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Lafarre, Anne; Verhoeff, Eline

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European Regulation of Sustainable Finance and Investor Sustainability Duties: Measuring is Knowing?

Anne Lafarre and Eline Verhoeff[*]

1. INTRODUCTION

Recent European legislative developments have shifted the focus from shareholder rights to shareholder duties,[1] highlighting institutional investors' duties.[2] Taking into account that sustainability is probably the single most important societal challenge facing humankind, it does not come as a surprise that a large part of these duties focus on sustainability (including environmental, social and governance factors (ESG)). The European premise is that sustainable finance is pivotal for a sustainable economy.[3] The financial sector needs to be able to allocate capital to sustainable investments while ensuring long-term economic growth.[4] Particularly institutional investors, being the largest and systematic owners of listed companies nowadays,[5] are considered to play a crucial role in developing more sustainable value creation in their investee companies with their capital allocations and important ownership rights.[6]

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[*] Dr. Anne Lafarre, MSc, is associate professor at Tilburg Law School, Tilburg University, the Netherlands. Eline Verhoeff, LLM, is 2022 graduate of the LLM Law & Finance at the University of Amsterdam, the Netherlands.

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[1] Hanne Birkmose, "From Shareholder Rights to Shareholder Duties: A Transformation of EU Corporate Governance in a Sustainable Direction?" (2018) 5:2 Intereulaweast at 69.

[2] Institutional investors are in this research defined as asset owners (including for instance pension funds, insurance companies) and asset managers. Note that, unlike the international finance literature, the European framework makes a distinction between institutional investors and asset managers.

[3] EU Monitor, "Communication From the Commission to the European Parliament, the European Council, the Council, the European Central Bank, the European Economic and Social Committee and the Committee of the Regions Action Plan: Financing Sustainable Growth" (2018), communication, online, *EU Monitor* <https://www.eu-monitor.eu/9353000/1/j9vvik7m1c3gyxp/vkmhhs21kfzs> [EU Monitor 2018].

[4] *Ibid.*

[5] Adriana De La Cruz, Alejandra Medina & Yung Tang, "Owners of the World's Listed Companies" (2019), online (pdf): *OECD* <https://www.oecd.org/corporate/ca/Owners-of-the-Worlds-Listed-Companies.pdf>.

[6] Hanna Ahlström & David Monciardini, "The Regulatory Dynamics of Sustainable

Generally speaking, their duties can be categorized in (disclosure) obligations related to i) the investment strategy and ii) active ownership.

Whether and to what extent institutional investors can actually contribute to sustainability, however, is far from clear. Whereas some authors advocate "investor-led sustainability" as the force to move the entire market towards more sustainability,[7] particularly the public concern over investor greenwashing practices widely resonates. For instance, whereas being a Principles for Reasonable Investment (PRI) signatory requires institutional investors to commit to using voice to improve corporate sustainability performance, United States (US) research finds that PRI signatories are not more responsible than their uncommitted peers.[8] Similarly, ESG and non-ESG products are often not distinguishable.[9] Tariq Fancy, BlackRock's former chief investment officer for sustainable investing, warns in an essay for sustainable investing as "a dangerous placebo that harms the public interest" and "is greenwashing our entire economic system."[10] Especially the lack of standardized sustainable investment information[11] may enable greenwashing practices. Here, uniform disclosure obligations at the European level like the Sustainable Finance Disclosure Regulation (SFDR)[12] and Taxonomy Regulation (TR)[13] to restore information imbalances may offer a solution.[14] Sustainability disclosure obligations require institutional investors to be more

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Finance: Paradoxical Success and Limitations of EU Reforms" (2022) 177:1 J. Bus. Ethics at 193.

[7] Wolf-Georg Ringe, "Investor-led Sustainability in Corporate Governance" (2021) European Corporate Governance Institute Working Paper No. 36, online: *SSRN* <https://papers.ssrn.com/sol3/papers.cfm?abstract_id = 3958960>.

[8] Soohun Kim & Aaron Yoon, "Analyzing Active Fund Managers' Commitment to ESG: Evidence from the United Nations Principles for Responsible Investment" (2021), online: *SSRN* <https://ssrn.com/abstract = 3555984>; Rajna Gibson et al., "Do Responsible Investors Invest Responsibly?" (2022) European Corporate Governance Institute Working Paper 712/2020, online: ECGI Finance Working Paper 712/2020, online: *SSRN* <https://ssrn.com/abstract = 3525530>.

[9] Dana Reiser & Anne Tucker, "Buyer Beware: Variation and Opacity in ESG and ESG Index Funds" (2020) 41:5 Cardozo L. Rev. at 1921.

[10] Tariq Fancy, "The Secret Diary of a 'Sustainable Investor' — Part 3" (August 2021), online: *Medium* <https://medium.com/@sosofancy/the-secret-diary-of-a-sustainable-investor-part-3-3c238cb0dcbf>.

[11] Florian Berg, Kornelia Fabisik & Zacharias Sautner, "Is History Repeating Itself? The (Un)Predictable Past of ESG Ratings" (2021) European Corporate Governance Institute Working Paper 708/2020, online: *SSRN* <https://ssrn.com/abstract = 3722087>.

[12] *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* (EU), 2019 [EU 2019/2088].

[13] *Regulation (EU) 2020/852 of the European Parliament and of the Council of 18 June 2020 on the establishment of a framework to facilitate sustainable investment, and amending Regulation (EU) 2019/2088* (EU), 2020 [EU 2020/852].

transparent, allowing clients and beneficiaries to compare investment opportunities and make informed investment decisions[15] and encouraging institutional investors to cater to their sustainability preferences. As a result, institutional investors need to compete on the sustainability spectrum of investments in addition to the classical financial gains.[16] Corporate sustainability leaders are able to distinguish themselves from laggards and experience reputational benefits that may enable them to attract more funds from sustainability-minded clients. Moreover, a standardized and harmonized European framework of sustainable economic investment criteria avoids a costly patchwork of diverging (national) requirements.[17]

Following this line of reasoning, also in the US, there is a movement towards more reliable sustainability information. Recently, the Securities and Exchange Commission (SEC) announced a proposal to increase transparency and confidence in ESG funds to address the lack of consistent, comparable and reliable information.[18] And for instance in the United Kingdom (UK) the Financial Conduct Authority (FCA) is going to introduce the Sustainability Disclosure Requirements (SDR) containing rules and guidance for certain institutional investors to make their disclosures consistent with the recommendations of the Taskforce on Climate-related Financial Disclosures (TCFD).[19]

Authors, however, question the effectiveness of such disclosure obligations as they do not directly require institutional investors to change their behaviour, so that their disclosures might reflect no more than the status quo.[20] Others

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[14] Alessio Pacces, "Will the EU Taxonomy Regulation Foster Sustainable Corporate Governance?" (2021) 13:21 Sustainability at 1.

[15] EU 2020/852, *supra* note 13 at para. 13.

[16] Pacces, *supra* note 14.

[17] EU Monitor 2018, *supra* note 3 at para. 2.1.

[18] See Mary Beth Houlihan, Brad Green, and David Marcinkus, "LongAwaited ESG Rules" (2022), online: *Harvard Law School Forum on Corporate Governance* <https://corpgov.law.harvard.edu/2022/06/26/long-awaited-esg-rules/>. For the proposals to amend CFR 17, see Securities and Exchange Commission, "Enhanced Disclosures by Certain Investment Advisers and Investment Companies about Environmental, Social, and Governance Investment Practices" (2022) online (pdf): *Securities and Exchange Commission* <https://www.sec.gov/rules/proposed/2022/ia-6034.pdf> and Securities and Exchange Commission, "Investment Company Names" (2022) online (pdf): *Securities and Exchange Commission* <https://www.sec.gov/rules/proposed/2022/ic-34593.pdf>.

[19] See Financial Conduct Authority, "Enhancing Climate-Related Disclosures by Asset Managers, Life Insurers and FCA-Regulated Pension Providers" (last updated 17 December 2021) FCA Policy Statement PS21/24, online: *Financial Conduct Authority* <https://www.fca.org.uk/publications/policy-statements/ps-21-24-climate-related-disclosures-asset-managers-life-insurers-regulated-pensions>. Note that there is some discussion about the overlap between the SDR and the European disclosure framework, and particularly the SFDR.

[20] Hanne Birkmose, "European Challenges for Institutional Investor Engagement: Is

highlight the complexity of sustainable finance information.[21] Moreover, as the European Commission (EC) duly notes, the effectiveness of disclosure obligations to overcome greenwashing practices highly depends on the supervision and enforcement of these obligations.[22]

Further, active ownership duties face complexities. The Preamble of the SRD II[23] mentions that shareholder engagement is one of the cornerstones of corporate governance, and greater involvement of shareholders can help improving the financial and non-financial performance of companies, including ESG factors. Therefore, the SRD II relies on the corporate governance assumption that shareholders hold the management to account for its actions.[24] Its obligations may even suggest that institutional investors are accountable to stakeholders and society in their exercise of shareholder rights.[25] Similar conclusions can be drawn from stewardship codes like the UK one. This is in sharp contrast with classical finance logic that is particularly prevalent in the US,[26] where it is fiercely debated whether fiduciary duties of institutional investors allow them to pursue sustainability goals.[27] BlackRock, for instance,

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Mandatory Disclosure the Way Forward" (2014) 11:2 ECFR at 214; Christopher Bruner, "Corporate Governance Reform and the Sustainability Imperative" (2022) 131:4 Yale L.J. at 1217. Bruner also argues that corporate decision makers' short-term interests are not addressed, as there is no recalibration of the corporate form.

[21] Hanna Ahlström & Beate Sjafjell, "Complexity and Uncertainty in Sustainable Finance: An Analysis of the EU Taxonomy" (2022), online: *SSRN* <https://papers.ssrn.com/sol3/papers.cfm?abstract_id=4060972>.

[22] The EC asked the different European Supervision Authorities (EBA, EIOPA and ESMA) for their input here. See European Banking Authority, "Request for Input to the European Banking Authority (EBA), the European Insurance and Occupational Pensions Authority (EIOPA) and the European Securities and Markets Authority (ESMA) Related to Greenwashing Risks and Supervision of Sustainable Finance Policies" (2022), online (pdf): <https://www.eba.europa.eu/sites/default/documents/files/document_library/About%20Us/Missions%20and%20tasks/Call%20for%20-Advice/2022/CfA%20on%20greenwashing/1036482/Report%20request%20to%20E-SAs_greenwashing%20monitoring%20and%20supervision.pdf> [EBA 2022].

[23] *Directive (EU) 2017/828 of the European Parliament and of the Council of 17 May 2017 amending Directive 2007/36/EC as regards the encouragement of long-term shareholder engagement* (European Union), 2017 [EU 2017/828].

[24] European Commission, "The EU Corporate Governance Framework" (27 October 2011) European Commission Green Paper COM(2011) 164 final, online: *Publications Office of the European Union* <https://op.europa.eu/en/publication-detail/-/publication/3eed7997-d40b-4984-8080-31d7c4e91fb2/language-en>.

[25] Birkmose, *supra* note 1. Also see EU 2017/828, *supra* note 23 at para. 16.

[26] Shipeng Yan, Fabrizio Ferraro & Juan (John) Almandoz, "The Rise of Socially Responsible Investment Funds: The Paradoxical Role of the Financial Logic" (2019) 64:2 Adm. Sci. Q. at 466.

[27] Jeffrey Gordon, "Systematic Stewardship" (last revised 2022) European Corporate Governance Institute Working Paper No. 566/2021, online: *SSRN* <https://ssrn.com/abstract=3782814>.

recently announced to support fewer environmental and social proposals based on right-wing fiduciary duty concerns and micromanagement arguments,[28] shifting from its earlier announcement to support such proposals.[29] The current rules on fiduciary duties for institutional investors that fall under the US *Employee Retirement Income Security Act of 1974* (ERISA) stipulate that the investor's fiduciary duties will be satisfied if the investor based its investment decision solely on "pecuniary factors."[30] Whereas some conclude that the fiduciary duty of large institutional investors implies that these investors need to address systematic risk factors like climate change,[31] the 2022 World Economic Forum (WEF) meeting in Davos highlighted the diverging opinions.[32]

Against this background, this research provides a comprehensive overview of recent institutional investor sustainability duties in Europe. After outlining the main steps in this movement (Section 2), it provides an in-depth discussion and comparison of the main implemented and proposed regulatory initiatives at the European level (Section 3), including a systematic overview of the main sustainability duties (Section 4). Based on this overview, Section 5 provides concluding remarks.

2. THE EUROPEAN SUSTAINABLE FINANCE MOVEMENT

The start of the European sustainable corporate governance and finance movement can be found about a decade ago; whereas in 2001, the EC defined Corporate Social Responsibility (CSR) as "a concept whereby companies integrate social and environmental concerns [. . .] *on a voluntary basis,*"[33] in 2011 the new CSR definition entailed "the *responsibility* of enterprises for their impacts on society."[34] Afterwards the Non-Financial Reporting Directive

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[28] Brooke Masters, "BlackRock Pulls Back Support for Climate and Social Resolutions" (26 July 2022), online: *Financial Times* <https://www.ft.com/content/48084b34-888a-48ff-8ff3-226f4e87af30>.

[29] Blackrock states in its 2021 Stewardship Expectations that: "given the need for urgent action on many business relevant sustainability issues, [it] will be more likely to support a shareholder proposal without waiting to assess the effectiveness of engagement." See BlackRock, "Our 2021 Stewardship Expectations: Global Principles and Market-level Voting Guidelines" (2021), online (pdf): <https://www.blackrock.com/corporate/literature/publication/our-2021-stewardship-expectations.pdf>.

[30] Sustainability factors may only be considered if investment alternatives are "economically indistinguishable". In October 2021, the US Department of Labor (DOL) proposed to remove this pecuniary requirement that was installed by the Trump administration.

[31] Gordon, *supra* note 27.

[32] Andrew Edgecliffe-Johnson, "The war on 'woke capitalism'" (27 May 2022), online: *Financial Times* <https://www.ft.com/content/e4a818e5-4039-46d9-abe0-b703f33d0f9b>.

[33] European Commission, "Promoting a European framework for Corporate Social Responsibility" (18 July 2001) European Commission Green Paper COM(2001) 366 final, online: *European Commission* <https://ec.europa.eu/commission/presscorner/detail/en/DOC_01_9> at 6.

(NFRD)[35] was introduced, requiring certain large companies operating in the single market to report on the impact of their activities on a range of non-financial issues, including for instance environmental and human rights impacts.[36] The SRD II, proposed in 2014 and introduced in 2017, marked a clear turning point in the role of institutional investors in corporate governance with its transparency provisions including on the development and disclosure of an engagement policy.

At the end of 2016, the focus on sustainable finance was significantly enlarged with the appointment of the High-Level Expert Group (HLEG) that submitted its Final Report *Financing a Sustainable Economy* on 31 January 2018.[37] Based on their eight key recommendations, the EC formulated its 2018 Action Plan to guide the European public and private capital flows towards sustainable and green sectors,[38] including the introduction of a common sustainable finance taxonomy to ensure market consistency and clarity to re-orient capital flows towards assets that contribute to sustainable development. Accordingly, the TR was adopted on 22 June 2020. The HLEG also recommended to clarify investor duties to extend time horizons and bring greater focus on ESG factors;[39] this recommendation formed the basis for the adoption of the Sustainable Finance Disclosure Regulation (SFDR) in November 2019 requiring institutional investors to integrate sustainability considerations in their investment decision-making processes in a transparent manner.[40]

In July 2021, the EC published its renewed strategy for Financing the Transition to a Sustainable Economy.[41] The EC identified three building blocks for a sustainable financial framework:

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[34] EU Monitor, "Renewed EU Strategy 2011-14 for Corporate Social Responsibility" (2011), communication, online: *EU Monitor* <https://www.eumonitor.eu/9353000/1/j4nvkkpftveemt7_j9vvik7m1c3gyxp/vitwrzhm31gk> at 6.

[35] *Directive 2014/95/EU of the European Parliament and of the Council of 22 October 2014 amending Directive 2013/34/EU as regards disclosure of non-financial and diversity information by certain large undertakings and groups* (European Union), 2014 [EU 2014/95].

[36] It does not offer any harmonized reporting framework, but mentions that companies may rely on existing international frameworks like the UNGPs for their disclosures.

[37] HighLevel Expert Group on Sustainable Finance, "Financing a Sustainable European Economy" (2018), online (pdf): *European Commission* <https://ec.europa.eu/info/sites/default/files/180131-sustainable-finance-final-report_en.pdf> [HLEG Sustainable Finance].

[38] EU Monitor 2018, *supra* note 3.

[39] HLEG Sustainable Finance, *supra* note 37 at 13.

[40] EU Monitor 2018, *supra* note 3 at para. 3.2.

[41] European Commission, "Strategy for Financing the Transition to a Sustainable Economy" (6 July 2021), communication, online: *EUR-Lex* <https://eur-lex.europa.eu/legal-content/EN/ALL/?uri=COM:2021:390:FIN>.

i) a taxonomy of sustainable activities, aiming at providing a robust, science-based classification system (TR);

ii) a disclosure framework for non-financial and financial companies (TR, SFDR, and the proposed Corporate Sustainability Reporting Directive (CSRD) that replaces the NFRD[42]); and

iii) investment tools that include benchmarks, standards, and labels (proposed regulation for a standard on European green bonds[43] and the European Union (EU) Climate Benchmarks Regulation that introduced the EU Climate Transition Benchmarks and the EU Paris-aligned Benchmarks[44]).

In addition, also part of Europe's sustainable finance strategy is the Markets in Financial Instruments Directive (MIFID) Delegated Regulation amendment holding that investment firms need to take into account clients' sustainability preferences in the advice process as part of their duties.[45] Finally, the most recent European legislative development we can point at is the EC's proposal for a Corporate Sustainability Due Diligence Directive (CSDDD)[46] that offers harmonized corporate sustainability due diligence duties for companies in their

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[42] European Commission, "Proposal for a Directive Amending Directive 2013/34/EU, Directive 2004/109/EC, Directive 2006/43/EC and Regulation (EU) No 537/2014, as Regards Sustainable Corporate Reporting" (21 April 2021), communication, online: *EUR-Lex* <https://eur-lex.europa.eu/legal-content/EN/TXT/?uri=CELEX%3-A52021PC0189> [EC Proposal 21 April 2021].

[43] European Commission, "Proposal for a Regulation of the European Parliament and of the Council on European Green Bonds" (6 July 2021), communication, online: *EUR-Lex* <https://eur-lex.europa.eu/legal-content/EN/TXT/?uri=CELEX%3-A52021PC0391>.

[44] *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* (EU), 2019.

[45] *Commission Delegated Regulation (EU) 2021/1253 of 21 April 2021 amending Delegated Regulation (EU) 2017/565 as regards the integration of sustainability factors, risks and preferences into certain organisational requirements and operating conditions for investment firms* (EU), 2021. Also see *Commission Delegated Regulation (EU) . . ./... amending Delegated Regulations (EU) 2017/2358 and (EU) 2017/2359 as regards the integration of sustainability factors, risks and preferences into the product oversight and governance requirements for insurance undertakings and insurance distributors and into the rules on conduct of business and investment advice for insurance-based investment products* (EU), 2021. For Alternative Investment Fund Managers (AIFMs), see *Commission Delegated Regulation (EU) 2021/1255 of 21 April 2021 amending Delegated Regulation (EU) No 231/2013 as regards the sustainability risks and sustainability factors to be taken into account by Alternative Investment Fund Managers* (EU), 2021 []EU Delegated Regulation 2021].

[46] *Proposal for a Directive of the European Parliament and of the Council on Corporate Sustainability Due Diligence and amending Directive* (EU), 2019 [EU Proposal 2019].

value chains with extraterritorial effects. In the next section, we further discuss all these regulatory initiatives introducing obligations for institutional investors.

3. REGULATORY INSTRUMENTS IMPOSING INVESTOR DUTIES

(a) SRD II

The EC underlined the shortcomings in the corporate governance of financial institutions which the global financial crisis revealed.[47] One of the shortcomings concerned the inadequate engagement of institutional investors. Following a 2012 Action Plan,[48] the EC announced a package to encourage long-term shareholder engagement and improve corporate governance reporting[49] that resulted in the adoption of the SRD II in 2017.

The duties for institutional investors are covered by Articles 3g-3i SRD II.[50] Pursuant to Article 3g(1)(a), institutional investors should disclose an engagement policy. Although the SRD II does not define shareholder engagement,[51] Article 3g(1)(a) provides that the engagement policy should set out how institutional investors: (i) monitor investments on important matters, such as "strategy, financial and non-financial performance and risk, capital structure, social and environmental impact and corporate governance"; (ii) enter into dialogues with investee companies; (iii) exercise voting rights and additional rights for shares; (iv) cooperate with the remainder of the shareholders; (v) relevant stakeholders of investee companies; and (vi) address conflicts of interest

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[47] Hanne Birkmose, *The Shareholder Rights Directive II* (United Kingdom: Edward Elgar Publishing, 2021) at Article 3(g): Engagement Policy.

[48] European Commission, "Communication From the Commission to the European Parliament, the Council, the European Economic and Social Committee and the Committee of the Regions Action Plan: European company law and corporate governance — a modern legal framework for more engaged shareholders and sustainable companies" (12 December 2012), communication, online: *EUR-Lex* <https://eur-lex.europa.eu/legal-content/EN/ALL/?uri=celex%3A52012DC0740>.

[49] European Commission, "Proposal for a Directive of the European Parliament and of the Council amending Directive 2007/36/EC as regards the encouragement of long-term shareholder engagement and Directive 2013/34/EU as regards certain elements of the corporate governance statement" (2014), communication, online: *EUR-Lex* <https://eur-lex.europa.eu/legal-content/EN/TXT/?uri=COM%3A2014%3A213%3AFIN>.

[50] *Ibid.* at Article 2(e). An institutional investor is defined as an undertaking pursuing activities of life insurance or reinsurance and an institution for occupational retirement provision. In turn, Article 2(f) defines an asset manager, including an investment firm providing portfolio management, alternative investment fund manager (AIFM) and undertakings for collective investment in transferable securities (UCITS). From this it follows that the SRD II makes a distinction between institutional investors and asset managers. For the discussion of the SRD II provisions, we use this distinction as well. Note, however, that in the remainder of this research the term institutional investor is used for both asset owners and asset managers.

[51] Birkmose, *supra* note 47.

related to their engagement. According to Article 3g(1)(b), institutional investors should disclose annually on their websites how this policy is implemented, taking into account an explanation of both voting behaviour and the most significant votes, and the use of voting advisors. Particularly, they should disclose how they have voted in the general meetings, except if the votes are insignificant because of the voting matter or the institutional investors' holding size.[52] These obligations are based on the comply-or-explain principle.

Pursuant to Article 3h(1), institutional investors should disclose how the key components of their investment strategy match the profile and duration of their (long-term) liabilities, and how these components effect the medium to long-term performance of their assets. Institutional investors can enter into individual and collective arrangements with asset managers; in the latter case, the asset manager invests the assets together with the other assets in the fund.[53] Institutional investors should disclose several characteristics of such arrangements following Article 3h(2), *inter alia* including how the institutional investor incentivises the asset manager to match its investment strategy with the institutional investors' (long-term) liabilities (under a), how the institutional investor incentivises the asset manager to base its investment decisions on analyses of the long-term (non-)financial performance of investee companies, and to engage with these companies so as to improve the medium to long-term performance (under b). Other than Article 3h(1), Article 3h(2) is covered by the comply-or-explain principle for the reason that the former focuses on the investment strategy of the institutional investor as its core function, rather than that it depends on the arrangement between the institutional investor and the asset manager.[54]

Finally, Article 3i(1) also requires asset managers to annually disclose to the institutional investor how its (implementation of) the investment strategy is in line with the arrangement and improves the medium to long-term performance of the institutional investors' assets. As such, Article 3i(1) aims to facilitate the informed selection of an asset manager by institutional investors, better aligning institutional investors' and asset managers' long-term interests.[55]

(b) SFDR

Following the recommendations of the HLEG on Sustainable Finance to make the consideration of sustainability in the investment processes more comprehensive,[56] the SFDR was introduced in 2019 to solve the attitude-

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[52] If an institutional investor has delegated the implementation of the engagement policy to an asset manager, it should specify where the voting information has been disclosed by the asset manager.

[53] Birkmose, *supra* note 47 at Article 3h: Investment Strategy of Institutional Investors and Arrangements with Asset Managers".

[54] Birkmose, *supra* note 47.

[55] Birkmose, *supra* note 47 at Article 3i: Transparency of Asset Managers.

[56] EU Monitor 2018, *supra* note 3.

behaviour gap, where beneficiaries do not invest conform their sustainability preferences.[57] Particularly, the SFDR aims at reducing information asymmetries towards beneficiaries on the consideration of sustainability risks, adverse sustainable impacts, sustainable investment, and the promotion of environmental or social characteristics.[58] It does so through harmonised transparency obligations, supported by the regulatory technical standards (RTS) that describe the standard presentation of information.[59]

The SFDR is applicable to financial market participants (FMPs) and financial advisers, *inter alia* including insurance undertakings making available insurance-based investment products (IBIPs), investment firms providing portfolio management, institutions for occupational retirement provision (IORPs), alternative investment fund managers (AIFMs), and undertakings for collective investment in transferable securities (UCITS).[60] Importantly, the EC confirmed that AIFMs from a third country entering the market of a Member State through a National Private Placement Regime must ensure compliance with the SFDR as well.[61] Under the SFDR, FMPs are subject to entity (Articles 3-5) and product (Articles 6-11) level disclosure.[62] At the entity level, FMPs should disclose on their website how they integrate sustainability risks into their investment decision-making process.[63] These sustainability risks are ESG events or conditions that could actually or potentially have a significant negative impact on the value of the investment.[64] When FMPs take into account principal adverse impacts (PAIs), i.e. the negative impacts of investment choices on sustainability factors,[65] they also need to describe on their website their due diligence policy regarding these impacts.[66] Notably, there is an opt out for FMPs

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57 Danny Busch, Guido Ferrarini & Seraina Grünewald, *Sustainable Finance in Europe: Corporate Governance, Financial Stability and Financial Markets* (Cham, Switzerland: Palgrave Macmillan, 2021).

58 EU 2019/2088, *supra* note 12 at Recital 10.

59 Whereas Level 1 of the SFDR already entered into force, the application of the RTS was deferred to 1 January 2023, because of the length and detail of the RTS, the time required for the submissions to the EC, and to ensure the smooth implementation of the Regulation. See *Information regarding regulatory technical standards under the Sustainable Finance Disclosure Regulation 2019/2088* (EU), 2021.

60 EU 2019/2088, *supra* note 12 at Article 2(1).

61 European Securities and Markets Authority, "Question related to 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 (SFDR)" (2019), online: *European Securities and Markets Authority* <https://www.esma.europa.eu/document/questions-related-regulation-eu-20192088-sfdr> [Question Related to EU 2019/2088].

62 Irene Bengo, Leonardo Boni & Alessandro Sancino, "EU Financial Regulations and Social Impact Measurement Practices: a Comprehensive Framework on Finance for Sustainable Development" (2022) 29:4 Corp. Soc. Responsib. Environ. Manag. at 809.

63 EU 2019/2088, *supra* note 12 at Article 3(1).

64 *Ibid.* at Article 2(22).

65 *Ibid.* at Recital 20.

that do not take into account adverse impacts. According to Article 4(1)(b), FMPs should provide on their website clear reasons for why they do not take into account adverse impacts and information as to whether and when they plan to take into account such impacts. Since 30 June 2021, this comply-or-explain principle is not available to FMPs with more than 500 employees or to FMPs that are parent undertakings of a large group with more than 500 employees.[67] Other than Article 4, Article 5 is not subject to the comply-or-explain principle; it requires all FMPs to integrate sustainability risks into their remuneration policies.

At the product level, FMPs should for each financial product describe in pre-contractual disclosures: (a) how sustainability risks are integrated into their investment choices; and (b) how sustainability risks might impact the returns of the financial products. In the case these sustainability risks are not considered relevant, FMPs should provide an explanation.[68] In addition, since 30 December 2022, FMPs that take into account PAIs should, for each financial product, provide information on these PAIs in pre-contractual disclosures.[69] Alternatively, FMPs should provide a statement that these impacts are not taken into account including the related reasons.[70]

Depending on the sustainable classification, FMPs may be subject to additional product level disclosure.[71] In order for a financial product to qualify as "light green" or "article 8 product,"[72] it needs to promote environmental and/or social characteristics, provided that the investee companies follow good governance practices. Remarkably, the EC put forward a broad definition of the term promotion[73] including different ESG approaches, ranging from exclusionary approaches to sustainable thematic approaches.[74] FMPs that offer light green products need to provide in pre-contractual disclosures: (a) when no designated index is used as a reference benchmark, information on how the environmental and/or characteristics are met; and (b) when a designated

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66 *Ibid.* at Article 4(1)(a). The PAI statement should include: (a) information on how the PAIs are identified and prioritized; (b) a description of the PAIs and of actions taken or planned to be taken with regard to these impacts; (c) a short summary of the engagement policy; and (d) a reference to compliance with responsible business codes and international standards for due diligence and reporting. Following Article 4(2).

67 *Ibid.* at Article 4(3), Article 4(4).

68 *Ibid.* at Article 6(1).

69 *Ibid.* at Article 7(1). This includes an explanation on whether and how the product takes into account PAIs and a statement that information about the PAIs is included in periodic reports.

70 *Ibid.* at Article 7(2).

71 Bengo, *supra* note 62.

72 EU 2019/2088, *supra* note 12 at Article 8.

73 Question Related to EU 2019/2088, *supra* note 61.

74 Morningstar, "SFDR Article 8 and Article 9 Funds: 2021 in Review" (2022), online: *Morningstar* <https://www.morningstar.com/lp/sfdr-article8-article9>.

index is used as a reference benchmark, whether and how that index is aligned with these characteristics.[75] In order for a financial product to qualify as "dark green" or "article 9 product,"[76] it needs to have sustainable investment as its objective. This means that an investment needs to contribute to an environmental or social objective and does no significant harm (DNSH) to other objectives.[77] Importantly, contrasting the enablement of beneficiaries to make informed investment decisions, this definition is broader than, and different from, the Article 3 TR criteria for environmentally sustainable economic activities (see section c). However, it includes the first Article 3 TR criterium as concerns an investment that substantially contributes to at least one of the six environmental objectives and overlaps with the second Article 3 TR criterium to the extent that an investment DNSH to the remainder of the environmental objectives.[78] When a sustainability index has been designated as a reference benchmark for a dark green product, FMPs need to provide in pre-contractual disclosures information on: (a) how that index is consistent with the sustainable investment objective; and (b) why and how that index differs from a broad market index.[79] When there is no such index designated, FMPs need to provide in pre-contractual disclosures an explanation on how the sustainable investment objective is to be achieved.[80]

FMPs should for each light and dark green product provide on their website also some additional information,[81] including the environmental and/or social characteristics or the sustainable investment objective, information on the assessment, measurement and monitoring methods used, information about the pre-contractual disclosures, and the periodic reports.[82] In these periodic reports, FMPs need to disclose: (a) for each light green product, to what extent the environmental or social characteristics are met; and (b) for each dark green product: (i) the overall sustainability-related impact of the product, using important sustainability indicators; or (ii) when a designated index is used as a reference benchmark, how this overall sustainability-related impact differs from that index and from a broad market index that uses sustainability indicators.[83]

(c) TR

The TR entered into force in 2020, establishing a common language for environmentally sustainable investments, aiming to facilitate the assessment of

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75 EU 2019/2088, *supra* note 12 at Article 8(1).

76 *Ibid.* at Article 9.

77 *Ibid.* at Article 2(17).

78 EU 2020/852, *supra* note 13 at Recital 19.

79 EU 2019/2088, *supra* note 12 at Article 9(1).

80 *Ibid.* at Article 9(2).

81 *Ibid.* at Article 10(1). The RTS do not provide a template for this disclosure, but set out the website sections that must be included.

82 *Ibid.* at Article 11.

83 *Ibid.* at Article 11(1).

sustainable investments, enhancing investor confidence and awareness, and combatting greenwashing, defined as the practice of having an unfair competitive advantage by offering financial products as environmentally sustainable, whilst the standards for environmental sustainability are not complied with.[84] Shortly stated, whereas the SFDR sets out the main sustainability disclosure requirements for FMPs, the TR addresses what can be considered sustainable. An economic activity is environmentally sustainable if the activity substantially contributes to at least one of the six environmental objectives[85] and it DNSH to the remainder of the environmental objectives following the technical screening criteria (TSC) in delegated acts. In addition, the activity needs to comply with minimum social and governance safeguards[86] (the Article 3 TR criteria). The TR applies to (a) measures from Member States or the EU which impose requirements for FMPs regarding financial products or corporate bonds that are marketed as environmentally sustainable; (b) FMPs offering financial products, including foreign FMPs offering financial products in the EU; and (c) undertakings covered by the NFRD.[87]

Like under the SFDR there are two types of disclosure; entity[88] and product[89] level disclosure. In line with the NFRD, not all FMPs but only large public-interest entities with more than 500 employees or parent public-interest entities of a large group which has more than 500 employees are subject to the TR entity disclosure.[90] As such, most of the institutional investors do not fall within the scope.[91] The institutional investors that do fall within the scope need to include in their consolidated non-financial statement how, and to what extent, their activities relate to the Article 3 TR criteria. The Delegated Act supplementing Article 8 TR[92] sets out the content and presentation of this information.

At the product level, the TR extends the disclosure obligations of the SFDR following the comply-or-explain principle: if the FMP claims that his product is sustainable, he must disclose the nature and extent to which this product conforms to the TR. If not, he will have to indicate that the product is not

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84 EU 2020/852, *supra* note 13 at Recital 11.

85 *Ibid.* at Article 9.

86 *Ibid.* at Article 18.

87 EU 2014/95, *supra* note 35.

88 EU 2020/852, *supra* note 13 at Article 8.

89 *Ibid.* at Article 5, Article 6, Article 7.

90 EU 2014/95, *supra* note 35 at Article 19a, 29a.

91 Note that the proposed CSRD extends this coverage.

92 *Commission Delegated Regulation (EU) 2021/2178 of 6 July 2021 supplementing Regulation (EU) 2020/852 of the European Parliament and of the Council by specifying the content and presentation of information to be disclosed by undertakings subject to Articles 19a or 29a of Directive 2013/34/EU concerning environmentally sustainable economic activities, and specifying the methodology to comply with that disclosure obligation* (EU), 2021.

aligned. FMPs should for light green products that promote environmental characteristics and dark green products that contribute to an environmental objective provide in their pre-contractual disclosures and periodic reports: (a) information on the environmental objective(s) of Article 9 TR to which the investments contribute; and (b) a description of how, and to what extent, the investments are associated with the Article 3 TR criteria.[93] For each light green product that promotes environmental characteristics, FMPs also need to disclose a statement that the DNSH principle is applicable to the investments that consider the Article 3 TR criteria, whereas the rest of the investments selected for the financial product do not.[94] As such, the relation between the SFDR and TR at the product level becomes clear; whereas dark green products should fulfil *all* the Article 3 TR criteria, light green products should fulfil the DNSH principle in part, i.e. with regard to the environmental characteristics. Where a financial product is neither light nor dark green, FMPs need to disclose a negative statement in their pre-contractual disclosures and periodic reports that the investments do not consider the Article 3 TR criteria for environmentally sustainable economic activities.[95]

Since 1 January 2022, the first Taxonomy Delegated Act is applicable,[96] specifying the conditions for substantially contributing to the first two environmental objectives, that is climate change mitigation and climate change adaptation, and for the DNSH criterium. In addition, despite criticism of the Platform on Sustainable Finance,[97] on 15 July 2022, the Complementary Climate Delegated Act on gas and nuclear activities has been published and is applicable from 1 January 2023 onwards.[98]

(d) CSRD

When the NFRD was introduced in 2014 covering large public interest entities,[99] the idea was that a high degree of flexibility in non-financial reporting

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93 EU 2020/852, *supra* note 13 at Article 5, Article 6.

94 *Ibid.* at Article 6.

95 *Ibid.* at Article 7.

96 *Commission Delegated Regulation (EU) 2021/2139 of 4 June 2021 supplementing Regulation (EU) 2020/852 of the European Parliament and of the Council by establishing the technical screening criteria for determining the conditions under which an economic activity qualifies as contributing substantially to climate change mitigation or climate change adaptation and for determining whether that economic activity causes no significant harm to any of the other environmental objectives* (EU), 2021.

97 EU Platform on Sustainable Finance, "Response to Complementary Delegated Act" (21 January 2022), online (pdf): <https://ec.europa.eu/info/sites/default/files/business_economy_euro/banking_and_finance/documents/220121-sustainable-finance-platform-response-taxonomy-complementary-delegated-act_en.pdf>.

98 *Commission Delegated Regulation (EU) 2022/1214 of 9 March 2022 amending Delegated Regulation (EU) 2021/2139 as regards economic activities in certain energy sectors and Delegated Regulation (EU) 2021/2178 as regards specific public disclosures for those economic activities* (EU), 2022.

was desirable, taking into account diversity in corporate strategies and materiality of different sustainability issues.[100] Nowadays, there is a consensus that such flexibility makes disclosures hard to assess, compare and value, increasing information asymmetries, complicating enforcement by supervisory authorities and rendering the NFRD largely ineffective.[101] In addition, some national competent authorities (NCAs) have no legal mandate to supervise the non-financial statements of certain companies.[102] As a result, to strengthen transparency around sustainability matters the EC published a proposal for a Corporate Sustainability Reporting Directive (CSRD) on 21 April 2021 replacing the NFRD.[103] Particularly, the CSRD would ensure alignment with other EU initiatives on sustainable finance including the SFDR and TR to "create a consistent and coherent flow of sustainability information throughout the financial value chain."[104] The EC explains that FMPs in order to be able to fulfil the requirements of the SFDR — and therefore ultimately to be able to meet the needs of end investors including individuals and households — need adequate information from investee companies, which is the aim of the CSRD. In addition, the TR sets out disclosure requirements about the extent to which economic activities are environmentally sustainable, and thus the CSRD needs to ensure that the NFRD disclosure obligations are consistent with the TR.

To this end, the CSRD not only introduces more detailed reporting requirements consistent with the European framework,[105] it also extends the scope of the NFRD to all large companies and all companies listed on regulated markets (except listed micro-undertakings), mandates the audit (assurance) of reported information, requires a single electronic reporting format, and clarifies that NCAs have legal mandate to supervise sustainability reporting.[106] The detailed reporting requirements (referred to as European Sustainability Reporting Standards (ESRS)) should ensure relevant, reliable, comparable,

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[99] EU 2014/95, *supra* note 35 at Article 19a: "Large undertakings which are public-interest entities exceeding on their balance sheet dates the criterion of the average number of 500 employees during the financial year".

[100] *Ibid.* at Recital 3.

[101] European Commission, "Commission Staff Working Document Fitness Check on the EU framework for public reporting by companies Accompanying the document Report from the Commission to the European Parliament, the Council and the European Economic and Social Committee on the review clauses in Directives 2013/34/EU, 2014/95/EU, and 2013/50/EU" (21 April 2021) European Commission Staff Working Document No. SWD(2021) 81 final, online: *EUR-Lex* < https://eur-lex.europa.eu/legal-content/EN/TXT/?uri = CELEX%3A52021SC0081 >.

[102] *Ibid.*

[103] EC Proposal 21 April 2021, *supra* note 42.

[104] *Ibid.* at 4.

[105] *Ibid.* at Articles 19a, 19b. Article 19b(1)(a) also explicitly refers to the SFDR, stating: "[. . .] at least specifying information corresponding to the needs of financial market participants subject to the disclosure obligations of Regulation (EU) 2019/2088."

[106] *Ibid.* at 5.

and understandable sustainability reporting and should be developed by the European Financial Reporting Advisory Group (EFRAG).[107]At the time of writing this article, the European Parliament and Council have reached a provisional agreement in negotiations, but the full text of the agreed CSRD has not yet been made public.[108]

(e) CSDDD

The latest regulatory proposal of the EC (23 February 2022) includes the proposed Directive on CSDDD.[109] It requires certain European companies[110] and third country companies to set up mandatory due diligence practices to identify, prevent or mitigate, and ultimately terminate adverse impacts of their corporate activities on human rights and the environment. It thus incorporates to a large extent the Human Rights Due Diligence (HRDD) process as outlined by the United Nations Guiding Principles (UNGPs).[111] In fulfilling these due diligence duties, "regulated financial undertakings"[112] must do so before providing financial services to their clients.[113] In addition, the CSDDD includes civil liability for non-compliance with due diligence duties (Article 22), addresses director's duties (Articles 25 and 26), and introduces a corporate climate plan (Article 15).

The CSDDD *inter alia* aims to supplement the requirements laid down in the European sustainable finance framework, further stimulating more detailed sustainability information in the market. Although the CSDDD is a highly welcomed regulatory initiative that converts international HRDD obligations into harmonized hard law,[114] it has been criticized for various reasons too.

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[107] At the moment of writing this article, the public consultation on the first set of draft ESRS was just finished. EFRAG needs to submit its final draft ESRS to the EC in November 2022, on which the ESAs will deliver an opinion. See for EFRAG's timeline, online: <https://www.efrag.org/Activities/2105191406363055/Sustainability-reporting-standards-interim-draft?AspxAutoDetectCookieSupport=1#>.

[108] The provisional agreement was reached on 21 June 2022. See for the legislative process overview, online: <https://www.europarl.europa.eu/legislative-train/theme-a-european-green-deal/file-review-of-the-non-financial-reporting-directive?sid=6001>.

[109] EU Proposal 2019, *supra* note 46.

[110] Article 2. Companies based in Europe with more than 500 employees and a net worldwide turnover of over 150 million EUR in the last financial year, and companies based in Europe with more than 250 employees, a net worldwide turnover of over 40 million EUR and 50% of this turnover in a high-risk sector.

[111] United Nations, "Guiding Principles on Business and Human Rights" (2011), online (pdf): *United Nations* <https://www.ohchr.org/sites/default/files/documents/publications/guidingprinciplesbusinesshr_en.pdf> at 15-16.

[112] *Ibid.* at Article 3(a)(iv).

[113] Note that the CSDDD defines value chain in a narrow way for these financial entities, including only the activities of their clients (or related entities) receiving financial services, and excluding SMEs.

[114] Anne Lafarre & Bas Rombouts, "Towards Mandatory Human Rights Due Diligence:

Particularly, the scope of the CSDDD substantially differs from the SFDR, TR, and the proposed CSRD, introducing different thresholds for companies.[115] Points of criticism relevant to the financial industry are the unclear relationship between the due diligence obligations and Article 4 SFDR,[116] and definition of "activities of clients."[117] Particularly, the SFDR assumes duties beyond pre-investment assessments, whereas the CSDDD seems not.

(f) MIFID

As we have seen in the brief outline of regulatory developments, the amendments to MIFID entered into force on 2 August 2022 and *inter alia* hold that investment firms need to take into account retail client's sustainability preferences in the advice process as part of their duties (the suitability test).[118] This suitability test aims at enabling retail investors to make sustainable investment choices in accordance with their preferences when they receive personalized recommendations.[119] Article 2 defines sustainability preferences (under 7), sustainability factors (8), and sustainability risks (9) in line with the TR and SFDR terminology. Sustainability preferences indicate the minimum proportion of TR-aligned economic activities, minimum proportion of sustainable investments under the SFDR, and/or qualitative or quantitative elements of PAIs. Investment firms will have to obtain information about the minimum sustainability threshold of their clients and based on this, provide their investment advice. Paragraph 12 of Article 54 adds that investment firms report to the retail client how the provided recommendation is suitable for the client, including his or her sustainability preferences. As retail investors oftentimes do not receive personalized investment recommendations, but advice like marketing communications, rules related to product governance are of importance too as part of the MIFID Delegated Directive amendments.[120] Following the Article 9

Assessing its Impact on Fundamental Labour Standards in Global Value Chains" (2022), online: *SSRN* <https://ssrn.com/abstract=4155836>.

[115] *Supra* note 110.

[116] PRI Association, "PRI Statement: European Commission Proposal on Corporate Sustainability Due Diligence" (2 March 2022), online (pdf): *PRI Association* <https://www.unpri.org/download?ac=15897>.

[117] Article 3g. See Eumedion Corporate Governance Forum, "Statement Regarding the Proposal for a Directive on Corporate Sustainability Due Diligence" (2022), online (pdf): *Eumedion Corporate Governance Forum* <https://www.eumedion.nl/clientdata/215/media/clientimages/Statement-on-CSDD-proposal.pdf>.

[118] See MiFID Delegated Regulation: EU Delegated Regulation 2021, *supra* note 45. Amendments proposed to Article 54 (suitability assessments and reports).

[119] Pacces, *supra* note 14.

[120] *Commission Delegated Directive (EU) 2021/1269 of 21 April 2021 Amending Delegated Directive (EU) 2017/593 as Regards the Integration of Sustainability Factors into the Product Governance Obligations* (EU), 2021. Note that these amendments are related to the MIFID Directive and thus need to be transposed by the EU Member States.

amendments, investment firms need to determine whether a financial instrument meets the identified needs, characteristics, and objectives of the target market related to sustainability factors (in line with the SFDR and TR). Moreover, sustainability factors need to be presented in a transparent manner to provide distributers with the relevant information to duly consider their client's sustainability-related objectives.

(g) Stewardship Codes

Although part of the national frameworks, the final (soft) regulatory initiatives that are relevant to discuss are stewardship codes. These soft law instruments cannot only legitimize sustainability engagement of institutional investors,[121] but are also able to increase the effectiveness of engagement.[122] The UK Stewardship Code (UKSC) has served as a model for stewardship codes around the world.[123] The first version of the UKSC was adopted in 2010 by the FRC, and after the 2012 version, a substantially revised version of UKSC came into effect on 1 January 2020. Particularly, in terms of engagement duties and disclosures, the SRD II only plays a residual role in the UK framework, as the UKSC applies to a broader range of subjects.[124] In addition, the UKSC contains the "apply-and-explain principle,"[125] going beyond the comply-or-explain principle adopted in the SRD II, requiring institutional investors to apply the principles and explain how they did so. Also the Dutch Stewardship Code (DSC) of 2018 (applicable as from 1 January 2019 to institutional investors of Dutch listed companies and, as appropriate, non-Dutch listed companies) goes beyond the duties in the SRD II, although to a lesser extent.[126] In regard to sustainability

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121 Jennifer Hill, *Stewardship Codes, ESG Activism, and Transnational Ordering* (at the ECGI Investor Sustainability Engagement conference). ECGI, "ECGI" (2022), online: <https://ecgi.global/content/investor-sustainability-engagement#!event-panel-discussions>.

122 Massimiliano Bonacchi et al., "The Effects of Credible Voluntary Disclosures: Institutional Investor Engagement and Investees' ESG Performances" (2022) European Corporate Governance Institute Working Paper No. 622/2022, online: *SSRN* <https://ssrn.com/abstract=4011957>. The authors refer to the tiering system to assess reporting under the UKSC. Note that with the introduction of the 2020 UKSC, another assessment system was introduced.

123 Dionysia Katelouzou & Dan Puchniak, *Global Shareholder Stewardship,* "Global Shareholder Stewardship: Complexities, Challenges and Possibilities" (Cambridge: Cambridge University Press, 2022).

124 Financial Conduct Authority, "Building a regulatory framework for effective stewardship discussion paper" (January 2019), online (pdf): *Financial Conduct Authority* <https://www.fca.org.uk/publication/discussion/dp19-01.pdf>.

125 Financial Reporting Council, "The UK Stewardship Code 2020" (2020), online (pdf): *Financial Reporting Council* <https://www.frc.org.uk/getattachment/5aae591d-d9d3-4cf4-814a-d14e156a1d87/Stewardship-Code_Final2.pdf> at 4.

126 Dionysia Katelouzou & Dan Puchniak, *Global Shareholder Stewardship,* Christoph van der Elst & Anne Lafarre "Shareholder Stewardship in the Netherlands: The Role of

duties, the DSC explicitly includes "social and environmental impact" as part of engagement and explains that stewardship should promote the investee's long-term value creation.[127] The UKSC explicitly refers to integrating ESG factors into stewardship in Principle 7,[128] stating that institutional investors should "systematically integrate stewardship and investment, including material environmental, social and governance issues, and climate change, to fulfil their responsibilities." Particularly, "institutional investors should disclose the issues they have prioritized for assessing investments, prior to holding, monitoring through holding and exiting. This should include the ESG issues of importance to them."

4. OVERVIEW OF SUSTAINABILITY DUTIES

In the previous section, we discussed the various sustainability engagement and investment strategy disclosure duties institutional investors in Europe face. Table 1 below summarizes the most important duties across these various legislative instruments in terms of i) sustainability engagement and stewardship and ii) their investment strategy.[129] Note that the CSDDD is not taken into account here, as significant changes to this proposed directive are to be expected.[130] To summarize, in regard to their engagement and stewardship, the table shows that institutional investors must disclose the integration of engagement and voting activities into their investment strategies, and how these investment strategies (and in case of arrangements with asset managers, the arrangements) are aligned with the long-term obligations of institutional investors. In regard to their investment strategy, institutional investors should

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Institutional Investors in a Stakeholder-Oriented Jurisdiction" (Cambridge: Cambridge University Press, 2022) at 91.

[127] Monitoring Committee Corporate Governance Code, "The Dutch Corporate Governance Code" (8 December 2016), online (pdf): *Monitoring Committee Corporate Governance Code* <https://www.dsm.com/content/dam/dsm/corporate/en_US/documents/corporate-governance-code-en.pdf> [Dutch Corporate Governance Code] at Principle 1. Note that in December 2022, the Dutch Corporate Governance Code 2022 was adopted, which highlights the importance of "sustainable long-term value creation" as a core principle.

[128] Dionysia Katelouzou & Dan Puchniak, *Global Shareholder Stewardship,* Paul Davies "The UK Stewardship Code 2010-2020: From Saving the Company to Saving the Planet?" (Cambridge: Cambridge University Press, 2022) 44.

[129] This Table does not purport to be exhaustive. For instance, also see the requirement for AIFMs to take into account sustainability risks in article 57(1) of the Delegated Regulation (EU) No 231/2013 that is applicable as from 1 August 2022. Another example is article 19(2) of Directive (EU) 2016/2341, requiring Member States to allow institutions for occupational retirement provision (IORPs) to take into account the potential long-term impact of investment decisions on environmental, social, and governance factors within the prudent person rule. Note that also the SDR as announced late 2021 by the FCA (UK) is not included in the table.

[130] Lafarre, *supra* note 114.

disclose the integration of sustainability risks and PAIs, the integration of sustainability risks into their remuneration policy, and, those investors who are subject to the NFRD, their taxonomy alignment. The integration of sustainability risks and PAIs must also be disclosed for each financial product. For light and dark green products, also information related to the sustainability characteristics and the sustainable investment objective, respectively, and the environmental objective(s) to which the products contribute, is required. Moreover, in the MIFID context, investors must take into account and assess their retail client's sustainability preferences.

Table 1 — Overview of Sustainability Duties for Institutional Investors

Duties	**Legal instrument**	**Scope**	**Content** **Disclosure obligations**
I. Sustainability engagement and stewardship	SRD II UKSC DSC	Institutional investors	**Engagement (stewardship) policy:** *Article 3g SRD II:* description of how engagement/stewardship is incorporated into: - investment strategies, including how: - investments on important matters (including social and environmental impact) are monitored; - dialogues with investee companies are entered into; - voting rights and additional rights for shares are exercised; - remainder of shareholders are cooperated with; - relevant stakeholders of investee companies are communicated with; - conflicts of interest related to engagement are addressed; - Once per year, description of how this engagement/stewardship policy has been implemented.
	SRD II UKSC DSC	Institutional investors	**Voting policy:** *Article 3g SRD II:* As concerns the exercise of voting rights information about: - the voting policy and, once per year, description of how this voting policy has been implemented, including: - use of proxy and/or voting services; - explanation of most significant votes; - description of voting behaviour in general meetings - votes cast: more in particular, link to voting records (*Principle 12 UKSC*)/account of

Duties	**Legal instrument**	**Scope**	**Content** **Disclosure obligations**
			voting behaviour for each individual company and voting item (*Principle 7 DSC*)
II. Sustainable Investment Strategy	SRD II UKSC DSC	Institutional investors	**<u>Investment Strategy (general):</u>** *Article 3h SRD II:* - description of how key components of equity investment strategy match (long-term) liabilities and effects on medium to long-term asset performance (and including material ESG factors ex *Principle 7 UKSC*); - If entered into an arrangement with an asset manager, a description of characteristics of such arrangement: – incentives to match investment strategy with (long-term) liabilities; – incentives to base investment decisions on long-term (non-)financial performance of investee companies and to engage with companies (and including material ESG factors, ex *Principle 7 UKSC,* integration of engagement/stewardship policy ex *Principle 1 DSC*); – evaluation of asset managers' performance and remuneration consistent with (long-term) liabilities and long-term performance; – monitoring of asset managers' portfolio turnover (costs and targets); – arrangement duration.
	SFDR TR [CSRD]	FMPs (for TR: NFRD coverage)	**<u>Sustainability risk policy and sustainable activities (entity level):</u>** *Article 3(1) SFDR:* description of integration of sustainability risks into investment decision-making process. *Article 4 SFDR*: description of due diligence policy regarding PAIs, including: - how PAIs are identified and prioritized; - description of PAIs and actions taken with regard to PAIs; - short summary of engagement policies; - reference to compliance with responsible business codes and international standards for due diligence and reporting. *Article 4 SFDR*: Where FMPs do not take into

Duties	Legal instrument	Scope	Content Disclosure obligations
			account PAIs (not available for FMPs > 500 employees and FMPs that are parent undertakings of large group > 500 employees): - clear reasons for why they do not consider PAIs; - whether and when they plan to take into account such impacts. *Article 5 SFDR*: description of how sustainability risks are integrated into remuneration policy. *Article 8 TR:* How and to what extent activities relate to environmentally sustainable economic activities, *inter alia* including qualitative information of KPIs. *[Articles 19a-b CSRD will ensure that sustainability information of investee companies is available].*
	SFDR [CSRD]	FMPs	<u>**Sustainability risks and sustainable activities (product level, general):**</u> *Article 6(1) SFDR:* for each product describe: - How sustainability risks are integrated into investment choices; - How sustainability risks might impact returns of financial product; - In case these sustainability risks are not considered relevant, reasons therefor. *Article 7(1) SFDR*: From 30 December 2022: - description of whether and how financial product considers PAIs; - reference to information on PAIs included in periodic reports. *Article 7(2) SFDR*: When FMPs do not take into account PAIs: - statement that PAIs are not taken into account and reasons therefor. *[Articles 19a-b CSRD will ensure that sustainability information of investee companies is available].*
	SFDR TR [CSRD]	FMPs	<u>**Light green products:**</u> Index pre-contractual information (*Article 8 SFDR*) and website disclosure (*Article 10 SFDR):*

Duties	Legal instrument	Scope	Content Disclosure obligations
			- No designated index: explain how environmental and/or social characteristics are met; - Designated index: how index is aligned with environmental and/or social characteristics. *Article 6 jo 5 TR:* other pre-contractual information, *Article 11 SFDR* periodic reports: - When promoting environmental characteristics: environmental objective(s) to which the investments contribute and description of how, and to what extent, the investments are considered environmentally sustainable; - Statement that DNSH is applicable to investments that consider the criteria for environmentally sustainable economic activities, whereas the rest of the investments selected for the financial product do not consider these criteria. *Article 11 SFDR* periodic reports (other): - Extent to which environmental and/or social characteristics are met. *Article 10 SFDR:* other website disclosure: - the environmental and/or social characteristics; - the assessment, measurement and monitoring methods used for the environmental and/or social characteristics; - to what extent the environmental and/or social characteristics are met. *[Articles 19a-b CSRD will ensure that sustainability information of investee companies is available].*
	SFDR TR [CSRD]	FMPs	**<u>Dark green products:</u>** Index pre-contractual information (*Article 9 SFDR*) and website disclosure (*Article 10 SFDR):* - Sustainability index: how that index is consistent with sustainable investment objective and differences from broad market index; - No sustainability index: how objective is to

Duties	Legal instrument	Scope	Content Disclosure obligations
			be achieved. *Article 5 TR:* other pre-contractual information, *Article 11 SFDR* periodic reports: - For dark green products contributing to an environmental objective: the environmental objective(s) and a description of how, and to what extent, the investments are considered environmentally sustainable. *Article 11 SFDR* periodic reports (other): - Overall sustainability-related impact of the product using important sustainability indicators or designated sustainability index. *Article 10 SFDR:* other website disclosure: - Sustainable investment objective; - Assessment, measurement and monitoring methods for the sustainable impact; - Overall sustainability-related impact of the product using important sustainability indicators or designated sustainability index. *[Articles 19a-b CSRD will ensure that sustainability information of investee companies is available]*.
	TR	FMPs	**Negative statement:** *Article 7 TR:* negative statement that investments do not consider article 3 TR criteria for environmentally sustainable economic activities.
	MIFID	Investment firms	**Personalized recommendations to retail clients:** *Article 54 MIFID:* include sustainability preferences in suitability test, aligned with TR and SFDR (minimum thresholds).
	MIFID	Investment firms	**Product governance:** *Article 9 MIFID:* - Determine whether financial instrument meets sustainability factors (in line with the SFDR and TR). - Present sustainability factors in a transparent manner.

5. CONCLUDING REMARKS

A sustainable world is a precondition for all current and future human ambitions. Today's immense sustainability challenges are fuelling fundamental changes in the role of shareholders, and institutional investors in particular, in corporate governance. They are expected to be good stewards that guide their investee companies in the direction of sustainability. Institutional investors are assigned a monitoring role: using their important powers as systematic owners, investors need to persuade companies to reduce negative externalities. How companies do this, however, remains a decision at the level of the corporate management.[131] The European regulation of sustainable finance — including also the SRD II and the proposed CSDDD — and the national (soft) regulatory efforts signal that it is nowadays expected from institutional investors to take into account sustainability interests in their decision-making. For instance, the DSC expressly states that institutional investors should promote "long-term value creation." Long-term value creation is the key principle in the Dutch Corporate Governance Code of 2016 (DCGC) that explicitly includes "stakeholder interests" and "any other aspects relevant to the company [. . .] such as the environment, social and employee-related matters, the chain within which the enterprise operates, respect for human rights, and fighting corruption and bribery."[132] An effective sustainable investment strategy and engagement requires a good understanding of investee companies and comparable and transparent information. Moreover, in order for institutional investors to attract sustainability-minded beneficiaries, they need to signal that they invest sustainably and are prepared to use their voice. Whereas before greenwashing opportunities limited the ability of green institutional investors to credibly signal their true sustainability efforts and beneficiaries to obtain reliable and comparable information about these actual behaviours,[133] with the European initiatives such practices are likely to be reduced following the old-time favourite motto "measuring is knowing."[134]

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[131] Pacces, *supra* note 14.

[132] Dutch Corporate Governance Code, *supra* note 127 at Principle 1.1.1. Note that the Dutch Corporate Governance Code of 2022 goes one step further with "sustainable long-term value creation" as its key principle: <https://www.mccg.nl/publicaties/codes/2022/12/20/dutch-corporate-governance-code-2022>.

[133] Authors have argued that in chasing the money of millennials and other sustainability-minded customers, investors put large emphasis on marketing activities to convey the story of being responsible, and publicly announce to be advocates of corporate sustainability goals, whereas their true behaviours may differ. See Michal Barzuza, Quinn Curtis & David Webber, "Shareholder Value(s): Index Fund ESG Activism and the New Millennial Corporate Governance" (2020) 93:6 S. Cal. L. Rev. at 1243. Such (perceived) actions discourage investors and beneficiaries from investing in sustainable economic activities and can lead to reputational risks.

[134] Harm-Jan de Kluiver, "Kroniek van het Ondernemingsrecht" (2021) 2021/1216 NJB 1241 at 1244.

In the introduction we raised the fundamental question of whether institutional investors can indeed play this pivotal role and whether disclosure obligations would impact investor behaviour. Whereas several scholars have raised substantial doubts about the incentives of institutional investors, and index funds in particular, to foster sustainability, most of these arguments relate to current greenwashing opportunities. In a more transparent system, also investors with only financial motives[135] will need to compete for sustainability-minded beneficiaries (asset owners and ultimate beneficiaries) in setting their TR-alignment, and thus the preferences of these beneficiaries will play a central role in their investment and engagement behaviours.[136] Whether the TR and other European sustainable finance initiatives can indeed increase sustainable value creation not only depends on beneficiary's preferences, but also on the design of these disclosure obligations, including the supervision and enforcement to monitor greenwashing risks.[137] To this end, the European Securities and Markets Authority (ESMA) provided a briefing attempting to enhance supervisory convergence among NCAs.[138] Here, it is important to solve any (potential) lack of coherence of the European regulatory framework. In this respect, it is important that the CSRD — including the ESRS — soon replaces the NFRD to achieve a further alignment with the TR and SFDR and standardized sustainability reporting requirements. As regards the CSDDD, it is highly recommended to ensure that it does not differ from the proposed CSRD, SFDR, and the TR in terms of definitions, scope of investors and duties that are considered, and that its relationship with these other regulatory initiatives is made clear. Although the actual ability to impact behaviours of these regulatory initiatives largely based on the comply-or-explain principle will become clear in the near future, conditional upon the proposed improvements, we are cautious supporters of the sustainable financing route that Europe has taken.

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135 Anne Lafarre, "Do Institutional Investors Vote Responsibly?" (2022), online: *SSRN* <https://ssrn.com/abstract=4042907>.

136 BlackRock has announced to allow their beneficiaries a direct voting choice. See BlackRock, Press Release, "BlackRock Expands Voting Choice to Additional Clients" (13 June 2022), online: *BlackRock* <https://www.blackrock.com/corporate/newsroom/press-releases/article/corporate-one/press-releases/2022-blackrock-voting-choice>. Also see on the market for stewardship: Dionysia Katelouzou & Eva Micheler, "The Market for Stewardship and the Role of the Government" (2021), online: *SSRN* <https://ssrn.com/abstract=3872827>.

137 The EC asked the different European authorities (EBA, EIOPA and ESMA) for their input here. See EBA 2022, *supra* note 22.

138 European Securities and Markets Authority, "Supervisory briefing Sustainability risks and disclosures in the area of investment management" (2022), online (pdf): *European Securities and Markets Authority* <https://www.esma.europa.eu/sites/default/files/library/esma34-45-1427_supervisory_briefing_on_sustainability_risks_and_disclosures.pdf>.