

# ESMA Brief – April 2023

## *Innovations and Sustainable Practices in Investment Management (sustainability)*

The company is focusing on data, innovation, sustainability, and retail investors. The adoption of new technologies enabled a balance between in-person and virtual meetings, and reduced unnecessary travel. There's a strong emphasis on sustainability, technological innovation, and data. ESMA's strategic priorities involve strengthening supervision, providing fair and effective markets while promoting sustainability and innovation. ESMA issued a briefing in May that suggested practices for supervising the integration of sustainability risks and disclosures. The briefing also addressed sustainability disclosures in fund documentation and marketing material and proposed additional supervisory actions. Guidelines on investment advice and portfolio management integrate sustainability factors, risks, and preferences. ESMA seeks to protect investors from unsubstantiated sustainability claims and provide clear criteria for assessing investment funds that include sustainability terms.

ESMA responded to international consultations on corporate sustainability reporting standards and reiterated the need for these standards to be interoperable with European standards. The company contributes to international efforts to standardize sustainability reporting and regulatory framework for digital reporting. It also reinforces supervision and enforcement of financial and sustainability information. ESMA continues to involve itself in European and international bodies, contributing to the consideration of sustainability factors in investment decision-making. The key drivers include sustainability and data and technological innovation.

## *ESMA's Initiatives, Achievements, and Future Directions in Sustainable Finance and ESG Approach (esg)*

ESMA has been actively monitoring new risks emerging from industry and capital market developments, including deteriorating economic conditions and the advent of ESG products. They have implemented measures to promote transparency, combat greenwashing, and enhance capability to assess ESG markets and risks. Efforts such as issuing guidelines for ESG disclosure and integrating sustainable finance into daily work and supervisory culture demonstrate their commitment to sustainability. To protect investors from unsustainable claims, ESMA launched a consultation for the use of ESG or sustainability-related terms in funds' names. Regarding market trends, ESMA continuously monitors the credit-rating market to address potential risks, which recently included concerns emerging from Russia's invasion of Ukraine and developments in cyber risk. There is an ongoing focus on incorporating ESG considerations into business strategies, strengthening cyber resilience, and facilitating investments in reputable ESG markets. Important discussion topics such as regtech, artificial intelligence, decentralised finance, and greentech are also on the radar. Looking forward, ESMA seeks to promote increased scrutiny on ESG disclosures, and addressing misleading or exaggerated sustainability claims, which might stem from various areas like ESG governance, performance metrics or sustainability impact.

## *ESG Factors and Governance Structures in Investment Decisions (governance)*

There is a growing investor interest in the non-financial characteristics of investments, with a focus on environmental, social, and governance (ESG) factors. The decision-making bodies governing ESMA are actively encouraging organizations to improve their internal control assessments and align their business strategies and governance structures with ESG concerns. ESMA also facilitates consultations to review guidelines and prevent mis-selling by ensuring client interests are prioritized throughout the investment life cycle. In addition, measures are being taken to increase cyber resilience. ESMA has integrated ESG factors into its mission to enhance investor protection and promote stable financial markets. Therefore, organizations are encouraged to consider sustainability implications and potential greenwashing risks when making ESG claims regarding their products or strategy.

### ***Sustainability, Market Integrity and The Role of Regulators in Financial Investments (environment)***

Discussions revolve around Russia's invasion of Ukraine, macroeconomics, and environmental impact relative to financial and non-financial activities. The use of terms 'environmental claims' and 'green claims' pertains to the suggestion of positive or zero environmental impact of certain goods or services. There is growing pressure on regulators of securities markets to bolster investor protection, maintain market integrity, and sustain a dependable environment for sustainable investments. This is amid rapid growth in environmentally-related financial products in the EU. ESMA, being in a dynamically changing environment, has been able to improve efficiency, traceability, and contribute to a greener environment through reduced paper use. With the growing recognition of the financial sector's big role in EU's transition to a more sustainable economy, ESMA has been aligning its organizational structure to best accommodate changes and challenges that may arise. An inclusive assessment of each firm's business model, strategy, and operating environment is advocated to mitigate potential vulnerabilities and risks. Despite differences in traditional market segmentation, the regulatory environment is comparable across different markets. Lastly, there's a need for undertakings to provide justifications for assertions relative to their environmental impact.

### ***Enhancing financial regulations and adapting technology in financial services (technology)***

ESMA's focus is on improving business continuity, quality, timeliness of the analytical process, information sufficiency, disclosure adequacy, and IT and information security. The report emphasizes the risk of greenwashing where financial instruments, products, and services may falsely promote environmental characteristics. Recounted also are harmful practices from financial advisors not considering the consumers' preferred Principal Adverse Impact (PAI). The report underlines ESMA's commitment to minimizing environmental impact by making use of technology for reducing waste and travel, and aiming for a paperless office. The agency has placed considerable emphasis on IT and information security, reviewing all associated incidents. Distributed Ledger Technology (DLT) is being explored, with a call for evidence issued in January. The report discusses the importance of automated tools and understanding how to effectively utilize these technologies for investment advisory services. The report underscores investing in technologies like video conferencing and digital/automated financial advice to streamline operations, and stresses the importance of keeping up with business model evolution and new technology trends.

### ***ESMA Recommendations on Benchmark Administrators' ESG Obligations and Clarifications on UCITS Directive (nist)***

ESMA suggests that ESRs cover information needed by Benchmark Administrators to meet their ESG obligations under the EU Benchmarks regime. This includes the application of minimum standards for EU climate transition benchmarks and EU Paris-aligned benchmarks. As part of these standards, it is noted that the definition of administrative bodies only partly aligns with the Shareholders' Rights Directive, and ESMA has advised on adjustments for clarity and consistency.

Furthermore, ESMA elaborates on conditions that would involve entrusting third parties with tasks related to the UCITS directive. These tasks, such as administrative or technical functions performed as part of depositary tasks, should not involve any discretionary judgement or interpretation. Any fees or commission related to these activities are subject to strict conditions. The document concludes by stressing that the sustainability reporting standards should not impose unnecessary administrative burdens on companies.

### ***Fostering Sustainable Finance and Innovation through Enhanced Regulations and Consumer Protections (innovation)***

ESMA (European Securities and Markets Authority) is focusing on enhancing the development of sound capital markets by prioritizing sustainable finance, technological innovation, and increased data use. Significant efforts are being made towards innovation and digitalisation, ensuring consumer protection, and understanding the impact of financial innovation on financial markets. There's an active participation in global initiatives, like IOSCO (International Organisation of Securities Commission) and FSB (Financial Stability Board), to put retail investors at heart of these activities. ESMA also contributed to the development of the digital finance rulebook, following the Digital Operational Resilience Act (DORA), Markets in Crypto-assets (MICA), and a pilot for market infrastructures based on Distributed Ledger Technology. Other areas of attention are the fast-growing crypto-asset risks on financial stability and the progression of FinTech innovations. Consumer protection remains a key focus, with both sustainability and technological data innovation gaining importance across the organisation. These steps have improved customer experience and digital security, adding to the workforce enablement, resilience, and increased IT needs.

### ***Evaluating the Confidentiality Obligations under EU Data Protection Regulations (confidentiality)***

Understandably, disclosure requirements for portfolio levels per EU regulations can raise concerns about maintaining client confidentiality. However, the promotion transparency of environmental, social, or sustainable investments must comply with both union and national data protection laws. This legislation necessitates respecting the confidentiality owed to clients, which rules out a standard confidentiality statement in an email as a non-disclosure request. The risks involved include 'data losses' – i.e., breaches that can lead to the compromise of data confidentiality and potentially, data integrity. Financial entities are obliged to analyze the consequences of any incident that impairs the availability, authenticity, integrity, or confidentiality of data under the DORA's Article (). When incidents lead to data being accessed by or disclosed to unauthorized parties, entities should consider those as losses to data confidentiality. These incidents have particularly high relevance to supervisors and represent significant impact, which should be regarded as 'major incidents' under Article (). Despite these regulations, scenarios where internal escalation is not initiated were observed frequently. The duration of the service downtime and the geographic spread are other important considerations in managing any cases of data losses.

### ***Evolution of the ESG Reporting Standards (business model)***

Topical standards are addressing Environmental (E), Social (S), and Governance (G) matters. The report emphasizes general principles that companies should follow under the ESG Reporting Standards (ESRS), addressing strategy, business model, governance, and materiality process. The ESRS encourages innovative business models while ensuring investor protection and market resilience. The standards provide a balanced principles-based approach and precise rules, presenting a flexible and reflective information delivery system. Specific requirements include disclosure content on policies, targets, and action plans related to all sustainability matters in the topical standards. The disclosed information provides insights into a company's resilience, actions, resources, and objectives achievement. The examples provided aim to aid stakeholders in implementation. However, they are not exhaustive of all potential business models.

### ***ESMA's Anti-Fraud Measures and Alignment with EU Directives (fraud)***

ESMA has taken multiple steps, including social media campaigns and shutting down copycat websites, to tackle fraudulent activities that harm investors. The continued implementation of ESMA's anti-fraud strategy underpins these efforts. However, discrepancies have been observed between ESMA's definition of corruption and that outlined in both the Council Framework Decision on combating corruption and the EU Directive on fighting fraud against the Union's financial interests. These EU directives also discuss topics such as severe human rights issues, renewable and non-renewable energy sources, non-cooperative jurisdictions for tax purposes, and threatened species. It is underscored that ESMA needs to realign its definitions with those existing in EU law.

### ***ESMA's Role in Empowering Internal Review Functions and its Influence in Media (interviews)***

ESMA is working rigorously to empower internal review functions, demonstrated through conducting relevant interviews with the CRA staff, directors, and frequent reviews of their policies and procedures. They have also made substantial attempts to interact with the media and the public, with numerous interviews, briefings, and mentions in media outlets. The agency recorded millions of visits to their website, which further underscores their impact. Regular and intensive assessments are carried out, including interviews with different stakeholders such as internal control functions, CEOs, board members, and bank compliance officers. Monitoring the obligations of the compliance function, reviewing their plans, and reports are the central parts of ESMA's supervisory approach.

### ***ESMA's Annual Corporate Reporting Enforcement and Regulatory Activities (accountability)***

The European Securities and Markets Authority (ESMA) has published its annual corporate reporting enforcement and regulatory report with a focus on investor protection. The report aims to provide transparency and accountability on ESMA's activities in the enforcement of financial and non-financial information. Accountability to the European Parliament and the Council of the European Union, is a part of ESMA's core responsibilities. Their mission involves the improvement of retail investor protection through promoting the convergence of supervisory and regulatory practices across the EU. ESMA collaborates with EU institutions

ensuring its accountability as an EU agency. Delegating financial market participants are expected to have the same information level on investments made by themselves and their delegate. An assessment focus on future compliance, social supply chain management, and risk remediation aims to continually monitor the investee company's accountability.

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