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EDITORIAL

Law and Regulation for Sustainable Finance

Iris H-Y Chiu[1,2] · Lin Lin[3] · David Rouch[4,5]

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There is a marked global trend of investment assets moving into 'ESG' (environmental, social and governance) or 'sustainable' investing strategies. It is reported in the US,[1] at the end of 2020, that 33% of assets under management were allocated to ESG strategies, in other words, approaches that in some way seek to take specific account of environmental, social or governance factors, instead of being agnostic towards them. Indeed, ESG funds have apparently continued to attract significant inflows, even as investment sentiments suffered during the COVID-19 pandemic and many conventional investment funds experienced outflows.[2]

Yet, for all this, sustainable finance and investing suffers from an identity crisis. Is it finance that will be profitable in the long term and hence be itself sustainable? Is it finance that is justifiable to society? Is it finance that can help solve sustainability challenges and, if so, which ones, and to what extent can or should it seek to do that? Further, is sustainable investing the same as responsible investing, ESG investing or ethical investing? We have not yet defined 'responsible investing' in relation to responsibility to whom and for what. Does sustainable investing take account of all or just some ESG factors and in what ways and for what reasons? Ethical investing is also unclear in terms of which ethical basis, and are there forms of investing that are therefore 'neutral' or 'unethical'?

[1] '"Sustainable investing" is surging, accounting for 33% of total U.S. assets under management', CNBC News, 21 Dec 2020. https://www.cnbc.com/2020/12/21/sustainable-investing-accounts-for-33percent-of-total-us-assets-under-management.html (accessed 29 October 2021).

[2] 'ESG funds defy havoc to ratchet huge inflows', Financial Times, 6 February 2021. https://www.ft.com/content/8e9f8204-83bf-4217-bc9e-d89396279c5b (accessed 29 October 2021).

✉ Iris H-Y Chiu
hse-yu.chiu@ucl.ac.uk

1 Professor of Corporate Law and Financial Regulation, University College London, London, UK

2 Visiting Professor (February to April 2021), Centre for Banking and Financial Law, National University of Singapore, Singapore, Singapore

3 Associate Professor of Law, Faculty of Law, National University of Singapore, Singapore, Singapore

4 Partner, Freshfields Bruckhaus Deringer LLP, London, UK

5 Keynote speaker at the Sustainable Finance and Capital Markets Conference, Centre for Banking and Financial Law, National University of Singapore, Singapore, Singapore

The issue is essentially one of purpose of investment. Is sustainable finance about making money by realising opportunities presented by sustainability challenges and preserving financial value by addressing the risks? Or is it about tackling sustainability challenges as goals in themselves? Is it about financial value or pursuing wider outcomes that align with core social values?[3] In reality, a good deal of sustainable finance appears to be about both, but aspirations to solve sustainability problems are often hiding in the shadows, uncertain whether they are allowed to show their face.

At one level, investors' and financiers' interest in the ESG performance of their investments clearly results from an increased recognition of the financial risk of ESG failures, sharpened considerably in some cases by policy initiatives such as those surrounding the Taskforce on Climate-related Financial Disclosure. We could think of this as 'instrumental sustainable finance', pursued with the goal of preserving or enhancing financial value. Drivers of financial risk include obsolete business strategies, stranded assets,[4] and reputational risk from ESG failures that could galvanise negative stakeholder and social opinion. Although not incontrovertibly resolved,[5] there is increasingly less question regarding the alignment between investment performance and positive ESG attainment in business and economic activities.[6] Yet growing attention to sustainability in investment processes is arguably also due to the concurrent concern regarding the non-financial impact of private investment activity, which can engage wider social aspirations. We could think of sustainable finance motivated by 'core valued goals', although, in practice, human motivation cannot be easily compartmentalised so that altruistic motivations may often be indistinguishable from instrumental sustainable finance.

Against this backdrop there is a range of new legal and regulatory initiatives to support and reinforce a trend policy-makers view as healthy. In particular, EU reforms, including the Sustainability Disclosure and Taxonomy Regulations, offer the possibility of regulatory competition towards more rigorous regulatory underpinning for sustainable finance. They move towards a universal baseline for sustainability risk integration by all regulated firms, and establish standards for the design and labelling of environmentally sustainable investment products. These are only the beginning of the EU sustainable reform agenda. More work is envisaged, for example, on the regulation of financial intermediaries and a social taxonomy for socially labelled investment products.[7] The EU reforms seek to move sustainable finance beyond current ESG investing practice, which is sometimes criticised as being opaque and not susceptible to meaningful comparison or evaluation.[8] In particular,

[3] Carney (2021)

[4] Buhr (2017); Fang et al. (2019).

[5] Ielasi et al. (2018); Boulatoff and Boyer (2017); de Haan et al. (2012).

[6] Schröder (2014); Dorfleitner et al. (2018).

[7] European Commission, Communication from the Commission to the European Parliament, the Council, the European Economic and Social Committee and the Committee of the Regions, EU Taxonomy, Corporate Sustainability Reporting, Sustainability Preferences and Fiduciary Duties: Directing finance towards the European Green Deal (21 April 2021). https://eur-lex.europa.eu/legal-content/EN/TXT/?uri=CELEX:52021DC0188 (accessed 30 April 2021).

[8] Arribas et al. (2019).

the sustainable label may help move the market for ESG investment products from strategies of exclusion[9] towards more innovative strategies that evaluate the influence of investment activity on sustainability factors. These EU reforms are likely to provoke policy thinking and development in many other jurisdictions, as the markets for ESG, green and sustainable investment products continue to grow globally and investors seek a more meaningful understanding and governance of products such as green bonds, sustainable investment funds and development finance.

However, hitherto, much policy activity has operated within an instrumental sustainable finance framework, even if such framework references the contribution of finance to wider sustainability goals. We are now at a juncture of legal and regulatory developments where policy choices need to address how finance should connect with the wider public interest and social good in sustainability outcomes—what is the role of 'core valued goals' in sustainable finance? Since the goals, and assumed goals, of an activity have a profound impact on decisions on how to regulate sustainable finance and the resulting behaviour on the part of investors, this moment of re-evaluation is extremely important.

In this light, the editors of this Special Volume curated the Centre for Banking and Financial Law Conference on Sustainable Finance, National University of Singapore, on 16 April 2021. We are thankful to the Centre for its sponsorship and support of the Conference. As a result, we have assembled a collection of articles offering a broad perspective on the connection between finance and the public and social good of sustainability outcomes, as well as discussions on the recent legal and regulatory developments in key sustainable finance markets, i.e., the EU and the Asia-Pacific, particularly China.

In his keynote speech at the Conference, David Rouch of Freshfields, also leading the firm's project for the UNEP FI on investing for sustainability impact, focused on the need for policy-makers interested in achieving sustainability goals to draw both on financial incentives and on wider social aspirations in seeking to move finance further towards supporting sustainable outcomes. Since many sustainability challenges are systemic, the two may often coincide: financial markets depend on sustainable economies, which in turn depend on sustainable social and environmental systems. Critically, this systemic dimension also means that responses ultimately need to galvanise whole systems. Solutions do not lie in the hands of markets or policy-makers alone. Both need to be engaged, but there is also a need to stimulate wider social coordination to maximise policy impact.[10] In finance specifically, wider sustainability aspirations based on core social values need to be recognised and affirmed, and existing competition paradigms need to be supplemented with a cooperation paradigm, since common goods require some degree of common action. These themes of purpose and motivation are strong in the articles in this collection, as is the balance between private action and public intervention.

[9] Which remain a dominant strategy, surveyed by EFAMA at end 2020. https://www.efama.org/Pages/Submitted%20after%202018-03-12T16%2022%2007/EFAMA-publishes-report-on-level-and-nature-of-sustainable-investment-by-the-European-asset-management-industry.aspx (accessed 29 October 2021).

[10] Rouch (2020).

The first article in this collection is MacNeil and Esser's contribution entitled 'From a Financial to an Entity Model of ESG'. It provides the broad background-setting and ideological thinking for sustainable finance, charting the development of sustainable finance from the era of 'corporate social responsibility' to 'ESG' investing, which focuses on the impact of material environmental, social and governance factors on portfolio risk. The article persuades us to view the increasing legitimacy of ESG integration into conventional portfolio risk management as being wedded to the dominant ideology and practice of shareholder primacy and financial primacy in investment management. This is in no small part attributed to academics', policy-makers' and industry's aligned efforts in framing the fiduciary duty for investment management in its modernised version as integrating material ESG. The article rightly challenges that the development of the financial sector's internalisation of material ESG may ironically result in a marginalisation in corporate activities of what the public or stakeholders conceive of as wider public or social good. It advocates that reform work inevitably must connect with regulating corporate decision-making and operations, and not merely reporting.

Policy intervention in primary corporate and wider economic activity is undoubtedly needed. Particularly in view of the systemic nature of the challenges, it is not realistic to expect financial markets to deliver solutions on their own. Yet, the fact that the challenges are systemic also means that financial markets have a role, and here some key questions are: whether finance needs to go beyond integration of sustainability factors from a financial risk perspective to orientating towards tackling the sources of risk themselves; whether financial incentives alone are a sufficient motivation or whether it is possible to draw on aspirations related to broader socially valued goals; and the extent to which policy action should involve direct regulatory intervention and how far it should rely on market initiatives.

There has clearly been an acceleration in the use of financial market-based policy initiatives to tackle sustainability challenges, especially concerning investors' influence upon portfolio companies' economic activities. There is certainly a logic to this micro-level, frequently financial incentive-based approach. Equally, there is always the risk that it could leave finance activity too narrowly focused on short-term financial considerations and fail to generate real behaviour change. To what extent can policy-making that depends on leveraging financial incentives steer markets towards sustainable outcomes the ultimate value of which is not purely financial? Can market-based interventions also draw on common aspirations for those sustainability outcomes to be achieved? Clearly, the policy rhetoric underlying the soft law of stewardship has begun to set normative expectations in terms of the roles of asset managers to achieve financial provision and wider social good in the long term. Further, private wealth and family offices often marry sustainable and development causes with financial interests in their investment mandates.

In this context, a number of articles in our collection examine the role of regulatory policy and design in steering and incentivising financial activity to achieve an integrated good that meets private financial interests while achieving long-term sustainability goods. The recent EU sustainable finance reforms are a highlight of this volume, and we also compare these with policy activity in China, concerning the market for green bonds.

In relation to the EU, Zetzsche and Anker-Sørensen provide a comprehensive overview of the policy rationales and the legislative matrix of recent reforms. The EU's programme is ambitious, comprising many amendments to existing investment firm and fund regulation, as well as new legislative initiatives. The article cautions policy-makers to observe and take stock of the implementation of the reforms for at least 5 years, in order to piece together crucial data relating to sustainability objectives and their effects upon corporate profit and investment performance. The paper warns that regulators will be regulating in the dark if more substantive initiatives are added before data gaps are addressed. Experimental forms of regulation may be more appropriate for EU policy-makers to observe the results of their pioneering initiatives.

Chiu's article also addresses the EU's reforms but argues that there is perhaps one further area for more regulatory development, despite the already ambitious programme. The EU's reforms are distinguished by the quest for 'double materiality' in investment fund management, i.e., the achievement of sustainable goods, for the purposes of public and social interest, alongside the private objectives of investment performance. The article argues that more policy governance is needed for implementing 'double materiality'. In particular, further development and governance are needed for metrics that would form the backbone for evaluating double materiality.[11] Evaluating the success of the EU's reforms crucially depends on the development and governance of the metrics that relate to double materiality, and the extent to which they are able to show the difference double materiality makes, compared to the financialised trend in single materiality highlighted in MacNeil and Esser's opening article. However, metrics governance is inevitably intertwined with market preferences, and in general, market-based governance for public goods still needs to be critically appraised, as argued in Tan's reflective paper discussed below. Both articles examining the EU's reforms agree that there are promises but also a continuing need for policy reflection.

Further, the success of sustainable finance reforms undoubtedly partly depends on credible and standardised corporate transparency to inform investment management and intermediary evaluation. Hence, Miglionico's paper concerns how technological advances such as algorithmic and machine learning processes for data collection and processing may help with sustainable information transparency and corporate decision-making in the corporate sector. The article focuses on climate risk information management for a start and provides insight into developing standardised and granular processes for managing corporations' climate risk information and data.

Turning to the Chinese policy experience, Lin and Hong's article discusses explicit policy steers in China to build a credible market for green bonds. This involves government leadership in facilitating issues of green bonds, as well as incentivising the demand side of the market. Although these policy steers have resulted in massive growth in bond issuances and investment, allowing China to grow phenomenally in its green bonds market, the article cautions against an excessively state-led approach because of the dangers of misallocation and other

[11] See further Hilf and Rouch (2021).

rent-seeking externalities. The article however shows that lessons can be learnt from the policy fostering of a credible market through law reforms and regulatory changes supporting the growth of a sophisticated investment sector.

We observe strong policy steers of the sort described above in relation to the EU and China, but these need to be accompanied by a growth in market-based initiatives. Private investors must ultimately develop the capacity and confidence to evaluate and participate in sustainable investment opportunities and tackling sustainability challenges that have a bearing on them. Turning to the issue of investors' incentives and motivations, this collection compares and contrasts two groups of investors. Lin's paper looks at how venture capitalists, dedicated to seeking out sustainable and profitable investment opportunities, can make a determined difference to nurturing greener and more sustainable innovations and also make market successes of them. However, there are clear needs in the legal and regulatory frameworks supporting venture capital finance which need to be met in order to mobilise and develop the sustainable venture capital market. On the other hand, the main group of private sector investors that must make a difference are institutional investors. Micheler's paper takes stock of large and small portfolio institutions and their incentives and motivations, showing that many are finely balanced between altruistic and financial considerations. The paper argues that many institutions would likely need more proactive motivating policy to allocate more towards sustainable causes, suggesting that government tax incentives can play a role.

The broader issue of how policy-makers can engage private finance to contribute to public and social good remains an ongoing experiment with mixed results so far. Despite a belief that policy can strengthen the integration of sustainability risks and opportunities in financial practice, and hence affect allocational decisions and influence the shape of corporate sector activity, deliberate involvement of private finance in securing public and social goods also carries risks. Realisation of public goods such as sustainability needs to take account of a broad range of political, social, ecological and justice issues, principally expressed and resolved through political and social structures. Market activity can help to sustain these. However, there is a balance beyond which it can also undermine them through marketisation and financialisation. Among other things, this could weaken the key role of states and public finance, ideologically and practically, for example in the important areas of governance and distribution. Worse, over-reliance on private sector finance can be hazardous for states in managing their sovereign debt exposures and volatile foreign capital flows. Tan's paper critically teases out the increased governance roles of private financial actors and how these roles interact with the need for public goods and the roles of public sector actors. It critically questions whether we are closer to or further away from achieving the real outcomes socially desired in the UN Sustainable Development Goals.

Finally, the Special Issue rounds off where we ideologically started—which is to raise the question whether financial market-reliant interventions in current law and regulation can ultimately do much in achieving the public interest goals of sustainability. Sheehy's paper provides the ideological 'last word' in this collection to remind us that sustainability goals concern issues of intergenerational justice and may need more than incentive-based regulatory frameworks. Although law and

regulation may be able to restrain excessive corporate damage to the environment, there is still a need for corporate law reforms to compel corporations to internalise socially and justice-oriented behaviour in their economic activities. Sheehy's paper, in some ways not dissimilar to MacNeil and Esser's opening article, posits corporate law reforms in terms of board reorganisation for decision-making that integrates socially-facing sustainability concerns and the introduction of 'stakeholder' organs in corporations. These ideological concepts are radical and would champion a move away from existing corporate governance structures in most jurisdictions.

The discussions in this volume ultimately offer a topical examination and critique of recent policy action focused on mobilising institutional investors in shaping broader corporate sector activities towards avoiding sustainable harm and achieving sustainable goods. The critique is however intended to enhance the capacity of the financial sector while pointing out the gaps in areas of policy reform that need to be addressed. All contributors in this volume are committed to advancing this continuing discourse as further reforms and market-based initiatives emerge. We thank the Centre for Banking and Financial Law, NUS, our contributors and participants at the Conference and Rainer Kulms, Editor of the European Business Organization Law Review, for giving us the opportunity to bring together this collection of articles as a whole.

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