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ESMA REGULAR USE

The Executive Director

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**Ms Ingrid Holmes (E3G),
Mr Steven Tebbe (CDP Europe),
Ms Alice Garton (ClientEarth),
Ms Mardi McBrien (Climate Disclosures Standards Board),
Mr Benoît Lallemand (Finance Watch),
Ms Catherine Howarth (ShareAction),
Ms Geneviève Pons-Deladrière (WWF European Policy Office)**

**Third Generation Environmentalism Ltd
47 Great Guildford Street
London SE1 0ES
United Kingdom**

Ref: ESMA's role in sustainable finance

Dear Ms Holmes, Mr Tebbe, M. Garton, Mr McBrien, Mr Lallemand, Ms Howarth, Ms Pons-Deladrière:

I would like to thank you for your letter regarding the role of ESMA in sustainable finance. We have carefully considered each of the proposed actions you set out in the letter for ESMA to undertake and assessed whether it is possible to engage with these in current circumstances. Our specific conclusions in relation to the individual areas are attached to this letter.

I firstly want to acknowledge the importance of the role of sustainable investment and finance for the real economy, and welcome the work being carried out by your organisations in this regard. In line with our mission to enhance the protection of investors and promote stable and well-functioning financial markets in the EU, as the climate and sustainability risk becomes progressively more prominent, ESMA's role in sustainable finance within our areas of competence and our mandate may need to be reconsidered. The areas of corporate reporting and corporate disclosure are examples of areas we engage with where there has been a lot of progress, with multiple initiatives on how to provide relevant information to the investors.

ESMA follows sustainable finance developments with interest, in particular the work of the Financial Stability Board's Task Force on climate-related financial disclosures and the EU's High-Level Expert Group on Sustainable Finance, and we look forward to seeing their conclusions. The importance of this work is notably reinforced by the stronger sustainable finance dimension in the recently published Capital Markets Union Mid-Term Review report, and is further supported in Vice-President's Valdis Dombrovskis speech on sustainable finance at the European Parliament earlier this month.

The scope and nature of involvement of ESMA depends on both the tasks entrusted to us by EU primary legislation and the existence of a converged legislative framework (such as a defined standard), for which compliance could be effectively promoted and supervised. In addition, our resources are commensurate to our current role and tasks, which also makes it difficult for ESMA to assume a bigger role in the area of sustainable finance currently. Nonetheless, while we face some constraints, we continuously seek to offer our expertise for sustainable finance initiatives impacting our remit. This is especially true in the area of corporate reporting and corporate disclosures and you will find some examples in the annex.

I regret not being able to provide you with a more enthusiastic response to your thoughtful letter, but hope that you understand the constraints under which we are operating. We would nonetheless appreciate to engage with your organisations in the future, and to receive any further input you may have on our work.

Yours sincerely

Verena Ross

Annex - ESMA response to proposals

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1. **Initiate a review to assess oversight by competent authorities on reporting of climate and wider sustainability and disclosures in issuer annual reports**

ESMA notes the absence of a harmonised framework at the EU level with regards to the climate and sustainability disclosure. This is as a result of the co-legislators granting a wide latitude to member states and issuers to comply with the high-level principles of the non-financial reporting directive.

ESMA notes that the requirements of the non-financial reporting directive are applicable for the first time for 2017 annual reports (unless individual member states did not apply them earlier). The European Commission's recent guidelines on the disclosure of environmental and social information will be particularly helpful in supporting companies fulfilling their reporting obligations in this respect. ESMA intends to enhance the supervisory culture of European enforcers on matters related to the disclosure of non-financial information and, thereby, ensure that issuers provide relevant corporate disclosures.

ESMA agrees that based on the existing requirements the management report should provide disclosure on major risks and uncertainties entity is facing, including where relevant, those related to climate change risks. While noting the lack of full harmonisation on the content and structure of the management report, ESMA will actively look at the level of compliance with the management report requirements and the supervisory practices in this area.

ESMA plans to include the management reports and in particular non-financial reporting in the overall strategy on corporate reporting. While supervisory convergence in this area is desirable and could be fostered by identification of best practices and encouraging specific disclosure, further harmonisation of requirements (both related to the content of the management report as well as supervision of these requirements) in European law and strengthening of the single rulebook at level 1 might be necessary.

Furthermore, integration with financial reporting might require adjustment in some accounting standards by the IASB (such as explicit consideration of the climate change in the impairment of non-financial assets as well as development of an accounting standard on accounting for emission trading schemes and related climate change/carbon emission type of disclosures).

2. **Include climate and wider sustainability information in the draft Regulatory Technical Standards on electronic reporting**

The Transparency Directive requires the electronic format from 1 January 2020 and this electronic format can only include the information required to be presented in the annual financial reports.

The lack of harmonisation of the content of the annual financial reports, and in particular non-financial statements that can be presented in the management report or separately, precludes using of detailed structured reporting (e.g. detailed tagging rules) on the non-financial reporting information.

3. **Include requirements for reporting on climate and wider sustainability risks in the guidelines on risk factors in prospectuses**

ESMA is currently developing the guidelines on risk factors in prospectuses. A Consultation Paper will soon be published that will enable stakeholders to comment on the proposed risk factors, and we would appreciate your contribution in the course of the consultation. However, it should be noted that the risk factors need to be sufficiently specific for individual issuers and thus it might not be possible to refer to individual risks specifically.

4. **Promote supervisory convergence for common regulatory and supervisory standards on climate and wider sustainability risk disclosures**

ESMA will actively monitor the recommendations stemming from the Financial Stability Board's Task Force on climate-related financial disclosures and the EU's High-Level Expert Group on Sustainable Finance. Based on these recommendations and any evolution of the EU legal framework in this respect, notably whether the EU law introduces common regulatory and supervisory standards, ESMA will consider how to best foster supervisory convergence on this area.

5. **Issue guidelines to CRAs to incorporate climate and sustainability risks into CRAs' methodologies**

As acknowledged in the proposal, ESMA cannot interfere with the content of CRAs' methodologies. Issuing guidelines to CRAs to incorporate climate and sustainability risks into CRAs' methodologies would however constitute interference with the content of CRAs' methodologies. It is down to the exclusive judgement of the CRAs as to whether climate and sustainability risks impact on the creditworthiness of a particular rated entity or industry, including sovereigns, and as to whether they would therefore have to be included as a factor in their rating methodologies.

In ESMA's view rating methodologies play a central role in ensuring that credit ratings issued by CRAs are of good quality and incorporate all relevant factors impacting on the creditworthiness of an issuer, including factors related to climate risks if relevant. In this respect, ESMA would like to point to the important work undertaken during the last two years regarding the validation and review of rating methodologies. In November 2016 ESMA published a set of guidelines on the validation and review of CRAs' methodologies[1], for which ESMA is now closely monitoring and engaging with CRAs on their implementation.

6. Assess risks posed by climate and wider sustainability factors in securities market to include in quarterly Risk Dashboard and bi-annual Trend Risk and Vulnerability report

ESMA is not aware of available commercial data and has no data in proprietary databases on climate and sustainability risk. If such data becomes available (and we have the adequate budget to purchase it), it would then be possible for ESMA to assess these risks more effectively as part of its regular risk assessment work, for example in the quarterly Risk Dashboard and bi-annual Trend Risk and Vulnerability report.

[1] https://www.esma.europa.eu/press-news/esma-news/cra-guidelines-validation-and-review-methodologies-now-available-in-all-eu