Presentation of Findings of the Sustainable Finance Legal and Regulatory Report

Delivered by Brónagh Maher, Matheson LLP at "The Evolving Landscape of Sustainable Finance In Ireland: Legal, Regulatory and Market Insights" at Euronext Dublin on 10 July 2024

Good morning everyone.

It is a pleasure to be here to present the findings of the Sustainable Finance Legal and Regulatory Study,[1] prepared by Matheson on behalf of the International Sustainable Finance Centre of Excellence. We are delighted to support the critical work that the Centre is undertaking to continue to position Ireland as a leader in sustainable finance, building on our excellent reputation as a global hub for financial and professional services serving major economies across the world.

We are facing an unprecedented environmental crisis. Legislators and regulators have responded to this, acknowledging that we need to fundamentally transform our economic and financial systems to become more sustainable, resilient, and aligned with environmental and social imperatives.

The large-scale investment required to achieve this transformation - to fund the transition to renewable energy, sustainable infrastructure, and a circular economy – presents both a moral imperative and an economic opportunity. Ireland is well-placed to avail of this opportunity, with a sophisticated and supportive regulatory environment, a thriving funds and asset management industry and a growing cohort of companies with deep expertise in sustainable finance.

1 The Sustainable Finance Legal and Regulatory Study was prepared by Matheson LLP and was commissioned by the International Sustainable Finance Centre of Excellence in partnership with Skillnet Ireland.

Outline of the Report

This legal and regulatory study was a critical input in the refresh of Ireland's National Sustainable Finance Roadmap and represents an update and progress report on an earlier study prepared in 2021. The roadmap is a key priority under Ireland's broader "Ireland for Finance" strategy, demonstrating the government's commitment to making the country a premier destination for sustainable finance activities.

The study was contributed to by a number of members of Matheson's ESG Advisory Group, our combined advisory platform that draws on years of experience advising on a number of innovative ESG projects.

Our ESG Advisory Group provides an integrated approach to support our clients in responding to legislative and regulatory change; delivery on their own ESG goals; and meeting the challenges and opportunities in doing so.

In the study, we provide an overview of the global legal and regulatory landscape, an update on European and Irish developments since the 2021 Report and an outline of pending and possible future developments with respect to sustainable finance. We examine the opportunities and challenges for Ireland as a centre of excellence for sustainable finance and comment on the progress made with respect to the recommendations made in the 2021 Report. Finally, we identify next steps and further implementation efforts to advance the progress made to date.

Outline of the Legal and Regulatory Landscape

What is clear from our review of developments over the past three years is that the sustainable finance legal and regulatory framework is evolving at pace, with all stakeholders being required to adapt quickly to new rules, often in the absence of finalised legal requirements and regulatory guidance at EU or national level to assist with compliance.

Our attempt to fit the key developments arising from the EU's Sustainable Finance Action Plan into one slide gives some idea of the extent of the task faced by financial market participants in seeking to understand the new requirements and put in place the operational changes and resources necessary to comply by the numerous deadlines that have arisen to date and that will continue to arise over the coming months and years.

It is commendable that the EU has sought to be a first mover and a global leader in advancing the sustainable finance agenda, but this may be an instance of having "first mover disadvantage" rather than first mover advantage.

The EU's highly ambitious legislative programme in this area, combined with delays in the legislative process, has presented challenges to stakeholders, who must contend with a complicated matrix of requirements.

Three years on from the introduction of detailed disclosure and transparency requirements under the Sustainable Finance Disclosure Regulation or SFDR, there is an ongoing lack of clarity in relation to key concepts such as the definition of "sustainable investments" and a lack of consistency with other legislative measures making up the sustainable finance framework, such as the EU Taxonomy Regulation.

It speaks volumes that the European Commission is already considering a significant review of the SFDR and the introduction of a product categorisation system, acknowledging that the market's use of the existing framework as a de facto labelling regime may in fact increase the risks of greenwashing rather than decreasing those risks.

In the more immediate term, there will be changes to the Level 2 measures introduced under the SFDR, requiring market participants to revisit their pre-contractual and periodic disclosures again very shortly after these measures were first introduced.

In the coming months, investment fund managers must also address the European Securities and Markets Authority's guidelines on funds' names using ESG or sustainability-related terms, which will require fund managers to consider whether to change the name of the relevant fund; or change their investment policy / strategy to comply with the Guidelines.

The ability to comply with the detailed disclosure obligations imposed on financial market participants under the SFDR and the EU Taxonomy Regulation is heavily dependent on the availability of data from underlying investee companies. The introduction of enhanced corporate reporting requirements under the Corporate Sustainability Reporting Directive is therefore a welcome development from this perspective, although the phased introduction of the CSRD and inconsistencies between the disclosure requirements and the corporate reporting requirements could continue to contribute to data challenges.

Challenges

More generally in relation to challenges in implementing the sustainable finance agenda, the report outlines some key issues that must be addressed and we have categorised these broadly as relating to legislation, regulation, data and resourcing.

I have mentioned some of the legislative challenges already, arising from the ambitious timeline set by the EU for the introduction of a high volume of inter-related legislation and the misalignment in the application dates of that legislation.

The ongoing lack of clarity in relation to key definitions and inconsistencies in the various legislative texts not only gives rise to implementation challenges and complexity for the end investor attempting to understand the disclosures, it has also given rise to the phenomenon of greenhushing or greenbleaching, where some financial market participants are reluctant to classify their products as sustainable and therefore subject to the detailed legislative requirements, thereby undermining the transparency objective of the framework. Greenhushing may also be a response to investor sentiment (in some quarters) that green funds are more expensive and perform less well than other funds.

The majority of requirements introduced under the sustainable finance framework take the form of EU regulations, which have direct effect in Ireland and are not required to be transposed into national law. There is therefore limited scope, from a legal point of view, for Ireland to devise a framework that differs to other EU member states and that would render Ireland a more attractive centre for sustainable investment products.

Gold-plating, that is, imposing additional legal requirements to supplement the framework established at EU level, would present challenges to financial market participants who operate on a cross-border basis. Divergences in approach at national level create operational and compliance challenges for these firms.

In relation to the regulatory challenge, the volume of changes and the implementation timeline has meant that the Central Bank of Ireland has had to deal with high volumes of filings of updated financial product documentation. The Central Bank has adopted a pragmatic approach to date, providing for streamlined filing processes and providing feedback to industry on its findings and expectations. It is important that there continues to be ongoing open discussion and consultation with industry to ensure future deadlines are met in an efficient and practical manner.

As regards the data challenge, the lack of availability of reliable, comparable sustainability data is one of the most significant impediments for asset managers, asset owners, and wealth advisors in meeting the expectations of sustainable finance disclosure.

The misalignment between the timing of the application of disclosure and reporting requirements, as well as a lack of consistency and coherency between third-party data providers, has led to significant data gaps and data challenges for market participants.

In relation to resourcing, the complex set of requirements under the Action Plan and the detailed and technical nature of those requirements mean that market participants, their service providers, government departments and regulators must ensure that their staff are adequately trained and have the necessary skills, expertise and experience to understand the issues and address the challenges arising from implementation. This may require recruitment in addition to training of existing staff. This creates a highly competitive environment for ESG talent.

Ireland's Strengths and Next Steps

Despite these challenges, significant opportunities lie in areas where Ireland has already established a strong reputation, for example, a knowledgeable and prudent financial regulator and a skilled, highly-educated talent pool supported by a well-established financial services infrastructure.

Continued government impetus to build on the outstanding success of financial services in Ireland to date has sustained the focus on innovation in the international financial services sector.

Ireland's coherent, consistent and reliable policy and regulatory framework means that Ireland is well-positioned to take advantage of opportunities presented by sustainable finance and to maintain and develop its reputation as a location of choice for domiciling and distributing products that meet growing investor demand for sustainable solutions. Ireland is internationally recognised as one of the world's most advantageous jurisdictions in which to establish international investment funds; is the jurisdiction of choice for the establishment of special purpose vehicles for a variety of debt issuance transactions; and attracts a large proportion of green bond listings.

To continue to build on these strengths, a number of steps may be taken.

In light of the inter-relationship between sustainable finance legislative initiatives and the impact of the sustainable finance agenda across various government departments, a holistic, multi-disciplinary, cross-governmental approach best utilises the opportunities and addresses the challenges presented by the sustainable finance agenda.

Ensuring that our regulators and representatives have a prominent place in international fora discussing sustainable finance matters will afford an opportunity to provide input and shape the agenda and ensure that Ireland has a leadership role in the development of legal and policy initiatives.

The Central Bank has a successful track record to date of engaging constructively with industry to implement the legislative initiatives arising from the Sustainable Finance Action Plan.

The ongoing consultation by the regulator and government departments with all relevant stakeholders will ensure a complete understanding of the challenges and opportunities in sustainable finance and the effective and efficient implementation of legislation. This engagement may also assist in identifying areas where domestic guidance might facilitate the implementation of initiatives and differentiate Ireland as a jurisdiction with a consistent and predictable regulatory environment.

Ensuring that we continue to support financial literacy initiatives will encourage buy-in and engagement at all societal levels and in this regard the Department of Finance’s national financial literacy strategy and the expected focus on financial literacy in the Funds Sector 2030 review are welcome developments.

Ireland can also position itself as a sustainable finance leader by ensuring that it has an attractive and fit-for purpose product suite available to managers and investors intending to channel capital into sustainable investments. The ongoing promotion of Ireland’s investment limited partnership vehicle and the accommodation of European Long Term Investments Funds in our regulatory framework are important initiatives in this regard.

Further initiatives referred to in our report that may contribute to strengthening Ireland’s reputation in this area include:

- encouraging the use of corporate power purchase agreements;
- incentivising investors to rescue stranded assets in so-called “brown spaces”;
- continuing to build on Ireland’s reputation as a leader in marine conservation, fisheries and offshore renewable energy to position Ireland as the jurisdiction of choice for international blue bond transactions; and
- advocating for preferential capital treatment for green and sustainability linked loans.

Concluding Comments

As the new European Parliament and European Commission convenes in the near future, there is some uncertainty as to whether the EU’s Green Deal will be pursued with the same zeal as applied in the early years of implementing the Sustainable Finance Action Plan. The Commission’s ability to advance the Green Deal may face political headwinds, with increased opposition from some lawmakers and some industry sectors concerned about the costs of transition.

However, even if it were conceded that the role of financial market participants is not to make the world a better place, there is general acceptance that market actors must take into consideration sustainability risks and their impact on returns.

There continues to be growing individual investor interest in sustainable investment opportunities, with many if not most investors considering positive environmental or social impacts alongside traditional financial metrics. Demand for a diverse range of sustainability-focused financial products is therefore likely to continue to grow. Financial market participants are faced with the challenge of allocating adequate resources to product innovation to meet this growing demand and meeting the compliance burden imposed by the high volume of new requirements.

To re-emphasise the need for a holistic, multi-disciplinary approach by government, we note that a great number of Ireland's sustainability experts hold positions in domestic regulatory bodies connected to financial services or in government departments, but are currently operating without significant touchpoints with one another. Increasing the frequency and quality of interactions between experts would assist progress in placing Ireland as a forerunner in global ESG-linked finance.

The ongoing work of the Centre and events such as this will play an important role in promoting constructive stakeholder engagement and ensuring that sustainable finance is foremost in the minds of policymakers, regulators and legislators and I would therefore like to thank you all for your attendance and participation this morning and for engaging with our report.

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Matheson

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