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insights

THE EU SUSTAINABLE FINANCE REGULATION 2022

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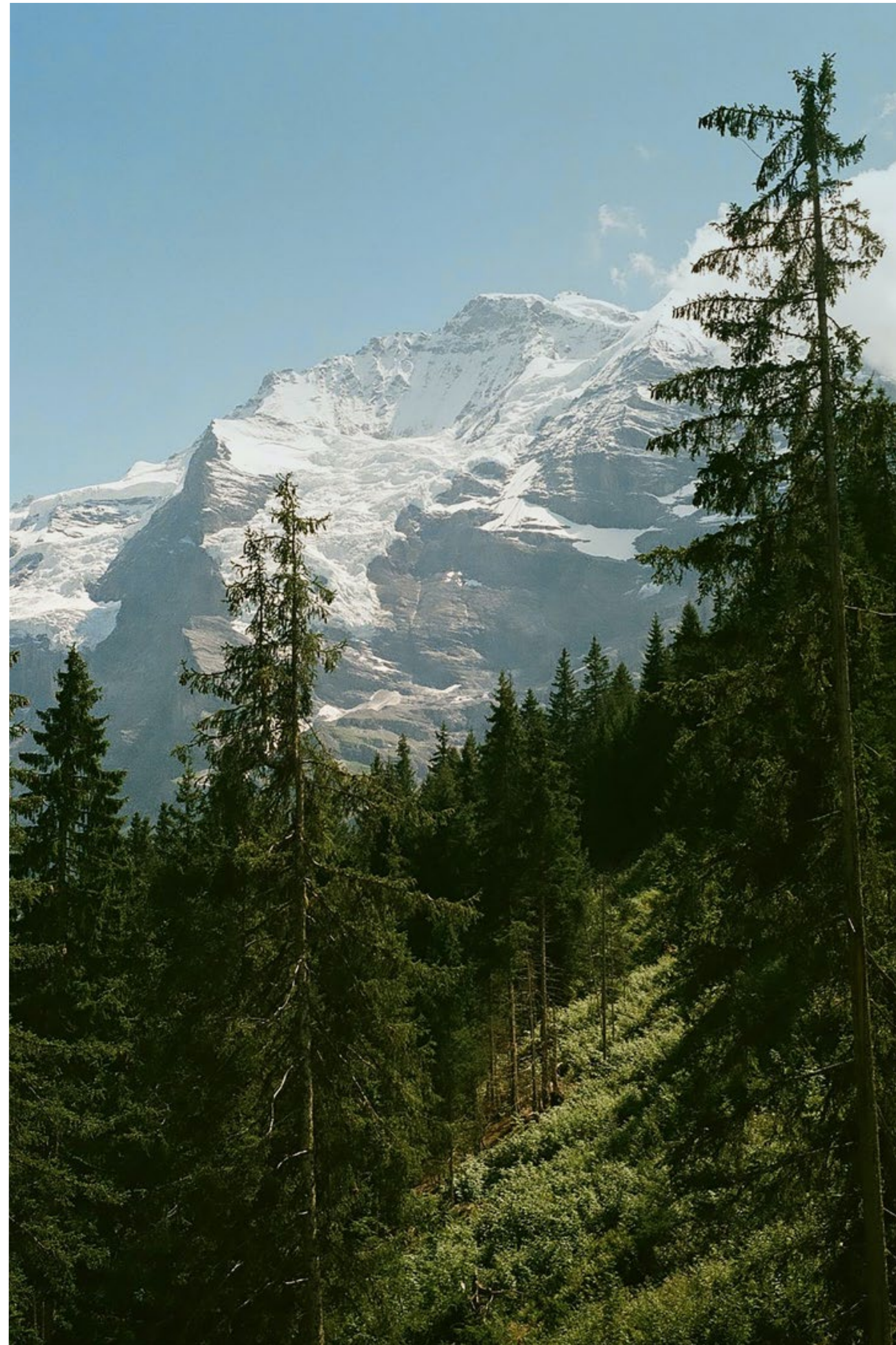


Credit: Svetlana Gumerova on Unsplash

the editor's word

Tracking the EU's sustainable finance expedition

It is exciting to be a pioneer, breaking new ground, exploring uncharted territory, and looking for vantage points that offer clarity and direction! However, it also means backbreaking work, frequent setbacks, and occasionally getting lost.

From the very beginning, the EU's sustainable finance regulators set out to be such pioneers, designing ground-breaking new rules, reshaping the market for sustainable investment, encouraging greater disclosure, and setting a benchmark for the rest of the world.

In this edition of NordSIP Insights, we check on the expedition's progress so far. We find out that while moving steadily forwards and upwards, the explorers have also encountered some serious obstacles and are, at times, unable to live up to everyone's high expectations.

We take the pulse of those leading the expedition, both visible and hidden heroes who persevere with carrying the heavy task of seeing the project through. We also talk to those on the ground, following the progress of the pioneers closely and hoping for a clear and comprehensive map to navigate the treacherous landscape.

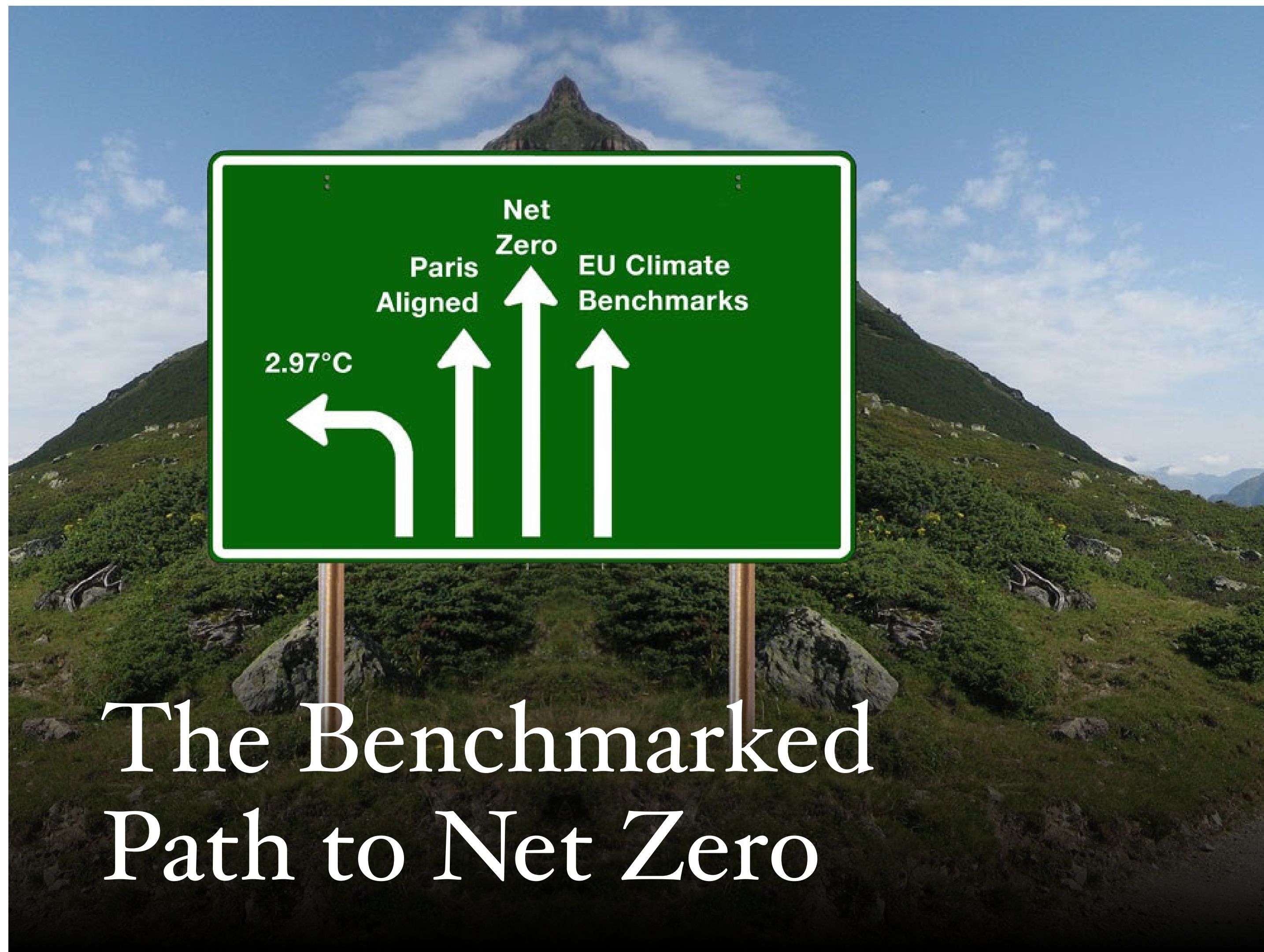
Much of the primary legislation is already in place, yet more detailed rules necessary to implement the package are still in the works. Will the EU Taxonomy, with all its extensions and additions, ever be complete? And is the already twice postponed Level 2 of SFDR going to answer all the remaining questions? With MiFID knocking on the door, how will asset managers align all the piling requirements?

It's a long way to the top...

Aline Reichenberg Gustafsson, CFA

Editor-in-Chief

NordSIP



The Benchmarked Path to Net Zero

While climate change has taken center-stage in recent years, it can be overwhelming to understand both the magnitude of the challenge that lies ahead of us, as well as the limited time at our disposal to act and transition towards a net-zero economy. According to the Intergovernmental Panel on Climate Change (IPCC), global warming scenarios of 1.5°C and 2°C will both be exceeded during the 21st century unless deep reductions in emissions occur in the coming decades. As shown in Figure 1, the reduction in global emissions will have to be drastic to stay consistent with 1.5°C and 2°C scenarios.

To keep the 1.5°C target within reach, the world needs to halve emissions over the next decade to reach net zero emissions by the middle of the century.

What is the current situation?

To assess how companies are currently aligned to these different scenarios, we can use the MSCI Implied Temperature Rise assessment, which provides an indicative temperature alignment for companies which can easily be compared to global warming scenarios depicted in Figure 1. Unfortunately, a substantial portion of listed companies are still misaligned with these goals. According to MSCI[1], and as shown on Figure 2, less than 10% of the MSCI ACWI IMI constituents are aligned with the goal of limiting temperature increase to below 1.5°C, while less than half are aligned with a below 2°C target.

If we break down the implied temperature rise of listed companies by region, Figure 3 indicates that none of the regions are aligned with the Paris Agreement target, and by quite a wide margin. Companies in developed markets are showing lower temperature rise levels compared to emerging markets, but they still fall short of global targets.

MSCI Climate Paris-Aligned indexes aim to be aligned with a 1.5°C scenario by 2030, which can support investors with their net-zero commitments. Thanks to their 10% self-decarbonization trajectory, we can already observe how they are moving towards their target.

For example, the implied temperature rise of the MSCI ACWI Climate Paris-Aligned index is equal to 2.12°C, while the MSCI ACWI index exhibits a rise of 2.97°C[2]

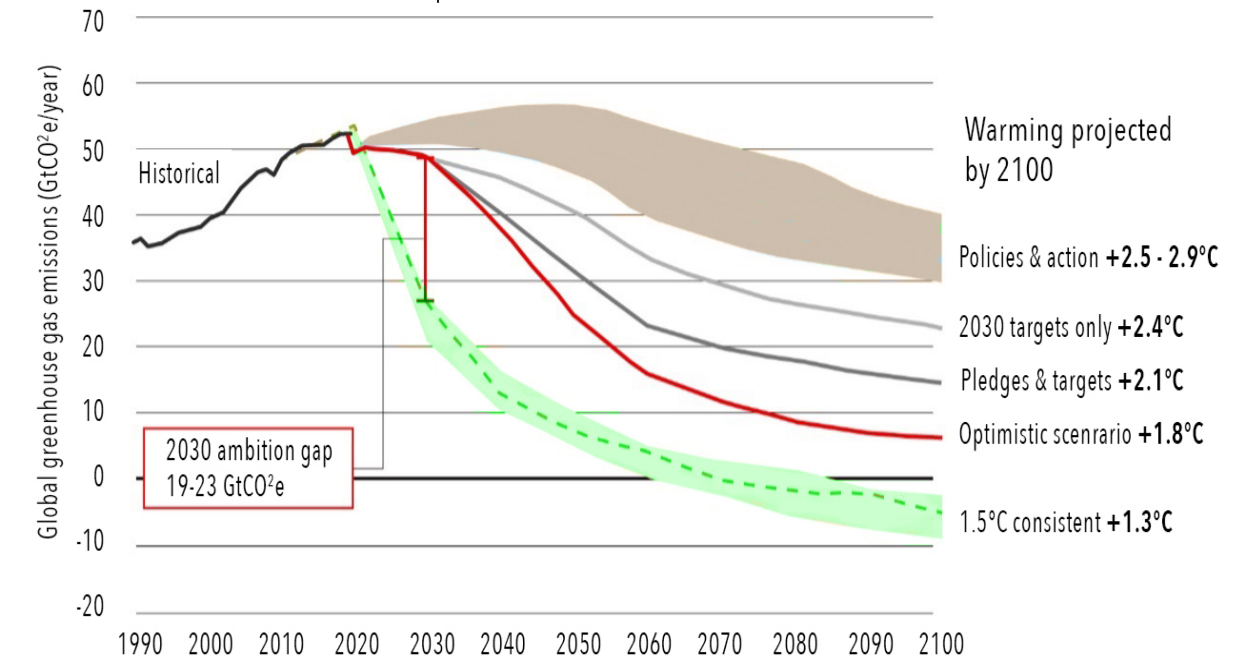
The role of corporates in transitioning to a more sustainable future

Corporates will play a significant role in the transition towards a more sustainable economic future as they will have to significantly decarbonize their business operations and products.

1 The MSCI Net-Zero Tracker, October 2021
2 MSCI. Index holdings as of 28 February 2022, Climate data as of 03 March 2022.

Figure 1: Warming projections under different scenarios

Source: Climate Action Tracker, November 2021 upates



To help financial market participants understand, manage, and disclose their exposure to climate risk (physical and transition) and climate opportunities, the Task Force on Climate-related Financial Disclosures (TCFD) recommends that firms enhance their climate disclosures along four dimensions.[3]

1. the role of the board of directors in assessing and managing climate risks and opportunities (Governance)
2. identifying the types of risks and opportunities posed by climate change (Strategy)
3. disclosing firm processes surrounding core risk management steps (Risk Management)
4. disclosing climate metrics and targets used to identify climate risks and opportunities (Metrics and Targets)

The MSCI Climate Paris-Aligned indexes are aligned with the recommendations of the TCFD. This is important, as the four dimensions holistically integrate how corporates are assessing the impact of climate change on their businesses, how they are adapting their strategies accordingly and how they manage climate risks / opportunities. Setting emission reduction targets and reporting on emissions is a crucial step for corporates, as we will show in the next section.

The importance of setting emission reduction targets

As corporates decarbonize their business operations and products, one of the key pillars to achieve this goal is linked to how they will be setting their emission reduction targets. One way to assess the credibility of these targets is to leverage the work performed by well-recognized organizations such as the Science Based Targets initiative (SBTi), or from ESG data providers such as MSCI ESG Research.

Florian Cisana
Head UBS ETF & Index Fund Sales Nordics

1) Science Based Targets initiatives (SBTi)

Since the launch of the Science Based Targets initiative (SBTi) and the Paris-Agreement reached in 2015, there has been a surge in corporate climate ambition, with SBTi companies leading the way.

Over 1,000 companies spanning 60 countries and over 50 sectors – including one fifth of the Global Fortune 500 – are working with the SBTi to the transition to a net-zero economy by setting emissions reduction targets grounded in climate science through the SBTi.

3 MSCI. FAQ-Understanding MSCI Climate Indexes. November 2021

Considering data from the SBTi, it is interesting to observe the significant increase in the number of companies committing to 1.5°C and Net-Zero targets. Figure 5 shows how from December 2019 to November 2021 the number of commitments increased from 117 to 1045.

As we can see in Figure 6, there has also been a paradigm shift between companies previously setting 2°C, or well-below 2°C targets from 2015 to 2019, to more recently where we have seen a significant increase in companies setting more stringent 1.5°C targets.

Setting science-based net-zero emission targets

Net-zero emission targets have rapidly moved to the mainstream: in 2019, net-zero pledges covered just 16% of the global economy; by 2021, nearly 70% had committed to net-zero by 2050. Rapid, deep cuts to value-chain emissions are the most effective and scientifically sound way of limiting global temperature rise to 1.5°C.

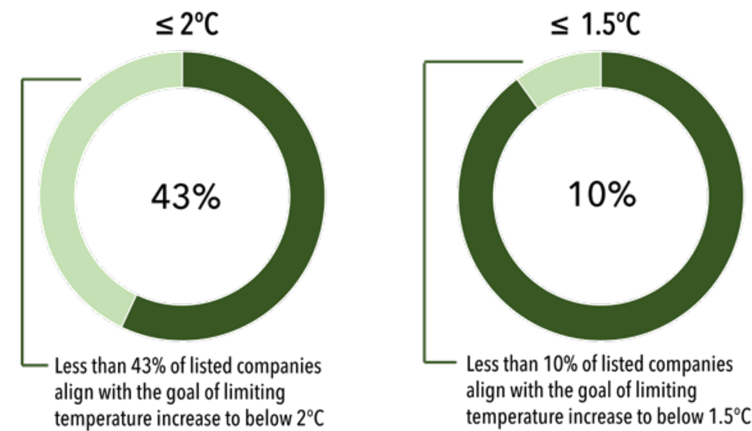
Most companies will require deep decarbonization of 90-95% to reach net-zero under the SBTi Net-Zero Standard.

2)MSCI ESG Research

To assess emission reduction targets, MSCI ESG Research has developed an analytical framework which breaks down targets by three main dimensions: comprehensiveness, ambition and feasibility.

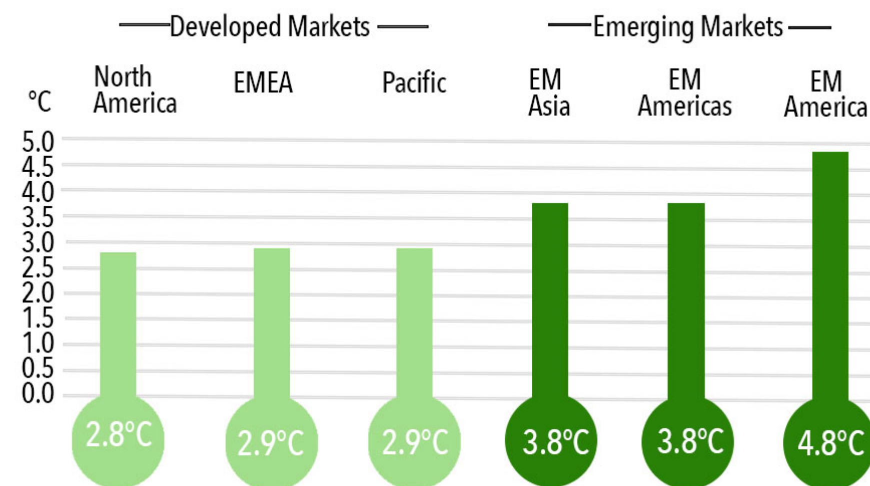
- Comprehensiveness: The model analyzes whether a target covers all emissions scopes, but more importantly it also looks at the percentage of the company footprint covered by the target.
- Ambition: Understanding the rate at which a corporation is planning to reduce its emissions, as well as the residual emissions by the target end year, is key.
- Feasibility: By looking at a company's track record in meeting previous targets or their progress on currently active targets, one can gain an understanding of how current targets are likely to be met.

Figure 2: Percentage of MSCI ACWI IMI constituents aligned with temperature increase scenarios



Source: MSCI, Net-Zero Tracker, October 2021

Figure 3: Implied temperature rise of listed companies by region



Source: MSCI, Net-Zero Tracker, October 2021

MSCI Climate Paris Aligned indexes support investors by overweighting companies setting credible emissions reductions targets by at least 20% compared to their corresponding parent indexes.

The role of investors in the transition to net-zero emissions

Now that we have highlighted the daunting task of transitioning to net-zero emissions, we can consider the role of investors. According to a McKinsey report, all members of society, including the investment community, will have to contribute to achieving net zero emissions, as they estimate an annual increase of 3.5 trillion USD in physical assets spending will be required. To put this figure in perspective, this 3.5 trillion USD corresponds to about half of global corporate profits, one-quarter of total tax revenue, and 7 percent of household spending.

How can asset owners contribute to this effort and play a role in the transition?

They can increase their exposure to companies with As shown in Figure 7, credible net-zero targets, while also engaging with firms to influence them to pivot their business models towards lower carbon emission strategies.

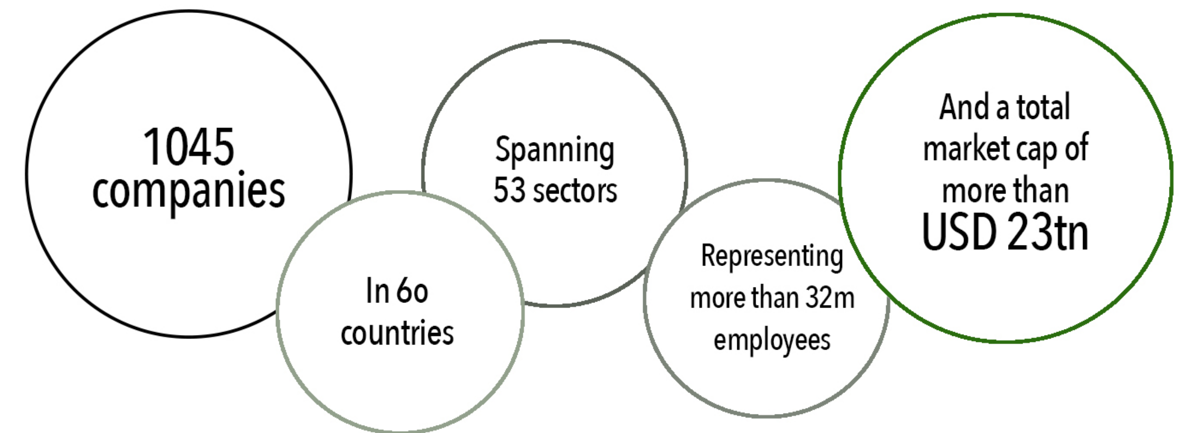
In addition, they can divert their capital towards businesses that provide green opportunities while at the same time reducing their exposure to companies exposed to climate risks and stranded assets.

To facilitate this process, the European Commission's climate benchmarks can support investors to reallocate capital towards a low-carbon and climate resilient economy. The minimum requirements for EU Paris-Aligned benchmarks provide a legal framework which helps legitimize climate solutions. Investors can use this benchmark as an instrument to stay at the forefront of the transition, favoring today the players of tomorrow's economy.

The MSCI Climate Paris-Aligned indexes not only meet, but exceed the minimum requirements for EU Paris-Aligned Benchmarks. Their methodology integrates a 50% carbon footprint reduction, together with a 10% year-on-year self-decarbonization glidepath, with the aim to achieve a 1.5°C temperature pathway by 2030 and support investors in meeting their net zero commitments.

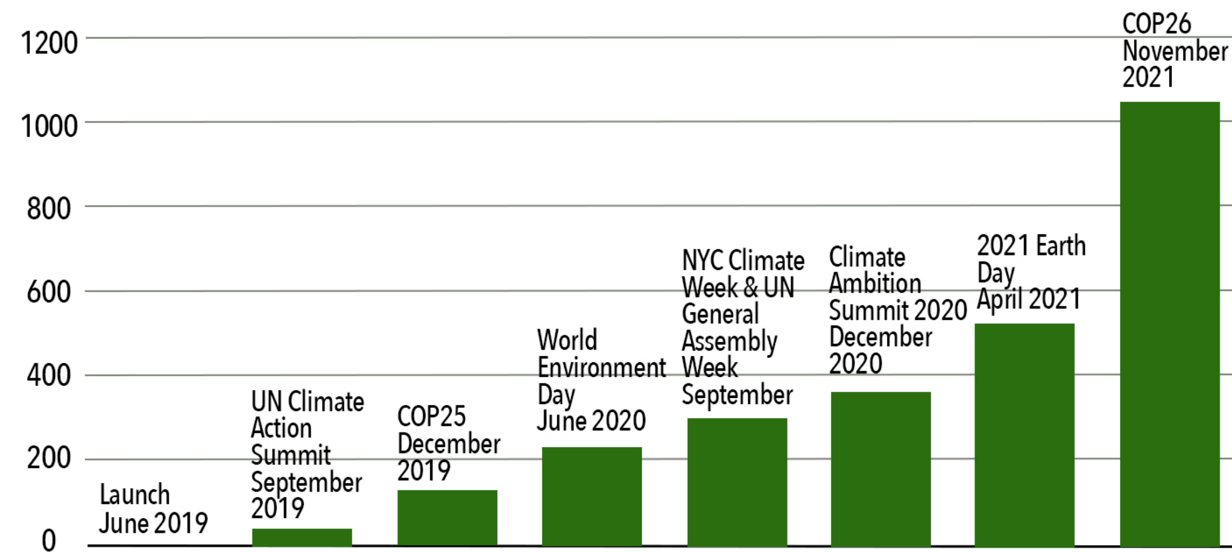
We can already observe that the indexes have achieved their first annual self-decarbonization. In Figure 8, we can see that all exposures have achieved this objective which started in June 2020 with the inclusion of Scope 3 emissions in the index methodology. Interestingly, for broader exposures like ACWI, EM or USA, the indexes have even achieved a higher self-decarbonization.

Figure 4: SBTi by the numbers



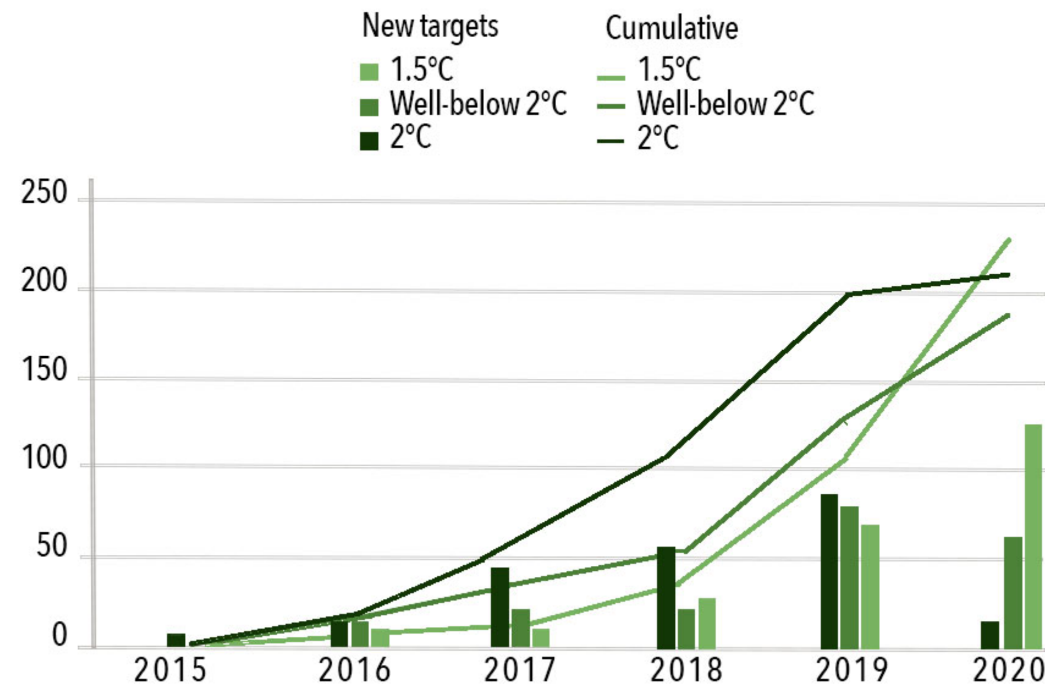
Source: SBTi: Status report: Business ambition for 1.5°C responding to the climate crisis

Figure 5: Campaigns and commitments growth



Source: SBTi: Status report: Business ambition for 1.5°C responding to the climate crisis

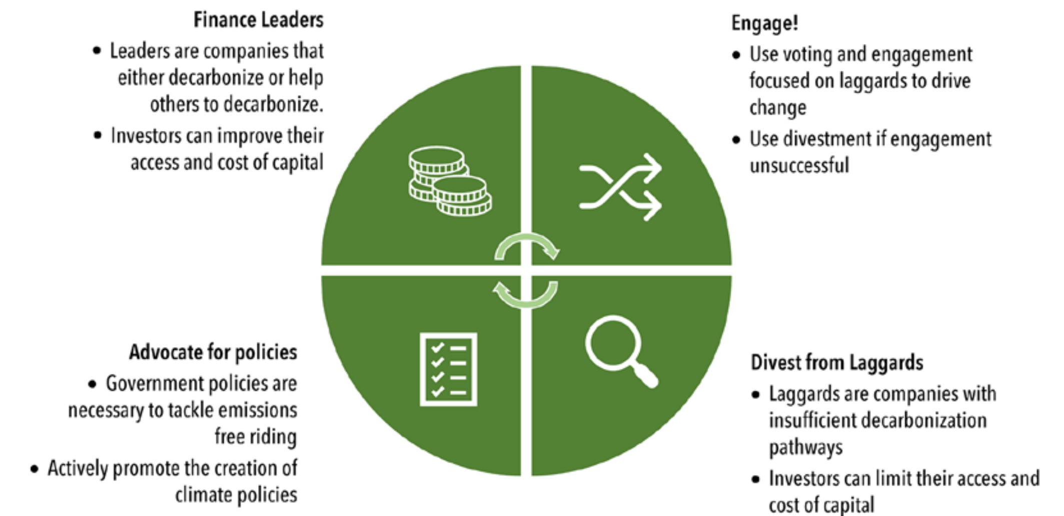
Figure 6: Temperature alignment of Scope 1+2 targets



Source: SBTi: Annual progress report, 2020

Companies are setting more ambitious targets than before, with the majority of scope 1 and scope 2 targets approved in 2020 aligning with a 1.5 °C pathway. Targets included in this chart were public as of October 31 2020 or earlier and represent the date they were approved by the SBTi.

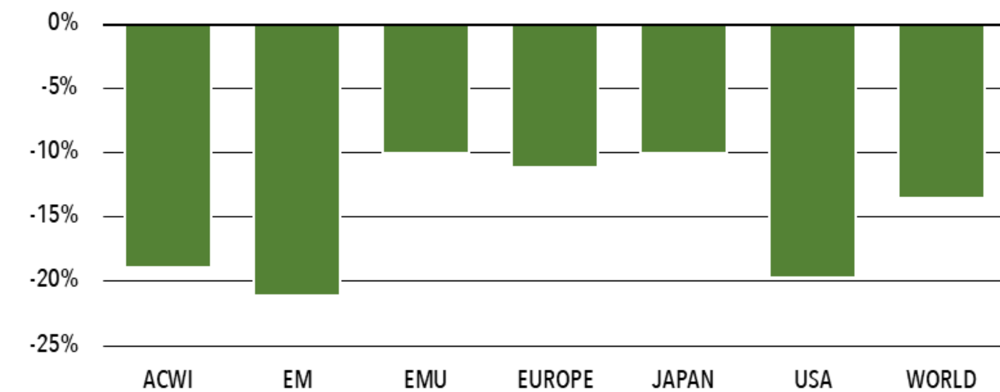
Figure 7: How can investors drive companies' Net-Zero alignment?



Source: MSCI. Net-Zero Alignment – Objectives and Strategic Approaches for Investors. September 2021.

Figure 8: Yearly decarbonization rate MSCI Climate Paris Aligned indexes

Carbon Intensity Reduction (June 2020 to June 2021)



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The EU Taxonomy

Through the Eyes of Sherpas

by Julia Axelsson, CAIA

Lauded as the centrepiece of the EU's ambitious sustainable finance package and breakthrough legislation expected to set global standards for classifying sustainable investments, the EU Taxonomy is remarkable for its ambition as well as its complexity. Its purpose stretches beyond identifying and classifying sustainable economic activities. Gradually, the taxonomy is being adopted both as a metric for sustainable reporting and as a benchmark for sustainable financial products.

The European Commission recognised early on the need to involve sustainability experts and various stakeholders in designing and developing the comprehensive and ground-breaking classification system. To that end, in 2020, the Commission launched the Platform on Sustainable Finance. Composed of 57 members and 11 observers, the Platform brings together world-leading sustainability experts from the private and public sector, all contributing with their different perspectives and skillsets.

The aim is to support the Commission in preparing the Technical Screening Criteria (TSC) that are the backbone of the regulation, aka Delegated Acts (DA). The experts are also to provide advice on the further development and implementation of the Taxonomy as well as on broader issues of sustainable finance.

Meet the Sherpas

It is a heavy task that the Platform has undertaken. Fortunately, the handful of experts appointed to carry it through are not alone. They can count on the help of so-called 'Sherpas'[1], assisting them in the arduous and precise work on the myriads of details within the Taxonomy complex. Just like the essential yet often invisible Himalayan Sherpas, those guides and porters without whom few mountaineers would make it to the top of Everest, the Platform's hidden soldiers are vital to the success of its efforts.

NordSIP reached out to two of these Sherpas, Fabiola Schneider and Nadine Viel Lamare, to get a glimpse of the Platform's inner workings and explore the past and future of the Taxonomy. Viel Lamare, Senior Advisor on Climate and Finance at the Swedish Environmental Protection Agency (Naturvårdsverket), acts as Sherpa for the European Network of the Heads of Environment Protection

1 The term 'Sherpa' in this context derives from the way G7 summits are organised. During the preliminary preparatory process which takes place in advance of a G7 summit, the leader of a G7 host country conventionally invites the other G7 participants to send representatives known as 'Sherpas' to develop the agenda topics and other matters.

“Fossil gas would never have passed on its own... It is just so blatantly wrong on so many levels. I guess that is why the politicians needed to create that 'unholy alliance' of gas and nuclear, bundling both together in order to get the critical mass needed to pass the DA.”

Agencies (EPA Network), an official observer of the Platform’s work. Schneider, a full-time PhD student at the UCD Michael Smurfit Business Graduate School in Dublin, is Sherpa to Professor Andreas Hoepner, the only scientist and tenured professor to continuously serve not only on the Platform for Sustainable Finance but also on its predecessor, the EU’s Technical Expert Group (TEG).

“Even though we do as much of the heavy lifting as members and observers, officially, we do not exist,” laughs Viel Lamare, who seems quite comfortable with the anonymity of the Sherpa role. On a more serious note, though, she explains that all the experts on the Platform, whether members, observers, Sherpas or the multitude of even more anonymous assistants, serve purely voluntarily, none of them getting paid for their work.

“I am lucky, as I can integrate some of my Platform duties into my daily job, but many others cannot do so,” she says.

Both Schneider and Viel Lamare find being part of this essential and meaningful endeavour gratifying in itself. Yet the non-paid voluntary nature of the job is potentially dangerous, as Viel Lamare points out. “It can create an imbalance, as lobby organisations and NGOs, each promoting their own specific agenda, have so much more time and recourses to influence the politicians than we do,” she says. Perhaps it is imbalances like this that have eventually come to haunt the evolution of the Taxonomy regulation.

The first act

“We were fairly happy with the first draft of the Delegated Act,” says Schneider. “Despite a few compromises, most of it was science-based; it was acceptable,” she adds. Not everybody on the Platform

Nadine Viel Lamare
Senior Advisor on Climate and Finance
Climate Policy unit, Swedish Environmental Protection Agency
Naturvårdsverket

shared her opinion, though. In April 2021, five NGOs (ECOS, WWF, Transport & Environment, BirdLife, and BEUC) chose to suspend their role in the Platform, protesting some of the adopted technical criteria regarding forestry and bioenergy, but also the process that led to their adoption.

“You need to understand that the Platform was not even involved in drafting the first Delegated Act,” explains Viel Lamare. “It was partially based on the recommendations provided by its predecessor, the Technical Expert Group (TEG), yet the Commission completely ignored some of the recommendations without a clear explanation. Governance-wise, it was all quite strange,” she adds.

Heeding the avalanche of criticism, the Commission responded, making a serious attempt to repair the damage. It proposed steps to address the concerns raised over the development process of the technical criteria. Assurances were made that the independence, integrity, and credibility of the Platform will be maintained and that it will be entitled to provide technical analysis on draft Delegated Acts. Consequently, in June 2021, the NGOs that had left in protest resumed their work on the Platform, hoping for the best.

The second act

Then came the fateful New Year’s Eve announcement that sent shock waves across the world of sustainability, and beyond. The Commission chose the last day of 2021 to release a draft of the complementary Delegated Act of the Taxonomy, noting that “it is necessary to recognise that the fossil gas and nuclear energy sectors can contribute to the decarbonisation of the Union’s economy.”

“We were completely unprepared to be side-stepped like this,” says Schneider. Back in January, Hoepner, the Platform member she serves as Sherpa to, called the draft “probably the biggest greenwash ever.” “This is not based on science,” he said. “And if it is based on science, there is a very, very liberal interpretation of what science is,” he added, arguing that experts’ opinions have not been considered ex-ante before drafting this proposal. Hoepner has calculated that the Taxonomy, as it stands, would not align with the official EU ‘fit for 55’ objective to reduce CO_2 emissions by 55 per cent by 2030. Instead, it provides merely a ‘fit for 38.5’.

Viel Lamare, too, laments how the EU Taxonomy got “hijacked” by politicians. “They just do not understand or want to understand that the purpose of the regulation was never to resolve energy capacity or security issues,” she says. “It was never intended to include every activity in the economy, in particular energy activities that must transition because emissions are currently too high.”

A toxic bundle

At the heart of the controversy is whether fossil gas and nuclear energy can be considered sustainable under certain circumstances. Despite emitting less CO_2 than coal, fossil gas is still a potent greenhouse gas and will eventually have to be largely phased out. Nuclear power, on the other hand, although a stable source of energy with near to zero greenhouse gas emissions, generates radioactive waste, for which a solution has yet to be found.

Professor Hoepner argued earlier this year that “declaring gas as green is like declaring that French fries are salad”. “Fossil gas would never have passed on its own,” comments Viel Lamare. “It is just so blatantly wrong on so many levels. I guess that is why the politicians needed to create that ‘unholy alliance’ of gas and nuclear, bundling both together in order to get the critical mass needed to pass the DA,” she speculates.

According to Schneider, the inclusion of nuclear in the Taxonomy is just as problematic as labelling gas green, albeit for different reasons. “Nuclear could arguably provide a substantial contribution to climate change mitigation,” she notes. “Yet mitigation is only one of the six environmental objectives, and according to the original design of the Taxonomy, these are equally important and should be equally weighted.”

Fabiola Schneider
Full-time PhD Studen
UCD Michael Smurfit Business Graduate School, Dublin
Sherpa to Prof. Andreas Hoepner

Both Schneider and Viel Lamare point out that nuclear energy strikes against the Taxonomy’s essential Do No Significant Harm (DNSH) principle. Its compliance with the Minimum Safeguards (MS) is questionable, too.

“Yes, there is a requirement that by 2050 you should have a plan in place,” says Schneider. “But what happens if come 2050, the plan is not there, or doesn’t work? Companies and investors would have by then enjoyed the benefits of a green label for years, with the taxpayers bearing all the risk,” she adds.

They mention more issues, such as the tail risk of accidents, biodiversity loss, etc. However, what worries Viel Lamare most is the potential crowding out effect of including sub-optimal transitional solutions like fossil gas and nuclear in the Taxonomy. “Ultimately, it means less capital flowing into renewables,” she says.

Member states and the European Parliament have a few more months to look at the complementary Delegated Act and object if they want to. The Act can only be blocked in its entirety, however, not just individual elements. Both Sherpas we talk to deem such a turn of events highly unlikely, even though the probability might have increased slightly due to the current geopolitical situation.

Carrying on the good work

“I feel that with the release of the complementary DA, the Commission killed the integrity of the

taxonomy, alongside the trust of those working to put together a robust, science-based dictionary of what is sustainable," comments Schneider. "What is the point of having a scientific body of advisors if you don't listen to the advice," says Viel Lamare, adding that it will be even more challenging to repair the damage this time around.

That said, both are determined to persevere in their efforts. "Even though the Commission ignored our recommendations, we have proved that we are a powerful voice in the debate," explains Viel Lamare, referring to the official response[2] the Platform sent to the Commission on 21 January. "Although the deadline for submitting feedback was extremely tight and the timing was terrible, many of us were energised and put hours and considerable efforts into formulating a factual and constructive criticism," she adds.

A lot remains to be done. On 28 February, the Platform submitted its final proposal for a Social Taxonomy to the Commission. The release of an Extended Taxonomy draft, covering an intermediate, 'Amber', performance category and an unsustainable category from which there must be an urgent and just transition, is imminent. "These might be even harder to agree upon than the original green taxonomy," comments Schneider.

Another focus area, according to Viel Lamare, is ensuring consistency between the Taxonomy and all the other pieces of the legislative puzzle already introduced or about to be. "We can't afford to have the Sustainable Finance Disclosure Regulation (SFDR), or the future Corporate Sustainability Reporting Directive (CSRD) and the EU Green Bond Standard contradicting with the Taxonomy," she says. "If we don't harmonise the different parts of the legislation, we risk blurring the picture for the end-users and turning it into a mere 'tick-the-box' exercise," she warns.

The future of the Taxonomy

"Creating a comprehensive science-based Taxonomy is a huge and meaningful work, and the Platform has an important role to play in it," says Viel Lamare. "It would of course be a shame if the Commission says that it is not the right time to adopt our recommendations or chooses to disregard them, but the efforts we put into it do matter anyhow. We are involved in ground-breaking work," she adds. She is right. Already the EU Taxonomy has created a precedent that many other jurisdictions have followed, with around 30 official sector taxonomies now existing or under development.

However, what encourages her the most is the positive feedback from practitioners, especially those within the investment community, who appreciate the guidance and are already implementing a lot of the technical criteria in their everyday work. "Our efforts are not in vain, and nothing is lost. What we do echoes everywhere," concludes Viel Lamare.

"By the way, the 'Sherpa' label strikes me as somewhat outdated these days," reflects Viel Lamare. "It may be an established term in the EU-diplomacy context, but it does have certain derogatory connotations. And I don't mean derogatory to us, working on the Platform, but to the Himalayan Sherpa people. Perhaps it is time to put that term to bed for good? What's wrong with calling us co-workers or assistants?"

So, the Platform's Sherpas, or co-workers, keep toiling, carrying the future of the taxonomy on their weathered shoulders.

[2] 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

The EU Taxonomy sets out four conditions that an economic activity must meet to be recognised as Taxonomy-aligned:

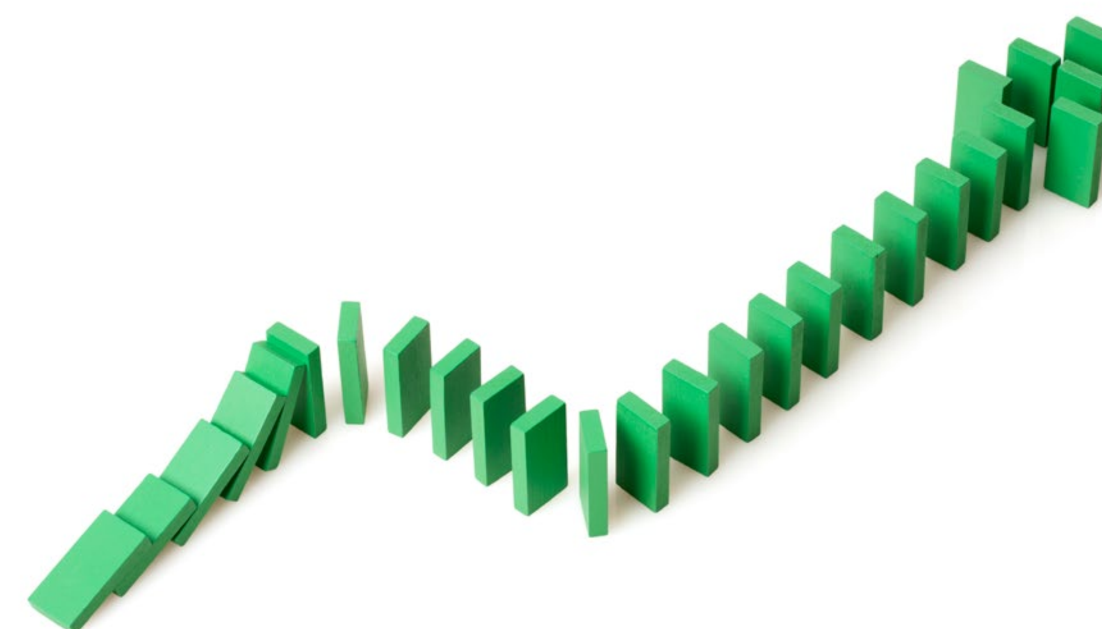
- Substantial Contribution (SC) to one or more environmental objectives
- Do No Significant Harm (DNSH) to any of the environmental objectives
- Compliance with Minimum Safeguards (MS)
- Compliance with the Technical Screening Criteria (TSC), which qualify both the Substantial Contributions (SC) and the DNSH

The EU Taxonomy lays out six environmental objectives:

- climate change mitigation
- climate change adaptation
- sustainable use and protection of water and marine resources
- transition to a circular economy
- pollution prevention and control
- protection and restoration of biodiversity and ecosystems

Getting in Line: Green Bonds and the Green Taxonomy

by Julia Axelsson, CAIA



As the EU sustainable finance regulation keeps evolving and branching out, coordinating between its different constituents is becoming increasingly challenging. Take the EU Taxonomy and the EU Green Bond Standard, for instance. Although they both stem from the same grand Sustainable Action Plan, ensuring alignment between the two is far from a trivial exercise. European asset managers and investors who want to show that the green bonds in their portfolios are compliant with the green Taxonomy face a challenging manual task. Mostly, they need to do it alone, without the help of third-party data providers.

NN Investment Partners (NN IP) are known for not shying away from this type of sustainability challenge. The firm's portfolio managers and analysts have been working tirelessly on assessing the alignment of their green bond portfolio with the Taxonomy since early 2021.

To find out more about how they go about it and what they have learned in the process, NordSIP reached out to Isobel Edwards, Investment Analyst Green Bonds at NN IP.

Early efforts

"Green bond alignment will improve eventually, as the EU defines more eligible economic activities and project-level detail increases," starts Edwards on an optimistic note. "For now, though, there is very little automated data and varying information quality to assess each activity financed by every bond in our portfolios," she adds.

Edwards tells us that NN IP's first green bond assessment round, completed in September 2021, was indeed challenging. "We were working under considerable time pressure as we thought we needed to be done ahead of the original regulatory deadline, January 2022. The issuers, however, were not held to the

Isobel Edwards
Investment Analyst Green Bonds
NN IP

same deadline. They technically don't need to report until a year after the asset managers and only certain companies need to report. Given this, some issuers hadn't even started the work and couldn't answer our questions. Luckily some had, so they knew what we were talking about and could help us. It is an unusual situation in which regulation calls for investors to go ahead of issuers in these disclosures," she recalls.

"It is getting much easier, though, now that we are doing a new iteration of the assessment. Nowadays, some issuers even provide an EU Taxonomy assessment in their second-party opinion pre-issuance," says Edwards. Although NN IP managed to compile the alignment data by the end of 2021, once the European Commission postponed the deadline to 2023, they chose to keep refining the assessment and are planning to release it in July this year.

Assessing the alignment, step by step

In 2020, NN IP designed a proprietary green bond EU Taxonomy alignment process, a series of steps that enables them to analyse each green bond's use of proceeds and determine its compliance with the EU Taxonomy. Edwards guides us through this process, explaining pedagogically the importance of each step and what it means in practice. "First, we take a green bond and look at which activities it finances," she explains.

"We go through the 'use of proceeds' section of the green bond framework of the issuer and check which activities are involved and if these would potentially qualify as eligible under the EU Taxonomy."

The next step is to examine whether these activities contribute to one of the environmental objectives. At the moment, the majority of the activities in our fund are focused on climate mitigation with a minor focus on climate adaptation. If one of the activities in the bond does not pass, this reduces the percentage of the bond's alignment to the Taxonomy but the 100% aligned activities can still be counted in the overall portfolio alignment to that objective.

The alignment to the objectives can be determined, first, through the technical screening criteria. These are all detailed in the Technical Annexes of the EU Taxonomy and are different for each economic activity in question. The second step is the Do No Significant Harm (DNSH) component of each activity. "There are environmental risk areas within each economic activity, also specified in the Technical Annexes. We check whether steps have been taken to assess these risks for each activity the bond finances and whether actions and infrastructure have been put in place to minimise them. Once we have determined that this is the case, the economic activity meets the DNSH criteria as the project is not harming any other environmental objectives," says Edwards.

The analysts would then repeat these steps for each of the activities that the bond finances. At this stage, each bond in the portfolio will have certain economic activities that are 100% aligned to one of the EU Taxonomy's objectives. Activities that are not at 100%, fall to 0% for reporting purposes, but not for engagement purposes. The green bond analysts would engage one-on-one with those issuers whose activities' alignment is less than 100% and encourage them to boost their score.

For those activities already at 100%, now comes time to calculate the fund's alignment. The weighting of the activity within the bond comes first, followed by the weighting of that bond within the portfolio.

Repeat that for all activities and bonds within the portfolio and you will get your portfolio alignment to the EU Taxonomy.

Lessons learned

Having done the same exercise numerous times, NN IP's analysts are starting to discern some patterns. They have noticed that engaging in certain types of activities or being a particular type of issuer seems to positively affect the alignment score. "For instance, being a utility company was a positive factor for many of the issuers in the portfolio," says Edwards.

"Currently it is quite vague what companies and other issuers mean when they say they are 'transitioning'."

"Transportation companies also generally did well." According to her, this is due to these sectors' green bonds being heavily tilted towards renewable energy or electric transportation. Not surprisingly, certain aspects of these two sectors are considered favourably in the EU Taxonomy, with its current focus on climate change mitigation and adaptation as the first two published objectives.

EU-based projects also have a clear advantage when it comes to the DNSH criteria, as the criteria often consist of existing EU Directives that are already being implemented in many areas in Europe. Of course, when EU issuers include projects outside the bloc in their bonds, they do not benefit from the same effect.

There are, however, green bond issuers who seem to struggle with the Taxonomy alignment. "Banks, for instance, often did not have enough information about the projects their bonds are financing to give us so we could perform the EU Taxonomy alignment exercise," says Edwards.

Sovereign green bonds also generally performed poorly in the alignment assessment, perhaps even worse than the bank-issued green bonds, reveals NN IP's analysis. "Here, the reason is not necessarily a lack of information, but rather the types of activities they finance and how they are documented," explains Edwards. "If a sovereign green bond allocates 25% to the Ministry of Environment without specifying exactly where the proceeds will be directed, we label this as non-green as we cannot link the bond's proceeds allocation to the EU Taxonomy criteria," she clarifies.

Whenever the information is insufficient, NN IP's philosophy prescribes taking a conservative stance and assuming that the activity is not aligned with the Taxonomy. "In the future, we hope that banks and sovereign issuers will take the EU Taxonomy criteria into account when developing their financing frameworks. Currently, it is hard for investors and asset managers to give them a high percentage alignment when they allocate proceeds in this way," concludes Edwards.

The expanding Taxonomy

NN IP's green bond funds will be releasing their EU Taxonomy alignment disclosures for their funds in July this year. "We are not concerned about not being 100% aligned for now, as the EU Taxonomy is still expanding to include new activities and being refined," says Edwards. "For now, we still consider buying bonds that are not aligned. Partly because four of the six EU Taxonomy objectives have not yet been rolled out but also as the details for some industry categories are still being debated. Over the next few years, our approach is likely to become stricter, in line with the latest guidance from the regulators," she adds.

However, issuers should bear in mind that once investors have disclosed their Taxonomy alignment, this can also include an alignment threshold which their fund cannot go below. This would mean effectively that if the fund is close to that threshold, a green bond with activities less than 100% aligned to the EU Taxonomy might be turned down.

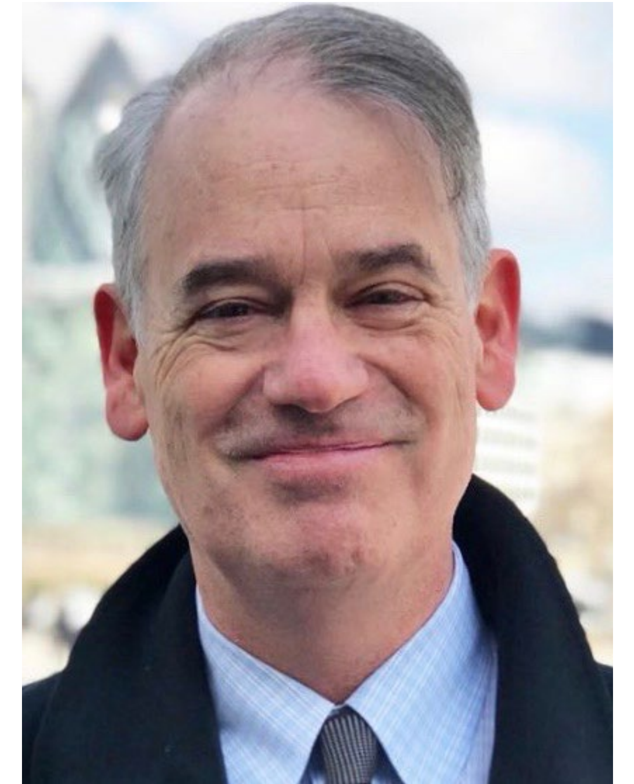
According to Edwards, a binary categorisation of activities into green and non-green is not necessarily helpful. She, for one, is happy to see the recommendations for an Extended Environmental Taxonomy, just revealed by the Platform on Sustainable Finance. "Currently, it is quite vague what companies and other issuers mean when they say they are 'transitioning'. The new 'amber' taxonomy might provide some guidance as to where they are exactly on their transition journey," she hopes. "Although the relative 'greenness' of transitional activities would be difficult to assess on a general level, without considering the country-specific context," adds Edwards.

Summing up, Edwards sounds favourable to the Taxonomy and pleased with the work she and her colleagues have done so far on the disclosures. "It is a work in progress, and there are still plenty of issues that need to be addressed," admits the analyst. "Yet from our perspective, issuers are now providing much more information to investors upfront pre-issuance, and there is much less ambiguity on the shades of green in their projects. In that sense, for us, the main goal of the Taxonomy has already been achieved," concludes Edwards.

Wake Up and Smell the Taxonomy

by Richard Tyszkiewicz

"It's not about people buying less, it's about changing the system... We created guidance that took away discretion on the part of the corporates or banks."



Sean Kidney
CEO & Co-founder
Climate Bonds Initiative

Without wishing to let us off the hook too easily, Climate Bonds Initiative (CBI) CEO and Co-founder Sean Kidney is unequivocal: individual actions will not save us from the climate crisis. Eating organic food, riding our bikes and "staycationing", while environmentally positive, are morally-driven actions that will only scratch the surface in his view. So, while these are steps in the right direction, he sees the tendency to put the environmental burden on individuals as a potential distraction from what we should be doing, which is advocating for systemic change.

Through his international Non-Governmental Organisation (NGO) and involvement with numerous national and supranational policy-making initiatives Kidney has dedicated himself to mobilising global capital at a speed and scale commensurate with the severity of the climate emergency. Speaking to NordSIP, Kidney shares some of the thinking behind the Climate Bonds Taxonomy, much of which served to inform the development of the European Union's (EU) own Sustainable Finance Taxonomy.

Why do we need sustainable taxonomies?

From its first release in 2013, well ahead of its EU equivalent, the Climate Bonds Taxonomy aimed to provide global issuers, investors and governments with a common, trusted guide to climate-aligned assets and projects. By providing this access to a comprehensive, science based and up-to-date set of verifiable green criteria, Kidney hopes to accelerate the growth of a thematic bond market that will help drive the transition towards a low carbon global economy. "It's not about individuals buying less, it's about changing the system," he says. Kidney believes that individual agency alone might only get us 5% of the change we need, which is paltry in the bigger scheme of things. Only by eliminating negative choices through systemic change can the world hope to meet its goal of limiting global warming to 1.5 degrees. For Kidney, if the only feasible way from London to Paris is by electric train, that is how people will travel and carbon emissions from plane travel will be removed from the equation.

Kidney explains the very pragmatic thinking behind the taxonomy: "We created guidance that took away discretion on the part of the corporates or banks." He sees the key to building a system that works for all market players as simplicity, the underlying complex analytical work having been translated into a user-friendly traffic light system.

"What sort of things are required in society to ensure it's more resilient in the face of the volatility that's baked into the 21st century?"

"We are moving into a new era of cheap, clean energy, and we need to get there faster!"

As Kidney puts it "you don't need to know anything about climate or carbon, you just need to know that a triple-glazed window manufacturer, for instance, is a green investment". Again, in the interest of simplicity, the focus is on use-of-proceeds rather than the fundamental nature of the companies involved in the transaction.

A catalyst for change

New projects, but also existing assets across all sectors need to be accurately labelled, Kidney insists. "Bonds are not used to finance new solar plants, that's project finance. Bonds are used to refinance assets, so in the $130 trillion bond market, unless you are tackling the issue of refinancing you will only affect a few million here and there. One of the goals of what we do is to show at large scale and volume the opportunity to colour the finance world green, and through that engage with those institutional investors who tend to only invest in existing assets."

Going global

The taxonomy acts as a rule book for the green bond market, with many asset types being fully or conditionally certifiable. Kidney estimates the size of the current certified market at $220 billion. He also explains how in 2014 the Climate Bonds Initiative began supporting the Chinese Central Bank in developing its own version of the taxonomy, the Green Bonds Endorsed Projects Catalogue. In 2017 the European Commission decided to engage help in drafting an EU-specific taxonomy, and Kidney has been deeply involved at every stage of that project. "Since then, the taxonomy idea has gone global", according to Kidney, with "taxonomies appearing all over the world." Ideally, there would be as much convergence and overlap as possible, although there are legitimate regional differences and priorities. Kidney has been working with the EU on a Common Ground Taxonomy with China, the first draft of which was published at COP26. It also has its first green bond issuance on the market and is expected to be adopted by Hong Kong as its standard official taxonomy.

When asked to compare the CBI and EU taxonomies, Kidney hints at a tendency for the EU to include somewhat excessive detail, which can be counterproductive. "The Commission didn't craft what we call the do-no-significant-harm measures as well as they could have, and a lot of them don't have data points, so issuers and investors just can't tell whether they qualify. We still have a lot of work to do on guidance." The percentage of qualifying assets is also still far too low to create momentum, Kidney explains. He is working hard to get the EU to adopt the Climate Bond Initiative's "simpler is better" philosophy.

A solid basis in science

During the early stages of developing the taxonomy CBI always stayed focused on the science as a means of staying on course. Kidney recalls how the original Intergovernmental Panel on Climate Change (IPCC) report was so compelling that even the likes of Saudi Arabia felt obliged to endorse it. This continued reliance on scientific fact helped the Climate Bonds Initiative avoid political or ideological influences in their efforts to set clear rules for an efficient, liquid green bond market. "It has become complicated, because we have gone through the fairly straight forward areas, energy, transport, water, property etc and now we are tackling things like industrial transitions," he explains. "What is the path forward for steel, because we are still going to need it, but it needs to be zero-carbon? So now it has become more complicated but that's what we're doing."

Too late to ignore climate change resilience

"What sorts of things are required in society to ensure it's more resilient in the face of the volatility that's baked into the 21st century?" Kidney asks. "Life's going to become harder, you've got to be able to stand up after being whacked sideways by cyclones, floods, pandemics and famines. It's a continual work to expand the understanding of investments that qualify." According to Kidney, resilience is an area where there will inevitably be different regional requirements and standards, despite efforts to follow common general principles.

An underlying sense of urgency

Away from the technicalities of global taxonomies, Kidney's genuine passion for the subject of climate change is evident.

He acknowledges that the 2030 carbon reductions targets set by European countries are reasonably ambitious but insists "they should do more – all Western countries should have much higher targets if we are to get to 55% globally." He believes that should have been negotiated at COP26 and argues that "most Western European countries should have a target of 75%, but while it's nice to have targets, emissions went up 6% last year and getting them down seems like a very difficult task, yet if we don't it's an existential threat to human society."

No time for climate politics

Kidney has little time for any attempts to politicise the climate crisis. "Let's not be foolish here, we are not going to get consensus," he comments. "There are always idiots, there are always people who choose to misread the science". His response to them would be "get out of the ****ing way!" This is not a trivial matter for people to argue about in the pub, but is "about science and extraordinary, vicious threats to our economies, societies, and the welfare of our children. Unless people understand that they cannot grasp the materiality of what we're addressing," Kidney explains.

The role of institutional investors

Focusing in on institutional asset owners, Kidney believes that their long-term investment horizon will help them understand that their portfolios will be decimated if they do not act. On a more positive note, he would like to remind them that with green bonds, contrary to the out-of-date belief that ESG eats into returns, "you can fund this transition and it's not going to cost you anything". Kidney's answer to climate sceptics is to show them that there is money to be made from the transition. "We can deal with the challenge by making it profitable to do so where possible, through public/private partnerships and other mechanisms".

Where appropriate, he also supports governments stepping in with bans as in the case of filament light bulbs, thus creating new investment opportunities in LED lighting. Kidney points to the growing size and demonstrable economic resilience of the green bond market as an added incentive for pragmatic investors to go down the green route, even if they are not yet fully convinced by the higher-level arguments.

What next for Nordic asset owners?

Nordic investors are well ahead of the pack in terms of their engagement with the green bond market, according to Kidney. Nevertheless, he believes assiduous asset owners in the region should closely examine the green credentials of each company in their entire portfolio using standards such as the taxonomy. More could be done to put concerted pressure on governments to create investment opportunities in areas such as green transport and urbanisation, both locally as well as in emerging markets. "We need strong state action, we need those pension funds and investors to push state actors to do more because this is a way for the state to achieve its public policy objectives without actually having to pay for it," Kidney adds.

Channelling frustration into action

Sean Kidney and his organisation have helped establish the solid underpinnings of a now rapidly growing green bond market. Despite this progress, he remains frustrated by the lack of urgency displayed by many of those in positions of authority. Kidney points to long-term complacency in the face of scientific evidence that means we have now run out of time and must move quickly and decisively. People should open their eyes to the positive side of the story, which is the fantastic range of economic opportunities that the transition represents, he urges. "We are moving into a new era of cheap, clean energy, and we need to get there faster!" The rigorous taxonomic discipline that Sean Kidney and the Climate Bonds Initiative have been instrumental in spreading around the globe will undoubtedly speed up our journey towards a cleaner, low-carbon world.

A Year With SFDR

by Julia Axelsson, CAIA

Expectations ran high as the ambitious EU's Sustainable Finance Disclosure Regulation (SFDR) finally came into force on 10 March 2021. Ever since the European Commission first released its action plan for financing sustainable growth back in 2018, it had been clear that the SFDR would eventually affect all EU financial market participants and financial advisers. NordSIP was quick to celebrate SFDR Day and check the pulse of the Nordic investment community as they were grappling with implementing the new disclosure rules.

From disclosure regulation to labelling exercise

Essentially, the SFDR was introduced to bring a level playing field for financial market participants and financial advisers on transparency concerning sustainability risks, the consideration of adverse sustainability impacts in their investment processes and the provision of sustainability-related information for financial products.

The regulation requires asset managers to provide prescript and standardised disclosures on how ESG factors are integrated at both an entity and product level.

However, it quickly transpired that most asset managers were preoccupied primarily with figuring out how to classify their products. Somehow, the focus shifted from the requirements specified in the first part of the regulation to the product-related articles, 6, 8 and 9. These categories, especially the middle one, Article 8, supposed to "promote environmental and social characteristics", turned out to be open to some interpretation due to the vagueness of the definitions.

Many asset managers adopted a 'shades of green' approach, labelling impact and thematic funds with a clear sustainable profile 'dark green' and listing them under Article 9 while trying to squeeze as many of the rest under the 'light green' Article 8 as possible. "We will on an ongoing basis be analysing our Article 6 funds to see which ones are candidates to move to Article 8," said Eric Pedersen, Head of Responsible Investments at Nordea Asset Management (NAM), in March last year. Storebrand SPP chose not to include article 6 in its classification at all. "Since all our funds are fossil-free and promote sustainability, they are categorised as article 8. The SPP Green bond fund and SPP Global Solutions fund have sustainability as an objective, so they are categorised as article 9," explained Sara Skärvad, Director of Communications at Storebrand Asset Management.

"At this point, we have reviewed the SFDR precontractual disclosures of Article 6,8 and 9 and based on this material, we have not observed concerns of greenwashing."

- Nina Männynmäki, Finanssivalvonta

"Many fund that place themselves into Article 8, for example, are not funds we would independently classify as sustainable funds."

- Morningstar

Enforcing the regulation

The early approach of the Nordic financial supervisory authorities to the incoming flood of EU regulation was quite relaxed. "Sustainable risks will be supervised among other risks, and sustainable finance disclosure is one area among other disclosure requirements," said Nina Männynmäki, Senior Market Supervisor at Finland's Finanssivalvonta, summarising the common sentiment.

Denmark's supervisory authority chose a different path, opting to up their sustainability game. "We have established a dedicated unit that focuses exclusively on sustainable finance," confirmed Theodor Christensen, Deputy Director Capital Market Regulations at Denmark's Finanstilsynet and head of the new Unit for Sustainable Finance. "The SFDR cuts across all the main financial institutions under the DFSA's mandate," said Christensen, adding that the new unit was ready "to hit the ground running and be ready for actual supervisory activities immediately after the SFDR came into force."

It didn't take long, however, before the regulators in all Nordic countries had to step up their game to ensure SFDR would not become a greenwashing tool. By the end of the summer, the Swedish Financial Services Authority, Finansinspektionen (FI), had found out that most funds (73.9%) in the country were self-reported as Article 8 under SFDR. FI also noted some apparent inconsistencies in 19 funds. "FI has not looked into the SFDR disclosures for individual funds or any other fund documents as this was not in scope in this activity," said Victoria Ericsson, Deputy Communications Director at FI. "A possible second step might be to look deeper into some funds' disclosures," she added.

Meanwhile, the Finnish FSA, Finanssivalvonta, had moved even further, guiding the local market and reviewing asset managers' disclosures.

"At this point, we have reviewed the SFDR pre-contractual disclosures of article 6, 8 and 9 and based on this material, we have not observed concerns of greenwashing," concluded Anna Mäkipeska, Market Supervisor at Finanssivalvonta.

Guidance, and lack thereof

At the end of October, the three European Supervisory Authorities (ESAs) – the European Banking Authority (EBA), the European Insurance and Occupational Pensions Authority (EIOPA) and the European Securities and Markets Authority (ESMA) published their Final Report with the draft Regulatory Technical Standards (RTS) for disclosures under the SFDR. Seeking to establish a single rulebook for sustainability disclosures, the ESAs agreed to amend the previous draft RTS and their accompanying templates in order to minimise duplication and complexity. They made several pertinent recommendations, emphasising the need for aligning SFDR with the EU Taxonomy.

However, the market participants continued to focus on their products' classification along the lines of SFDR's articles 6, 8 and 9 instead of the detailed disclosures themselves. In November, the European Fund and Asset Management Association (EFAMA) concluded in its comprehensive state-of-the-SFDR report that the implementation of the new regulation has, in practice, split the EU fund universe into three categories.

"The coverage of funds by SFDR Articles 8 and 9 is considerably uneven across Europe," commented Thomas Tilley, Senior Economist at EFAMA. "Various factors play a role here, such as different SFDR Level 1 text interpretations by national regulators, the delayed implementation of the Level 2 measures and varying maturity levels of ESG fund markets between the Member States."

By the end of the year, it became clear that those waiting for more details and increased regulatory clarity regarding the SFDR will have to curb their curiosity once again. On November 25, the European Commission published a letter sent to the European Parliament and the EU Council, announcing that the second part of the SFDR will likely be delayed by another six months and adopted from January 1, 2023. According to the announcement, the delay was "due to the length and technical detail" of the 13 regulatory technical standards and aims "to facilitate the smooth implementation of the delegated act by product manufacturers, financial advisers and supervisors".

Greenwashing concerns over SFDR

As we embarked on a new year, and NordSIP gauged the priorities ahead for the Danish, Swedish and Finnish Financial Supervisory Authorities (FSAs), it was clear that concerns about data, definitions, regulations and, above all, greenwashing were common themes. "Increasingly, we are concerned about sustainable investment products being promoted as much more sustainable than they actually are," shared Theodor Joachim Christensen, Deputy Director Capital Market Regulations and Head of the Unit for Sustainable Finance at Danish Finanstilsynet. "There has been a huge surge in the labelling of article 8 and 9 financial products, but from a retail investor perspective, it is very difficult – close to impossible – to distinguish the products from each other and gauge which is more or less sustainable. There is a significant risk that the various levels of sustainability become blurred and that investors will sour on the whole concept of sustainable investments because of a perception that financial companies are not living up to their sustainability claims," Christensen warned.

Echoing similar concerns, in February, Morningstar noted that they had made an "extensive review" of fund documents in Europe in the fourth quarter review of global sustainable fund flows, basically reverting to a pre-SFDR fund universe.

They complained that the new regulation has led to more confusion and suspicion of greenwashing instead of providing the clarity and transparency it was supposed to. "Many funds that place themselves into Article 8, for example, are not funds we would independently classify as sustainable funds," stated the Morningstar research paper.

The future of SFDR

The SFDR Level 2, to enter into force on 1 January 2023, promises to subject both light-green and dark-green funds to additional, more thorough disclosure requirements in accordance with the Taxonomy alignment of their portfolios and mandatory disclosure templates. As asset managers are eagerly awaiting the final SFDR rules, the focus seems to be shifting, if ever so slightly. There is a growing realisation that merely classifying funds into the three buckets of Article 6, 7 and 8 is not enough anymore. With MiFID II knocking on the door, fund managers are required to be much more specific about the proportion of assets in environmentally sustainable investments in line with the Taxonomy Regulation as well as about the Principal Adverse Impacts (PAIs) on sustainability factors.

The categorisation regarding sustainability preferences in MiFID II is, as of now, not fully aligned with the classification of financial products as identified in the SFDR. It might prove especially difficult to find a middle ground between the MiFID II classification and the financial products in Article 8 of the SFDR.

The regulatory landscape is evolving quickly. Watch this space as NordSIP continues to update you on the latest developments and gauges their uptake in the Nordic financial markets.

We Need Better Information

Not More Standards!

by Filipe Albuquerque

Although the EU's Sustainable Finance Disclosure Regulation (SFDR) is mainly targeted at asset managers, the disclosures it generates stream along the investment chain all the way to asset owners. Varma may not be directly exposed to the burdens of SFDR compliance but this does not mean that the new regulation is not valuable. "We don't need to report based on SFDR, but our asset managers do," says Hanna Kaskela, Director of Responsible Investment & Sustainability at Finnish pension and insurance company Varma.

According to Kaskela, the value of SFDR and of any other sustainable finance regulatory framework is in its ability to facilitate a wider and better flow of information about the effects of investments. However, she is also keen to warn against the dangers of creating too many ESG standards and the disclosures burdens they would impose on corporates and fund managers

Accessing the data behind the labels

Regarding the positive impact that SFDR has had over the last 12 months since it was implemented, Kaskela is keen to highlight the contributions of the SFDR's Principal Adverse Impact (PAI) indicators, the ESG indicators and metrics, such as carbon emissions, considered to always have a negative impact, that asset managers now have to report.

"For the active equity funds that incorporate sustainability factors into their investment process the fact that asset managers would have to report PAI indicators is a very positive development brought about by SFDR. It provides us with several data points with which to assess potential funds."

For Kaskela, the main benefit of SFDR and other regulations is in their ability to increase the amount of information available to investors. Unfortunately, the standardisation inherent to these new regulations are not as appealing to the Finnish asset owner. "We don't have any process or rule according to which we have to invest some part of our portfolio into Article 8 or Article 9 funds. The SFDR's classification is not replacing nor is it particularly complementing Varma's internal classifications," Kaskela explains.

"The SFDR's Articles 6, 8 and 9 classification is merely providing yet another standard to an ESG market place already crowded by a panoply of different approaches. As a rule, Varma is more interested in accessing the data behind the labels being used, rather than on the classifications themselves," Kaskela adds. That being said the labels can provide a useful signal. "We would expect a fund that is classified as Article 9 to be able to provide us with extensive information about its impact," she says.

Slow but Steady Implementation

"We find that implementation is progressing steadily among asset managers. SFDR implementation is not immediate.

There are hurdles to this process. Funds need to consider the underlying assets and analyse what their impact is.

To do that, investors need to have the data, which can take some time, particularly if the fund managers were not already collecting that information," Kaskela says.

"The task is also complicated if the companies are not reporting the data themselves," Kaskela continues. As corporate disclosure regulations and the taxonomy continue to be implemented across the EU, the problem may become less accentuated across Europe but it will remain for companies in other jurisdictions. "Fund managers will have to use other sources of data beyond what the companies can give to serve as proxies for the variables that we are interested in," she says.

The SEC steps in

Beyond the EU frameworks, Kaskela also noted the impending publication of new disclosure climate change risk disclosure standards by the US Securities and Exchange Commission (SEC). "The SEC has been in the process of discussing and has announced this week their proposed Rules to Enhance and Standardize Climate-Related Disclosures for Investors. We will have to review disclosures they require from US companies regarding climate change risks but this is a positive development," Kaskela argues

"Up until now there were no compulsory requirements for companies in the USA. Disclosures pertaining to climate change were only made if investors were particularly insistent on them. By the end of 2021, 41% of our listed equities were in North America. It'll be an extremely positive development to have those companies start providing more advanced reporting on climate change risks," she explains.

Despite the fact that this is a broadly positive development, Kaskela argues that this development from across the pond adds another framework to an already crowded chessboard of reporting frameworks.

Tackling greenwashing through auditing and assurance

Given its piecemeal implementation concerns of greenwashing have floated around. Nordic regulators have repeatedly warned fund managers to be careful with the way they classify their funds. In October 2021, a survey of fund managers by the Swedish Financial Services Authority (FSA), Finansinspektionen (FI), found several inconsistencies. Some of the funds marketed as "sustainable" were categorised as neither Article 8 nor Article 9 products. FI also noted that one fund which includes 'ESG' in its name is categorized as neither Article 8 nor Article 9 product.

"All ESG investments are exposed to the risk of greenwashing. However, by imposing a legal requirement of disclosure, SFDR is actually extremely useful in creating a chain of accountability that makes the information more robust. SFDR makes companies and fund managers liable for any misrepresentation in their sustainability claims.

This creates an incentive for outside auditors to come in and assess these issues and provide investors with an added layer of assurance as to the credibility of these statements," Kaskela argues.

Too many standards

Kaskela concludes by once again warning against the problems that too many sustainable finance reporting frameworks. According to her, the focus should be on consistency and simplicity in regulatory requirements and disclosure frameworks. "At the moment, asides from SFDR, there is also, the Taxonomy, the Corporate Sustainability Disclosure Regulation (CSDR), the Taskforce for Climate-Related Financial Disclosures (TCFD), and now the SEC's own framework. All these reporting frameworks provide important data but it is all a too dispersed," says Kaskela.

"The problem is not abstract. While the EU's regulation could be the single framework for a European equity portfolio, a global portfolio with real estate and equity and debt would have to deal with a wide array of frameworks. From our point of view, when we invest in different asset classes, it would be ideal if reporting requirements were uniform across all regions. Unfortunately, that is not the case," she explains.

"Some of the ESG standards overlap, some extend the information set available to investors, but the focus should be on providing more information, that is reliable and audited. Ideally, ESG disclosures should be like all financial performance disclosures, which are very simple: The USA uses the Generally Accepted Accounting Principles (GAAP) and Europe and many Asian countries use International Financial Reporting Standards (IFRS). That's what we need for sustainable disclosures," Kaskela concludes.

Nordic FSAs to Tackle Greenwashing in 2022

by Filipe Albuquerque

Johanna Fager Wettergren
Head of Sustainable Finance
Sweden's *Finansinspektionen*

As we embarked on yet another year, NordSIP took the opportunity to reach out to the Danish, Swedish and Finnish Financial Supervisory Authorities (FSAs) to hear what their agenda for 2022 looked like and take their temperature on the main challenges facing the industry.

Concerns about data, definitions, regulations and, above all, greenwashing were common themes among the supervisors. Last, but not least, regulators have taken note of the geopolitical developments since the start of the year, but remain confident of their agendas and goals.

Finanstilsynet to keep supervisory pressure against greenwashing

"In the area of sustainable finance, our work is centred around three main tasks," Theodor Joachim Christensen, Deputy Director Capital Market Regulations and Head of the Unit for Sustainable Finance at Finanstilsynet, Denmark's FSAs, commented to NordSIP in January 2022.

The first focus of the Danish FSA will be to contribute to the ongoing development of EU regulation in the field of sustainable finance. Second, Finanstilsynet will supervise the compliance with existing legislation.

Finally, it will inform relevant parties on the new regulation and setting supervisory expectations around how the requirements are met.

"In 2021 the Danish FSA prioritized providing information and guidance in order to raise awareness of the new regulation and ensuring decent implementation in the financial sector," Christensen explained.

Theodor Joachim Christensen
Deputy Director Capital Market Regulations
and Head of the Unit for Sustainable Finance
Denmark's *Finanstilsynet*

"In 2022 we will devote more resources to actually supervising compliance with the various pieces of sustainable finance legislation. More specifically, we will increasingly focus on supervising the implementation of the EU Disclosure Regulation and initiate supervision of the EU Taxonomy Regulation," Christensen added at the start of the year.

For Christensen, the main challenges facing sustainable investments are the data difficulties faced by investors, as well as greenwashing. "Obviously, there are still challenges around the familiar themes of data and measurement difficulties, which harm sustainable investment and investor protection, since the lack of standards and transparency imply a risk of greenwashing. This also extends to problems in the sphere of ESG ratings that are not aligned on definitions and measurement methods or fully capture the specific requirements from new EU regulation," he argued.

"Increasingly, however, we are also concerned about sustainable investment products being promoted as much more sustainable than they actually are. There has been a huge surge in the labelling of article 8 and 9 financial products, but from a retail investor perspective, it is very difficult – close to impossible – to distinguish the products from each other and gauge which is more or less sustainable. There is a significant risk that the various levels of sustainability become blurred and that investors will sour on the whole concept of sustainable investments because of a perception that financial companies are not living up to their sustainability claims," Christensen warned.

Finansinspektionen to Take Three-Prongued Approach

The Swedish FSA has a similar approach to its Danish counterpart. "Finansinspektionen will have three main priorities for sustainable finance in 2022: New regulations, supervisory activities and global cooperation," Johanna Fager Wettergren, Head of Sustainable Finance at Finansinspektionen, the Swedish FSA, told NordSIP at the start of 2022.

"Firstly, as new EU regulations entering into force will have major impact, our main focus will be on ensuring that firms are working actively to adapt to the new requirements. We will be in close dialogue with market participants and other stakeholders. Secondly, supervision is one of the most important tools that FI has for carrying out its assignment. To the greatest extent possible it will be risk-based. For 2022 we will focus on two risks: greenwashing and transition risk.

Nina Männynmäki
Senior Market Supervisor
Finland's *Finanssivalvonta*

Thirdly, global challenges require global solutions. For that reason Finansinspektionen has taken an active role in the global cooperation on sustainable finance. One outcome will be a new global climate standard, expected to become a reality during 2022. This will be a game-changer," she explained.

Discussing the main challenges facing sustainable investments, Wettergren pointed the finger at the lack of definitions and rapidly evolving regulations. "I think everyone can agree that the absence of common definition of green finance and lack of international standards is one of the main challenges facing sustainable investments. Also, and as a consequence, there is a profound disconnect between the ESG data investors need and what's available to them. Though I am quite optimistic we will be able to improve the quantity, quality and comparability of climate-related disclosures by implementing common frameworks," she said.

"Other challenges facing investors has to do with the fast development and the rapidly changing regulatory landscape. Investors have to develop new skills and expertise to be able to actively adapt to new regulations.

Putting in place a comprehensive approach to ESG issues and a way to embed these new risks within their existing enterprise risk-frameworks is crucial," Wettergren added.

"So far, the work is progressing in a fast speed and according to the plan," Wettergren reiterated to NordSIP in March, noting that the international events in the intervening months did not affect FI's plans. "The plan is intact, we stick to our toppriorities," she explains. However the Swedish FSA is not oblivious to the ongoing geopolitical turmoil.

"The Russian invasion of Ukraine is bringing a catastrophic loss of life, human suffering and political and economic disruptions on a global scale. At Finansinspektionen, we are closely following developments and are ready to deal with possible effects on the financial markets. What is happening is not separated from what we are trying to achieve within the field of sustainable finance. It is all the more important that we never cease to extol the virtue of democracy and ethics. The crisis has not yet forced us to re-prioritize our planned work on sustainable finance, though the development is putting more focus on the 'S' in the ESG," Wettergren continued.

Finland Fights Greenwashing

According to Nina Männynmäki, Senior Market Supervisor at Finanssivalvonta, Finland's FSA, Finnish supervision of sustainable finance in 2022 will focus on entities' risk management and greenwashing.

"Sustainability risks have to be incorporated into the supervised entities' business strategies and risk management," Männynmäki explains. "A wide choice of new products coming available in the market and growing investor demand might create room for mis-selling of ESG-labelled products. It is important to ensure that retail investors have access to adequate and understandable information on the greenness of investments while trying to prevent potential greenwashing," she added.

Männynmäki argues that sustainable finance regulation remains a challenge, in no small part due to the fact that is still incomplete. "Supervised entities will be expected to comply with level 2 disclosure requirements under SFDR and TR in the very short preparing period. Also, the need for high-quality sustainable data and high-quality standards for corporate sustainability reporting is a challenge for all in the area of sustainable finance markets," she continued.

"The crisis in Ukraine has affected FIN-FSA's work, but not our priorities in sustainable finance. As I mentioned earlier this year FIN-FSA focuses on two topics in its supervision of sustainable finance this year and that has stayed unchanged. The first topic is to make sure the supervised entities incorporate sustainability risks into their risk management. The other one is supervision of greenwashing. For example, we watch funds' sustainability disclosures and we expect the material to be coherent and align with funds' investments. To that end, we have published several interpretations of TR and SFDR regulations," Männynmäki concluded.

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THE EU SUSTAINABLE FINANCE REGULATION

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