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Will the EU Commission Successfully Integrate Sustainability Risks and Factors in the Investor Protection Regime? A Research Agenda

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Abstract: Building a common EU framework for sustainable finance undoubtedly implies the integration of sound and sustainable processes and skills across the whole structure and governance of financial institutions. Consequently, a new financial paradigm is going to be needed, which will require the strengthening of investor care and protection, so contributing to the restoration of trust in the financial sector. In particular, on 18 December 2018, the European Securities and Markets Authority (ESMA) launched two public consultations on draft technical advice for the integration of sustainability risks and factors into the Directive on Markets in Financial Instruments (MiFID), the Alternative Investment Fund Managers Directive (AIFMD), and the Undertakings for Collective Investment in Transferable Securities Directive (UCITS) regimes, with the aim to clarify the so-called fiduciary duties and to increase transparency in the financial services industry. However, the success of the EU initiatives on investor protection regulation may be seriously endangered by the existence of many challenges, weaknesses, and contradictions raised by economists and stakeholders in relation to the definition of sustainability, ESG data availability and reliability, the development of an EU taxonomy, conflicts of interest, product governance, and suitability assessment. This paper starts by briefly analyzing the recent developments of the regulation of sustainable finance at the global level, then offers a more detailed view on the establishment of a common regime on sustainable finance in the EU, with particular reference to the action plan 'Financing Sustainable Growth'. Then, it examines the recent proposals for regulation on sustainable finance, specifically considering the barriers to the integration of sustainability risks and factors in the EU investor protection regulation—with particular reference to investment services—with respect to its four main dimensions: (1) disclosure of product information, (2) conduct of business (COB) rules, (3) product governance and intervention, and (4) financial education. The paper concludes that the EU reforming proposals, though admirable, risk oversimplifying a complex issue that cannot be easily solved without considering its practical implications on each category of financial operators in the performance of different financial services.

Keywords: sustainable finance; investor protection regulation; ESG investing; EU law; non-financial reporting

1. Introduction

Nowadays, sustainability is one of the most challenging global issues, affecting not only individuals but also organizations, both those operating in the financial and non-financial sector, from small- and medium-sized enterprises (SMEs) to large commercial companies and governmental institutions. Degradation of natural resources, climate change, wildlife extinction, poverty, illnesses, and discrimination are only a few of the destructive environmental and societal effects deriving from human business activities, and which have to be readdressed in order to "meet the needs of the present without compromising the ability of future generations to meet their own" [1].

Accordingly, by building on the previous Millennium Declaration and Millennium Development Goals (MDGs) [2], in 2015, the UN Global Agenda 2030 set 17 sustainable goals to be reached by 2030 [3], covering issues from ending poverty and hunger to ensuring access to sustainable and modern energy and clean water for all.

To combat the detrimental consequences of the climate change phenomenon, in 2016, by signing the Paris agreement [4], governments from around the world established specific environmental targets to reduce the level of greenhouse gas emissions released in the atmosphere and to limit global warming to well below 2 °C. In the same year, the Addis Ababa Action Agenda [5] and the Sendai Framework for Disaster Risk Reduction [6] were also adopted.

With specific reference to the financial sector, in 1992, a partnership between the United Nations Environment Programme and the global financial sector (UNEP FI) was launched with a mission to promote sustainable finance. The UNEP FI nowadays counts more than 200 financial institutions as members, committed to respecting sustainable finance principles by adhering to the backbone of the initiative, the UNEP Statement of Commitment by Financial Institutions on Sustainable Development. Subsequently, a multitude of other sustainable finance initiatives were launched or supported by UN agencies (such as the 2006 Principles for Responsible Investment, the 2012 Principles for Sustainable Insurance, the 2017 Principles for Positive Impact Finance) or other international bodies, such as the Financial Stability Board [7] and the International Association of Insurance Supervisors (IAIS) [8]. At the Paris 'One Planet Summit' in December 2017, many central banks and banking supervisory authorities gathered in the Network of Central Banks and Supervisors for Greening the Financial System (NGFS) with the aim to promote best practices in the banking sector for the transition to a sustainable world economy. The first Principles for Responsible Banking were launched at the UNEP FI Global Roundtable in Paris on 26 November 2018, and published in July 2019 after open consultation [9].

Since the launch of the EU Sustainable Development Strategy in 2001 [10], which was revised in 2006 [11] and 2009 [12], the EU Commission has made a clear commitment to contribute to promoting sustainable development in key cross-sectorial projects, by stepping up its involvement in all environmental, social, and governance (ESG) areas. The introduction of the Europe 2020 Strategy in 2010 [13] and the explicit link made to the UN Sustainable Development Goals in the 2016 Commission Communication on the next steps for a sustainable European future [14] confirmed the EU's role as a frontrunner in the implementation of the UN agenda.

This paper starts by briefly analyzing the recent developments of the regulation of sustainable finance at the global level, then offers a more detailed view on the establishment of a common regime on sustainable finance in the EU, with particular reference to the action plan 'Financing Sustainable Growth'. Then, it examines the recent proposals for regulation on sustainable finance, specifically considering the barriers to the integration of sustainability risks and factors in the EU investor protection regulation—with particular reference to investment services—with respect to its four main dimensions: (1) disclosure of product information, (2) conduct of business (COB) rules, (3) product governance and intervention, and (4) financial education.

2. The EU Action Plan for Sustainable Finance

Financial institutions, as key providers of funding, play a major role in the transition to a new sustainable and circular economy. As also highlighted by the EU Commission in the action plan "Financing Sustainable Growth" published in March 2018 [15], change is possible only by reorienting private capital to more sustainable investments. In fact, it was estimated that more capital flows should be oriented towards sustainable investments to close the €180-billion gap of additional investments needed to meet the EU's 2010 targets of the Paris Agreement. In the meantime, great financial risks might occur for business activities in case of inaction, as it was estimated that delays in tackling the climate issue could cost companies nearly $1.2 trillion over the next 15 years for a universe of 30,000 listed companies [16].

As a consequence, at the end of 2016, the EU Commission appointed a High-Level Expert Group (HLEG) on sustainable finance to advise it on developing a comprehensive EU strategy on sustainable finance and development. The HLEG final report [17], issued in January 2018, stresses the importance of promoting sustainable finance through a systemic review of the financial framework, and proposes eight recommendations, as well as crosscutting recommendations and actions addressed to specific financial sectors.

In March 2018, on the basis of the final report published by the HLEG, the EU Commission adopted the action plan, "Financing Sustainable Growth" ('Action Plan') [15], which establishes a strategy for enhancing the connection between the financial industry and sustainable development. The action plan specifically pursues three objectives: (i) reorienting capital flows towards sustainable investment, in order to achieve sustainable and inclusive growth; (ii) managing financial risks stemming from climate change, environmental degradation, and social issues; and (iii) fostering transparency and long-termism in financial and economic activity. The EU strategy specifically develops around 10 key actions to be fully implemented by the end of 2019, which are: (a) establishing an EU classification system for sustainable activities; (b) creating standards and labels for green financial products; (c) fostering investment in sustainable projects; (d) incorporating sustainability when providing financial advice; (e) developing sustainability benchmarks; (f) better integrating sustainability in ratings and market research; (g) clarifying institutional investors' and asset managers' duties; (h) incorporating sustainability in prudential requirements; (i) strengthening sustainability disclosure and accounting rule-making; and (l) fostering sustainable corporate governance and attenuating short-termism in capital markets.

The EU Commission set up a technical expert group on sustainable finance (TEG), including representatives of the civil society, academia, and financial sector, for assistance in relation to actions (a), (b), and (d). The TEG began to work in July 2018 and operated until June 2019, when the mandate was extended until the year-end of 2019. In particular, the EU Commission was supported by the TEG but also by EIOPA and ESMA in the better integration of sustainability risks and factors in relation to organizational requirements, operating conditions, risk management, and product governance. This required the amendment of existing delegated acts under the UCITS Directive 2009/65/EC, the AIFM Directive 2011/61/EU, the MiFID II Directive 2014/65/EU, the Solvency II Directive 2009/138/EC, and the IDD Directive 2016/97, or the adoption of new delegated acts under the same directives [18,19].

The EU Commission has already taken concrete steps in the enactment of the action plan, and in May 2018, it adopted a package of measures, which include: (i) the regulation on the establishment of a framework to facilitate sustainable investment [20]; (ii) the regulation on disclosures relating to sustainable investments and sustainability risks and amending Directive EU 2016/2341 ('IORP II') [21]; and (iii) the regulation amending Regulation EU 2016/1011 on low carbon benchmarks and positive carbon impact benchmarks [22].

On 24 July 2018, the EU Commission sent a formal request to ESMA and EIOPA to provide technical advice, by the end of April 2019, on potential amendments to, or the introduction of delegated acts under, Directive 2009/65/EC (UCITS Directive), Directive 2009/138/EC (Solvency II Directive), Directive 2011/61/EU (AIFMD), Directive 2014/65/EU (MiFID II), and Directive 2016/97/EU (IDD) with regard to the integration of sustainability risks and sustainability factors. The overall objective of the reforming acts is to clarify the so-called fiduciary duties and increase transparency in the financial services industry [23]. ESMA issued its final reports on 30 April 2019 [24,25].

In relation to the insurance sector, on 28 November 2018, EIOPA launched a public consultation on the draft technical advice on the integration of sustainability risks and factors in the delegated acts under Solvency II and the Insurance Distribution Directive [IDD], with specific reference to: organizational requirements, operating conditions, risk management, and target market assessment for the IDD only. On 30 April 2019, E published its final technical advice [26]. Moreover, in August 2018, the EU Commission mandated EIOPA for the draft of an opinion on sustainability within Solvency II, with specific reference to climate change mitigation, to then be considered for the preparation of the EU Commission's report on the Solvency II Directive [27]. EIOPA formally opened the consultation on 3 June 2019, in order to provide an opinion by 30 September 2019. On 1 February 2019, the EU Commission, consistently with action 10 of the action plan, requested advice from ESMA, EBA, and EIOPA on undue short-term pressure from the financial sector on corporations.

Finally, in June 2019, the TEG published three reports, a report on EU taxonomy [28], a report on EU green bond standards [29], and an interim report on climate benchmarks and benchmarks' ESG disclosures [30]. The extension of TEG's mandate until the end of the year will allow it to conduct a call for feedback in relation to the proposed climate change mitigation and adaption taxonomy, advise the commission on the on the link between the EU green bond standards and the EU taxonomy, and integrate the feedback it will receive in the final report on EU benchmarks, which is expected to be delivered by the end of September 2019 [31].

This complex reforming process is still in progress and entails an intense amount of cooperation among the EU Commission, the TEG, and the ESAs, which, however, if successful, will contribute to ground-breaking progress towards the transition to a sustainable financial system.

3. Integrating Sustainability in EU Investor Protection Regulation

'Investor protection' can be defined as the set of rules and principles expected to preserve the interests and the rights of a person in its role as the investor, or the 'defensive protection of the vulnerable investor against unscrupulous market participants' [32]. Investor protection regulation aims at ensuring that investors make informed financial decisions that are better aligned with their interests and profile.

After the financial turmoil in 2007, and considering the increasing complexity of financial markets, the EU legislator intervened to set a suitable level of protection and transparency in investment services [33]. In particular, it has provided the main criteria that financial intermediaries should follow while carrying out their activities by introducing a regulatory framework including: Directive on Markets in Financial Instruments (MiFID) [34], the related Markets in Financial Instruments Regulation (MiFIR) [35], the Directive 2009/65/EC on the coordination of laws, regulations, and administrative provisions relating to undertakings for collective investment in transferable securities (UCITS) [36], the Alternative Investment Fund Managers Directive (AIFMD) [37], the Insurance Distribution Directive (IDD) [38], and the regulation on key information documents for packaged retail and insurance-based investment products (PRIIPs) [39].

In particular, based on previous contributions on the subject [40–42], we distinguish among four main dimensions of EU investor protection regulation [43]: (1) disclosure of product information, (2) conduct of business (COB) rules, (3) product governance and intervention, and (4) financial education.

The approach followed by the EU financial authority in the integration of sustainability concerns in the EU investor protection regime could be analyzed by focusing on the effects of the implementation of the current proposals on sustainable finance on each of the aspects mentioned above.

However, before starting the analysis, we should briefly consider what "sustainability" means and, in particular, how terms "sustainability", "sustainability risks", and "sustainability factors" have been defined by EU financial authorities, as well as the importance of the establishment of a common sustainable finance taxonomy for the identification of assets that can contribute to all or any of the identified sustainability goals.

4. Defining Sustainability

In order to understand how 'sustainability', 'sustainability risks', and 'sustainability factors' are interpreted by ESMA and EIOPA, we should recall the first institutional definition of 'sustainable development', given by in the Brundtland Report in 1987, as the development that "meet(s) the needs of the present without compromising the ability of future generations to meet their own" [1]. The UN's Sustainable Development Goals refer to sustainability as issues concerning poverty, health, inequality, climate and environmental degradation, responsible citizenship and consumption, and peace and justice.

At the EU level, Directive 2014/95/EU on the disclosure of non-financial and diversity information refers to sustainability where it requires large undertakings and public-interest entities to disclose certain information about their approach and impact on environmental matters, social and employee matters, respect of human rights, anti-corruption and bribery issues, and diversity on company boards (in terms of age, gender, educational, and professional background).

The lack of a common definition of concepts and terms relating to environmental, social, and governance matters was one of the main shortcomings denounced by respondents to the public consultations (e.g., [24] (p. 5); [25] (p. 9)), together with the lack of an expressed reference to materiality [25] (p. 6). In particular, the Securities and Markets Stakeholder Group (SMSG) stated that "the lack of agreed definitions and labels at the EU level is a substantial shortcoming and seriously hampers the implementation of a harmonized approach on sustainable finance. This should not prevent firms from making progress in order to incorporate sustainability risks and factors, but this should be taken into account by regulators and supervisors" [44] (p. 2).

For these reasons, new definitions of 'sustainable investments', 'sustainable risks', and 'sustainable factors' have finally been provided in the political agreement on the final text of the regulation on sustainability-related disclosures in the financial sector reached by the European Parliament and EU Member States on March 2019 on new rules on disclosure requirements related to sustainable investments and sustainability risks [45].

'Sustainable investments' are now defined as those "investments contributing to an environmental objective (in terms of use of energy, renewable energy, raw materials, water and land, on the production of waste, and greenhouse gas emissions, and on the impact on biodiversity and the circular economy) end/or those contributing to a social objective (e.g., tackling inequality, fostering social cohesion, social integration, and labor relations)", provided that the investments do not significantly harm any of those objectives and that the investee companies follow good governance practices, in particular with respect to sound management structures, employee relations, remuneration of relevant staff, and tax compliance. It should be noted that a substantial amendment has been made to the definition delivered in the first proposed regulation, according to which even investments in companies following "only" good governance practices could have been classified as sustainable investment [21] (Article 2(o)). The previous definition was undoubtedly too broad and risked not being functionally helpful in identifying sustainable investment in terms of the ESG criteria.

'Sustainability risk' is now defined as an environmental, social, or governance event or condition that, if it occurs, could cause an actual or a potential material negative impact on the value of the investment arising from an adverse sustainability impact (Article 2(o)) [45]. It should be noted that EIOPA, on the contrary, in its final technical advice did not mention "materiality" in its definition of sustainability risks (as those "that could affect the insurance and reinsurance undertakings' risk profile, on the investments and liabilities side, due to ESG factors") [26] (p. 6). To be true, some commentators proposed the inclusion of materiality in the definition, but EIOPA rejected the proposal, as it "would not reflect the complex nature of sustainability risks and would be inconsistent with the treatment of other risks (e.g., reputational risks)" [10,26].

Finally, 'sustainability factors' are intended, in line with Directive 2014/95/EU, as 'environmental, social, and employee matters, respect for human rights, anti-corruption, and bribery matters'.

Due to the new definitions included in the new rules on sustainability-related disclosure requirements, which also refer to materiality, ESMA refrained from suggesting new definitions in its final draft technical advice [25] (p. 6). The authority has also invited the EU Commission to ensure a consistent interpretation and application of rules, by including cross-references to the relevant definition set out in other regulations.

Since inconsistency between definitions could lead to the danger of diverging interpretations, it is very important that ESAs should, EIOPA included, adopt the same approach in dealing with sustainability definitions, a task which will be made easier when the EU taxonomy is finalized.

5. EU Taxonomy

The establishment of a common sustainable finance taxonomy was the first key recommendation by the HLEG in its final report [17] (p. 15). The taxonomy will enable identification under which criteria any investment or financial product will contribute to the EU sustainability objectives, by also making a comparison across standards, labels, and products easier. It should be noted that, though the creation of the taxonomy was also the first action provided in the action plan by the EU Commission, due to the complexity of developing a full classification system covering both environmental and social aspects, the EU Commission decided to approach, in a first step, only the environmental activities contributing to the six environmental objectives defined in Article 5 of the regulation proposal on the establishment of a framework to facilitate sustainable investment [20]: (i) climate change mitigation, (ii) climate change adaptation, (iii) sustainable use and protection of water and marine resources, (iv) transition to a circular economy, waste prevention and recycling, (v) pollution prevention and control, and (vi) protection of healthy ecosystems. The establishment of the taxonomy for social sustainability will be addressed in a second step, once the environmental taxonomy has been finalized [15] (p. 12).

In June 2019, the EU TEG published a report on EU taxonomy [28], and held a call for feedback from 3 July until 16 September.

The lack of a finalized EU taxonomy on sustainable products is still one of the main issues threatening the effective implementation of the EU reforms. Indeed, many respondents to ESMA's consultation papers on integrating sustainability risks and factors in MiFID II denounced the challenges of proposing and implementing a fully harmonized approach to sustainability risks and factors in investor protection regulation before the establishment of a common EU taxonomy. The SMSG, for example, noted that "the lack of agreed definitions and labels at the EU level is a substantial shortcoming and seriously hampers the implementation of a harmonized approach to sustainable finance", and that the lack of a common taxonomy may lead to several negative effects, including (a) the development of products incorrectly claiming to be sustainable, (b) misunderstandings and frustrated expectations, (c) legal disputes between clients and investment firms/funds, (d) a risk of crowding or bubble effect within certain asset classes, and (e) the creation of obstacles to the development of pan-European products and to the export of EU product into non-EU jurisdictions" [44]. Since the finalization of the EU taxonomy has recently been delayed to the end of 2021, instead of the end of 2019 [46], due to the challenging task of discriminating between crucial industrial policies, the difficulties will be passed on the implementation of the level 2 measures, accruing even more the risk of failure of the entire reform.

6. Disclosure of Product Information

The initial obligation to produce a prospectus, which was first harmonized at the EU level in 1985 and initially only targeted undertakings for collective investment in transferable securities UCITS funds [47], evolved with the introduction of the so-called 'Key Investor Information Document' (KIID), a two-page document containing the essential features of the fund [48] (Article 78), and finally extended to a larger range of financial products with the 'Key Investor Document' (KID) [39]. The main objectives of this requirement are protecting unsophisticated investors' trading in the securities market, ensuring the efficiency of the financial markets and reducing agency costs [49], and dealing with the concerns deriving from information overload [50], investors' limited rationality, deviant behavior [51], and non-uniformity among different types of financial products.

As mentioned above, on March 2019, the European Parliament issued a legislative resolution on the proposal for a regulation of the European Parliament and of the Council on disclosures relating to sustainable investments and sustainability risks [45] (Article 2). The new regulation lays down harmonized rules on how financial market participants and financial advisors should integrate environmental, social, or governance (ESG) risks and opportunities in their processes, as part of their duty to act in the best interest of clients. It also establishes how financial market participants should make end investors informed about their compliance to the integration of ESG risks and opportunities. The aim of the regulation is therefore to "reduce information asymmetries in principal–agent relationships with regard to the integration of sustainability risks, the consideration of adverse sustainability impact, and the promotion of environmental and social characteristics as well as sustainable investment by means of pre-contractual and ongoing disclosures to end investors, acting as principals, by financial market participants [45] [Article 2(a)] or financial advisors [45] [Article 2(a)], acting as agents on behalf of principals" [45] [Recital 3(a)].

Specifically, financial market participants and financial advisers should publish, on their websites, information on their policies on the integration of sustainability risks, respectively, in their investment decision-making processes and in their investment or insurance advice [45] (Article 3), as well as on whether they consider the adverse impacts of investment decisions on sustainability factors in their decision-making processes or in their investment or insurance advice [45] [Article 3(gamma)]. Transparency is required also in relation to the consistency of remuneration policies with the integration of sustainability risks [45] [Article 3(a)]. The integration of sustainability risks and opportunities is also required in relation to pre-contractual disclosures [45] (Articles 4 and 5) and periodic reports [45] (Article 7). In order to avoid greenwashing practices, the regulation requires financial market participants and financial advisers to also ensure that their marketing communications do not contradict the disclosed information [45] (Article 9).

As both financial market participants and financial advisors are required to integrate sustainability risks and opportunities while performing their activities, there is a growing need for them to employ ESG indexes and ratings for the assessment of companies' ESG performance. However, the reliability of data on which ratings are built is all but ensured.

Indeed, a recent study conducted by Busch et al. concluded that though sustainable concerns are integrated in investment processes, the shift towards more sustainable business seems rather weak, as it failed to effectively produce beneficial effects on the environment and society [52]. The authors claim that a major cause for this failure is the lack of trustworthy ESG data and clarity regarding how such data are taken into consideration in investment policies. Another study identified four main reasons why ESG data are not fully reliable [53]: (i) Ratings have little focus on material issues, and negative material issues can be easily cancelled by positive non-material ones; (ii) the nature of most of the information on which they are based is voluntary and difficult to verify, and this also favors large multinationals that can afford to spend significant amounts of money on sustainability communication; (iii) scores are generally focused on operations instead of the products of the companies, which leads to the irrational result of awarding businesses operating in essentially unsustainable industries (such as, for example, the coal and tobacco industries); and (iv) attentive assessment is excluded by the fact that each analyst should usually cover about 70 stocks at the same time. Another recent study investigated the drivers of the great divergence among ESG ratings, finding that differences in measurement, weight, and personal judgement on individual indicators end to create an 'aggregate confusion' and result in rating systems playing a poor role in guiding companies towards improvement [54].

Both the demand for more transparency, against the refusal by companies to disclose their ESG-related data, but also the low reliability of data that is disclosed [55], lead to the rise of two different needs translating into two complementary trends: (i) pushing companies to disclose their data, especially carbon emission-related ones, and (ii) making data more reliable, verified, and verifiable.

The EU legislator promptly responded to the first need with Directive 2014/95/EU on the disclosure of non-financial and diversity information, which requires large undertakings and public-interest entities to disclose certain information about how they operate in regular reports with reference to environmental, social, and employee matters, respect of human rights, anti-corruption and bribery issues, and diversity on company boards (in terms of age, gender, education, and professional background). In accordance to Article 2 of the directive, in 2017, the commission published some voluntary guidelines on methodology for reporting non-financial information in order "to help companies disclose high quality, relevant, useful, consistent and more comparable non-financial information in a way that fosters resilient and sustainable growth and employment, and provides transparency to stakeholders" [56]. Moreover, in compliance with Action 9.2 of the action plan, the EU Commission integrated such guidelines to improve the corporate disclosure of climate-related information [57] in line with recommendations made by the EU TEG [58].

However, it should be noted that the disclosure directive applies to 'large undertakings' and 'public-interest entities', and follows a comply-or-explain principle. As to 'large undertakings', it refers to organizations that have both: (a) An average number of employees exceeding 500 during the financial year; and either (b) a balance sheet total exceeding EUR 20 million or a net turnover exceeding EUR 40 million. 'Public-interest entities' include: (a) trading transferable securities on the regulated market of any Member State, (b) credit institutions, (c) insurance undertakings, or (d) those entities designated by a Member States as a public interest entity. This means that other entities are also welcomed to disclose non-financial information, but they do not have to justify their choice if they chose not to.

Moreover, the disclosure of large amounts of data is not sufficient to ensure the high quality and efficacy of non-financial reporting, as the more information is disclosed, the higher the risk of data manipulation and information overload, which would make ESG reports rather confusing instead of clarifying, and hardly comparable, especially considered that, according to Recital 9 of Directive 2014/95/EU, each company may rely on different reporting frameworks. It is clear that reducing information to be disclosed in a limited number of common indicators, always applying the materiality principle, would be way more effective in measuring corporate ESG performance, and may also result in enhanced transparency, as well as lower time costs for both companies in disclosing their information and financial operators in collecting and analyzing them.

In the US, where corporate resistance to disclose information is stronger [59], the need to have more data disclosed turned into a growing shareholder pressure for corporate transparency that interested, especially, big oil companies [60,61]. ESG engagement by institutional investors is therefore becoming key to the transition to a sustainable economy, especially where there is a lack of regulatory provisions requiring disclosure. Interestingly, an empirical study conducted across 41 countries found a positive relationship between E&S performance, based on data obtained from the Thomson Reuters ASSET4 ESG database, and institutional ownership [62].

As for the second need to be addressed, data reliability, the role of auditing should be first addressed. Recital 16 of Directive 2014/95/EU requires that "statutory auditors and audit firms should only check that the non-financial statement or the separate report has been provided" and leaves to Member States the discretionary power to "require that the information included in the non-financial statement or in the separate report be verified by an independent assurance services provider". This means that there is no assurance requirement with regard to the content of information that is disclosed. Moreover, according to a 2017 report by CSR Europe and GRI, most EU Member States in 2017 did not even comply with requiring auditors' involvement in verification procedures. This varied approach to verification could undoubtedly lead to high levels of greenwashing practices in countries where assurance measures are not required.

A first solution could be regulatory, i.e., the amendment of the directive and/or its guidelines in order to require a minimum common verification system of disclosed information. Another-non-regulatory solution against greenwashing is the double-checking with external data sources of data. We are not talking only about data deriving from NGOs and business review websites but about the possibility of combining artificial intelligence and data from satellites (which are publicly available thanks to the European Union's Copernicus network and the US Landsat network) to track, in real time, air pollution coming out of cities and even single power plants [63].

The combination of the two trends, corporations disclosing in a more efficient way, and external auditors and data providers verifying disclosed information, will probably ensure more reliable rating and ranking systems but, at the same time, strengthen investors' trust in new ESG products.

7. Conduct of Business Rules

Built on the fiduciary doctrine [64], conduct of business regulation aims to protect investors from possible harm caused by the conduct of financial intermediaries during the operations performed on the behalf of investors. Although a first set of standards was introduced among Member States in 1993 with the issuance of the Investment Services Directive [65], a first complete set of rules was established in 2004 with MiFID I and its Implementing Directive (2006/39/EC), and then further developed under MiFID II and its implementing standards.

Current conduct of business rules (COB rules), by generally requiring financial intermediaries to 'act honestly, fairly, and professionally in accordance with the best interests of (their) clients' [33] (Article 24), now consist of strict provisions applying to all investment firms, credit institutions, and UCITS management firms when providing investment services or ancillary services. In particular, the best interest duty does not only act as a "gap filler" in the protection of investors' interest, where more specific conduct of business rules do not apply [66], but can be also seen as a key for the interpretation of other provisions [66], such as those related to suitability or appropriateness assessments [33] (Article 24(2)(3)), conflict of interest [33] (Article 23 and Recital 56), inducements [33] [Article 24(8)(9)], staff remuneration practices [33] [Article 24(10)], and best execution [33] [Article 27].

The main tool for the implementation of the best interest duty, in relation to investment advice and individual portfolio management, is the performance of a suitability assessment, which has been the subject of amendment proposals to include sustainability consideration in relation to investors' preferences.

7.1. Suitability Assessment

Under MiFID II, firms providing investment advice and portfolio management are required to obtain the necessary information to carry out suitability assessments, collecting information concerning the client's knowledge and experience in the investment field, his financial ability to bear losses, and his investment objectives (Art. 25(2)).

Nonetheless, the information about investment goals generally refer to financial objectives, such as information on the length of time for which the client wishes to hold the investment, his/her preferences regarding risk taking, risk profile, and the purposes of the investment, while non-financial objectives of the client, such as ESG preferences, are usually not taken into account [67] (p. 3). Existing suitability assessments generally do not include questions on clients' ESG preferences, and evidence shows that most clients do not raise ESG issues during the advisory process themselves. The reasons for such inactivity have been identified as three main factors: (i) the lack of transparency of information on ESG products, (ii) the high risk of 'greenwashing' in existing documentation, and (iii) the lack of education on the impact of ESG factors on risk and performance [4,67]. However, in line with HLEG's recommendation to "require investment advisers to ask about, and then respond to, retail investors' preferences about the sustainable impact of their investments, as a routine of financial advice" [17] (p. 28), the EU Commission now requires that such non-financial considerations should be taken into account by investment firms in accordance to their obligation to act in the best interests of the client.

In response to the EU Commission's request of advice, in its consultation paper [24], ESMA suggests some amendments to paragraph 28 and 70 of the guidelines on certain aspects of the MiFID II suitability requirements [68]. According to the amended paragraphs, a firm would be expected to (i) "take into account ESG preferences in the context of assessing client's investment objectives and (ii) to consider ESG factors in the context of product classification" [24] (p. 22). In particular, ESMA requires that the information collected on clients' ESG preferences "should be granular enough" and should "be consistent with the EU's classification system of ESG investment products, once developed". However, ESMA clarifies that ESG preferences should not "outweigh the relevance of the other suitability criteria in a way that might not result in the client's best interest" [24] (p. 23). As such, ESG preferences should be addressed only once the suitability has been assessed in accordance with the criteria of knowledge and experience, financial situation, and investment objectives. Moreover, ESMA clarifies that the requirement for integrating ESG considerations in the suitability assessment does not imply that sustainable investments should automatically be deemed unsuitable for clients that do not have ESG preferences, nor that investments that do not have ESG characteristics should automatically be deemed unsuitable for clients who have expressed ESG preferences.

However, respondents to the ESMA consultation paper raised many issues concerning the proposals. First, even though most commentators agreed on the inclusion of ESG preferences when gathering information on a client's investment objectives, some claimed that the level of maturity of the market is not compatible with ESMA's proposed amendments of paragraph 28. These require that the ESG preferences collected from the client should be "granular enough" and "consistent with the EU's classification system of ESG investment products" (see responses to the consultation paper on integrating sustainability risks and factors in MIFID II by AFG, Finanzplaner Forum, Nordic Securities Association, and the Portuguese Banking Association). In relation to the granularity requirement, it should be noted that the majority of clients are currently not even aware of their ESG preferences, so that such a high level of granularity cannot be ensured. On the contrary, the questions to be asked to clients should be the simplest and most understandable possible or, at least, more granular questions should be posed only in case of the client answering affirmatively to a general question on his interests in taking into account ESG considerations. In line with this reflection, requiring that questions should be based on the EU taxonomy could be far too complex for both advisors and clients to deal with. Some respondents even observed that the wording "EU's classification system of ESG investment product" should not coincide with the EU taxonomy but should be intended in a broader sense (see responses to the consultation paper on integrating sustainability risks and factors in MIFID II by Association for Financial Markets in Europe, BNP Paribas AM, Mirova, BlueBay Asset Management LLP SRI services, and INVESCO). In any case, rewording is required in order to facilitate the implementation of such a new requirement.

Second, most commentators agree that firms should collect clients' ESG preferences as a single indicator instead of three separate indicators, at least in a first stage of implementation (see responses to the consultation paper on integrating sustainability risks and factors in MIFID II by AFG, BVI, INVERCO, Nederlandse Vereniging van Banken, European Fund and Asset Management Association, European Association of Co-Operative Banks, Finance Watch, BIPAR, Association Française des Marchés Financiers (AMAFI), AFG, French Banking Federation, Banken Verband, German Banking Industry Committee, German Savings Banks Association German Association of Cooperative Banks, BVI, Association of German Public Banks, World Savings and Retail Banking Group + European Savings and Retail Banking Group, Spanish Banking Association, Asociación de Instituciones de Inversión Colectiva y Fondos de Pensiones, Dutch Fund and Asset Management Association, Nederlandse Vereniging van Banken, and HSBC), while a few adopted an opposite (see responses to the consultation paper on integrating sustainability risks and factors in MIFID II by European Financial Congress, WWF, and Portuguese Banking Association) or a mixed/flexible approach. The suggestion of a single-indicator requirement would undoubtedly align with the new definition of sustainable investments, where compliance with sound governance principles is now an essential requirement for all sustainable investments. Moreover, certain minimum standards concerning all environmental, social, and governance factors should be ensured for this kind of investment, although in practice, several funds usually emphasize companies' contribution to a specific social or environmental-related issue.

Finally, in order to facilitate the implementation of the new requirements, some respondents suggested that an additional standard ESG-specific questionnaire should be developed and could be annexed to the ESMA and EIOPA guidance, to be used as a default option by financial advisors and insurance intermediaries (see response to the consultation paper on integrating sustainability risks and factors in MIFID II by WWF). In its final report, ESMA has not addressed such comments and proposals yet, as it plans to deal with them at a later stage, but we expect it to take them into consideration in its final amendment proposal.

However, as already indicated, the usefulness of such proposals could be that it only ensures whether proper product governance policy, approval, and review processes are established (see Section 7.3) and investors are adequately financially educated (see Section 8). Some risks could also arise in relation to the potential conflicts of interest that might occur and mislead financial advisors' conduct (see Section 7.2).

7.2. Conflict of Interests

Even if not included in the section related to conduct of business rules, we consider conflicts of interest strictly connected to the need to ensure that investment firms act in the best interest of their clients.

In general, conflicts of interests might arise when an agent is entrusted to act in the interest of another person but, at the same time, has an "another interest (that) interferes with his ability to decide according to his duty", where 'interest' means "any influence, concern, emotion, loyalty, or other factor that has a direct impact on the decision of that person" [69]. The diffusion of such a phenomenon was stimulated by many factors, such as the increasing labor division and specialization, and the globalization of services [69].

Due to the growing complexity of financial markets and, therefore, investors' constant need for assistance by financial intermediaries, the risk of potential conflicts of interest is particularly high in the financial sector [70]. Additional risks might arise from financial innovation, fragmentation, and competition among financial advisers [71]. For such reasons, and in line with the investment firm's general duty to act in accordance to the best interest of the client, regulation of conflicts of interests in the financial sector developed to safeguard fairness, pursue efficiency, and cope with investors' cognitive limitations [72].

Based on the necessity of preventing potential conflicts of interests deriving from the performance of simultaneous financial activities, which would "adversely affect the interests of [...] clients, MiFID II (Recital 56) adopted specific organizational and disclosure rules. In relation to organizational requirements, which can be considered a first line of defense against possible damages deriving from conflicts of interests, MiFID II requires investment firms to "take all appropriate steps to identify and to prevent or manage conflicts of interest between themselves, including their managers, employees, and tied agents, or any person directly or indirectly linked to them by control and their clients or between one client and another that arise in the course of providing any investment and ancillary services, or combinations thereof, including those caused by the receipt of inducements from third parties or by the investment firm's own remuneration and other incentive structures" (Article 23(1)). The MiFID II-delegated regulation [73] specifies that investment firms should identify all situations from which conflicts of interest may arise while providing investment and ancillary services that comprise situations of (i) likely financial gain or avoidance of loss at the expense of the client (Article 33(a)), (ii) a firm's interest in an outcome distinct from the client's interest in that outcome (Article 33(b)), (iii) incentives to favor other clients' interests over the interests of the client (Article 33(c)), (iv) existing competition between firm's and clients' businesses, and (v) inducements in relation to a service provided to the client (Article 33(d)).

As to the second tool, disclosure, the performance of special disclosure duties is required in relation to conflicts of interests that nonetheless might arise when organizational arrangements reveal insufficiency, and to mitigating measures to be undertaken by the investment firm to prevent damage to the client (MIFID II, Article 23(2)(3)).

In the EU Commission's request for advice for the integration of sustainability risks and factors, it explicitly required of ESMA and EIOPA a technical recommendation on the "measures and policies specifically considering types of conflict of interest that might arise in relation to sustainability considerations".

As a consequence, ESMA proposed the addition of a new recital 59bis, concerning conflict of interests, to the MiFID-delegated regulation, which requires that "when identifying the types of conflicts of interest whose existence may damage the interests of a client, investment firms should include those that may stem from the distribution of environmentally sustainable investments, social investments or good governance investments" and that "firms should have in place appropriate arrangements to ensure that the inclusion of ESG considerations in the advisory process and portfolio management does not lead to mis-selling practices".

However, the proposed new recital was one of the most criticized recommended amendments by respondents to the ESMA's public consultation.

To many, the recital is unnecessary. In particular, most respondents claim that conflicts of interest are already regulated in a broad sense under MiFID II, and therefore ESG factors would be implicitly included too (see responses to the consultation paper on integrating sustainability risks and factors in MIFID II by the Association for Financial Markets in Europe, European Banking Federation, European Financial Congress, Bipar, AMAFI, AFG, Af2i Société Générale, Deutscher Derivate Verband, Banken Verband, German Banking Industry Committee, Finanzplaner Forum, German Savings Banks Association German Association of Cooperative Banks, Association of German Public Banks, World Savings and Retail Banking Group, European Savings and Retail Banking Group, ABI, ASSOSIM, Spanish Banking Association, INVERCO, Dutch Fund and Asset Management Association, Nederlandse Vereniging van Banken, The Investment Association, HSBC, and Schroders). Moreover, some argued that the prevention of mis-selling practices should be addressed in other ways, such as in relation to advisory and product governance process (see responses to the consultation paper on integrating sustainability risks and factors in MIFID II by the European Fund and Asset Management Association and BVI).

Others commented that the notion of what could be a conflict of interest that might arise in relation to sustainability considerations is not sufficiently defined, and more clarifications are needed (see responses to the consultation paper on integrating sustainability risks and factors in MIFID II by Mirova, Société Générale, CFA Institute, ABI, and Bank Gospodarstwa Krajowego). In particular, SMSG suggested that ESMA should explicitly add the examples provided in paragraph 13 of the consultation paper in the recital. Consequently, ESMA included the examples of mis-selling practiced in the new recital 59(bis) of the MiFID II delegate (" ... as an excuse to sell own-products or more costly ones, or to generate churning of clients' portfolios, or to misrepresent products or strategies as fulfilling ESG preferences where they do not.") [24] (p. 14)

Other commentators viewed the recital as confusing since ESG conflicts of interest are being linked to the performance of investments, whereas the articles in the delegated text refer to conflicts of interest between parties (investment firm and/or clients) (see responses to the consultation paper on integrating sustainability risks and factors in MIFID II by the European Association of Co-operative Banks).

In relation to UCITS and AIFMS level 2 legislation, ESMA proposed the addition of new recitals (17 bis of the Commission Directive 2010/43/EU and 48(bis) of the Commission Delegated Regulation (EU) 231/2013) requiring that, when identifying the types of conflicts of interest, authorized entities should include those that stem from the integration of sustainability risks and factors [74] (p. 17). While some respondents to the public consultation supported the proposed recitals, many others were opposed, as they stated that they could not see potential conflict of interest that are specifically linked to sustainability risks [25] (p. 19). Maintaining the approach adopted in the consultation paper, ESMA confirmed the addition of the recital in its final advice, but, as it was required by several respondents, it added some examples of conflicts of interests that could rise in relation to sustainability risks and factors. In particular, conflicts of interest could arise from "remuneration or personal transactions of relevant staff as well as any source of conflicts that could give rise to greenwashing, mis-selling, misrepresentation of investment strategies, or churning" or between "funds with different investment strategies managed by the same UCITS management company" or in situations "where there are other business relationships with investee companies, conflicting group interests, investments in entities with close links, or similar circumstances" [25] (p. 22).

As highlighted by many respondents, the existing provisions on conflicts of interest are already intended to encompass all situations with the broadest approach possible. However, we agree with the convenience of providing further guidance on the specific situations of conflicts of interests that might arise in relation to ESG products. At this stage, further clarity is necessary for operators in order not to incur unintentional misconduct.

7.3. Product Governance and Intervention

If, originally, the EU policymaker, for the sake of market innovation, avoided any imposition of quality requirements for financial products, the necessity of protecting clients from possible harmful financial products became urgent following the financial turmoil that started in 2007. Some first quality requirements were provided under the UCITS Directive [36], which regulated the conditions under which an investment fund could be allowed to use the label 'UCITS', followed by the Alternative Investment Fund Managers Directive (AIFMD) [37], which intervened on (non-UCITS) funds' managers. Following the ESMA final report [75], the EU legislator established a set of specific product governance and intervention rules under MiFID II and IDD.

The product governance rules under MiFID II apply to investment firms and banks but also to managers of UCITS and AIFs, as long as they provide investment services. However, a distinction is made between firms that manufacture the product (a 'manufacturer' is "a firm that manufactures an investment product, including the creation, development, issuance, or design of that product, including when advising corporate issuers on the launch of a new product") [76] (32) and firms that distribute the product (a 'distributor' is "a firm that offers, recommends, or sells an investment product and service to a client") [76] (32), in respect to which the EU legislator provides specific product governance obligations. These pertain to three main sets of provisions related to corporate governance [33] (Articles 9(3)(b), 9(6), and 10(8)), investor protection, and organizational requirements [77] (175).

As to investor protection, manufacturers must ensure, by performing a product approval process, that (i) financial products are designed to meet the needs of an identified target market of end clients within the relevant category of clients, (ii) the strategy for the distribution of the financial instruments is compatible with the identified target market, (iii) and take reasonable steps to ensure that the financial instrument is distributed to the identified target market [33] (Article 24(2) §1 and Article 16(3)).

On their side, distributors must (i) understand the financial instruments they offer or recommend; (ii) assess that the financial instruments they are offering are compatible with the needs of the clients, also taking into account the identified target market of the end client; and (iii) ensure that financial instruments are offered or recommended only when this is in the interest of the client. [33] (Article 24(2) §2). ESMA published guidelines to better address both manufacturers and distributors especially in relation to the identification and assessment of the target market. [76]

Moreover, a review process shall be regularly performed in order to assess whether the financial instrument remains consistent with the needs of the identified target market and whether the intended distribution strategy remains appropriate [33] (Article 16(3)). In such a way, the quality assessment of the financial product covers its entire life cycle, starting at the design phase and ending with the review phase. Moreover, in order to address an investor's protection concern or preserve the integrity of the financial system, ESAs may temporarily prohibit the marketing, distribution, and sale of certain products to retail investors or a type of financial activity or practice [35] (Articles 40–41).

The integration of ESG factors in product governance requirements represents the second need addressed by ESMA in its consultation paper for the amendment of the Commission Delegated Directive 2017/593 (MiFID II-delegated regulation) [23]. In particular, ESMA's proposals concern paragraphs 9, 11, and 14 of Article 9 of the MiFID II-delegated regulation concerning requirements for the manufacturer, and paragraphs 2 and 6 of Article 10 of the same the regulation concerning the requirements for distributors, as well as paragraph 18 of the ESMA guidelines on MIFID II product governance requirements in relation to target market assessment. As the amendments follow a principle-based approach, ESMA proposed the inclusion of a simple reference to "ESG preferences" in the relevant articles. However, such proposals gave rise to some criticism among respondents to the ESMA consultation paper.

First of all, many commentators argued, as they did in relation to proposals for amending provisions on suitability requirement rules, that the required high level of granularity for ESG products, implying the necessity to specify if a product fulfils an E, S, or G preference [23] (p. 14), could be extremely complex and does not reflect the majority of sustainable funds (see responses to the consultation paper on integrating sustainability risks and factors in MIFID II by European Fund and Asset Management Association, AFG, French Banking Federation, Société Générale, Deutsche Kreditbank AG, Asociación de Instituciones de Inversión Colectiva y Fondos de Pensiones, and Invesco). In line with this comment, most respondents suggested treating ESG factors as a single indicator, given the fragmented legal framework and the absence of market standards (see responses to the consultation paper on integrating sustainability risks and factors in MIFID II by European Fund and Asset Management Association, European Association of Co-Operative Banks, Finance Watch, Bipar, AMAFI, AFG, French Banking Federation, Banken Verband, German Banking Industry Committee, German Savings Banks Association German Association of Cooperative Banks, BVI, Association of German Public Banks, World Savings and Retail Banking Group + European Savings and Retail Banking Group, ASSOSIM, Spanish Banking Association, Asociación de Instituciones de Inversión Colectiva y Fondos de Pensiones, Dutch Fund and Asset Management Association, Schroders, and Invesco), while a few recommended a more granular (see responses to the consultation paper on integrating sustainability risks and factors in MIFID II by European Financial Congress, SD-M® GmbH, Bank Gospodarstwa Krajowego, Portuguese Banking Association, SRI services, and WWF) or flexible approach (see responses to the consultation paper on integrating sustainability risks and factors in MIFID II by Better Finance, BNP Paribas AM, Af2i, Mirova, Société Générale, HSBC, The Investment Association, and BlueBay Asset Management LLP).

Second, some of the paragraphs were viewed as being not totally compliant with the principle-based approach due to their lack of flexibility (see response to the consultation paper on integrating sustainability risks and factors in MIFID II by AMAFI). Nevertheless, ESMA confirmed the approach chosen in its draft technical advice, committing to the provision of further guidance when finalizing the update of the ESMA guidelines on product governance.

A third issue was raised in relation to the mandatory inclusion of ESG factors as a target market criterion in the target market assessment. Many recommended delaying such an inclusion, as the taxonomy is still to be finalized (see response to the consultation paper on integrating sustainability risks and factors in MIFID II by European Association of Co-Operative Banks). Indeed, in the absence of a definitive taxonomy, the reference to ESG considerations could also lead to a wide range of very different products (see response to the consultation paper on integrating sustainability risks and factors in MIFID II by Better Finance). The lack of a final taxonomy is also leading many manufacturers to refrain from declaring their product to be sustainable due to potential liability risks. For this reason, some commentators suggested that ESMA should assist them by requiring in the guidelines or in the final report that the determination of the target market criterion of sustainability can occur, for example, through certification by independent certification bodies (see responses to the consultation paper on integrating sustainability risks and factors in MIFID II by German Savings Banks Association German Association of Cooperative Banks, World Savings and Retail Banking Group + European Savings, and the Retail Banking Group).

An interesting issue raised by respondents concerns the fact that the ESG criteria cannot be properly identified by manufacturers and distributors but rather by the respective issuers that own the required information and data (see response to the consultation paper on integrating sustainability risks and factors in MIFID II by Banken Verband). According to others, only the manufacturer has the necessary knowledge of the product to undertake the classification (see responses to the consultation paper on integrating sustainability risks and factors in MIFID II by German Savings Banks Association German Association of Cooperative Banks). The main problem is that, as many manufacturers are not captured by MiFID II and the delegated directive, as they do not qualify as investment firms, the assessment of the target market criteria with respect to the ESG factors and characteristics of the underlying company/issuer becomes the sole responsibility of the distributors. The regulatory frameworks for UCITS/AIFs/prospectus should therefore be aligned with the product governance obligations for manufacturers, in order to avoid distributors being legally required to provide information regarding ESG factors, even though some producers of investment products may not be legally required to provide the same information (see responses to the consultation paper on integrating sustainability risks and factors in MIFID II by European Association of Co-Operative Banks and ABI). In response to such criticism, ESMA clarified that distributors are expected to conduct their own target market assessment according to Article 10/2 of the MiFID II-delegated directive, and not to recommend or market products for which they are unable to at least check, through own data, the plausibility of certain product features, as clients are even less informed than distributors.

Even if not addressed by ESMA in its final report, it should be highlighted that some respondents suggested that instead of using the distinction between 'ESG-positive products' and 'non-ESG products', ESMA should rather distinguish among: (a) 'ESG-orientated' products (where ethical/sustainability/responsible considerations are proactively/explicitly/formally part of the investment objective and strategy, and such factors act as the primary driver for inclusion of an issuer in the strategy), (ii) 'ESG-integrated' products (where ESG factors are proactively/explicitly/formally part of the investment process, but the focus is on those that are considered investment material), and (iii) strategies where there is no proactive/explicit/formal consideration of ESG factors within the investment process (see responses to the consultation paper on integrating sustainability risks and factors in MIFID II by BlueBay Asset Management LLP, Dutch Fund, and Asset Management Association).

In relation to the amendments to the ESMA guidelines on product governance, it should be noted that some commentators raised many objections towards the proposed case study, which states:

"An open-end fund with variable capital, investing in renewable energy, organic farming, sustainable real estate, nature and landscape projects and environmental technology. The fund aims to provide explicit positive impact on the environment, measured in carbon- footprint, as well as a positive cash flow to its investors, created by the projects funded. The fund invests mainly in loans, secured by mortgages, (state) guarantees, or alternative collateral. The risk indicator of this fund is 2 on a scale of 7 (low risk, low return). More than 70% of the fund is invested in projects certified as "green projects". The fund is priced daily. Investors can buy or sell shares in the fund every trading-day. A key investor information document (KIID) is issued in accordance with the UCITS directive, the KID Regulation for PRIIPs and national law" [23] (p. 18, 19).

According to respondents, the case study is: (i) Unrealistic, as it predominantly relates to illiquid assets and would not, in practice, have the low risk indicator suggested in the consultation (see responses to the consultation paper on integrating sustainability risks and factors in MIFID II by the European Fund and Asset Management Association, AFG, DVI, and Dutch Fund and Asset Management Association); (ii) too granular (see responses to the consultation paper on integrating sustainability risks and factors in MIFID II by Société Générale, German Savings Banks Association, German Association of Cooperative Banks, Association of German Public Banks, World Savings and Retail Banking Group + European Savings, and Retail Banking Group); (iii) not a representative market example (see responses to the consultation paper on integrating sustainability risks and factors in MIFID II by European Banking Federation, Nederlandse Vereniging van Banken, and Invesco); and (iv) oversimplifying ESG products (see response to the consultation paper on integrating sustainability risks and factors in MIFID II by Schroders). Moreover, according to other respondents, "it is necessary to clarify what is allowed when a client who expresses an ESG objective, but there is no such ESG product available" (see response to the consultation paper on integrating sustainability risks and factors in MIFID II by European Banking Federation). In particular, when the client, who has certain ESG preferences, should still be able to trade in a product that does not have ESG characteristics but matches another client's preferences. A two-step approach should be followed: (1) The firm should send a clear statement to the client that the product meets all the clients' characteristics except the ESG preferences; and (2) the client responds to the firm of whether he wishes to trade in the product (see responses to the consultation paper on integrating sustainability risks and factors in MIFID II by Securities and Markets Stakeholder Group, European Banking Federation, and Société Générale).

It is clear that proposals related to product governance are far from being satisfactory, especially in relation to the level of granularity of ESG products required, which does not reflect the current market development stage, and which should be associated to a still undefined classification system. A lack of reliable data makes such proposals even more unrealistic. A 'lighter' and more general approach should be preferable at this stage, which could then evolve into a stricter and more detailed one in a second stage of the reforming process.

8. Financial Education

Proper disclosure of information concerning financial products and conflicts of interests and the correct performance of suitability assessments cannot succeed in protecting investors' interest without effectively educating them, and overcoming their cognitive biases.

In the view of EU authorities, a lack of financial literacy 'may have contributed to worsening the impact of the financial crisis in Europe in the autumn of 2008' [78]. As one of the 'post-crisis top priorities', many initiatives were then undertaken, both at the international and domestic level. From an international point of view, financial literacy was addressed by the Organization for Economic Co-operation and Development (OECD) and developed, in particular, by its International Network on Financial Education (INFE). A OECD survey published in 2016 covering 30 countries showed that just 56% of adults across participating countries and economies achieved the minimum target score in understanding very basic financial principles [79]. Gender differences also matter, as 61% of men achieved the minimum target score compared with only 51% of women across participating countries.

Risks for consumer protection are also augmented by digitalization, which makes access to financial markets easier but, at the same time, facilitates the aggressive marketing of highly speculative products to retailed investors who, however, remain for the most part financially illiterate [80].

At the European level, ESAs (ESMA, EBA, and EIOPA) were all mandated with the task of "reviewing and coordinating financial literacy and education initiatives by the competent authorities" [81–83]. In 2011, EIOPA published a Report on Financial Literacy and Education Initiatives by Competent Authorities, which showed that most EIOPA members did not have a national strategy on financial education, but many domestic programs and initiatives have been undertaken in the form of cooperation between supervisors and the various entities involved in consumer protection, as well as cooperation between supervisors and schools, universities, and academic bodies [84]. In 2017, the European Banking Authority (EBA) established a repository that collects financial education initiatives promoted by national authorities [85]. To date, the repository consists of 84 initiatives, most of which are established in Ireland, Portugal, and Sweden and consist of online resources. However, in line with the strive to reach harmonization at a cross-sectoral level among financial services, the objective for the future is to publish reports via the Joint Committee of the European Supervisory Authorities (i.e., ESMA, EBA, and EIOPA) [84].

An adequate level of financial education is not only key to the prevention of another financial crisis and of financial abuse in general, but it is also an essential factor for the success of the UN Agenda 2030 and the EU strategy for sustainable finance.

At the global level, according to the Center for Financial Education and Capability, financial education can play a role in meeting six sustainable development goals, such as ending poverty (SDG 1), ensuring healthy lives (SDG 3), achieving a quality education (SDG 4), enhancing gender equality (SDG 5), building resilient infrastructures and fostering innovation (SDG 9), and fighting against climate change (SDG 13) by means of socially responsible investments [86].

As for the European Union, the HLEG deals with financial literacy and education in its cross-cutting recommendation addressing the empowerment "of citizens to engage and connect with sustainable finance issues". In particular, according the HLEG, financial education is key to ensuring that citizens are aware of the business activities they are funding and about the impact of these activities on the environment and society [17,45,52]. In order to ensure such an awareness, the HLEG recommend the EU Commission to: (a) promote greater financial literacy on sustainable finance by supporting Member States in the development of strategies for financial education with a strong sustainable finance component, but also by including financial education in school programs and increasing social awareness; (b) promote free and easily accessible information on sustainable finance by supporting the creation of free corporate sustainability benchmarking but also market research on the matter (e.g., that developed by Eurosif); and (c) facilitate citizen engagement on sustainable finance issues by, for example, producing recommendations on emerging financial technologies that might facilitate such engagement.

Although financial education is one of the key factors predicting the success of sustainable financial reforms and shaping investors' informed choices, many limitations could still occur, especially in consideration of cognitive limitations [87] and the behavioral inconsistency of human beings, which could ultimately arise as a discrepancy between what people say and what people do. Surveys show that a large part of the population, in particular women and the so-called 'millennials', display a growing attention to addressing money in a responsible manner [88–91]. However, some studies also revealed that people do not always mean what they say, which could depend on many factors, such as the way questions are formulated, self-judgement, social desirability, and other cognitive factors that may lead respondents to report false information [91]. As an example, even if a large number of surveys have shown that a large number of consumers do care about the ethical aspect of the products they buy [92], empirical studies show that actually a few consumers behave accordingly and are willing to pay more for ethical products [93–95]. Therefore, educating people on sustainability and sustainable investing may not be enough to make them willing to invest in ESG products. In other words, surveys could be used to investigate individual attitudes towards corporate responsibility, but they can reveal that they are inadequate in understanding or predicting actual behavior. Moreover, studies found that investors' over-confidence and myopic loss aversion, the tendency to over-weight attention from information that is consistent with their existing beliefs and over-estimate the precision of their own private information, could also affect investors' behavior [96].

Therefore, the disclosure of information and traditional sustainable finance education could be ineffective in leading investors to make responsible investing decisions, and new tools and mechanisms based on behavioral economic studies, such as the well-known 'nudges' ("low-cost, choice preserving, behaviorally informed approaches to regulatory problems, including disclosure requirements, default rules, and simplification") [92], should be implied in order to change investors' choice architecture.

9. Conclusions

The current enactment of the action plan is a sign of the EU's efforts to support the transition to a sustainable economic system, so complementing other existing EU environmental and climate policies, in a clear commitment to the common goals set by the 2016 Paris Agreement on climate change and the UN 2030 Agenda for Sustainable Development.

Investor protection regulation represents one of the first segments on which the EU authorities intervened, as the duty to act in investors' best interest necessary implies that ESG preferences are also duly taken into account. The new regulatory proposals, as well as the recommended changes to existing regulation (MiFID II, AIFMD, UCITS, etc.) clearly aim at providing more clarity on financial operators' duties in terms of ESG consideration but also at improving the quality of offered investment services and products by better aligning them with investors' preferences [23] (p. 30). Moreover, such measures are expected to, on the one hand, reward more sustainable and innovative businesses, and, on the other, lead other companies to adopt more responsible production and decision-making processes, as well as to properly disclose the impact of their activities.

This paper gave an overview of the EU efforts to ensure the convergence of national approaches to the integration of sustainability factors in investment decision and advisory processes, especially in relation to the disclosure of product information, COB rules—with a special focus on suitability assessment—, product governance and intervention, and financial education. Although the reforming process is still under development, we considered that a first analysis of existing challenges and criticism to such proposals could be useful for both regulators and market operators to evaluate proper solutions to future potential barriers to an effective implementation.

A first main challenge is the lack of a common methodology, standards for classification, or labelling of the relevant financial products, which could impact on the demand for sustainable investments. Indeed, the delay in the definition of the taxonomy, which was intended as the first key action of the action plan, risks causing a delay or at least putting into danger the successful implementation of the entire financial reform.

The proper disclosure of reliable ESG data and data assessment, verification, and comparison is another problematic issue risking the lower the level of trust in sustainable finance by investors, negatively impacting on product governance obligations, and raising market confusion. A strengthening of the reporting verification system should be enhanced by the EU legislator in order to avoid greenwashing. Comparability could be improved by requiring a limited number of common indicators to be disclosed, thus avoiding data manipulation and information overload. Other non-regulatory measures, such as cross-referencing with external data sources, could enhance data reliability.

Another regulatory challenge consists in ensuring a balanced level of flexibility and providing a gradual approach to ESG integration, avoiding the requirement that financial operators adapt to a high level of granularity any ESG products when the market for financial products is not mature enough, especially in relation to suitability assessments, as most investors are not even aware of their ESG preferences, and product governance.

High levels of financial education and culture are also vital for the success of the reforming processes. In this regard, as explained above, aiming for better disclosure of financial information, the performance of surveys and other financial education initiatives could be insufficient if not complemented with other behaviorally informed approaches that are able to change investors' choice architecture, thus avoiding a misalliance between investors' declared preferences and actual behavior.

In conclusion, will the EU Commission successfully Integrate sustainability risks and factors in the investor protection regime? As already stated, the reforming process is still under development and further research on the outcomes of each of the analyzed factors is going to be needed once finalized. The aim of the paper was to highlight which are the main issues at stake in relation to investor protection and will need special analysis, as well as which factors could hamper the effective implementation of the reform, both cultural and legal. From a legal perspective, it should also noted that the nature of most of the proposed changes is merely additive with respect to the current regulatory framework. The main question, which should be addressed and answered once the first set of rules is finalized, is whether such integrations will be sufficient to ensure the successful restructuring of the EU financial system towards a sustainable and responsible economy, or if significant and substantial changes will be required, which would translate to the establishment of special rules in relation to fiduciaries duties and a re-focusing of the relevant liability regime of the directors of companies. In other words, the recent EU reform proposals, though admirable, risk oversimplifying a complex issue that cannot be easily solved without considering their practical implications on each category of financial operators in the performance of different financial services.

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