of 5-, 10- and 15-year bonds. There was very strong investor interest in these highly rated instruments, and the oversubscription resulted in favourable pricing terms for the bonds. The raised funds are transferred to the beneficiary Member States in the form of loans to help them directly cover the costs related to the financing of national short-time work schemes and similar measures as a response to the pandemic. On 27 October 2020, the EU SURE social bond was listed on the Luxembourg Stock Exchange, and will be displayed on the Luxembourg Green Exchange, the world's leading platform exclusively dedicated to sustainable securities.⁵

Moreover, at the extraordinary European Council of 17–21 July 2020, the European Heads of Government reached an agreement on the European Multiannual Budget and the Corona Recovery Fund (the Next Generation EU Plan).⁶ The Agreement on the EU budget (2021–2027) looks roughly as follows. The European budget for 2021–2027 will be EUR 1.074 billion. More money is going to innovation, sustainability and the climate. 30% of all expenditure in the budget must contribute to the European climate target. Member States that receive money from the EU budget must put the European values of freedom and democracy into practice. Thus, they must have independent judges.⁷

The Corona Recovery Plan consists of the following. There will be a fund of EUR 750 billion, funded by bonds issued by the European Commission itself. Of this amount, EUR 390 billion are for subsidies. The other EUR 360 billion are loans. 30% of all expenditure of the Corona Recovery Fund must contribute to the European climate target. So as soon as the Corona Recovery Fund is released, the European Commission will over time issue bonds of a total nominal value of EUR 750 billion. At least 30% of those bonds will be issued as green bonds. Member States must implement reforms and investment plans to get or borrow money from the Recovery Fund. Member States that receive subsidies or loans from the Fund must strengthen their

⁵ See https://ec.europa.eu/info/business-economy-euro/economic-and-fiscal-policy-coordination/financial-assistance-eu/funding-mechanisms-and-facilities/sure_en/.

⁶ See https://ec.europa.eu/info/strategy/eu-budget/long-term-eu-budget/eu-budget-2021-2027_en.

⁷ See https://ec.europa.eu/info/strategy/eu-budget/long-term-eu-budget/eu-budget-2021-2027_en.

economies. The European Commission advises the Member States on this. This concerns, for example, reduction of the national debt, pension reforms and combating (youth) unemployment. Other Member States can (temporarily) stop grants or loans if there is insufficient progress in the implementation of reforms and investment plans. Here too, Member States that receive money must put the European values of freedom and democracy into practice. Thus, they must have independent judges.⁸

The European Parliament has further tightened the requirement that the rule of law must be respected. In Poland and Hungary, the independence of the judiciary is under threat, the freedom of the press is under pressure, and the rights of LGBTI people are being curtailed. For a long time, Poland and Hungary threatened to exercise their right of veto to block the European Multiannual Budget and the Corona Recovery Fund, because in their view according to the new agreements they could be punished in the future if they would not comply with the rule of law. On 10 December 2020 they ceased their opposition after everyone agreed to a compromise proposal from Germany.⁹ Unfortunately, a new obstacle has appeared on the road. According to the Bündnis Bürgerwille action group, the Corona Recovery Fund is in violation of European law and Germany runs the risk of being liable for the entire sum of 750 billion euros if the other member states do not comply with their obligations. At the request of this action group, the German Constitutional Court (Bundesverfassungsgericht, BVerfG) has for the time being prohibited the head of state (the Bundespräsident) from signing the German Corona Restoration Fund Ratification Act (Hängebeschluss). The next step is a substantive procedure at the BVerfG. If the BVerfG is of the opinion that European law is at stake, it can submit preliminary questions about this to the European Court of Justice (CJEU). All this could, least of all, delay the Corona Recovery Fund becoming operational.¹⁰

⁸ See https://ec.europa.eu/info/strategy/eu-budget/long-term-eu-budget/eu-budget-2021-2027_en.

⁹ <https://nos.nl/artikel/2360118-akkoord-over-begroting-op-top-europese-unie.html> (10 December 2020).

¹⁰ See <https://www.bundesverfassungsgericht.de/SharedDocs/Pressemitteilungen/DE/2021/bvg21-023.html>; <https://buendnis-buergerwille.de/bverfg-bundespraesidenten/>.

1.3 GENERAL ASPECTS

We will now turn to providing a summary and overview of the chapters contained in this book. Apart from the current Chapter 1, Part I features an overview chapter on the European Commission's Sustainable Finance Action Plan (Chapter 2). In this chapter, Danny Busch, Guido Ferrarini and Arthur van den Hurk conclude that the actions proposed by the European Commission's Action Plan respond to five broad strategies that can be defined as 'public incentives', 'standardisation', 'disclosure', 'corporate governance' and 'financial regulation'. The first strategy consists of fostering investments through financial and technical support for sustainable infrastructure and other projects. In perspective, the European Commission will establish a single investment fund providing support and technical assistance to crowd in private investment. The second strategy includes the establishment of an EU taxonomy of sustainable activities which should help shifting capital flows towards them. It also includes the setting of standards and labels for green financial products, which should enhance the trust in the market of these products and ease investors' access to them. These two strategies will help establishing well-defined and deep markets in sustainable investments and will work as preconditions to the others. The third strategy covers both corporate disclosure and third party information and assessments. The Non-Financial Disclosure Directive is being reviewed and complemented by other measures, such as an impact assessment of International Financial Reporting Standards (IFRS) on sustainability, and potentially changes to the roles and functioning of institutions such as the IFRS Foundation and the European Financial Reporting Advisory Group (EFRAG), to facilitate the credibility and reliability of non-financial information for users of that information. Sustainability benchmarks have been developed in order to allow investors to track and measure performance and allocate assets accordingly. In addition, credit rating agencies and market research services should integrate sustainability into their assessments. The fourth strategy combines sustainable corporate governance with attenuating short-termism in capital markets and assumes that boards should develop their own sustainability strategies and act in the company's long-term interest. Both disclosure and corporate governance are traditional strategies in capital markets regulation and functioning, while their extension to sustainability is a reflection of the new interest of investors and

corporate stakeholders for ESG issues in addition to financial performance. The fifth strategy implies at least three types of regulatory reform. First, the Markets in Financial Instruments Directive (MiFID II) and the Insurance Distribution Directive (IDD) should be amended in the sense that investment firms and insurance distributors should consider sustainability issues when offering financial advice. Second, fiduciary duties of asset managers and institutional investors should be clarified so as to include ESG factors in the investment processes. Third, ESG should be incorporated in prudential requirements of financial institutions so that they channel their investments towards a more sustainable economy, while reducing the risks deriving from unsustainable economic development and at the same time maintaining credible and effective risk-based prudential frameworks in Europe. These five strategies represent a very ambitious design of the European Commission which will require multiple actions at all levels. These actions generally require regulation and/or supervision often at EU level, but private incentives and cultural developments towards an environmentally sustainable economic system will also be important in furthering the success of the Action Plan.

The third and final chapter included in Part I (Chapter 3) is written by Marco Dell’Erba. The author focuses on sustainable digital finance and the pursuit of environmental sustainability. In recent years technology and sustainability emerged as two main drivers for the economy and finance, each with its own characteristics and following independent paths of development. The general discourse on the relationship between technology (more recently financial technology or fintech) and sustainability tends to emphasise the role of technology as a tool for pursuing sustainability mostly from the perspective of financial inclusion. Therefore, the relationship with environmental sustainability is less often considered. The author tries to answer the question on the role of digital finance as a tool for pursuing environmental sustainability and the way specific policies might contribute to pursuing this goal. Adopting this perspective, the author considers the emergence of sustainable digital finance as the clearest result of the interplay between technology and sustainability, assessing its potential for contributing to environmental sustainability. In doing this, he considers the most relevant public initiatives at the international level, and provides a brief overview of the technologies involved in sustainable digital finance, assessing their own specificities and complementarity. Finally, the author makes some policy suggestions

to strengthen sustainable digital finance in view of achieving ambitious societal goals.

1.4 SUSTAINABLE FINANCE AND CORPORATE GOVERNANCE

Part III of this book deals with sustainable finance and corporate governance. Chapter 4, written by Guido Ferrarini, concentrates on sustainability and corporate purpose. An increasing number of firms make reference to the pursuit of environmental and social goals in the definition of their purpose. This raises important issues with respect to the way in which the trade-offs between profit maximisation and social value should be solved. As the author shows in this chapter, there are different perspectives that can be adopted to this end depending on the field of scholarship selected: economics, finance, management and law. Each perspective offers different nuances as to the way in which corporate purpose is defined and the conflict between the pursuit of profit and social value is dealt with. The author argues that a broader concept of corporate purpose has gradually emerged over the years in economics, finance and management studies, as a result of various approaches to corporations such as corporate social responsibility (CSR) and stakeholder theory, which have been gradually integrated into the corporate governance framework. Environmental and social sustainability has come to characterise most of the instances of CSR and some core aspects of stakeholder governance, without discarding the pursuit of corporate profits as a long-term goal of the corporation. At the start of this century, sustainability concerns have entered into the area of finance studies through the theory of ‘enlightened shareholder value’ (ESV) and its homologues like ‘shared value’. The author furthermore argues, from a comparative law perspective, that corporate purpose has been variously defined in different jurisdictions, while European laws often consider the company’s interest rather than corporate purpose. However, corporate purpose is generally identified in practice with the pursuit of corporate profits, albeit with variations concerning the relevance of given stakeholders and social values in corporate governance. In general, legal definitions of corporate purpose are flexible and allow for different types of solution to the conflict between economic value and social value at firm level and within a given system. Then the author goes on to critically analyse recent economics and management studies which argue that corporate purpose should be

modified to reflect the prevalence of social value over shareholder value, and that the latter should be pursued by managers only derivatively, as a result of pro-stakeholders actions directed to increase the ‘total pie’. The author objects to this recent trend from a law and finance perspective and shows his preference for keeping the relevant discussion within the confines of the ESV theory. However, the author admits that corporate purpose should be larger than profit from a behavioural perspective if we want to motivate people to perform outstandingly and sustainably in organisations. Finally, the author emphasises the mounting role of regulatory and ethical constraints to business conduct deriving from sustainability concerns. These constraints go beyond the mere calculus required by ESV, which asks management to pursue stakeholder interests only to the extent that this increases the long-term value of the firm. According to the author, ethical considerations as reflected by international standards and consolidated best practices should apply to the running of businesses without necessarily requiring a prior analysis of their precise impact on financial performance.

In Chapter 5, Alessio Paces discusses sustainable finance from a shareholders perspective. The debate on sustainable finance seldom includes the perspective of shareholders. However, the author argues that shareholders are important for the governance of publicly held corporations today, because their holdings are concentrated in the hands of few institutional investors. Institutional investors can therefore have an impact on the sustainability of the largest companies in the world, as they often claim they do—particularly in communications with their beneficiaries. Whether institutional investors actually have such an impact is an open question according to the author. Recent changes in EU financial regulation aim to bring more clarity on this matter. For instance, the revised Shareholder Rights Directive requires companies, on a comply-or-explain basis, to disclose voting policies and behaviours concerning sustainability. More in general, EU law is increasing the supply of standard measures of sustainable investment, to be used in institutional investors’ communications with their beneficiaries. This chapter also discusses whether this legislation can align the incentives of institutional investors to pursue sustainable corporate governance with the prosocial preferences of their beneficiaries.

Part III of the book concludes with a chapter by Michele Siri and Shanshan Zhu on sustainability considerations in corporate governance codes (Chapter 6). In the light of the strong commitment by the EU

to a sustainable path towards the goals set by the Paris Agreement and the UN 2030 Agenda, and the EU initiatives concerning the establishment of a sustainable corporate governance, the authors argue that it is more pressing than ever to evaluate how companies can truly integrate a long-term sustainable approach in their strategies and operations, and therefore whether corporate governance codes could provide a useful tool towards such objectives. Many authors have investigated the effective implementation of corporate governance codes, but only a few have considered the role of the codes in promoting environmental and social responsibility. The aim of this chapter is to comparatively evaluate the most recent attempts to integrate sustainability considerations in corporate governance codes of listed companies within the EU Member States, in order to understand whether such progress is on the way and which best practices could be taken into consideration and disseminated by the EU authorities in the years to come.

1.5 SUSTAINABLE FINANCE AND SYSTEMIC RISK

Part IV of the book concentrates on sustainable finance and systemic risk. In Chapter 7, Seraina Grünewald addresses the topic of climate change as a systemic risk in finance. The author highlights that there is growing acknowledgement among policymakers that climate change may give rise to (potentially catastrophic) financial risk and may impact financial stability. This chapter thus explores the specific features of climate-related financial risks, drawing on a growing body of macrofinancial literature and policy work, and discusses the options macroprudential policymakers have in the face of such risk. It finds that there are significant challenges associated with ‘greening’ macroprudential policy, both epistemological and methodological as well as behavioural, and points to potential ingredients of a ‘green macroprudential policy’. Separate sections are devoted to the crucial questions of the timing of policy action in the light of the radical uncertainty in relation to the nature of climate-related financial risks and of the role that Central Banks can and should play in the transition to a low-carbon economy.

In the second contribution to Part IV of this book, Sara Lovisolo offers a critical review of policy and market-based approaches to climate change as a threat to financial stability (Chapter 8). The author explains that sustainable finance has so far been primarily defined through two complementary approaches, one centred around the notion of impact

and the other one around risk management. The author argues that this twofold theory of change, also formalised in the Sustainable Finance Action Plan, requires deeper scrutiny when applied to the banking sector, in the context of the Basel accords and their aim to foster financial stability. This chapter sets out to answer the question of whether the risk management or financial stability goal, decoupled from its impact twin, can—from a theoretical perspective and based on a critical review of models embedded in policy and market-based solutions—achieve the objectives of sustainable finance.

Chapter 9, written by Antonio Luca Riso, explores the role that prudential supervisors can and should play with a view to sustainable finance. After analysing how climate-related risks may affect the prudential framework, the chapter discusses the difficulty of apprehending risks in a scenario of radical uncertainty and highlights some methodological challenges. The author further offers his reflections on the implications that climate-related risks in combination with the limited current toolkit may have for the mandate of prudential supervisors. The chapter concludes with an overview of the *status quo* of supervisory practices and experiences in the light of the policies recently adopted by the ECB and the European Banking Authority (EBA).

1.6 SUSTAINABLE FINANCE AND FINANCIAL MARKETS

The final part of this book (Part V) deals with sustainable finance and financial markets. In Chapter 10, Marieke Driessen provides an overview of ESG in the financial markets. The author sets out that sustainable finance has been around for years. After publication of the Sustainable Finance Action Plan by the European Commission in March 2018, sustainable finance rose to the top of the EU legislative agenda for the financial markets, as well as the regulatory and supervisory agenda of EU and national supervisors and competent authorities of the financial sector. The author provides an overview of various sustainable and ESG products that have been a feature of the international financial markets, such as green, ESG and sustainability-linked loans and bonds. The author also discusses the current legal framework in which these financial products are issued, with a focus on EU level legislation, including the Taxonomy Regulation and the Sustainable Finance Disclosure Regulation, and considers legal and regulatory developments on the horizon, such as the Green Bonds Standard and Climate Benchmarks. The chapter

concludes with a few remarks on general trends in ESG and sustainable finance developments in the financial markets.

In Chapter 11, Christos V. Gortsos analyses and discusses a crucial building block of the EU's sustainable finance strategy: the Taxonomy Regulation. The author explains that, on the basis of the Sustainable Finance Action Plan of 8 March 2018, which forms part of the political priority to establish a (European) Capital Markets Union (CMU), the European Parliament and the Council already adopted on 27 November 2019 Regulation (EU) 2019/2088 on sustainability-related disclosures in the financial services sector and Regulation (EU) 2019/2089 as regards EU Climate Transition Benchmarks, EU Paris-aligned Benchmarks and sustainability-related disclosures for benchmarks. The third—and probably most important—part of the related ‘trilogy’ is the Regulation on the establishment of a framework to facilitate sustainable investment (the so-called Taxonomy Regulation), adopted on 18 June 2020. The objective of this legislative act is to establish the criteria for determining whether an economic activity qualifies as environmentally sustainable for the purpose of establishing the degree to which an investment is environmentally sustainable. It does not itself establish a label for sustainable financial products; the details of what constitutes an environmentally sustainable activity or product is being built up through delegated acts to be adopted by the European Commission, of which the first two are scheduled to apply from 31 December 2021 and the other four from 31 December 2022. The purpose of this chapter is threefold. First, it briefly albeit systematically presents the ‘system of rules’ relating to the ‘core element’ of the Taxonomy Regulation, namely the criteria according to which an economic activity will be considered environmentally sustainable and the six environmental objectives. Second, it analyses the Regulation's scope of application and the obligations imposed on Member States and the EU with regard to existing or potentially new eco-labelling or other legislative measures, financial market participants who offer financial products as well as undertakings falling under the scope of the Non-Financial Reporting Directive. Third, the chapter makes some considerations on how the core element of the Regulation will be of primary importance even for entities which are not covered by its scope of application, namely beyond the reach of the CMU project. These considerations are based on the author's view that the environmental objectives, as developed within the Taxonomy Regulation, will be used as a benchmark for the prudential

regulation of several categories of regulated financial firms by virtue of other legislative acts.

In Chapter 12, Danny Busch discusses another important building block of the EU's sustainable finance strategy: the Sustainable Finance Disclosure Regulation. The aim of the chapter is twofold. On the one hand, it explores the main features of the Sustainable Finance Disclosure Regulation. On the other hand, it tries to assess whether the Sustainable Finance Disclosure Regulation is likely to succeed in harmonising sustainability-related disclosure rules and fiduciary duties, not only across Member States, but also across financial products and distribution channels. The author concludes that before we reach a sufficient degree of harmonisation of sustainability-related disclosure rules and fiduciary duties there is still a long way to go. And even if we reach the required degree of harmonisation in the EU, it is not given that this will necessarily lead to a more sustainable world. As may be gleaned from the European Green Deal and the Sustainable Finance Action Plan, the EU is aiming high when it comes to sustainability. But the EU is not an island. The author argues that there are roughly two opposite scenarios. In a pessimistic scenario, the more lenient or even non-existent sustainability agenda of other geopolitical powers gives them a competitive edge that is detrimental to the EU. In a positive scenario, the EU becomes a global standard-setter in the area of sustainability. Large global institutional investors such as Blackrock and State Street in any event say they are strong supporters of the sustainability agenda. Also, the re-entry of the United States of America in the Paris Climate Agreement under the Biden Administration may give us some hope.

In Chapter 13, Veerle Colaert discusses the proposals to integrate sustainability considerations into the MiFID II and the IDD. MiFID II and IDD define the legal framework for the relationship between investment firms or insurance distributors and their clients. In April 2019 ESMA and EIOPA advised the European Commission on how to integrate sustainable finance into these frameworks, after elaborate consultations of the industry. The author critically assesses the changes to the MiFID II and IDD investor protection frameworks. She first sketches the behavioural problems explaining why retail investors do not always act upon their investment preferences and the role of the investment product distributor in this respect. Against this background, the author offers a critical overview of the most important changes to the MiFID II and IDD investor protection frameworks.

In the final contribution to Part V of this book, Filippo Annunziata discusses the topic of emission allowances in relation to the MiFID II framework (Chapter 14). While the structure and the mechanisms that underpin the functioning of the EU Emissions Trading System (ETS) are, by now, well known, discussions on the protection of the environment, and the development of secondary markets for emission allowances, have stimulated a process of gradual inclusion of CO² allowances in the perimeter of financial markets regulation. A first, significant step in this direction was taken by MiFID I: building on the definition of commodity derivatives introduced by the Investment Services Directive of 1993, MiFID I enlarged and amplified the catalogue of derivatives that would be considered as falling into its scope. The catalogue included then derivatives on emission allowances. The landscape set by MiFID I was, however, just a first step towards the inclusion of emissions trading in the scope of financial markets legislation. A second step has been taken by MiFID II, as the latter directly classifies rights on emissions allowances falling in the EU regime as financial instruments. The author argues that the reasons that led to the qualification of emissions allowances as financial instruments in MiFID II are basically a consequence of the tremendous evolution that secondary markets of allowances have seen in the last few years. The growing amount of transactions and the need to preserve and ensure the transparency and integrity of secondary markets convinced the European Commission of the opportunity to include emissions allowances in the scope of MiFID II and, therefore, in the scope of the Market Abuse Directive (now Market Abuse Regulation or MAR). Looking at the positive effects for environmental protection that may derive from the inclusion of emission allowances in the scope of capital markets legislation, these are basically linked to the fact that—as a consequence of the approach stemming from MiFID II—secondary markets should effectively become more transparent, efficient and secure. However, according to the author, some potential drawbacks must be considered. Trading in emission allowances has become more expensive after MiFID II, and transaction costs might impact negatively on the liquidity of the market. The application of the Capital Requirements Directive (CRD IV, now CRD V) prudential requirements might also require the absorption of important levels of capital that would be distracted from direct investments in the industry. The effect that this might have on the system is, at the moment, unclear. The landscape introduced by MiFID II is also quite

complex: there are at least two, if not three, different sets of comprehensive legislation that may potentially be relevant for trading emission allowances, either on the spot, or on the derivatives market: the ‘old’ EU-ETS; MiFID II and MAR; and more tangentially, the Regulation on wholesale Energy Market Integrity and Transparency (REMIT). The author discusses the implications of each of them and argues that opting in and out of each of these systems, through a complicated system of exemptions and exclusions, does not benefit the overall coherence of the regulatory approach.