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Sustainability information and financial market efficiency

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This Debate Paper[1] highlights key challenges for appropriate implementation of the new EU sustainability reporting framework and how disclosure of reliable and comparable sustainability information might contribute to efficient capital allocation. To reach these objectives, the following urgent action points have been identified:

1. *Ensure full interoperability between the ISSB and ESRS standards, so that companies which comply with the ESRS are considered to be complying with ISSB standards*
2. *Proper and swift transposition and implementation of the CSRD*
3. *The European Commission needs to ask the CEAOB to develop a specific assurance standard that defines the sustainability assurance process, taking into account the work done by the IAASB*
4. *Develop a regulatory and supervisory framework for ESG ratings, notably to increase the transparency of sustainability rating methodologies*
5. *Elaborate a strategic vision for the EU in order to create a more diversified and competitive EU market for auditors, data providers, rating agencies and index and benchmark providers, which will improve the preparation of the EU sustainability data "eco-system".*

Introduction

In the context of the adoption of the European Union Corporate Sustainability Reporting Directive ("CSRD"), the AEFR proposes through this debate paper a brief and concise review of the key implementing issues regarding the development and dissemination of sustainability information on capital markets. The CSRD aims to create the conditions for sustainability reporting to become as strong a pillar as financial reporting, and to reduce greenwashing. To this end, it seeks to facilitate investment choices in sustainability assets by improving the assessment, the comparability, and the transparency of sustainability information.

[1] ***This Debate Paper was prepared by a dedicated working group composed of representatives of institutional members of the AEFR participating in a personal capacity (see appendix) whose aim is to initiate a discussion on key issues at stake for a proper implementation of the recent EU laws on sustainability reporting and sustainable finance. The views expressed in this paper do not necessarily reflect the views of the individual members of the working group. The study has greatly benefited from interviews carried out with key institutional and market participants stakeholders, who should be thanked for their very valuable contributions.***

The specific objective of the paper is to address two issues: (i) the quality, reliability, and harmonization of sustainability information and (ii) their impact on capital markets. This study seeks to highlight the challenges in implementing the CSRD, particularly on environmental issues. The paper does not seek to reopen issues that have already been agreed upon. It is a qualitative review based on interviews with stakeholders and related academic research.

1 Sustainability Data

This section aims to discuss the construction, reliability, and comparability of sustainability data at the company and aggregate (rating agencies and funds) levels. First, at the firm level, it seeks to highlight the issues related to the collection, the processing of sustainability data and the production of reliable sustainability information by companies. In addition, it mentions key differences in sustainability standards. Second, at the aggregate level, it provides a global assessment of data quality, of comparability, and of the evolution of the sustainability information available on financial markets. Furthermore, it discusses the practical implementation of the forthcoming regulations by stakeholders.

1.1 "Meaningful" information challenges: reliability and comparability of sustainability information at the company level

The CSRD aims to improve the comparability of sustainability information reported by companies based on specific standards. This is intended to encourage the allocation of capital to companies and activities that respond positively to key sustainability challenges and, therefore, contribute to the private financing of more sustainable economies and in particular the Green Deal objectives (Commission, 2019). For this purpose, the CSRD supersedes the previous reporting requirements introduced by the Non-Financial Reporting Directive ("NFRD"). The European Commission has mandated the European Financial Reporting Advisory Group ("EFRAG") to develop European Sustainability Reporting Standards ("ESRS") that will be applicable for all companies that fall under the scope of the CSRD.

The purpose of the CSRD is to ensure that quality sustainability information is disclosed by companies following a proper assessment by management and the governing bodies and for which an assurance has been carried out by an external auditor or an independent service provider. Quality information means information that is relevant, that provides a faithful representation, that is verifiable, that is understandable and that allows for comparability in general and within a specific sector. Combined with the European Single Access Point ("ESAP") initiative, the information will be easily available and free of charge. According to the probable outcome of the final EU legislative process, ESAP will be a centralised platform operated by the European Securities Markets Authority ("ESMA") that will gradually provide access to up-to-date financial, capital markets and sustainability-related data, which financial services firms and competent authorities will be required to make public or submit on a voluntary basis ((EUROFI, 2022).

Stakeholders consider the CSDR to be a significant and meaningful change in sustainability reporting but have expressed concerns about differences (i.e., on double materiality) and possible conflicts with other international

standards such as those of the International Sustainability Standards Board ("ISSB") and those developed by the US Securities and Exchange Commission ("SEC").

1.1.1 Differences between sustainability standards is leading to implementation challenges

One of the most notable changes introduced by the European sustainability reporting regime is the explicit measurement of double materiality by companies. As was also the case of the previous European regulatory framework, the ISSB and the SEC limit themselves to simple materiality, also known as financial materiality. This implies considering only the *Outside-In* approach (i.e., information regarding the positive and negative impacts that the environment and the society have on a company). In this context, positive impacts are equivalent to opportunities while negative impacts constitute risks. In addition to this more restrictive vision of the definition of materiality, EU sustainability reporting requires the adoption of an *Inside-Out* approach that covers information on the negative and positive impacts that a company has on the environment and society. The integration of those two dimensions defines the concept of double materiality. The major challenge companies face for the application of the CSRD is therefore to translate the double materiality principle into concrete and practical ways of assessing the current materiality of all risks, opportunities, and impacts.

Supervisors face similar implementation difficulties, particularly with a lack of experience on how sustainability information will interact with financial information and how the resulting information will fit into financial statements.
In addition, the scope of application of the ESRS, the ISSB standards and the SEC standards differ. The European sustainability reporting regime covers a larger perimeter of companies than the NFRD and the ISSB. The ESRS will apply to all large companies[2], and all EU listed European companies other than micro-companies. In addition, to ensure a level playing field, the ESRS will also apply to non-European companies with an aggregated revenue in the EU of more than €150 million if they have at least one large subsidiary in the EU with a revenue of more than €40 million. The ISSB framework, on the other hand, grants national jurisdictions the freedom to define which companies it is to be applied to, while the SEC considers that nearly all its registrants, including foreign private issuers, should be included.

In addition, EFRAG plans to release several industry-specific standards in the next 3 years. The ISSB already proposes in its climate standard industry-specific disclosures, in addition to climate-related financial data, that firms apply its 77 industry-specific Sustainability Accounting Standards Board ("SASB") standards for other topics. Finally, until now the SEC has only requested reporting of greenhouse gas ("GHG") emissions intensity.

Overall, apart from climate-related disclosures for which the three sets of standards have significant similarities (scopes 1, 2 and 3, and transition plans founded on science-based scenarios), a good number of discrepancies remain on specific items. Multinational companies subject to several frameworks still fear having to comply with different or even conflicting sets of standards that would translate into significant costs. Additionally, companies active in the US are often legally challenged in States that oppose sustainability disclosure or even forbid it.

Another tricky point that may emerge due to these differences is the measurement of pollution. Indeed, these

[2] Large companies meet the following requirements: they have on average more than 250 employees, their net turnover is higher than €40 million and/or balance sheet total €20 million.

differences can make it difficult to compare scopes 1, 2 and 3 through different standards. For example, if each standard is adopted by a company and influences the delineation of scopes 1, 2 and 3, this may result in different emission levels being estimated for the same company.

That said, significant convergence efforts have been made by EFRAG when transforming its ESRS exposure drafts into its formal draft ESRS sent to the European Commission (alignment of key concepts and definitions, including on financial materiality and value chain) with the objective of creating as much as possible interoperability between the ESRS and the ISSB standards. It is generally felt that a key goal is that companies complying with the ESRS should be considered as complying with the ISSB standards to avoid companies active in several jurisdictions being required to undertake multiple reporting.

Large companies who emphasize that they already apply the NFRD will more easily comply with the CSRD framework. However, small companies with no experience in the matter will face a significant number of awareness and process challenges. To overcome and mitigate such gaps, the CSRD and all standard setters suggest a proportionate and progressive approach depending on the size of the company.

As regards the materiality test and helping companies to select the key information that is significant enough to be disclosed, EFRAG has revisited its initial "refutable presumption concept" to adopt a more pragmatic approach. Companies will not be required to explain why some information is not disclosed. However, a specific set of information will be mandatory in all circumstances (i.e., not subject to the materiality test): it will include the general information under ESRS E2, climate change information under ESRS E1, sustainability information required by other EU laws and, for companies with more than 250 employees, some key social indicators not covered by the Sustainable Finance Disclosure Regulation ("SFDR").

1.1.2 Learning by doing a sustainability information production chain

The ambition of the EU legislators is to create sustainability reporting of equal magnitude to that of financial reporting. For that purpose, sustainability has been added to every step of the financial reporting production chain. Collection, aggregation, and presentation of sustainability data should be subject to rigorous processes and internal controls, and sustainability information now fully belongs to the duties of audit committees. Sustainability information will initially be subject to a limited assurance by the statutory auditor(s) or another independent provider of assurance services (where allowed by a Member State). Such steps also aim to ensure consistency between financial and sustainability information.

That said, the process of producing sustainability information is new territory for all parties involved, including supervisors. "Learning by doing" will guide the initial phase of the implementation of the CSRD. Companies will progressively diversify and improve the quality of sustainability information. Auditors will play a significant role in fostering best practices. Investors will signal what information they consider the most meaningful and relevant for their investment decisions. Supervisors will create case law on a case-by-case basis.

Fixing practical implementation issues at an early stage through delegated acts, transposition laws/acts or guidelines would create higher certainty and predictability. To illustrate, Member States should designate as soon as possible the national competent authorities under the CSRD, their scope of competence and, where

different, their articulation with closely connected authorities that oversee the information disclosed by companies. This need for prompt supervisory clarity also applies to the audit regulatory and supervisory framework. Member States should clarify whether they will allow independent assurance service providers to carry out the required assurance. Applicable ethical and auditing rules should be in place well in advance to lead to high quality assurance. Where a joint audit is applicable or voluntarily implemented, the same level of quality as with financial information should be the norm, with sustainable information assurance being split between the two auditors and benefiting from a cross review. Accordingly, sustainability assurance standards should promptly be prepared by the Committee of European Auditing Oversight Bodies ("CEAOB"), the European Commission and, where relevant, the Member States.

Finally, companies publishing sustainability information for the first time will be compared with others, including competitors in the same sector. Without a track record, these companies' initial sustainability performance might be misinterpreted and be comparatively penalized. To avoid such situations, ESRS should include a phase-in approach that makes it possible to wave some disclosure requirements. Supervisors should also accept a progressive enforcement intensity.

Identified points needing action

The EU has a more ambitious sustainability agenda that is reflected in both scope and depth of the ESRS. Successful implementation requires:

1. Acceptance by supervisors, investors, and other stakeholders that sustainability reporting will require a "learning curve".
2. Full consistency between the ESRS and other international standards and absence of contradicting calculation methodologies needs to be established to avoid misleading information and excessive compliance costs for companies active in several jurisdictions that require different sets of standards. Interoperability, which makes it possible for companies complying with the ESRS to be considered as complying with the ISSB standards, will be key.
3. Better predictability from Member States on the legal and regulatory framework resulting from national transposition of the CSRD, notably regarding competent supervisory authorities and the sustainability assurance process.
4. A request by the European Commission to the CEAOB to develop a specific auditing standard specifying the sustainability assurance process, taking into account/ considering the work done by the IAASB.

1.2 Reliability and comparability of aggregated sustainability information

Sustainable or green assets are trusted assets in the sense that investors cannot determine or verify by themselves the accuracy of the sustainability information disclosed, and because investors rely on the producer of aggregated sustainability information. Two types of sustainability information can illustrate the issues at stake since they are widely used by investors: sustainability ratings and fund labels. Both aim to improve confidence and provide an overall assessment of global sustainability, knowing that investors (mainly retail) have neither

the time, the means nor the expertise to assess it. However, a major difference between ratings and fund labels, beyond the entity that is being examined (ratings assess firms' sustainability and labels a portfolio of funds), is that ratings provide an assessment following a specific undisclosed methodology, while labels accredit a portfolio that meets a set of pre-established criteria. In both cases, they represent part of the information that investors increasingly use for their investment decisions.

1.2.1 Sustainability Ratings

Sustainability reporting by companies is collected, analysed and aggregated by rating agencies in order to provide a more accessible and straightforward assessment of the firms' sustainability performance. The aggregated information is mostly designed to facilitate investors' choices when investing in sustainability assets. Corporate managements and scholars increasingly use sustainability ratings under the assumption that they are valid while in fact robust academic studies have questioned their reliability.

It should be underlined that the process of assessing sustainability performance requires overcoming several difficulties. The first difficulty comes from quantitatively assessing elements that are intrinsically qualitative, and the second relates to grouping several criteria that have significantly different characteristics (Capelle-Blancard and Petit, 2017). To provide an overall assessment, rating agencies aggregate criteria by assuming that they are fungible and commensurable, although by nature they are not. Several academic studies even suggest that companies often adopt both socially responsible and irresponsible attitudes (Mattingly and Berman, 2006; Delmas and Blass, 2010; Oikonomou et al., 2012). They show that companies having high scores on positive attributes also have high scores on negative ones. Therefore, sustainability disclosures may even be deliberately used by some companies to mitigate their unsustainable practices. When this concerns environmental information, it may typically be a form of greenwashing.

As regards the ratings themselves, a key question relates to their comparability, as well as the variety and robustness of the methodology used. Berg et al. (2019) have analyzed the differences in ratings provided from major rating agencies. They find very significant differences in assessments and show that 56% of those differences come from measurements (i.e., measuring the same attribute with different indicators), 38% from the scope (i.e., different attributes are considered for the same score) and 6% from weighting (i.e., different weights applied on sub-categories when computing an overall score). In addition, their results indicate that the rater's overall opinion of a company influences their assessment. We can conclude from all these studies that the method used will always be questionable. That said, any method will always be subjective and imperfect by construction. A proper assessment of ratings requires a better understanding of the methodologies themselves. Unfortunately, sustainability ratings suffer from a lack of transparency, which prevents users from knowing what differentiates each rating. Apart from the transparency, which is commonly agreed on, as Berg et al. (2019) point out, regulators could investigate "the *potential benefits of harmonizing ESG disclosure and establishing a taxonomy of ESG categories. Harmonizing ESG disclosure would help provide a foundation of reliable data. A taxonomy of ESG categories would make it easier to contrast and compare ratings*".

However, to what extent should harmonization and standardization be implemented? The question remains open. Some would prefer a strong standardization of the methods used by the different agencies to reduce bias and possible manipulation. Others, such as Edmans (2022), defend the idea that *"ESG are a range of issues,*

many of which can't be measured, and reasonable people can disagree about what the issues are to begin with and how to weight them". The second opinion is shared by most of our interviewees. In addition, the methodologies developed by the rating agencies are part of their intellectual property and constitute a differentiating factor in a competitive market that presupposes legal and total transparency. The European Commission and the ESMA have launched a consultation on this major issue.

1.2.2 Fund labelling

Since the first sustainability label for French funds (Finansol) in 1997, a dozen green and sustainability fund labels have been created in the EU's financial markets, but with great disparity between countries. According to Novethic, there are 6 labels in France (SRI, CIES, Novethic, Greenfin, Finansol and Novethic Green Funds), 3 in Luxembourg (LuxFLAG ESG, LuxFLAG Environment, LuxFLAG Climate Finance), 2 in Austria (Umweltzeichen, FNG-Siegel), 1 covering Germany and Switzerland (FNG-Siegel) and 1 covering Norway, Sweden, Finland, Denmark and Iceland (Nordic Swan Ecolmabel). ESMA has started a convergence process towards best practices.

The problem is being careful not to multiply labels. As pointed out by Crifo et al. (2020), instead of simplifying investors' choices, the multiplication of labels makes it more difficult for them to clearly distinguish between each label and, above all, to rely on the labels themselves. In fact, for fund managers, this plurality of labels encourages opportunistic behavior, consisting of following the least demanding standards in terms of sustainability at the lowest price. Hence, the multiplication of labels tends to minimize the intrinsic effort made by each actor, which then leads final investors to turn away from labeled products.

Crifo et al. (2020) questions whether sustainability funds have significantly different practices when compared to conventional funds. Multiple non-labeled funds use the terminology of "socially responsible" funds without being labelled, thus potentially misleading the market. Confronted with this market integrity threat, in 2020 the AMF published a doctrine providing a framework for the communication of sustainability information for the asset management industry: it defines a minimum standard "ESG" label, including a rating system, with the objective of "*establishing a new internationally recognized standard*" to reduce the current market fragmentation spread over numerous national labels (AMF, 2020).

European regulators have a key role to play in tackling such asymmetries, enhancing trust, and increasing investor confidence. EU-wide standardization would help integrating and forging the Capital Markets Union (CMU). In its November 2022 consultation on ESG funds labels guidelines, ESMA acknowledges that investors allocate an ever-increasing proportion of their portfolios to ESG strategies for sustainable purposes and that they may reasonably expect funds with ESG names to invest in companies with investment strategies consistent with ESG standards. The purpose of the guidelines is to justify funds' names by proposing quantitative threshold criteria for the use of ESG on sustainability-related terminology.

During elaboration since the beginning of 2019 under the impetus of the European Commission and in conjunction with stakeholders, the upcoming European Ecolabel will reinforce the integrity of financial products offered to retail customers. The label is based on an a priori selection and will cover retail products: investment funds (UCITS) and investment funds open to individuals (FIA), insurance products with an investment

component (unit-linked life insurance), and term deposit and savings accounts. At the time of their adoption, eco-label standards correspond to 10-20% of the highest quality products available on the market in terms of environmental performance throughout the life cycle.

Identified points needing action

Excessive heterogeneity of aggregated information based on sustainability reporting can confuse investors and can be a threat to market integrity. To ensure an efficient allocation of capital to more sustainable companies, the following further EU-wide steps of implementation should be considered:

- a regulation and supervision of ESG ratings, particularly in order to increase the transparency of sustainability rating methodologies
- an EU standardisation of sustainability "labels" for financial products, particularly funds.

1.3 Getting EU sustainability data and the information "eco-system" prepared

Sustainability information disclosed by companies will be subject to an assurance carried out by an auditor or an independent assurance provider and processed by data analysts, rating agencies and index benchmark providers. Such aggregated sustainability information will be calculated by financial intermediaries to make it possible to take financial decisions, put together dedicated financial products and, concerning investors, to build their portfolio strategies. The CMU will be the first regional "financial center" mandating sustainability reporting, but it lacks a structured EU sustainability data and information eco-system.

The key market players of the financial data and information eco-system are all expanding their know-how and service offers on sustainability data and market information. In the EU, such an eco-system market structure is composed of duopolies (rating agencies and data disseminators) or oligopolies (auditors and index/benchmark providers) that have jointly created global platforms to capture the opportunities of the forthcoming sustainability information market. In addition to the high level of concentration of these markets, there is a clear divide between a small number of very large non-EU service providers and many significantly smaller EU service providers.

The ECOFIN conclusions on the open strategic autonomy in the financial market (Council, 2022) emphasized the risk of such excessive concentration being replicated on the sustainability data and information market, and the importance of the Commission taking initiatives to diversify the number of auditors, data providers and rating agencies. Although there are entity specific regulatory initiatives, there is currently no EU strategic vision that embraces competition, single market, Green Deal and CMU objectives to create a vibrant EU sustainability data and information eco-system.

Economic and financial risks attached to the lack of choice for service providers could jeopardize the efficiency of the introduction of sustainability information in EU financial markets. They include price inefficiency and an

increase in the cost of capital, poor audit quality, benchmarks prioritizing sustainability information as a short-term risk rather than a long-term value-added factor, and incentives to save for unsustainable goals.

Identified points needing action

Getting the EU sustainability "eco-system" prepared is key to ensuring that the interjection of sustainability information within financial market results in efficient allocation of capital. The EU should consider elaborating a strategic vision to create a more diversified and competitive EU market for auditors, data providers, rating agencies and index and benchmark providers.

2 Sustainability information impact on capital markets

This section analyses how financial market players incorporate sustainability information in their market behavior and analyzes the incentives and trends of different kinds of investors (institutional and retail), as well as the impact of demand on asset prices.

2.1 The demand for sustainability assets

Sustainability or ESG as investment criteria in portfolio strategies emerged in the 1970-1980s. Since the early 2000s, public attention to ESG issues and the creation of sustainability assets have gradually made this investment strategy increasingly relevant. In the EU, assets under management qualifying as Socially Responsible Investment (SRI) have been taking off: €4.6 trillion in 2009, €16.1 trillion in 2015, and €22.6 trillion in 2017 (Eurosif, 2010, 2016, 2018).[3] A similar trend can be observed on the other side of the Atlantic. However, if the above figures seem to be tangible proof of the enthusiasm of investors and professionals, their motivations raise questions.

2.1.1 From institutional investors

Multiple robust studies show that institutional investors (asset managers, pension funds, insurance companies or sovereign wealth funds) are increasingly assessing the sustainability performance of companies. For example, institutional investors do not necessarily select companies with the best ESG performance but do prefer not to invest in companies with weak ESG profiles. Similarly, some evidence shows that institutional investors have begun to divest from the most carbon-intensive companies.

Studies also suggest that institutional investors promote sustainability within the companies they target, as shown by a large international study by Dyck et al. (2019) and confirmed by Azar et al. (2021) on the subgroup of the "*Big Three*" (BlackRock, Vanguard, and State Street Global Advisors) concerning the reduction of CO^2

[3] Based on the authors' calculations.

emissions. In the case of long-term institutional investors, it has also been shown that their presence can improve employee satisfaction (Garel and Petit-Romec, 2021) and increase the value created by companies' ESG policies (Nguyen et al., 2020).

Investment fund behavior has had a much less positive impact. Overall, sustainability funds are slightly more rigorous than conventional funds regarding sustainability.

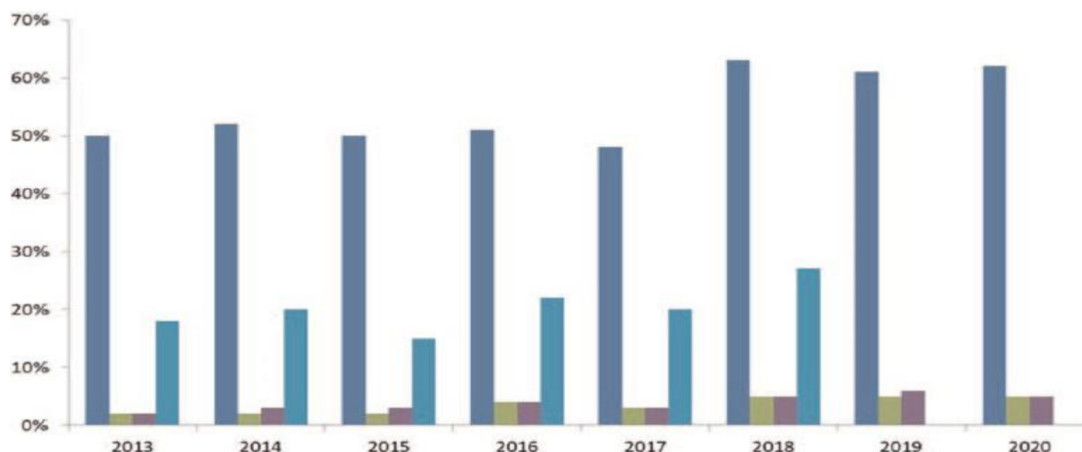
2.1.2 From retail investors

If sustainability assets have gained significant attention from financial institutions, Capelle-Blancard et al. (2021) show that this has not been the case for retail investors.

Probably due to the lack of data, little solid information exists about retail investors' knowledge of sustainability assets. In France, the polling and market research firm IFOP was commissioned by the *Forum pour l'investissement Responsable* (FIR) and the rating agency Vigeo Eiris to publish a study whose main results are presented in Figure 1[4]. The results show that two-thirds of investors attach significant importance to the environmental and social impact of their investments. Moreover, it shows that this number has increased slightly in recent years. Nevertheless, only 5% of respondents have invested in sustainability assets. This can be explained by two factors. The first is the lack of information among retail investors: only one-third of French citizens has ever heard about sustainability investment, and another quarter of respondents have heard about it without really knowing what it means. By comparison, nearly two-thirds have heard of crowdfunding. The second explanation is that only 5% of respondents have received a proposal to invest in sustainability assets. These results show significant room for improvement.

Surprisingly, therefore, retail investors are reluctant to invest in sustainability assets even though social and environmental issues are becoming increasingly prominent.

FIGURE 1 – Sustainability assets and investors



[4] The surveys were conducted from a sample of 1,000 people representative of the French population aged 18 and over (representativeness ensured by the quota method - gender, age, profession - after stratification by region and category' agglomeration). The interviews were conducted through a self-administered online questionnaire at the end of August 2018, 2019, and 2020.

In dark blue: What role do you give environmental and social impact in your investment decisions today?
In green: Have you ever invested in an SRI fund?
In red: Has your bank or advisor ever proposed an SRI fund to you?
In light blue: If SRI was proposed to you, would you be willing to invest your savings in SRI?
y-axis: percentage of positive answers. Source: IFOP

A partial explanation of this paradox is provided by the June 2019 Audirep survey commissioned by the AMF[5]. According to this survey, a smaller proportion of people (53% versus 61% in the previous survey) say they consider sustainable development issues when making investment choices. These people are much more likely to say they consider these issues when making consumption (88%), transport (79%) or electoral (70%) choices. The survey also confirms the general public's lack of knowledge of sustainability investment. Interestingly, the terms least known to the public are those most used in the academic literature. Thus, one person in five (20%) knows about Socially Responsible Investment (SRI) and only one in six (16%) knows about ESG investments.

When it comes to sustainability investments, more than two-thirds of respondents (69%) believe it is *"important for financial institutions to take sustainability issues into account"*. But only a quarter consider that financial institutions do it sufficiently. The reason most often given is that *"it's good for the banks' image"* (75%). More than two-thirds (70%) consider that taking social and environmental criteria into account is "*a public relations argument rather than reality*". More than half of respondents (56%) believe that responsible investments *"are never totally responsible"*. Nearly half of respondents, if they had to make a responsible investment, would prefer to choose the securities themselves (possibly from a pre-established list of companies) and only one in five (19%) trust a fund manager. Finally, more than two-thirds (70%) request clearer and more in-depth information about this kind of investment and a guarantee that they will have a real sustainability impact. The sample used in the two surveys are French citizens, therefore the results should be generalized with caution.

In terms of socio-demographic profile and motivations of sustainability investors, global surveys suggest that they tend to be women who are young, college graduates, urban, upper class, and service workers. In contrast, the effect of their income level remains unclear. Regarding the attitudes and behaviors that SRI investors adopt, they tend to be more religious, more committed to the environment, and unsurprisingly consume more organically grown products or buy from companies whose practices they approve. They also are more altruistic, which is shown by their desire to leave an inheritance for their descendants or their work in the health and education sectors. They are also more often unionized and politically engaged.

Surveys suggest that retail investors are willing to invest in companies that communicate more about their ESG policies and that they are ready to see their profits reduced if they are convinced by the sustainability commitments that are made.

[5] Survey conducted among a sample of 1,028 people representative of the French population aged 18 and over. Self-administered questionnaire conducted in June 2019. https ://www.amf-france.org/sites/default/files/2020-02/les-francais-et-les-placements-responsables-–etude – audirep – pour – lamf.pdf

Identified points needing action

To increase the allocation of capital to more sustainable companies, better implementing these measures should be considered:

- Improving public knowledge on sustainability investment and reducing the complexity of assets to improve public understanding of them.
- Distributors in retail banks should play a more proactive role in explaining and promoting sustainable investment products.

2.2 Financial markets' inclusion of sustainability information

Market efficiency and optimal allocation of capital requires that all available public information be considered and reflected in market prices. Accordingly, if investors are responsive to sustainability information disclosure, this should be evidenced by market price movements on both equity and bond markets.

2.2.1 Impact on equity markets

Most empirical studies on sustainability information disclosure and the reaction of financial markets are focused on equity markets. It is expected that if shareholders consider sustainability information they then will react positively (negatively) to environmentally or socially positive (negative) announcements. However, the interaction between corporate sustainability performance and financial performance is still unclear.

In fact, sustainability information disclosure assumes that an efficient market can be entrusted with the responsibility to sanction and reward. In practice, in the short and medium term, robust studies find that financial markets react only weakly to sustainability information disclosure, demonstrating a relatively limited interest by shareholders. The magnitude of this reaction is stronger in the case of negative announcements.

This reaction seems to be explained by the direct cost that these events might have on the company's production capacity as well as by the indirect regulatory costs that can ensue. For positive announcements such as sustainability investment decisions, the reaction is at best slightly positive but often nil or negative. This may be due to two factors: (1) shareholders read these decisions as costly or irrelevant or associate them with greenwashing or (2) shareholders find it difficult to evaluate future corporate cash flows into intangible assets of which most sustainability-related investments are a component. Data quality and transparency improvements through standardized sustainability reporting will allow for a better assessment. Regarding the second factor, several academic studies have tended to show that over a longer period (at least three years) positive sustainable behaviors are financially rewarded: more sustainable companies have higher financial returns.

Thus, despite shareholders' willingness to invest in sustainability assets, robust research remains unclear about the relationship between the disclosure of sustainability information and the financial performance on equity

markets. Overall, results show that sustainability decision factors per se are not yet major drivers: risk diversification and the search for higher returns remain the main criteria of investors for their portfolio choices.

2.2.2 Impact on bond markets

"Sustainability", "Social" and in particular "Green" bonds are frequently analysed to assess the preferences of sustainability investors. Social and Green bonds are debt securities issued by public entities to finance projects whose goal is to have a positive impact on the environment and society at large.

The Green bond market has attracted an increasing number of investors. Since 2007, it has attracted $512 billion to green assets (Climate Bonds Initiative, 2019) and it is expected to continue growing. From 2018 to 2019, Green bond issuance grew from $171.2 billion to $258.9 billion (Climate Bonds Initiative, 2020).

This impressive market size growth reflects a clear and unified trend toward environmentally friendly preferences from both bond issuers and investors. Demand is so strong that several studies show a green premium (i.e., the difference between the yield of conventional bonds and that of green bonds with similar characteristics). As shown by MacAskill et al. (2021), the green premium is confirmed in 56% of primary and 70% of secondary market studies when bonds are government issues or investment grade and if they adopt strong governance and reporting procedures[6]. Overall, in the primary and secondary markets, the green premium observed is negative - meaning that green bonds traded at a lower yield than conventional bonds with similar characteristics. This means that environmentally friendly investors are willing to accept a lower yield in exchange for an opportunity to invest in a green project. In addition, by committing themselves to develop environmental projects, issuers benefit from lower financing costs.

Conclusion and further steps

The EU legal framework to channel private financing towards the transition to a more sustainable economy will progressively become applicable and will impact the functioning of the Capital Markets Union. The CSRD is one of the key building blocks of such a framework and will require large EU companies to report on their sustainability policy and impact. The set of ESRS drafted by EFRAG for the European Commission should form the basis for high quality, reliable and comparable sustainability information. Such Sustainability Reporting will be the "raw material" from which financial markets players will structure their financing and investment strategies.

If the principles are clear, several practical implementation issues remain to be fixed. A miscalibration of several functioning pillars would risk jeopardizing the introduction of standardized sustainability information contributing to market efficiency. Indeed, in the implementation phase, a balance needs to be found between investors' desire to obtain easily comparable sustainability information, which would require extensive, full, and detailed harmonization on the one hand, and the corporate preference of focusing on a more limited range of meaningful information valid in all jurisdictions to avoid unnecessary or duplicative costs on the other hand.

[6] The studies were conducted by both academics and professionals.

The ESRS attempt to achieve such balance and disclosure under the ESRS should be considered as complying with the ISSB and SEC standards.

Considering the tight CSRD implementation timetable, the predictability of the detailed requirements and of the applicable supervisory framework has been a success. Prompt adoption of the ESRS by delegated act after the European Commission process is a prerequisite. All market players would also benefit from transpositions by the Member States, defining as soon as possible their competent authorities for the regulation and supervision of sustainability disclosure and for the provision of limited and reasonable assurance. To allow companies to anticipate the choice of their assurance provider, Member States should also promptly decide whether they will allow independent assurance services providers and, under the advisement of the CEAOB and consistent with the work developed by the IAASB, the Commission should also promptly adopt a standard detailing the assurance process.

Aggregators of sustainability information like data analysts, index and benchmark providers, rating agencies and even asset managers using or referring to such data will play a key role in providing a straightforward access to such information for investors. But an EU-wide regulatory framework for transparent and understandable aggregated data in order to avoid misleading practices is still missing. Regulation and supervision of ESG ratings to enhance the transparency of methodologies as well as a standardization of the ESG "label" for financial products, notably funds, would significantly contribute to the fair functioning of the market and efficient allocation of capital.

Even with these additional regulatory measures are in place, sustainability disclosure will experience a "learning curve" and this must be accepted by investors, sustainability information aggregators and supervisors. The introduction of "phasing-in" approaches that make it possible to wave some disclosure requirements and apply a progressive supervisory intensity should be part of the implementation phase.

That said, the EU sustainability data ecosystem (data analysts, index and benchmark providers, rating agencies and auditors) does not exist as such. The financial information ecosystem is expanding its skills set and service offer to sustainability data but in the EU, such an ecosystem is structured around duopolies and oligopolies that have jointly created global alliances or platforms. In addition, there is a high level of concentration, with a small number of very large non-EU services providers and a large number of significantly smaller EU players. A clear EU strategy to implement the recent ECOFIN conclusions calling for a diversification of auditors, data providers and rating agencies would mitigate the risk of poor sustainability assurance quality, pricing inefficiencies and possibly an increase in the cost of capital. The demand for sustainability assets will result in efficient allocation of capital to sustainable objectives if the ecosystem is fair and competitive.

The way retail and institutional investors consider sustainability information and define their portfolio strategies differs widely in the equity markets and bond markets. Further standardization and access to sustainability disclosure would favor informed investment decisions, but further steps by financial intermediaries are needed to improve public knowledge on the importance of sustainability information and appropriateness of investment vehicles. By progressively signaling to the market the kind of information that will guide their investment decisions, investors' behavior will be the key driver of the introduction of sustainability information factors in the functioning of capital markets. The way *Inside-Out* information will be introduced in investment decision-making processes will help assert the relevance of double materiality.

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