

*“The sustainable future of financial
markets: a direct obligation in terms of
E.S.G.?”*

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ABSTRACT:

Recently, concerns about sustainability have grown significantly and ESG factors have emerged, forcing companies to adapt to a new reality.

The financial market has been driven by ESG factors and sustainable finance has been the subject of legislative impulses.

The corporate purpose and strategies of companies and their boards and market trends are undergoing changes, or better said, we are facing a *green behavioural revolution*.

KEYWORDS:

ESG; sustainable finance; directors' duties; financial markets

Resumo:

Recentemente, as preocupações sobre sustentabilidade têm tido um crescimento significativo, surgindo os fatores ESG, forçando as empresas a adaptarem-se a uma nova realidade.

O mercado financeiro tem sido impulsionado pelos fatores ESG e as finanças sustentáveis têm sido objeto de impulsos legislativos.

O propósito societário e a atitude/deveres dos administradores, perante as empresas e as tendências “verdes” do mercado, estão a sofrer alterações, melhor dizendo, estamos perante uma verdadeira revolução de comportamento.

Palavras-chave:

ESG; finanças sustentáveis; deveres dos administradores; mercados financeiros

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I - Sustainable Finance: A paradigm shift in directors' duties regarding E.S.G. factors?

1. Introduction

The *Environmental, Social and Governance* (ESG) factors and sustainability are quickly becoming the Holy Grail for governments, businesses, and society.

Also, the European Union (EU) has long been a leader in the push for sustainability, namely in finance. Sustainable finance is the practice of ESG considerations into financial decision-making, including through the development of new regulations, guidelines, and reporting frameworks. It acknowledges the need to align financial practices with the transition to a sustainable economy, as traditional methods often overlook long-term environmental and social impacts.

Nonetheless, in EU there is no legislative harmony or mandatory rules common to all Member-States that stipulate the content of directors' duties, namely the duty of care, and the way in which they can be held accountable in relation to ESG metrics.

The question that rises is: *legislation shall be amended, or the financial market can achieve the same purpose?*

2. Directors' role in Corporate Social Responsibility practices

Corporate Social Responsibility (CSR) debates arise from the divergence between contractualist and institutionalist theories, demonstrating that the social interest of a company is the common interest of the shareholders as such and no other, or rather the interest of the company “in itself”, also considering stakeholders.¹

“Some believe that the directors are required to act with the exclusive interest of the shareholder in mind. Others share the view that directors have a fiduciary duty not only towards the shareholders, but in relation to the company itself, as a permanent

¹ COUTINHO DE ABREU, JORGE, *Curso de Direito Comercial - vol. II, Das Sociedades*, 6a ed., Almedina, Coimbra, 2019

organization in which several constituencies are involved, including employees, consumers, suppliers and other stakeholders, or society in general, with a consequential sacrifice of the shareholders' exclusive interest.”²

In the last century, the Anglo-American legal system argued that the focus should be on profit maximisation (*Wealth Maximisation*) - the so-called *shareholder value approach*³, with the dual purpose of *accountability and efficiency*.

In 1970, Milton Friedman published “*The Social Responsibility of Business Is to Increase Its Profits*”⁴ in which he expressed the idea that the social responsibility of business makes no sense since responsibility lies with people. For Friedman “*extolling the virtues of CSR and expressing scepticism about the social benefits of profit-making can erode public trust in capitalism and make corrective action by the state more likely if corporations do not live up to the expectations they create with their own rhetoric.*”⁵

Nonetheless, this shareholder primacy has been losing prominence in the face of stakeholder value. The concept of stakeholder⁶, *latu sensu*, means individuals or organisations that affect and/or are affected by a particular company.

This perspective was marked by the appearance of a pro-stakeholder (*stakeholder-friendly*) discipline in the Companies Act 2006, introducing the concept of *enlightened shareholder value* into English Law.

In 2019, Business Roundtable, which includes the main CEOs of the United States, announced the release of a new *Statement on the Purpose of a Corporation* signed by

² SEQUEIRA, MANUEL / FERREIRA, BRUNO, “Business Judgment Rule as a Safeguard for ESG Minded Directors and a Warning for Others”, in *The Palgrave Handbook of ESG and Corporate Governance*, Paulo Câmara and Filipe Morais, Palgrave Macmillan, 2022

³ SERRA, CATARINA, “*The New Company Law: Towards a responsible Corporate Governance*”, *Scientia Iuris*, Londrina, p.155-179, 2010

⁴ FRIEDMAN, MILTON, *The social responsibility of business is to increase its profits*, in *The New York Times Magazine*, 1970

⁵ *Ibidem*

⁶ According to MAFALDA SÁ AND RUI PEREIRA DIAS, stakeholders are relevant players in a companies' sustainability. PEREIRA DIAS, Rui / DE SÁ, Mafalda, “*Deveres dos administradores e sustentabilidade*”, in: *Cadernos Do Programa De Pós-Graduação Em Direito*

181 CEOs who commit to lead their companies for the benefit of all stakeholders - customers, employees, suppliers, communities, and shareholders.⁷

CSR presupposes that companies are not completely self-interested, that its leaders can, do, and will consider impacts on others or the social good in their decisions.⁸

The challenge is to ignite a sense of societal responsibility within corporations. This can only come from the people who make the corporation an actor in society, its directors.⁹

2.1. Directors' Fiduciary Duties

The concept of fiduciary relationships encompasses any type of relationship in which one person trusts in the integrity and loyalty of another, regardless of the legal, social or personal nature.¹⁰

It is extremely important to understand whether, and to what extent, directors, are linked to duties of conduct beyond the cases covered by specific duties.¹¹

According to MENEZES CORDEIRO¹², the administration is a potestative right, insofar as it reflects a normative permission for directors to decide and act regarding their

⁷ [Business Roundtable Redefines the Purpose of a Corporation to Promote 'An Economy That Serves All Americans' | Business Roundtable](#)

"This new statement better reflects the way corporations can and should operate today" added Alex Gorsky, Chairman of the Board and Chief Executive Officer of Johnson & Johnson and Chair of the Business Roundtable Corporate Governance Committee. *"It affirms the essential role corporations can play in improving our society when CEOs are truly committed to meeting the needs of all stakeholders."*; *"I welcome this thoughtful statement by Business Roundtable CEOs on the Purpose of a Corporation. By taking a broader, more complete view of corporate purpose, boards can focus on creating long-term value, better serving everyone – investors, employees, communities, suppliers and customers,"* said Bill McNabb, former CEO of Vanguard.

⁸ GODFREY, PAUL C., et al, "The relationship between corporate social responsibility and shareholder value: an empirical test of the risk management hypothesis", in *Strategic Management Journal*, 425–445, 2009

⁹ WINTER, JAAP, "The Duty of Societal Responsibility and Learning Anxiety", in *The Palgrave Handbook of ESG and Corporate Governance*, Palgrave Macmillan, 2022

¹⁰ FERREIRA, BRUNO (2009), "*Os deveres de cuidado dos administradores e gerentes (Análise dos deveres de cuidado em Portugal e nos Estados Unidos da América fora das situações de disputa sobre o controlo societário)*", in *Revista Direito das Sociedades*, Ano I – número 3

¹¹ FERREIRA GOMES, JOSÉ, *Novas regras sobre o governo das instituições de crédito: primeiras impressões (incluindo densificação da obrigação de administração de acordo com o "princípio da responsabilidade global")*, in *Revista de Direito das Sociedades*, Ano VII – Número 1, Almedina, 2015

duties towards the company. However, others consider that administration is also an obligation that encompasses the directors in the passive dimension of this legal position.¹³ Administration thus becomes, a power-duty of the manager or director of the company.

In US, as in Portuguese law (article 405 of the Commercial Companies Code), the obligation of administration is established in a generic and indeterminate manner¹⁴, so it has been the task of jurisprudence and doctrine to dissect its content.

Therefore, the obligation of administration, as other legal obligations, can be fulfilled effectively, fulfilled defectively or not fulfilled at all. To fulfil the obligation properly, the administrator must comply with certain qualities, and their conduct must be directed towards a certain objective and in that regard the criteria of a careful and orderly manager arose, by Anglo-Saxon influence.¹⁵

Moreover, this obligation reveals the necessity to fulfil fundamental duties: *duty of care and duty of loyalty*. They are fiduciary duties as they arise from the relationship of trust established between the director and the company for the management of other parties' interests.¹⁶

For the purposes of this study, we will emphasise the duty of care and the responsibility of directors towards the company, particularly the role of the Business Judgement Rule (which originated in US court rulings and has been implemented in several European legal systems) linked with sustainability issues.

¹² CORDEIRO, ANTÓNIO MENEZES, in *Direito das Sociedades I Parte Geral*, Almedina, 2011.

¹³ RAMOS, FREIRE SILVA GABRIEL, in *A business judgment rule e a diligência do administrador criterioso e ordenado antes da reforma do Código das Sociedades Comerciais*, Revista de Direito das Sociedades, Ano V – Número 4, Almedina, 2013

¹⁴ RAMOS, MARIA ELISABETE, in “*Responsabilidade Civil dos administradores e directores das sociedades anónimas perante credores sociais*”, Coimbra, 2002.

¹⁵§93(1) of AktG establishing the criteria of a careful and orderly manager (*ordentlichen und gewissenhaften Geschäftsleiters*). These criteria are also very important in the US context. MOREDO SANTOS, HUGO / VOGLER GUINÉ, ORLANDO, (2013), “Deveres Fiduciários dos Administradores: algumas considerações (passado, presente e futuro)”, in *Revista do Direito das Sociedades*, 4, 691-711.

¹⁶ SERRA, CATARINA, “O novo direito das sociedades: para uma governação socialmente responsável”, 2010, Scientia Juris, Londrina

2.2. The Duty of Care and the Business Judgement Rule

The duty of care is a standard that should be followed by directors. It encompasses an objective - *care that an ordinarily prudent person* – and a subjective criterion - *to exercise in a like position and under similar circumstance*.

The duty of care has specific variants such as *the duty to monitor, duty of inquiry, the duty of a reasonable decision-making process* and *to take a reasonable decision*, which are broken down into two very important sections: (i) monitoring of corporate activity and its oversight and (ii) the decision-making process.

The BJR (originated in US law) stipulates that the liability of a director can be excluded in relation to a certain act if (i) *he proves that he acted in an informed manner*, (ii) *free from any personal interest* and (iii) *according to criteria of business rationality*.

The merit directors' decisions are not judged by the court based on reasonableness (a more demanding criterion),¹⁷ the director will only be civilly liable¹⁸ when the decision is deemed to be irrational, causing damage to the company as a *standard of review*.

This rule is explained by the fact that the management of a company requires a certain amount of entrepreneurial decision-making discretion on the part of its directors, *i.e.*, from among several possible decisions, these individuals have the power of choice in making a specific decision. BJR therefore assesses the actions of directors and managers not by the result, but by the devaluation of their behaviour.

On a jurisprudential level, in the case *Cede&Co. v. Technicolor*, the court of Delaware stated that the duty of care should be understood as an element of the BJR. However, duties have a broader scope of application than the BJR itself, since the duties

¹⁷ ABREU, COUTINHO, in *Responsabilidade Civil dos Administradores das Sociedades Comerciais*, IDET, Cadernos, n.º5, Almedina

¹⁸ FRADA, CARNEIRO, *A Business Judgment Rule no Quadro dos Deveres Gerais dos Administradores*, RAO, Ano 67 – Vol. I, 2007, www.portal.oa.pt

govern the entire action of directors, whereas the BJR will only apply when it is recognised that a certain business decision has been taken.

2.2.1. In United States

In US, the origins of fiduciary duties lie in negligence law, but the duty of care is treated autonomously from corporations' law¹⁹. The legal provisions associated with this duty began to emerge in the 1970s, namely in Section 8.30 of the Model Business Corporation Act - "*Standard of Conduct for Directors*".

In both the US and United Kingdom the "*outsider*" system of corporate governance prevails in which the capital is dispersed, as opposed to the European "*insider*" system where is a lower dispersion of capital. It explains the importance given to fiduciary duties in the US, given that there is a large role for directors as opposed to the supervisory role of shareholders.

Before the 1980s, the understanding of the BJR was quite incisive: if directors did not have a direct interest in the decision and it was not absolutely irrational, there was no breach of duty of care.

However, the scenario changed with the case of *Smith v. Gorkom*, that considered that under the BJR there is no protection for directors who have made an unintelligent or unadvised judgment. BJR has therefore be considered, according to the principles of Corporate Governance of the American Law Institute, as a safe harbour, since it shows that there are decisions that, even if they are free of conflicts of interest, well-intentioned and informed, can, later, cause damage and be considered imprudent, in the long term.

In the mid-1980s, new transactional duties began to be distinguished within the duty of care: duty of vigilance and control ("*duty of monitor*")²⁰, which requires the director

¹⁹ FERREIRA, BRUNO, "*Os deveres...*"

²⁰ This duty imposes the supervision of the company and its activity - the first degree of intra-corporate supervisory control - defined in various degrees depending on the activity that the director is pursuing.

to be constantly attentive to fluctuations in the company's profitability, to control human resources and, in the case of public limited companies listed on the stock exchange, to be attentive to the securities market, for instance; the duty to investigate and ascertain the reliability of information (“*duty of inquiry*”)²¹; the duty, in the decision-making process, to behave reasonably and to obtain sufficient and rational information to make a proper decision (“*reasonable decision making process*”²²); and the duty to take and implement reasonable, equitable and measured decisions (“*reasonable decision*”²³)^{24, 25}.

In the 21st century, with the emergence of the “new economy” caused by the “bursting of the stock market bubble”, several *corporate governance* issues have emerged, along with other US corporate scandals and bankruptcies²⁶.

The apogee and culmination came with the *Sarbanes-Oxley Act of 2002*, since most of the measures dealt with the conduct of directors. This act has influenced, although indirectly, fiduciary duties, including the duty of care, since when evaluating directors’ conduct, judges may consider the rules established by the Sarbanes-Oxley Act or the

It should be emphasised that the search for relevant information is all the more indispensable the further away from the executive positions held by the board of directors, as non-executive directors tend to have less regular knowledge of day-to-day company life.

²¹ The duty to inquire establishes that directors, if they suspect any wrongdoing, or even on a more routine basis, investigate certain situations, either directly, by delegation or by contracting investigations/audits, through the company's internal and/or external structures.

²² This is a legacy of *Van Gorkom*, in that the director must take reasonable care in the process of acquiring information, in which the circumstances of the decision taken are assessed, to the extent that it is recognised whether the decision needs to be taken urgently or whether there is time to prepare it.

²³ The last two duties are directly related with the management decision - one relating to the procedural aspect or the form of the decision and the other to the substance of the management relationship.

²⁴ Management is not an exact science, so there is usually a range of possible decisions that, *ex ante*, can be considered reasonable in view of the intended purpose. Directors are expected not to incur disproportionate risks or waste company assets by selling them, for example, at fire sales merely to fulfil a short-term financial need.

²⁵ F. MAGALHÃES, V. PATRÍCIA, “A Conduta dos Administradores das Sociedades Anónimas: Deveres Gerais e Interesse Social”, p. 390; Case Law of Tribunal da Relação do Porto de 12 de abril 2012, available at <https://www.dgsi.pt/jtrp.nsf/d1d5ce625d24df5380257583004ee7d7/230da8b4503cfd4f802579ea00313dd0?OpenDocument>

²⁶Bankruptcy of large corporate groups such as Enron, WorldCom, Adelphia.

motivation behind its approval. The idea here is that directors have increased supervision and control obligations, *i.e.*, in procedural terms.²⁷

2.2.2. In Portugal

Directors' fiduciary duties are set out in article 64 of Portuguese Companies Commercial Code (CCC). The origin of this precept is Article 17(1) of Decree-Law 49 381 of 15 November 1969 stipulating that directors were obliged to "*employ the diligence of a careful and orderly manager*".

In 1986, the Portuguese legislator included both criteria in the initial version of Article 64 of the CCC: directors had to act (i) with the "*diligence of a careful and orderly manager*" and (ii) "*in the interests of the company, taking into account the interests of the shareholders and employees*".

The 2006 reform project of the CCC aimed to upgrade national corporate legislation (regarding the developments in *corporate governance* felt in 1970s in the US and brought to Europe in 1990s).²⁸ Thus, the final version of article 64 CCC arose, being divided the duties of care and loyalty into separate paragraphs.

Portuguese law, for the purposes of fulfilment of the duty of care, requires that availability, technical competence, and knowledge appropriate to the duties performed, be considered. In our opinion, these statements are imperfect and insufficient. According to RICARDO COSTA²⁹, they are, in fact, required circumstances for the manner in which the real manifestations of the duty of care must be carried out.

Other circumstances, in addition, are relevant to the specific analysis of the directors behaviour: the type, the purpose and size of company, the time available to obtain the information and make the decision, the costs of obtaining the information, the

²⁷ FERREIRA, BRUNO, "*Os deveres.*"

²⁸ FERREIRA, BRUNO, in *A responsabilidade dos administradores e os deveres de cuidado enquanto estratégias de corporate governance (Implicações da Reforma do Código das Sociedades Comerciais)*, Caderno do Mercado dos Valores Mobiliários

²⁹ COSTA, RICARDO, "Deveres Gerais dos administradores e 'gestor criterioso e ordenado'"

confidence of the directors in those who have examined the matter and presented it to the board, among others. This led us to the need of transactional duties listed above in US law and for that purpose article 64 CCC should be read together with article 72 CCC.³⁰

The liability content of the general duty of care is determined by the grounds for exclusion of liability provided for in Article 72(2) CCC (BJR), since directors are liable towards the company.

It has generated controversy among legal commentators. Some argued that directors would only be liable for breaches of duties established by law, in the articles of association or agreements (or, in case of gross negligence, under the *bona fides principle*). Others assumed that management errors, including those not covered by gross negligence, would only be relevant to assess accountability if specific processes and/or care standards were not followed. In this context, there is only one published decision from a first instance court, dated 27 October 2003, in which the BJR was used as a limit on the court's *ex-post* analysis of management decisions.

The legislature intended that, if there was evidence that the directors' actions were informed, free from personal interests and rational, as set out in article 72(2), the court would not analyse the merits and appropriateness of the management decision.

Therefore, article 72(2) monitors the general duty of care in its following manifestations: (i) the duty to take reasonable and appropriate decisions; (ii) the duty to reasonably obtain information in decision-making process.

This precept has not eliminated, by exempting the director, the fulfilment of the relevant instrumental duties of care. However, the only manifestation of the duty of care that is scrutinised is the first - (i) -, the (principal) duty to take materially reasonable decisions, with the nuance that the merits of the decision are not judged by the more

³⁰ FERREIRA, BRUNO, "Os deveres de cuidado..."

qualified criterion (reasonableness), but by a more limited criterion (rationality). The remaining manifestation – (ii) - is *truly* a *procedural* requirement for concluding that the duty to make reasonable decisions has been pursued.

Directors only need to respect the minimum and sufficient content of the general duty of care. Although that duty is much richer, only its essential content, will be scrutinised. A breach of the duty to take rational decisions will inevitably result in the breach of the main duty of care, since irrationality will necessarily result in unreasonableness.

3. Sustainable Finance

3.1. Preliminary considerations

Sustainable finance refers “to the process of taking **environmental, social and governance (ESG) considerations** into account when making investment decisions in the financial sector, leading to more long-term investments in sustainable economic activities and projects. **Environmental considerations** might include climate change mitigation and adaptation, as well as the environment more broadly, for instance the preservation of biodiversity, pollution prevention and the circular economy. **Social considerations** could refer to issues of inequality, inclusiveness, labour relations, investment in people and their skills and communities, as well as human rights issues. The **governance** of public and private institutions – including management structures, employee relations and executive remuneration – plays a fundamental role in ensuring the inclusion of social and environmental considerations in the decision-making process.”³¹

This definition comprises not only the potential financial risks associated with a given investment but also the impact of social and environmental components.

³¹ EUROPEAN COMMISSION, *Overview of Sustainable Finance, What is Sustainable Finance?*, available at: https://finance.ec.europa.eu/sustainable-finance/overview-sustainable-finance_en

Sustainable finance is a tool. Someone has to decide to build something first and then sustainable financing can be used as a tool to finance the investment. Sustainable financing will help people connect to investors and flag their strategy. It can also help with pricing and to gain access to financing, a process we need to make much easier and fast.

In that regard, market players³² (issuers, financial intermediaries, professional and non-professional investors) are increasingly recognizing the significance of allocating resources toward sustainable initiatives meaning moving towards a green economy.³³

3.2. Legislative and Regulatory Background on Sustainable Finance

3.2.1. Europe as a Green Driving Force

EU has long been a leader: *“The transition towards a greener and more sustainable economy has become a priority for the European Union.”*³⁴

European Commission, in 2016, appointed a High-Level Expert Group³⁵ that published a final report, offering a comprehensive vision on how to build a sustainable finance strategy for the EU³⁶. *“The Report argues that sustainable finance is about two urgent imperatives: (1) improving the contribution of finance to sustainable and inclusive growth by funding society’s long-term needs; (2) strengthening financial stability by incorporating environmental, social and governance (ESG) factors into investment decision-making.”*³⁷

In 2018, the European Commission published the Action Plan to support Sustainable Finance, to tackle the transition of existing activities to more sustainable

³² MIRANDA BARBOSA, MAFALDA, (2023), “Fatores ESG e investimentos sustentáveis: breve reflexão”, in *RDFMC*, 1-38.

³³ [What is sustainable finance \(eib.org\)](https://www.eib.org/what-is-sustainable-finance)

³⁴ EUROPEAN SECURITIES AND MARKETS AUTHORITY, *Sustainable Finance*, available at: <https://www.esma.europa.eu/esmas-activities/sustainable-finance>

³⁵ https://ec.europa.eu/info/sites/info/files/180131-sustainable-finance-final-report_en.pdf

³⁶ European Commission, Communication from Commission to the European Parliament, the European Council, the Council, the European Economic and Social Committee and the Committee of the Regions, The European Green Deal, COM/2019/640 final, December 11, 2019, paragraph 2.2.1.

³⁷ BUSCH, DANNY et all, “The European...”

production processes³⁸, including create standards and labels for green financial products, clarifying institutional investors' and asset managers' duties, fostering sustainable corporate governance, attenuating short-termism in capital markets, among others.³⁹ The seventh concrete action included in the Action Plan⁴⁰ requires that institutional investors, advisors and asset managers act in the best interest of their end-investors/beneficiaries, being it a 'fiduciary duty': "*Fiduciary duty exists to ensure that those who manage other people's money act in the interests of beneficiaries.*"⁴¹

In December 2019, European Commission launched the European Green Deal that encompassed a new commitment with climate and environmental-related challenges along with the elaboration of a new growth strategy for the EU.⁴² The main objective stated is no net emissions of greenhouse gases in 2050⁴³. The Green Deal is an integral part of Commission's strategy to implement the United Nation's 2030 Agenda and the UN Sustainable Development Goals.^{44 45}

As part of the Sustainable Finance Action Plan, the European Parliament and the Council have proposed several legal instruments.

Regulation (EU) 2020/852 of the European Parliament and of the Council of 18 June 2020 on the establishment of a Framework to facilitate sustainable investment, and

³⁸ PACCES, ALESSIO M., "Sustainable Corporate Governance: The role of the Law", in *Sustainable Finance in Europe*, Palgrave Millan

³⁹ European Commission, Action Plan: Financing Sustainable Growth, COM(2018) 97 final (8 March 2018), pp. 4–11.

⁴⁰ SZTARICKSAI, TIBOR, Switch2Green, "The EU Action Plan on Financing Sustainable Growth", available at: <https://www.switchtogreen.eu/the-eu-action-plan-on-financing-sustainable-growth/>

⁴¹ <https://www.unpri.org/policy/fiduciary-duty/>

⁴² Communication from Commission to the European Parliament, the European Council, the Council, the European Economic and Social Committee and the Committee of the Regions, *The European Green Deal*, COM/2019/640 final, December 11, 2019

⁴³ United Nations, General Assembly, Resolution 70/1 adopted by the United Nations General Assembly on 25 September 2015. Available at: <https://www.switchtogreen.eu/the-eu-action-plan-on-financing-sustainable-growth/>

⁴⁴ <https://sdgs.un.org/goals>

⁴⁵ United Nation's Sustainable Development Goals, available at: <https://www.switchtogreen.eu/the-eu-action-plan-on-financing-sustainable-growth/>

amending Regulation (EU) 2019/2088 (hereinafter, the “Taxonomy”)⁴⁶ introduces the first legislative framework in the world defining sustainable economic activities.

Until Taxonomy was difficult for private and state actors to compare green investments, as various definitions and ratings for sustainability were in use⁴⁷. *“Taxonomy Regulation already sets the principle that in order for any activity to be labelled as sustainable, it must fulfil four conditions: (i) contribute significantly to one of the 6 sustainability goals (climate change mitigation; climate change adaptation; sustainable use of water resources; transition to circular economy; pollution prevention; protection of biodiversity); (ii) do not significantly harm any of the other goals; (iii) comply with the relevant technical standards; (iv) respect additional safeguards to be specified by secondary legislation.”*⁴⁸

It will have a huge impact on portfolio choices of institutional investors since environment-friendly beneficiaries can verify what is sustainable or not⁴⁹, creating security for investors from currently practices such as greenwashing.⁵⁰⁵¹

Taxonomy aims to establish a benchmark for sustainability labels in the private investor market, enhancing transparency and comparability for end customers. It can be demonstrated at a firm level, to evaluate a portfolio of assets when lending capital to the company or in project level, in which taxonomy is used in specific investments, where benefits will automatically be observed to the firm by lowering its cost of capital -when investing in a new sustainable project, a company can borrow capital at a lower interest rate (banks have incentives to fund sustainable economic activities) and a good

⁴⁶ <https://eur-lex.europa.eu/eli/reg/2020/852/oj>

⁴⁷ FRANZISKA SCHÜTZE, et all, “EU taxonomy increasing transparency of sustainable investments”, available at https://www.diw.de/sixcms/detail.php?id=diw_01.c.807292.de

⁴⁸ Ibidem

⁴⁹ According to article 7 of the Taxonomy Regulation it is required an explicit disclosure of products that do not qualify as sustainable

⁵⁰ https://finance.ec.europa.eu/sustainable-finance/tools-and-standards/eu-taxonomy-sustainable-activities_en

⁵¹ It is the practice in which companies do less about the protection of the environment than what they show, to attract investors and convince stakeholders

classification, in its balance sheet, in terms of sales or expenses taxonomy-aligned allow them to profit through a higher demand in the capital markets.

Regulation (EU) 2019/2088 of the European Parliament and of the Council of 27 November 2019 on sustainability-related disclosures in the financial services sector (hereinafter, the “SFDR”)⁵² requires that players in financial markets reveal how much they're exposed to climate-related risks and to disclose the sustainability of their investments according to the Taxonomy.

This regulation targets financial market participants and financial advisors⁵³, applying to their overall practices as well as specific financial products.

It differentiates between disclosures related to risks associated with sustainability and disclosures concerning sustainability factors. Additionally, it distinguishes between regular financial products, financial products that emphasize environmental and social attributes, and products with sustainable investment as their final goal.

Regulation (EU) 2019/2089 of the European Parliament and of the Council of 27 November 2019 amending Regulation (EU) 2016/1011 as regards the European Union's climate transition benchmarks, Paris Agreement benchmarks aligned and sustainability-related disclosures for benchmarks (hereinafter, the “Low Carbon Benchmark”)⁵⁴.

It establishes a fresh benchmark in the market, enabling companies to more effectively communicate their carbon emissions and the carbon footprint associated with their investment portfolios to investors and stakeholders. The fundamental principle underlying these benchmarks is to reduce carbon emissions, aligning with the Paris Agreement's objective of curbing global warming.⁵⁵ It also introduced new transparency requirements on consideration of ESG factors by benchmarks.

⁵² <https://eur-lex.europa.eu/legal-content/EN/TXT/?uri=celex%3A32019R2088>

⁵³ According to article 2 of SFRD. Article 2(11) includes financial market participants providing investment or insurance advice, as well as (e.g.) insurance intermediaries providing advice regarding insurance based investment products (IBIPs).

⁵⁴ <https://eur-lex.europa.eu/legal-content/EN/TXT/?uri=celex:32019R2089>

⁵⁵ BUSCH, DANNY, et al, “Sustainable Finance..”

Directive of the European Parliament and of the Council amending Directive 2013/34/EU, Directive 2004/109/EC, Directive 2006/43/EC and Regulation (EU) No 537/2014, as regards corporate sustainability reporting (hereinafter, “CSRD”)⁵⁶.

It aims to expand the scope and upgrade the Non-Financial Reporting Directive (NFRD)⁵⁷, permitting that approximately 50.000 companies in total are subject to corporate sustainability reporting (non-financial reporting⁵⁸) and being also applicable to Non-EU companies if they generate over EUR 150 million on the EU market.

Commission explained *“There is ample evidence, however, that the information that companies report is not sufficient. Reports often omit information that investors and other stakeholders think is important. Reported information can be hard to compare from company to company, and users of the information are often unsure whether they can trust it (...) investors need to know about the sustainability impact of the companies in which they invest. Without such information, money cannot be channelled towards environmentally friendly activities.”*⁵⁹

This sample is comprised of all listed or non-listed large companies and listed small and medium enterprises⁶⁰, and consultations carried out by Commission found that many of the stakeholders are in favour of extending reporting requirements to additional categories of companies. The European Financial Reporting Advisory Group have

⁵⁶ <https://eur-lex.europa.eu/legal-content/EN/TXT/?uri=CELEX%3A52021PC0189>

⁵⁷ <https://eur-lex.europa.eu/eli/dir/2014/95/oj>

⁵⁸ Non-financial reporting is about communicating non-financial measure of performance that go beyond the traditional financial statements (income statement, balance sheet, cash flow statement). The idea is that non-financial reporting (which provides information on the company’s sustainability risks, metrics, and impacts) allows the company shareholders and other stakeholders to make informed investment and achieve ownership decisions.

⁵⁹ https://ec.europa.eu/commission/presscorner/detail/en/qanda_21_1806

⁶⁰ Large companies are those who meet two of the following three criteria: more than 250 employees, turnover superior to 40 million euros, and/or total assets valued at over 20 million euros. Small and Medium listed companies are in a “phasing-in period” getting extra years to comply with the requirements of the CSRD, until January 2026.

published technical recommendations and a roadmap to guide the application of the CSRD to develop these new sustainability-reporting standards.⁶¹

So, it is understandable that the CSRD and the Taxonomy shall be hand in hand in sustainable life to comply with the Action Plan *“Together with the CSRD, the EU Taxonomy will ensure that companies falling under the scope of the CSRD disclose their environmental performance information and their Taxonomy aligned economic activities.”*⁶²

Proposal for a Directive of the European Parliament and of the Council on Corporate Sustainability Due Diligence and amending Directive (EU) 2019/1937 (hereinafter, the “CSDD Proposal”⁶³).

Its purpose is to enforce mandatory due diligence obligations on companies concerning both human rights and environmental considerations. These obligations extend not only to the companies' own operations but also to their supply chains.

*“They will be required to identify (...) prevent, end or mitigate adverse impacts of their activities on human rights (...) and on the environment, for example pollution and biodiversity loss. For businesses these new rules will bring legal certainty and a level playing field. For consumers and investors, they will provide more transparency. The new EU rules will advance the green transition and protect human rights in Europe and beyond.”*⁶⁴

⁶¹ <https://www.efrag.org/Lab2?AspxAutoDetectCookieSupport=1>

⁶² SG Enterprise, “SFDR, NFRD and CSRD: Guidance on EU Taxonomy”, available at: <https://www.esgenterprise.com/esg-reporting/eu-taxonomy-sfdr-nfrd-csrd/>

⁶³ <https://eur-lex.europa.eu/legal-content/EN/TXT/?uri=CELEX%3A52022PC0071>

⁶⁴ https://ec.europa.eu/commission/presscorner/detail/en/ip_22_1145

CSDDD (Corporate Sustainability Due Diligence Directive), on 28 February 2024, was not approved since there was no (qualified) majority in the European Council.⁶⁵ However, it was approved later, on 13th March 2024.

Revised Shareholder Right Directive (EU) 2017/828 (“SRD II”), requires institutional investors to either comply with certain transparency requirements regarding their voting policies and behavior or explain why they haven't complied. Institutional Investors are required to annually reveal their voting strategies and detail their execution by interacting directly with individual companies. This disclosure encourages long-term shareholder engagement, to favour sustainable finance.

4. Sustainable Finance and Corporate Purpose

As discussed before, an endless debate is taking place regarding the interests that directors should pursue when managing a company.⁶⁶

In our opinion, directors have a fiduciary duty not only towards the shareholders, but in relation to the company itself, as a permanent organization in which several constituencies are involved, including sustainability.⁶⁷

In Commissions’ view “*to manage and steer sustainable businesses, it is necessary that sustainability becomes embedded in the governance structure, rules and practices. There needs to be an alignment (...) to ensure consistency and actual delivery of results.*”⁶⁸ In that regard, an increasing number of firms are referring ESG in their purpose - contradicting the (alleged) paradox between profit maximization and social value in capitalist system.⁶⁹⁷⁰

⁶⁵ <https://www.loyensloeff.com/insights/news--events/news/the-csddd-is-off-the-table-for-now-no-majority-is-reached-in-the-european-council/>

⁶⁶ CAETANO NUNES, PEDRO, “O Dever de Gestão dos Administradores de Sociedades Anónimas”, Almedina, 2012

⁶⁷ SEQUEIRA, MANUEL / FERREIRA, BRUNO, “Business...”

⁶⁸ NEVES, RUI, “The EU Taxonomy Regulation and Its Implications for Companies”

⁶⁹ FERRARINI, GUIDO, “Redefining...”

⁷⁰ Ibidem. This phenomenon is the so-called “*The New stakeholderism Credo*” shown in the Davos Manifesto 2020 adopted by I World Economic Forum (WEF), available at

According to a 2004 Global Compact Report, more than 20 global financial institutions stated that addressing ESG was important to the management of companies.⁷¹ It creates social value as firms are complying with legal requirements, soft standards and moral obligations, which are either binding on the individual firms or voluntarily accepted by them.⁷²

Even though directors be concerned about the morality of their actions, or simply care about the so-called “reputational damage”, consumers and investors will monitor the firm’s compliance with the relevant standards. So, in any case (towards regulation, conduct guidelines, ethical standards) sustainability is pictured as a *game changer*.⁷³

Corporate purpose, as a *corporate governance* instrument, can be seen as a mechanism to include sustainability in companies’ structure. Law and Management differ in the perception of this concept since the first field is more focused on the duties of the directors, the definition of the companies’ interest and the second grounded in concepts of market economy or firm value maximization⁷⁴.

Nevertheless, recent finance and management studies⁷⁵ show that the value to maximize is not only shareholder value (or firm value), but social value (considering ESG factors).

<https://www.weforum.org/agenda/2019/12/davos-manifesto-2020-the-universal-purpose-of-a-company-in-the-fourth-industrial-revolution>

⁷¹https://www.unepfi.org/fileadmin/events/2004/stocks/who_cares_wins_global_compact_2004.pdf

⁷² Many actions are performed by firms, particularly the largest ones, in compliance with ethical standards that are globally recognized in statements and guidelines issued by international organizations. As examples we have the documents either published or referred to by the UN Global Compact and the Guidelines for Multinational Corporations published by the OECD that are not binding, *per se*, but their principles are often reflected in the applicable national laws and for the rest may be followed voluntarily by the corporations concerned.

⁷³ Ibidem

⁷⁴ The macro-institutional norm for business is profit making.

GODFREY, PAUL C., et al, “The relationship between corporate social responsibility and shareholder value: an empirical test of the risk management hypothesis”

⁷⁵ Ibidem

Corporate purpose is, therefore, not to be confused with social interest (interest of society, in a collective/common meaning⁷⁶, not only the shareholders' interest⁷⁷⁸), it is an element, defined by the shareholders, which directors must consider in their organisational management strategy.

According to COLIN MAYER, Corporate Law should require companies and financial institutions to articulate their purposes, incorporate them in their articles of association, and demonstrate how their corporate structures and conduct promote their purposes.⁷⁹

However, considering this theory, to be enforceable, corporate purpose should be stipulated by contract and fiduciary duties based on the purpose so defined, resulting in Company Law replacing regulation⁸⁰, besides the fact that this matter differs across the various legal systems (even across EU).⁸¹ Moreover, it would not be compatible with CSR practices as it is mainly dominated by voluntariness.⁸²⁸³

⁷⁶ PEREIRA DIAS, RUI / DE SÁ, MAFALDA, “*Deveres...*”

⁷⁷ COUTINHO DE ABREU, JORGE, *Curso de Direito Comercial - vol. II, Das Sociedades*, 6a ed., Almedina, Coimbra, 2019, pp.275-276

⁷⁸ This presupposes the so-called stakeholder engagement since *the management and control function of companies must allude to the various interests*. OLAVO CUNHA, PAULO, “Corporate & Public Governance nas sociedades anónimas: primeira reflexão”, DSR,2010

⁷⁹ MAYER, COLIN, “Prosperity. Better Business makes the greater good”, Oxford: Oxford University Press, 2018.

⁸⁰ Moreover, we cannot expect companies to fully internalize the social costs of their externalities and rely on corporate governance and shareholders as the main instruments to preserve the integrity of corporations.

⁸¹ In UK, *company purpose* is embraced by *soft law*, where according to the *UK Body Corporate Governance*, in its *Board Leadership and Company Purpose* section, directors are only required to explain to the market the reasons for non-compliance - the *comply or explain* model. The English version of the Corporate Governance Code precisely illustrates this idea insofar as it does not spell out the legal and corporate meaning of “Social purpose”, and in the words of MARIA ELISABETE RAMOS, it is not concern to do so either, which leaves the (inevitable) opening for the *hard law* nature of state law to act. In Portugal, the purpose of companies is to make a profit, according to Article 980 of the Civil Code and Article 6 of CCC.

In France, unlike the UK which approached *purpose* through a *soft law* mechanism, the *corporate purpose* movement has reached “legality”. The PACTE Law of 22 May 2019 - *Loi n. ° 2019-486 du 22 mai 2019 relative à la croissance et la transformation des entreprises* - was enacted, which enshrines a model of responsible capitalism that is sensitive to social needs by integrating the “*raison d'être*” concept into Article 1835 of the French Civil Code.

⁸² CARDINAL CARVALHO, RUI, “Corporate Purpose: revolução ou utopia no Direito Societário?”, in *Direito das Sociedades em Revista*, 2022

The understanding of “*corporate governance*” or “*corporate purpose*”, is not consensual. In pragmatic terms, the behaviour of companies varies according to the social rules of conduct and cultural values in force in each legal system (and in each company)⁸⁴.

Also, in practice, adopting and defining a *corporate purpose*, even if it is by the articles of association, will have minimal or no legal consequences in terms of directors’ liability in case of breach with ESG metrics.

Company legislation rarely expressly stipulates what is included in the interests of the company, the interpretation is thereby left to the boards.⁸⁵

Corporate purpose definitions hardly ever appear in specific or quantitative terms, so the burden of proving that the director’s conduct was contrary to the corporate purpose would be quite complicated, as it appears (almost always) in abstract and undefined propositions.⁸⁶

It is therefore understandable that it is neither clear nor strictly mandatory that companies adopt sustainable practices and mitigate climate change by simply adopting a sustainable corporate purpose.

⁸³Portuguese law does not prevent a company’s articles of association from specifying the corporate purpose and from outlining objectives, given that the current legal rules on the companies’ agreement and the articles of association do not oppose this. Corporate Law rules on the elements of the contract or its content do not prevent the shareholders from incorporating clauses into the articles of association that are not expressly provided for by law - Articles 176, 199, 272, 466 of the CCC.

⁸⁵ SJAŦJELL, BEATE, “Reforming EU Company Law to secure the future of European Business”, in *The Palgrave Handbook of ESG and Corporate Governance*, Paulo Câmara and Filipe Morais (eds.), Palgrave Macmillan, 2022

The author proposes a corporate purpose at a European Level “*A redefined corporate purpose should be expressed on an overarching level in EU legislation, without replacing the specific purposes that the legislation governing the various forms of undertakings in the Member States may set out.*”

⁸⁶ ZHU, MICHELE, “Integrating Sustainability in EU Corporate Governance Codes”, in *Sustainable Finance in Europe*, EBI Studies in Banking and Capital Markets Law, Series Editors, Palgrave Millan, p.178

In financial markets, companies will adopt sustainable governance corporate actions depending on the sustainability preferences of investors, banking activity, and the consumer demand.⁸⁷

5. An E.S.G. Duty for Directors: *Is it mandatory to be Green?*

Various legal systems have realised over time that sustainable concerns have ended up strongly contaminating corporate action.⁸⁸ The question is whether this reality forms a real obligation itself for companies and its directors.

Commission has addressed this concern. The communication on “The European Green Deal” states that sustainability shall be covered in corporate governance framework as many companies still focus too much on short-term financial performance⁸⁹ and some studies⁹⁰ have been made on directors’ duties and sustainable corporate governance. In Commission’s opinion, companies do not adequately address sustainability problems and connects this premise to a narrow interpretation of company laws - particularly of the rules on the company’s interest and directors’ duties.

According to BRUNO FERREIRA and MANUEL SEQUEIRA *“despite these ESG advancements, directors are still strictly conditioned to act in accordance with the controlling shareholders’ interests, disregard of stakeholders’ interests as set out by law.”*⁹¹

In that regard, progress was made in the European Union towards imposing a genuine duty of corporate diligence and corporate responsibility⁹², based on injunctive

⁸⁷ PACCES, ALESSIO M., “Sustainable..”

⁸⁸ MIRANDA BARBOSA, MAFALDA, “Fatores ESG...”

⁸⁹ European Commission, Communication on The European Green Deal, Brussels, COM (2019) 640 final, available at https://ec.europa.eu/info/strategy/priorities-2019-2024/european-green-deal_en#actions.

⁹⁰ Study on directors’ duties and sustainable corporate governance. Final report prepared by EY for the European Commission DG Justice and Consumers, https://ec.europa.eu/info/business-economy-euro/doing-business-eu/company-law-and-corporate-governance_en#studies.

⁹¹ SEQUEIRA, Manuel / FERREIRA, Bruno, “Business..”

⁹² MORAIS ANTUNES, ANA FILIPA, (2022), “ESG, racionalidade empresarial e novos contenciosos”, in *Revista de Direito Comercial*

rules, as highlighted in the European Parliament Resolution of 10 March 2021⁹³: “(...) considers that the Union should urgently adopt binding requirements for undertakings to identify, assess, prevent, cease, mitigate, monitor, communicate, account for, address and remediate potential and/or actual adverse impacts on human rights, the environment and good governance in their value chain (...)”.

Nevertheless, the situation is not so straightforward. In a preliminary phase, CSDD Proposal⁹⁴ contained article 25 which regulated the duty of care of directors, establishing an obligation to create and supervise due diligence actions and adapt business strategy to consider some negative effects.

Further, Council of the European Union's General Guidance of 30 November 2022⁹⁵ announced that Articles 25 and 26 will be eliminated.⁹⁶ The arguments for the removal grounded on the impact that it could cause in some Member States' legislation as well as in deeply rooted concepts of national company law, since the “company interest” mentioned in article 25 does not exist everywhere and the “duty of care” borrowed from the Anglo-Saxon tradition is also interpreted differently by Member-States⁹⁷.

Legal and financial literature have raised⁹⁸ whether is needed a legislative reform to induce directors to consider ESG factors when fulfilling their duty to act in the interests of their companies. Some authors argued⁹⁹ that it is doubtful that a directive is needed to

⁹³ <https://eur-lex.europa.eu/legal-content/EN/TXT/PDF/?uri=CELEX:52021IP0073>

⁹⁴ <https://eur-lex.europa.eu/legal-content/EN/TXT/?uri=CELEX%3A52022PC0071>

⁹⁵ The European Council press release can be found here: <https://www.consilium.europa.eu/pt/press/press-releases/2022/12/01/council-adopts-position-on-due-diligence-rules-for-large-companies> and also the Point F, n.º 30 from the accompanying justification note: <https://data.consilium.europa.eu/doc/document/ST-15024-2022-REV-1/pt/pdf>

On 14 december 2023, the Council and the European Parliament have reached a provisional <https://www.consilium.europa.eu/pt/press/press-releases/2023/12/14/corporate-sustainability-due-diligence-council-and-parliament-strike-deal-to-protect-environment-and-human-rights/>

⁹⁶ https://www.mlgs.pt/xms/files/site_2018/Newsletters/2022/Orientacao_geral_do_Conselho_da_UE_so_bre_a_proposta_de_Diretiva_relativa_ao_dever_de_diligencia_das_empresas_em_materia_de_sustentabilidade_-_Legal_Alert_ML_-_PT-.pdf

⁹⁷ The article is also silent on the link between this duty of care and the BJR systems existing in some Member States or on the procedural aspects relating in particular to the right of action to sanction the violation of such a duty of care.

⁹⁸ FERRARINI, GUIDO, “Redefining..”

⁹⁹ Ibidem

harmonize directors' duties in sustainable matters, since legal systems have flexibility to regulate those issues and reach similar outcomes on their own either through soft law measures, national legislation or through market practices.

The flexibility expected of Member-States presupposes that, if necessary, they will intensify their corporate governance structures, considering a much more challenging duty of care in terms of sustainability.

Directors should consider material ESG metrics when deciding. It is reflected in instrumental duties attached to the duty of care: (i) duty to monitor – in case of existing any risk, irregular event or, for instance, a case of discrimination, directors must pay attention to these problems, as well as request information, adopt reporting systems and, if necessary, create “ESG” departments in order to allow the board to monitor corporate compliance with all applicable laws; (ii) duty to properly prepare management decisions and inquiry - in the process of analysing information, ESG data should be collected, on a reliable information system basis, by the board and time and resources shall be invested in studying them; (iii) duty to take rational management decisions - ESG are considered when a coherent decision is made and explained, since decisions will be increasingly complex and will be demanding discussed them in the board and explaining them to shareholders; (iv) duty to take reasonable management decisions - ESG stimulates directors to make decisions and perform socially responsible acts.¹⁰⁰

In theory, it means that if ESG were ignored by directors, it is highly likely that the administrator would be violating the instrumental duties of care and could be held liable for his action.

However, in Portugal, as previously explained, the failure in fulfilment instrumental duties does not automatically trigger a breach of the duty to make reasonable decisions and if so, would exist a large margin to argue that the mere “rationality” (a very weak criteria) was attended. In addition, the majority of judgements only discuss a potential

¹⁰⁰ Ibidem

breach of the duty of loyalty and never the breach of the duty (and its instrumentals) of care.

Portuguese law, among others, does not directly include ESG factors in the scope of its law, neither within a true legal duty. This would only be possible if CCC was amended by introducing some ESG considerations on both articles 64 and 72.

II - The Financial Impact of E.S.G. factors

6. The Role of ESG Driven Investors in Financial Markets

ESG investing refers to a set of standards for a company's behaviour used by socially conscious investors to screen potential investments.¹⁰¹

The nature of investment does not only hold the dimension concerned with shareholder returns, in fact, earning money and engaging in morally upright behaviour are frequently compatible.¹⁰²

Moreover, Sustainable Finance initiatives in EU, as Action Plan, have been reformulated the financial market players and investors mentality, replacing the profit-centric perspective giving space to engage in stakeholder-value drivers and more conscious practices.

This consciousness is essentially reflected in the increasing transparency of ESG performance, the availability of green investments, ESG scoring and the appearance of ESG tax incentives.

ESG Scoring¹⁰³ make investors able to make more informed decisions and assessing company's performance according to its ESG criteria; transparency will encourage competitive advantage by identifying competitors in the market that adhere to the highest ESG standards; tax incentives foster investors to pursue green sustainable projects since tax benefits will be derived from it.

¹⁰¹ <https://www.investopedia.com/terms/e/environmental-social-and-governance-esg-criteria.asp>

¹⁰² This is the opposite of Friedman's theory. People can be affected to the damaging consequences of externalities of certain business activities and by taking efforts to minimize the impact of those externalities, welfare could be boosted.

¹⁰³ Credit rating agencies have also begun to issue ratings with green and ESG factors, with each rating agency applying its own criteria. ESG factors are considered in relation to country risk assessments, risk position and corporate governance. Credit ratings play an important role in helping investors make better-informed decisions and judge the risk of lending money to a given company.

<https://www.spglobal.com/ratings/en/research-insights/special-reports/esg-in-credit-ratings>

Nonetheless, when assessing ESG ratings, investors must look beyond the scores, understand the methodology, deciding if it aligns with their own preferences. It is acknowledgeable that ESG rating are different from credit ratings; it is necessary to exercise the judgement and form an independent assessment

“A new kind of sustainable conscious investor is beginning to emerge.”¹⁰⁴

6.1. Sustainable Financial Products and ESG Bonds

Financial Markets distinguish between (i) financial products that are dedicated to types of projects with (some degree of) ESG signature and (ii) financial products that are meant to support the issuers/borrowers of the products in their ambitions in (some degree of) ESG.

The International Capital Markets Association (“ICMA”)¹⁰⁵ is committed to contribute to the development of sustainable finance through the capital markets¹⁰⁶ and has issued voluntary guidelines known as Principles for Green Bonds: Green Bonds Principles¹⁰⁷, Social Bonds Principles, Sustainability-Linked Bonds Principles¹⁰⁸ which describe the best practices for issuing debt securities that fulfil social and/or environmental purposes.¹⁰⁹

Green Bonds¹¹⁰ are debt securities issued by governments and private or public entities, whose proceeds are used to finance green projects/assets. For instance, GB

¹⁰⁴ <https://lande.finance/blog/who-is-the-sustainable-conscious-investor>

¹⁰⁵ <https://www.icmagroup.org>

¹⁰⁶ <https://www.icmagroup.org/About-ICMA/mission/>

¹⁰⁷ *“Issued in November 2008, the World Bank’s first green bond created the blueprint for sustainable investing in the capital markets. Today, the green bond model is being applied to bonds that are raising financing for all 17 Sustainable Development Goals.”*
<https://www.worldbank.org/en/news/feature/2018/11/27/from-evolution-to-revolution-10-years-of-green-bonds>

¹⁰⁸ [https://www.icmagroup.org/sustainable-finance/the-principles-guidelines-and-](https://www.icmagroup.org/sustainable-finance/the-principles-guidelines-and-handbooks/sustainability-linked-bond-principles-slbp/)

[handbooks/sustainability-linked-bond-principles-slbp/
https://www.icmagroup.org/assets/documents/Sustainable-finance/Translations/Portuguese-GBP-2021_06.pdf](https://www.icmagroup.org/assets/documents/Sustainable-finance/Translations/Portuguese-GBP-2021_06.pdf)

¹⁰⁹ A bond is a security that establishes a credit relationship between the purchaser of the bond and the issuer. The purchaser pays a certain amount of money up-front to the issuer, and in exchange expects to receive the principal at the end of the life of the bond, as well as coupon payments over the life of the bond. Buyers of bonds are mainly large institutional investors such as pension funds, insurance companies, mutual funds.

Bond prices are computed as the present value of the cash flows the bond provides for its holder.

The appropriate discount rate at which cash flows are discounted is called the Yield to Maturity (YTM) - represents the rate of return that investors require before investing in a bond

¹¹⁰ In Europe, the corporate sector issued 24% of the global volume of green bonds issued in 2019 (approximately US\$60 billion), followed by government-backed entities (22%) and financial institutions. FERNANDES, NUNO, “Climate Finance”, 2023, p.36

are issued to finance specific projects that help reduce GHG emissions, such as renewable energy infrastructure.

The issuer of a bond can label it “green” and for it, the issuer must provide investors with details on the green eligibility criteria, namely stipulations regarding the use of the proceeds and reporting. To increase transparency and accountability, issuers can ask for an independent external review (Second parties’ opinions) aiming to assure investors that a GB meets the defined global standards, however, there is no effective monitoring mechanism to ensure compliance with the standards, and it is not easy to legally enforce the green integrity of the bonds.

Greenium occurs when issuers of GB benefit from lower borrowing costs, *i.e.*, bonds are sold at a premium relative to conventional bonds, which is equivalent to a lower YTM (when YTM at issuance date is lower, the price of the bond is higher, which in turn translates into higher proceeds to the issuer).

There is evidence of a positive relationship between the issuance of GB and a firms’ financial performance. WANG ET ALL (2020) analysed a sample of 159 corporate GB issued in China from January 2016 to 2019 and found positive stock market returns for corporate GB issues.¹¹¹

Sustainability-linked Bonds are a new trend¹¹², a borrowing instrument where financial and structural characteristics are based on whether the issuer achieves sustainability metrics within a given timeframe. The interest paid varies according to predefined ESG targets – the coupon rate is set at a base level, however, it goes down if goals are achieved and goes up if the opposite.

Bonds market is a self-labelled market: ICMA is an example that has been provided efforts, guidelines, principles to help market players to pursue their ESG ambitions on a voluntary basis. In fact, regarding the exponential growth of green

¹¹¹ Ibidem

¹¹² <https://www.lse.ac.uk/granthaminstitute/explainers/what-are-sustainability-linked-bonds-and-how-can-they-help-developing-countries/>

corporate financing is becoming increasingly difficult for bond issuers to access the market with ESG-labelled bonds when their corporate strategy is misaligned with those objectives.¹¹³¹¹⁴

EU is also using current market practices as inspiration to convulse them in legal requirements.¹¹⁵

The European Green Bond Standard (inspired by ICMA principles) is the first financing tool incorporating the European Taxonomy ensuring that the funds raised through GB are used to finance climate-friendly projects that are in line with the European Commission's long-term goals.¹¹⁶

Regulation (EU) 2023/2631 of the European Parliament and of the Council of 22 November 2023 on European Green Bonds, applicable from 21 December 2024, represents another pillar in the regulatory edifice for implementing the EU's strategy for sustainable financing that favors the transition to a climate-neutral economy. It applies to issuers (financial and non-financial, public, and private) of debt securities distributed in the EU.

This deeper and complex regulation encompasses incentives and benefits to investors as they are conscious that their investments choices are contributing to the

¹¹³ EISENEGGER, MARIO, "Green Bonds, Blue Bonds, ESG Bonds Galore – a beginner's guide for fixed income investors", 2021, available at: <https://bondvigilantes.com/blog/2021/02/green-bonds-blue-bonds-esg-bonds-galore-a-beginners-guide-for-fixed-income-investors/>

¹¹⁴ Investors willing to invest in sustainable finance instruments also flock to ESG investment funds, they do so on a voluntary basis to meet market demand and not under a legal obligation as they apply their own standards.

¹¹⁵ Also, entities such as European Securities and Markets Authority (ESMA) and the European Insurance and Occupational Pensions Authority (EIOPA) were mandated by the European Commission to provide technical advice on potential amendments to, or the introduction of, delegated acts regarding the integration of sustainability risks and sustainability factors under various sector-specific directives and regulations. https://www.esma.europa.eu/sites/default/files/library/esma34-45-688_final_report_on_integrating_sustainability_risks_and_factors_in_the_ucits_directive_and_the_aifmd.pdf

¹¹⁶ https://finance.ec.europa.eu/sustainable-finance/tools-and-standards/european-green-bond-standard-supporting-transition_en

fulfillment of the goals established by the EU and promote more sustainable business activities.

Sustainable Finance practices are, in fact, driving legislation (to be greener) and action from lawmakers to support and regulate the existing sustainable finance market, ensuring its proper functioning. The aim is to provide financial incentives for companies to invest in financial products that are beneficial to the environment.

*“Yes, bonds and ESG are a match”.*¹¹⁷

6.2. The Role of Banks and Green Asset Ratio

The mutual interdependency intrinsic to strong sustainability is particularly true for the banking sector, given its crucial role in financing the economy. *“Sustainability financing can be an attractive opportunity for commercial and investment banks. Given stakeholders’ pressure to incorporate ESG strategies and minimize climate risks, banks have been increasing their business in this area”*¹¹⁸

ESG in Banking sector has two relevant dimensions since (i) there is an impact on banks themselves, affecting aspects such as their purpose, the information they provide, the risks to be managed, and (ii) there is a further impact arising from banks as lenders, through the pressure they exert over financed entities.¹¹⁹

Banks are affected by environmental risks (as well as social and governance risks). Risks arise from banks’ exposure to their counterparties. There are several transmission channels which work as drivers of pre-existing financial risks - mostly identified in relation to environmental factors - with consequences on balance sheets, portfolios, decreased profits, and increased exposures.

The most extreme case of transition risk occurs when assets become stranded, for instance, abandoned oil platforms, refineries, and coal-fires power plants.

¹¹⁷ <https://www.investopedia.com/news/esg-and-bonds-its-match/>

¹¹⁸ FERNANDES, NUNO, “Climate...”, p.127

¹¹⁹ SÁ, MAFALDA, “ESG and Banks: Towards Sustainable Banking in the European Union”, Palgrave Handbook of ESG and Corporate Governance, , Palgrave Macmillan

European Commission, following the European Banking Authority (EBA), has adopted a broad, prudentially oriented definition of ESG risk as meaning the risk of losses arising from any negative financial impact on the institution stemming from the current or prospective impacts of [ESG] factors on the institution's counterparties or invested assets.

Alongside sustainable capital market products, such as GB, there are also banks' sustainable products such as Green and Sustainability-linked Loans. *Green Loans* are loans that a financial institution grant to an individual/company exclusively to finance green projects, which need to provide clear environmental benefits. *Sustainability-linked Loans* are loans whose terms are predetermined in accordance with sustainable performance; the rate of these loans is linked to sustainability performance targets. Both require reporting duties.¹²⁰¹²¹ I

In their capacity as lenders, banks are willing to provide some interest rate reduction to companies and are in a privileged position to influence and lead to change in the financed entities.¹²²

Credit institutions may be aligned with regulatory expectations¹²³¹²⁴ as well as to provide conditions and incentives to foster the flow of funds to a more sustainable economy.

For credit institutions, the *Green Asset Ratio (GAR)* has been established by the European regulatory authorities as a *key performance indicator (KPI)* for measuring the

¹²⁰ There are also *Green Deposits*, in which the funds are allocated to a given pool of eligible assets that fulfil certain environmental criteria.

¹²¹ Green and sustainability-linked loans have been standardised by a group of loan market associations, establishing the core principles which these products should comply with. Loan Market Association/Asia Pacific Loan Market Association/Loan Syndications and Trading Association, "Green Loan Principles", December 2018, and "Sustainability Linked Loan Principles", 2019 www.icmagroup.org

¹²² FERNANDES, NUNO, "Climate...", p.127

¹²⁴ NFRD, Taxonomy, the CRR2 already requires banks to address ESG risks and how they plan to face these risks and the SFRD with the goal of making the sustainability profile of funds to provide a better comparison between them for the investors and other interested stakeholders.

proportion of Taxonomy-aligned¹²⁵ on-balance-sheet exposure in relation to the total assets. It shall be disclosed in aggregate terms (total GAR) and broken-down by environmental objective, type of counterparty and subset of transitional and enabling activities. Also, it is intended to uncover the exposure of credit institutions, through their main lending and investment to different economic activities as classified by the Taxonomy, displaying the extent to which their financing is (or is not) sustainably aligned.¹²⁶

It will allow stakeholders to assess a bank's portfolio from an ESG perspective, namely in terms of environmental risk exposure. Conversely, it will demonstrate how they contribute to the development of green sectors through their lending options.

The calculation of the GAR is dependent upon an inquiry of the Taxonomy-alignment of the financed entities' activities that are subject to the disclosure obligations under the NFRD, however, the denominator of the GAR also includes the exposures of counterparties not subject to NFRD.

Due diligence will be required of both parties, since banks will need to evaluate their loan books and their counterparties will need to assess their activities to correctly qualify them. Firms with a higher share of Taxonomy-aligned activities will receive cheaper loans.

¹²⁵ If an activity *per se* can be eligible under the Taxonomy but violates e.g. the technical screening criteria, the activity may be called Taxonomy-eligible but not Taxonomy-aligned. In order to enable investors to evaluate the degree of sustainability of a specific non-financial or financial undertaking, it is crucial to disclose the proportion of economic activities that are Taxonomy-aligned, only Taxonomy-eligible or neither.

Therefore, suitable KPIs have been introduced measuring the proportion of Taxonomy-aligned economic activities. The Taxonomy ratio of non-financial undertakings can be calculated as the proportion of Taxonomy-aligned turnover, capital expenditure or operational expenditure.

Disclosure Delegated Act 2021/2178 have set forth appropriate KPIs for financial undertakings depending on their business model - Annex V establishes KPIs for credit institutions - it shall measure the proportion of the credit institution's assets financing and invested in Taxonomy-aligned economic activities as a proportion of total covered assets; Annex VI has the corresponding template.

It also be understood with the Commission Implementing Regulation 2022/2453, Template 7 (Mitigating actions: Assets for the calculation of GAR) - *Prudential disclosures on ESG risks (Article 449a CRR)*

¹²⁶ SA, MAFALDA, "*ESG and Banks..*"

The solution is to legislate in such a way as to put pressure on private investment towards sustainability, by implementing information and action obligations.

The obligation to inform arises from various European laws such as the SFRD, Regulation 575/2013 (“CRR”), Taxonomy and the CSRD, while the obligation to act will come from the CSDDD. Information creates pressure, visibility, comparison, and market image, which is crucial as the pressure passes from financial institutions (banks) to large companies and from these, in turn, to the value chain (SMEs), still indirectly but inevitably.

Moreover, banks are preparing themselves for extensive compliance requirements - as signaled by the European Commission’s proposed Banking Package¹²⁷ - since the emerging sustainable banking law in the EU is penetrating the core of banking regulation.

7. ESG Factors as a Game Changer

The choice of ESG factors allows for different standards for comparing companies in addition to traditional balance sheets, corporate reports, and accounts. ESG, in addition to changing the paradigm of financial players, is also influencing the actions and alignment of financial market authorities.

The European Securities and Markets Authority (“ESMA”) in 2022 announced that it was changing its Union Supervisory Strategic Priorities to include ESG disclosures alongside market data quality. The new ESG disclosure priority replaces the costs and performance of retail investment products and represents an important step in the implementation of ESMA's strategy, which gives a prominent role to sustainable finance.¹²⁸ Moreover, ESMA launched in 2023 with the National Competent Authorities

¹²⁷ [Latest updates on the banking package - European Commission \(europa.eu\)](https://ec.europa.eu/economy_finance/press-releases/2023/03/23_01_en)

¹²⁸ <https://www.esma.europa.eu/press-news/esma-news/esma-work-esg-disclosures-new-union-strategic-supervisory-priority>

a Common Supervisory Action on sustainability-related disclosures and the integration of sustainability risks.¹²⁹¹³⁰

EBA issued the Pillar III ESG that requests information to the banks on the environmental, social and governance risks, how the balance sheet is affected and how banks act to hedge these risks. These requirements are qualitative and quantitative with templates, including the GAR specified in the Taxonomy. Also, in 2022 EBA published a roadmap on sustainable finance outlining the objectives and timeline for delivering mandates and tasks in the area of sustainable finance and ESG risks.

Recently, on 18 January 2024, was launched a public consultation on draft Guidelines on the management of ESG risks. The draft Guidelines set out requirements for institutions for the identification, measurement, management and monitoring of ESG risks, including through plans aimed at addressing the risks arising from the transition towards an EU climate-neutral economy.

Besides that, ESG factors are “contaminating” various important concepts: such as the positioning of consumers, companies’ supply chains, corporate strategy and performance, as well as the competitiveness and strategic market positioning.

Concerns about environmental issues are spreading to consumers. In December 2019, an online survey of 19,964 consumers across 28 developed and developing countries showed that about 70% of the respondents has changed the products and services they used due to environmental concerns.¹³¹ These changes in consumption attitudes affect the way companies design their strategies, as they strive to meet the consumer demand for more responsible products.

Firms may choose to invest in ESG in response to investor or consumer expectations, thereby reducing their cost of capital, or improving their profit margin.

¹²⁹ <https://www.esma.europa.eu/press-news/esma-news/esma-work-esg-disclosures-new-union-strategic-supervisory-priority>

¹³⁰ The goal is to assess the compliance of supervised asset managers with the relevant provisions in SFDR, the Taxonomy Regulation and relevant implementing measures, including the relevant provision in the UCITS and AIFMD implementing acts on the integration of sustainability risks.

¹³¹ FERNANDES, NUNO, “Climate...”

Investments in ESG may also lead to lower costs and risks, so those factors are not merely “nice to have”, they relate to corporate performance and risk.

Many companies are incorporating ESG issues in their supply chain and global trade network, fostering change. They are using novel supply chain finance contracts¹³², where the suppliers’ payment terms and the implied interest rate are contingent on their sustainability standards. Thus, corporate initiatives by large multinational companies are expanded throughout their supply chains, namely to SME’s worldwide, and incentives are used to drive behaviors.

As investors understand that ESG factors can be material to investment performance, the traditional finance relationship risk-return is being redefined.

The value-enhancing role of ESG presupposes that is in the company’s own best interests to adopt ESG objectives as such objectives make good business sense. For instance, HEINKEL ET ALL (2001) showed how firms excluded by socially responsible investors suffer a reduction in their investor base and have higher cost of capital and the positive effects of ESG are also confirmed by positive shareholder reactions to successful ESG engagements.¹³³

LARRY FINK, CEO of BlackRock, said¹³⁴ that when we factor in all risks properly, portfolios take sustainability and climate change into consideration should provide better risk-adjusted returns to investors.

That is, high-ESG companies should benefit from a lower cost of capital, consistent with the lower risk, in fact, reduced cost of capital means stock prices should increase, as shareholders expect rate of return in lower. If a company is responsible and the market knows it, the company’s current value in the market should reflect this.

¹³² Supply chain finance is a financing program set up by a bank that allows suppliers to be paid earlier and usually with a better conditions than those they could get on their own. Sustainable SCF schemes allow suppliers to access better financing conditions from banks, depending on their carbon footprint or environmental performance (or other goals, scores).

¹³³ Some associate better environmental performance to both higher accounting performance (return of equity and return on assets) and with higher stock market returns. FERNANDES, NUNO, “Climate...”, p.239

¹³⁴ Ibidem

Nonetheless, as NUNO FERNANDES points, during a transition period, companies are rewarded for their good sustainability performance and their share prices should outperform those of their counterparts – this occurs when market is repricing shares. As companies with more sustainable practices generate higher cash flows and have lower risk than the market expects, in the short run, they outperform their counterparts in terms of short-term stock returns.

The evidence suggests that the reduction in demand (due to investors being unwilling to hold companies with poor ESG performance) translates into lower stock prices today and higher returns in the future.

Once transition is over, greener companies will benefit from a lower cost of capital which means a lower expected return¹³⁵ on investors' capital but investors appreciate owning them and they also offer a hedge against climate risk.

PÁSTOR ET ALL (2022)¹³⁶ explained that greener assets have lower expected return in the future but as investor tastes shift toward green assets and products, these greener assets realize higher returns (it was due an increase in investor concerns about climate). Also, in German government bonds was evidence that GB has outperformed its non-green twin, as their yield has decreased – this is the *greenium* (difference in the price of GB and conventional bond).

This phenomenon suggest that some impact investors are willing to earn lower returns in exchange for impact (even it varies across investors), they are becoming conscious investors and are more committed to their investments.

Moreover, having an ESG profile is becoming more important for a company's brand, as the media and the public will increasingly hold companies accountable for failing to do so and turn it public.

¹³⁵ Consistently, high stock returns and high valuation levels are incompatible, since when a company carries a higher risk, investors are willing to bear the risk only if higher returns are expected.

¹³⁶ Ibidem

On the other hand, it can be beneficial since it gives space (namely to the largest companies) to demonstrate how they are complying, in advance, - *being pioneers* – with ESG demands (some EU regulation will only apply in the future).

Communicating with the market (different from *greenwashing*) regarding their green attitude will make them to better position themselves, fostering competition, while implementing new business strategies and innovations across the sector. This will also put pressure to small and medium-sized companies that sooner or later will also have to adopt green measures (even proportionally).

In that line, companies can also take advantage from track-record as it refers to a company's historical performance and accomplishments in a particular area of focus. A strong track-record of ESG performance can enforce the credibility to investors and/or stakeholders.

A company with a strong track-record of energy efficiency and emissions reduction is less likely to experience regulatory fines or reputational damage related to environmental concerns.

It is also aligned with the idea that regulatory risks have begun to materialize, namely on behalf of the European legislator, and complying with the regulation is perceived and guaranteed to be a permanent benefit.

7.1. The role of directors in the company and in the supply chain: A *Behavioral Revolution*?

One of the board's most important responsibilities is the management of long-term risk. ESG pose unique challenges for boards, as it affects the company in multiple ways such as consumers, suppliers, financing and capital market changes, regulatory risk, etc.

As concerns about climate risks have increased, investors and regulators are also demanding greater disclosure of these risks, and boards that ignore climate risks may be

vulnerable to shareholder actions. Ultimately, neglecting climate change risks and opportunities can be considered a failure in fiduciary duties.¹³⁷

In January 2020, BlackRock published “Global Principles” that guide its investment stewardship. BlackRock supports boards that effectively manage strategic, operational, and material ESG factors. BlackRock assesses director performance considering the assessment of sustainable business practices and performance and considers not supporting the re-election of directors if company does not adequately disclose its strategy and commitment to sustainability, as they are considered accountable for this lapse.¹³⁸¹³⁹

The idea of conscious capitalism is beginning to spread. The aim has been to ensure that private investment is channeled towards sustainable activities, either by defining sustainable criteria that allow investors to weigh up the risk, or by imposing strict information obligations.¹⁴⁰

Even though there are no harmonised corporate governance mechanisms, such as corporate purpose, powerful enough, *per se*, to bond the behaviour and performance criteria of company directors towards sustainability, there will be consequences from the point of view of the concrete and particular private relationships that may be established within the company and with stakeholders.

¹³⁷ PwC (2020) surveyed approximately 700 board members of large corporations, and 45% confirmed that climate and ESG issues are a regular part of boards agenda. A growing number of institutional investors are submitting shareholder resolutions calling for companies to appoint a board member with environmental expertise.

FERNANDES, NUNO, “Climate...”

¹³⁸ [Investment Stewardship | BlackRock](#)

¹³⁹ With other attitude is Vanguard’s CEO: Tim Buckley is challenging the asset-management industry’s environmental, social and governance orthodoxy. “*Our research indicates that ESG investing does not have any advantage over broad-based investing.*” “*The firm offers ESG index funds that exclude certain companies, which allow investors to express their values and preferences*” but this “*has to be an individual investor’s choice*” Mr. Buckley said. Matching word to deed, his comments came after he had withdrawn his firm from the \$59 trillion Net Zero Asset Managers initiative, an organization that is part of the \$150 trillion United Nations-affiliated Glasgow Financial Alliance for Net Zero. Mr. Buckley claims the financial world, swept up in climate-change fervor, can’t make such commitments without renegeing on its fiduciary duties. [Vanguard’s CEO Bucks the ESG Orthodoxy - WSJ](#)

¹⁴⁰ BARBOSA. M. MAFALDA, “Fatores ESG...”

For example, following MAFALDA M. BARBOSA, a legal agreement to purchase securities that violates ESG criteria can even be invalid, insofar as the will to invest may have been determined by special environmental concerns.¹⁴¹

In GB case, after issuing GB, the issuer is still obliged to fulfil a series of information duties (such as submitting periodic reports), which are essential for investors to be able to monitor the green nature of the investment and the real impact of the project that they are financing. This means that if the capital invested is used for a project other than the one previously planned, or if the project is modified by losing its “green” nature, the contract can be terminated.

Thus, if the plan to carry out the environmentally sustainable project is part of the basis of the business and constrains the structuring of the main obligations assumed, then a change in the destination of the borrowed capital cannot avoid affecting the essential core of the business and, consequently, there would be clear repercussions in terms of the subsistence of the main obligations.

In addition, since the obligation is dependent on the financial return from the success of the environmentally sustainable project it is intended to finance, a change in the destination of the loan capital ultimately leads to a breach of the main obligation itself, with the necessary impact on the termination of the contract.¹⁴²

It is consequently widely acknowledged that ESG is changing the market and that it is not because there are no real legal behavioural obligations related to fiduciary duties adapted to these new standards¹⁴³ and effective means of holding directors accountable within the company by breaching ESG criteria that company directors have not modelled their corporate governance practices, including their purposes. Moreover,

¹⁴¹ Ibidem

¹⁴² Ibidem

¹⁴³ Despite of all the efforts that have been made in EU in that regard. For instance, HLEG Report has recommended *inter alia*, the strengthening of director duties related to sustainability and invited the Commission to explore ways to enhance director duties and incorporate sustainability in corporate practice.

the restructuring of corporate governance practices will be an obliged step to the achievement of international sustainability targets.

The fiduciary relationship and its underlying duties have evolved through time. As *fiduciary duty* is a dynamic concept, it must be interpreted according with the existing changes.¹⁴⁴¹⁴⁵

Directors are exercise their skills to consider the direct and indirect impact of the company's business model, production, and sales processes towards stakeholders and the environment as well as improving their risk management practices¹⁴⁶ and competitiveness.¹⁴⁷ According to European Commission boards have a "*vital part to play in the development of responsible companies*".¹⁴⁸¹⁴⁹

¹⁴⁴ MATIAS, TIAGO DOS SANTOS, "The EU Asset Managers' Run for Green"

¹⁴⁵ Regarding investments funds, by expressly imposing the integration of ESG factors in the investment decision process of fund managers, the EU framework (SRD II, SFRD, Taxonomy, NFRD) implicitly recognizes that fiduciary duties are, in fact, dynamic. Fiduciary principles impose on fiduciaries a duty of care and a duty of loyalty towards beneficiaries, where the duty of care requires fiduciaries to exercise skill and prudence when looking after the beneficiaries' assets and the duty of loyalty requires fiduciaries to manage funds in the beneficiaries' interests, and not their own, in order to provide beneficiaries with the benefits of such management.

Therefore, the dynamic nature of the fiduciary duty is precisely the reason why the European legislator has explicitly foreseen the integration of sustainability risks in the investment decision process and disclosure rules on how such integration is undertaken.

EU has chosen to lead the way, providing for a legal framework that will allow its fiduciaries, especially fund managers, to be at the forefront of the integration of ESG factors and, at the same time, allowing its beneficiaries to understand how and to what extent that integration is made by fiduciaries and investees themselves, becoming the standard-setter in the long run for the different shades of green.

Ibidem

¹⁴⁶ Integrating ESG factors in enterprise risk assessment will account for non-financial risks and will reduce company's exposure to liabilities (resulting from litigation or sanctions) and loss of value (which may result from negative press or knock-on effect on shares in the case of listed companies) resulting from unprecedented events. The consideration of the interconnection between impact/dependencies in the context of the business model will help companies map the spectrum of ESG risks and opportunities and manage them accordingly.

¹⁴⁷ The HLEG also recommended that sustainability-related competencies should be considered during board nomination processes, the company management should develop a climate strategy aligned with climate goals, and remuneration should be aligned with long-term and sustainability goals.

SIRI, MICHELE / ZHU, SHANSHAN, "Integrating Sustainability in EU Corporate Governance Codes", in *Sustainable Finance in Europe*

¹⁴⁸ European Commission, The EU Corporate Governance Framework (Green paper). COM(2011) 164 final, 5.4.2011, p. 5.

¹⁴⁹ Without the commitment of the board to direct the corporation towards achieving a purpose that benefits society and our planet, it is unlikely that the corporation will indeed do so. WINTER, JAAP, "*Duty of Societal...*"

The core function of the board is to promote the interests and define the corporate purpose of the company. Recently, jurisdictions have come to expect boards of directors to ensure legal compliance insofar as company law offers - across this whole spectrum - a wide latitude to the board of directors and, by extension, to management, to shape activity in a sustainable format.

The greater concern and demands of conscious investors and the banking activity itself will be reflected in the greater concern of directors to fulfil these demands in corporate governance¹⁵⁰, otherwise their companies will not be able to keep up with the financial market in this real paradigm shift.

In our opinion¹⁵¹, there is no need of a specific duty of societal responsibility for the board of directors of the corporation since the functioning of the financial market itself will do that pressure and be responsible for the same effects.

Whether due to circumstances or because of circumstances, directors and their dynamic fiduciary duties will have to be increasingly *green*.

8. Conclusions

Without a sustainable future for humanity on this planet, there is no sustainable future for business either. Business does not exist as a bubble separate from society and the environment.¹⁵²

¹⁵⁰ For instance, Corporate Governance Codes from Austria, Belgium, Czech Republic, France, Germany, Netherlands, Portugal, and Sweden recommend that companies should be managed in order to ensure a sustainable development/value creation/sustainable long-term value, intended as the maximization of shareholders' wealth with the permanent consideration of stakeholders' interests. Also, a growing number of codes tend to mention sustainability, CSR, social, and environmental issues, so signaling a growing interest towards the impact of environmental and social factors on business success in the long term. Specifically, some codes, such as the Italian and the Spanish codes, mentioned the new concept of 'sustainable success' introduced—but not defined—by the UK Code.

¹⁵¹ See J. WINTER, an opposite view. In "*Duty of Societal...*"

¹⁵² SJÄFJELL, BEATE, "*Reforming EU...*"

In a rising number of situations firms internalize externalities not only because it is profitable in the long run or at least suitable to reduce their risk exposures, but also to comply with the regulatory and ethical standards that protect relevant stakeholders.

In line with this reality, the EU has made several efforts to ensure that Sustainable Finance is becoming more and more apparent, even though there are still many gaps to be filled, many fields to be regulated.

Regulatory and legislative framework is still too incohesive to create the security that an emerging market like Sustainable Finance needs and there is no mandatory legal duties within the corporate governance of the major of the Member States that obliges directors to act *green* or to hold them accountable if they not act within a *green mindset* in their decision-making process.

Nonetheless, the market is demanding new financial instruments which allow investors (both private and institutional) and banks to invest in a conscious, impactful, and responsible manner.

Also, social media is encouraging consumers to disapprove companies' policies and are making them more aware and experienced in analysing the impacts and repercussions of companies' actions, inactions and policies on issues that concern them.

Concluding, this phenomenon and financial market demand are dynamically and progressively shaping the behaviour and practices of the directors and the companies themselves towards a sustainable corporate governance attitude making them adopt *green purposes*.

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