The Use of Sustainable Financial Instruments in Relation to the Social Impact Investment: ESG Policies, Capital Markets' Approach and Investors' Protection: An Innovative Perspective for a Global Surveillance Authority

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Abstract

Social Impact Investment (SII) refers to the provision of finance to organizations addressing social needs. It is intended to achieve both a social impact as well as garner financial returns. Thus, SII may be understood as a business case for what was previously considered mostly philanthropic activities. In the case of SRI (Sustainable and Responsible Investment), investors decide in which company to invest on the basis of Environmental, Social and Governance (ESG) criteria. They consider a company's performance with respect to its effects on nature, its relationships with employees, clients and society, and the transparency of its governance. Where possible, companies should provide quantitative, comparable and forward-looking performance metrics to facilitate ESG integration. It is recommended that companies should use credible indicators which are included in internationally recognised reporting frameworks like GRI, SASB, IIRC, TCFD, CDP or UNGC. Companies should disclose their methodology and provide explanations to support quantitative indicators (ESG metrics), establishing the link between ESG and financial performance. The investor perspective is in important issue, which should be taken under consideration by European and local supervising authorities, under the provisions of the Market Abuse Directive and the MiFID, especially after the introduction and use of ESG and sustainable financial instruments, in both, Banking and Capital Markets. Therefore, SII can be a very useful tool for achieving EU Social Policy objectives. EU efforts (DG EMPL/FISMA) can be targeted at four specific aims that concern impact measurement: 1) promotion of the standardisation of impact measurement through the further development of the taxonomy regulations to include social objectives or the creation of standardised guidelines or the further development of ESG metrics; 2) capacity building in the area of impact measurement; 3) increasing the availability of the data needed; and 4) the promotion of additional and more specialized sustainable financial instruments linked to the Banking Sector and Capital Markets, which in turn will leverage more the total investment amount derived from the InvestEU tool and offer to all stakeholders more flexibility. Therefore, the global liquidity will be increased, and a strong economic turmoil could be avoided under the surveillance of a theoretically established Global Surveillance Authority. The use of sustainable financial instruments by a P.E.S. (social enterprise) under a public-private partnership (PPPs) is also feasible and socially rewarding.

Keywords: social impact investment, labour policies, social action plan, financial products, public employment service, capital markets, global surveillance authority, sustainable financial instruments

1. Introduction

Social Impact Investment may be understood as a *business case* for what was previously considered mostly philanthropic activities (Maduro et al. 2018, Note 1). The aim of this study is to give the readers (incl. members of the DG Employment, Social Affairs and Inclusion) a good understanding of what SII is and which financial instruments are engaged under the EU Capital Market perspective. The investor perspective is also examined, under the provisions of the Market Abuse Directive/Regulation (MAD, MAR) and the MiFID (I/II). SII is driven by the intention of addressing social needs. It aims to create a measurable impact based on how those needs are addressed and how that action generates financial returns. while SII seems a promising tool for addressing social issues and bringing financial returns, it also has its own potential risks and weaknesses. The major general problems associated with SII are:

• **Difficulties in measuring impact**. One of the key concerns forming the basis of SII is its measurable impact. However, the measurement of impact is proving to be extremely difficult because it is a relatively new area that lacks a common understanding, standards and methodology. Furthermore, access to comparable and comprehensive relevant data remains limited and the actual methods for measuring social impact are themselves very complex. This issue may also lead to more specific yet highly problematic issues discussed in the bullet points below. (Maduro et al. 2018).

• **Cream skimming and cherry picking of results**. SII may lead to triggering the wrong kind of incentives whereby only those areas that promise easy delivery of results are targeted, hence the cream skimming, or leave aside those target groups that are very difficult to reach. Both the cream skimming and the cherry picking of results may lead to misleading reports on the success of SII activities, leading to the so-called gaming of results.

• **Risk of impact washing**. SII may unwittingly encourage enterprises to exploit their activities as a marketing strategy instead of seeking actual commitment and a positive impact (Deloitte 2018, Note 2).

• **Transaction costs of financial instruments**. For example, Social Impact Bonds (SIBs), which are becoming increasingly popular across the world, in fact entail significant transaction costs making these instruments difficult to implement in instances where significant funding is not readily available.

• **SII is not a 'silver bullet' for solving all social challenges**. Societal needs cannot always solely be satisfied through market mechanisms and ongoing requirements for public and philanthropic support remain extremely important. This means that not all problem-solving approaches are commercially viable and thus suitable for SII investment (Scheck & Spiess-Knafl 2020, Note 3).

The driving force behind SII is the desire to address *social needs* (OECD 2019). Capital providers (i.e. investors) are on the **supply side** of the SII ecosystem (OECD 2019). This side includes all of the entities or independent actors that provide financing (World Economic Forum Investors Industries 2013, p. 12, Note 4). Investors may come from either the public or private sector. Investment targets (investees) are located on the demand side of the SII ecosystem. The **demand side** consists of a variety of organisations that directly address social needs through their activities (OECD 2019). They require sufficient know-how and have a variety of financing needs that depend upon their geographies, stage of development and the social mission undertaken.

Intermediaries are mainly entities and independent actors that link or provide support to supply- and demand side actors of the SII ecosystem. Depending on their function, intermediaries may be labelled as financial or capacity-building entities. Financial intermediaries are 'the middlemen in transactions' (World Economic Forum Investors Industries 2013, p. 16). They are often further grouped into bank financial intermediaries and non-bank financial intermediaries.

Startups need capital, and social enterprise startups are no exception. For instance, a social entrepreneur with a vision can invest his own savings and max out his credit cards trying to build a company that produces both good for society and profit. Depending on his individual net worth and his pool of connections, he may be able to turn a good idea into a chugging small business. Eventually, though, he will need—or simply want—to fund his social enterprise with capital beyond the levels of his personal network can supply. When he does so, he will encounter a daunting, and double-sided, trust problem. How can he identify investors with a commitment to a dual mission that matches his own, investors who will not push him to sideline his enterprise’s social commitments in exchange for a greater financial return? In addition, if committed dual-mission investors can be found, how can he convince them he is not a wolf in sheep’s clothing herself?

Social entrepreneurs, *PESs with a partnership with a private investor*, and other investors engage in a stag hunt of their own. The big prize for them is a combination of social and financial returns. They all seek this blended value but cannot achieve it alone. The social entrepreneur needs capital. The investor, perhaps an impact fund, an individual investor seeking a combined social and financial return, or even a philanthropic foundation, needs entrepreneurs’ ideas, creativity, and know-how to turn an investment into a return—on both the financial and social fronts. The same a PPP (public – private partnership) scheme with a PES and a private investor.

The changing environment and the challenges we encounter globally have transformed our understanding of the role of the corporation in society. Exchanges across the world are joining forces in unprecedented ways through initiatives such as the UN-backed Sustainable Stock Exchanges (SSE) program to promote good governance and sustainable business practices by encouraging ESG disclosure among listed companies. This mobilization aims to help develop more resilient, well-regulated markets and encourage good corporate practices that prioritize long-term value creation over short-term gain. In the past, Stock Exchanges were called to play a key role in the adoption and mainstreaming of strong corporate governance in capital markets by collaborating with regulators and other stakeholders. In this day and age, good governance invariably includes the integration of solid practices on environmental and social issues, as well as an array of other impacts of corporate activity.

ESG assets surpassed $35 trillion in 2020 up from $30.6 trillion in 2018 and $22.8 trillion in 2016 reaching a third of current total global assets under management, according to the Global Sustainable Investment Association. ESG assets crossing the $35 trillion mark is in-line with BI's (Bloomberg) own base-case scenario. Assuming 15% growth, half of the pace of the past five years, ESG assets could exceed $50 trillion by 2025. BI adds that the world is on track to have a $1 trillion ESG ETF market and an $11 trillion ESG debt market by 2025. Both ESG ETF and ESG debt are leading the growth among ESG investing strategies (Note 5).

Several drivers encouraged this rapid development of the SII market across the EU. Mainly, the higher profile of the SDGs fueled interest in this investment approach. Nevertheless, public and philanthropic funds are expected to cover only about one third of the funding needed to achieve the SDGs in developing countries worldwide, which leaves an annual funding gap of €2 trillion (Bloomberg, 2021) (*see detailed analysis, on '**7.1 SII Investments, ESG data performance and trends'** chapter***).**

Regarding recent specific developments in the SII market across the EU, there are five noteworthy trends:

• **Emerging criteria for defining SII**. There is an ongoing discussion between experts, policy makers, and SII actors about the types of investment that can be interpreted as SII.

• **Growing investments**. First, SII funds are becoming progressively larger. This leads to a larger supply in funds compared to direct investments. This evolution is happening because funds aim to generate higher management fees on their managed assets.

- **Cross-border investments**. Some investors, who until now have primarily relied on national investments (cross-border investments being the exception in this field), are starting to look beyond their borders for suitable social enterprises.
- **A trend towards integrated business models**. Many investment-readiness programs (a type of intermediary) are currently enlarging their field of activities.
- There is also an active discussion on **whether SII is most needed for very early start-ups or for the scale-up** of proven problem-solving approaches.

There are some examples across the EU proving that employing government structures to ensure the rapid development of the SII market and the development of comprehensive SII strategies are necessary conditions that in turn result in significant positive changes across the entire SII environment in the country (OECD 2019). For instance, the key reason why Portugal and Finland have made significant breakthroughs in developing the SII market over the past number of years has been the establishment of institutions that are focused on the development of this approach in their countries, as well as the creation of national plans for SII development.

Spain National Advisory Board. NAB in Spain promotes impact investment in the country by mobilizing public and private capital to solve global challenges. In 2018-2019, the NAB mobilized more than 70 organisations from the Spanish impact investment sector to create three (3) reports on the supply, demand and intermediation of capital. At the beginning of 2018, it managed €90 million in impact investment. By 2021, Spain NAB aims to quadruple the volume of impact investment and manage €360 million in the Spanish impact investment market.

Steering of SII market in Portugal. The rapid development of the SII market in Portugal started around a decade ago when social innovation and social entrepreneurship emerged as priorities in the Portuguese public agenda. Portugal identified these two areas as a key priority of its 2014-2020 Partnership Agreement with European Commission. The entire SII development process in Portugal was led and managed by several dedicated organisations. The Portuguese Social Investment Taskforce (also called the Portuguese NAB) was launched in 2014. The Portuguese Social Investment Taskforce brought together a wide range of organisations and perspectives from the private, public and social sectors to support social innovation and build an Impact Investment market.

Steering of SII market in Finland. The progress of the SII market in Finland started in 2014 when the Finnish Innovation Fund (Sitra) took on the role of SII market builder. Sitra was directly responsible to the Parliament of

Finland. Sitra closely collaborated with the Finnish National Impact Investing Advisory Board. By supporting the public sector, service providers and inventors, the National Advisory Board has sought to advance the development of the impact-investing ecosystem in Finland. It currently has the largest Fast Employment and Integration SIB fund in Europe with a total of €13.5 million.

Regarding **European Investing Fund (EIF)**, it provides strong support to an emerging class of intermediaries focusing their investment activities on achieving social impact. Entrepreneurs in this field seek to address mounting challenges to Europe's social cohesion through business models that generate tangible and measurable societal benefits coupled with sound economics. In particular, EIF is implementing (2014-2020) the following tools in the field of social impact, as precursors (for funding SII development) :

Social Impact Accelerator (SIA) as a precursor. The Social Impact Accelerator (SIA) was the first pan-European public-private partnership addressing the growing need for availability of equity finance to support social enterprises. SIA operated as a fund-of-funds managed by EIF and invests in social impact funds, which strategically target social enterprises across Europe. In the context of the SIA, a social enterprise operated as a self-sustainable SME whose business model serves to achieve a social impact.

EFSI Equity Instrument (and EFSI Skills and Educational Guarantee Pilot) as also precursors. As of early 2020, the European Commission (EC) and the EIF have been making available additional resources through initiatives under the EFSI Equity Instrument and InnovFin Equity to further support innovations in the fields of artificial intelligence, block chain, space technology, impact investing and blue economy. With these initiatives, the EC and the EIF are stepping up their efforts in areas of strategic relevance for the EU, supporting the transition towards a new digital era, and contributing to promoting sustainability and impact entrepreneurship in the European investment ecosystem. The Skills & Education Guarantee Pilot (S&E Pilot) was a new debt financing initiative dedicated to stimulating investments in education, training and skills – as part of the solution to get more people into jobs and to better respond to the European economy's changing needs.

From now on, under the '*Social Investment and Skills'* window (SISW) of the InvestEU tool, there is the capacity to promote a set of financial instruments for the SII. Essentially, can develop and consolidate the nascent market structures underlying the European social economy organisations and social enterprises ecosystem.

The Commission has adopted various implementing acts and guidance documents in the framework of the InvestEU programme (guidelines). The ***Investment Guidelines*** offer detailed information on the requirements that financing and investment operations must satisfy in order to receive support from the InvestEU Fund. Those guidelines gave details on how the financing and investment operations under the InvestEU Fund are to meet the three dimensions of the EU's sustainability commitments: *climate, environmental and social*. This guidance complemented with an additional climate and environmental tracking guidance. In addition, the Implementing Decision establishing the InvestEU Portal lays down simplified rules for the functioning of the easily-accessible database of investment opportunities within the EU. Moreover, the Commission has already taken a series of decisions related to the governance of InvestEU.

Finally, in this study, we also examine the Sustainable Financial Instruments and their link to financial markets, the Social Impact Investment, the introduction of financial instruments and their use into the EU Banking Sector, an EU Capital Markets' approach, ESG metrics regarding the *'Social'* parameter and finally we ended up with some conclusion remarks and comments for further research.

2. Literature and Current Research Studies

All SII definitions are very clear in pointing to the three key elements of SII, namely impact intentionality, impact measurement, and profit orientation (Höchstädter & Scheck 2015, pp. 449–475; GIIN n.d.). This means that SII is driven by the intention of addressing social needs. It aims to create a measurable impact based on how those needs are addressed and how that action generates financial returns.

Sustainable and responsible investment (SRI) is 'a long-term oriented investment approach' (Eurosif 2018) that takes into account the negative or positive societal effects created by business (Gajdošová 2011, pp. 127-137). In contrast to SII, SRI's positive social or environmental effects are usually a complementary aim or an externality rather than the main business goal. In the case of SRI, investors decide in which company to invest on the basis of Environmental, Social and Governance (ESG) criteria. They consider a company's performance with respect to its effects on nature, its relationships with employees, clients and society, and the transparency of its governance.

Responsible investment is mostly about the avoidance of harm. Responsible investment excludes investments in businesses that might create a negative social value (e.g. guns, tobacco, gambling, adult entertainment) (Maduro et al.

2018, p. 21). Sustainable investment not only avoids harm but also tries to facilitate the creation of positive effects by prioritising investment in businesses that follow the principles of social justice and environmental sustainability (Maduro et al. 2018, p. 21). For instance, in the case of sustainable investing, investors might prefer investing in a company that employs socially vulnerable groups.

Firms with strong ratings on material sustainability issues have better future performance than firms with inferior ratings on the same issues (Mozaffar K. et al., p. 26, Note 6). In contrast, firms with strong ratings on immaterial issues do not outperform firms with poor ratings on these issues. In addition, firms with strong ratings on material issues and concurrently poor ratings on immaterial issues have the best future performance. Collectively these results are consistent with materiality guidance being helpful in improving the informativeness of ESG data for investors.

Many companies have failed to recognize that the functional role of ESG data has changed over time. Initially such data was used to judge a company's willingness to avoid harm and do good. As a result, it was primarily an input to help form policies that signaled a firm's commitment to achieving positive outcomes for the environment and society (Serafeim, 2002, Note 7).

However, investors are increasingly asking a different question: not whether a company has good intentions but whether it has the strategic vision and capabilities to achieve and maintain strong ESG performance. That means companies need to start measuring and reporting the results of their initiatives. Instead of communicating their policies for improving data privacy, water management, climate change mitigation, diversity, and other issues, they must communicate outcome metrics such as the number of customer accounts hacked, liters of water consumed per unit of product produced, carbon emissions saved, and percentage of women and people of color promoted internally to management positions.

A growing body of research has confirmed a strong relationship between performance on ESG metrics and financial performance of companies (Eccles R., et. al, 2016), thus demonstrating that ESG information is financially material and relevant to investors (Note 8). In the absence of ESG disclosure, investors can miss important information on a company's operations (Amel-Zadeh A., et. al, 2017, Note 9) competitive positioning and long-term strategy. The growth in endorsements of the UN-backed *Principles for Responsible Investment* (PRI), which in 2021 reached over 3,826 PRI signatories (3,404 investors and 422 service providers) representing just over US$121 trillion in assets under management, highlights the shift that is taking place among investors who are progressively incorporating information on ESG performance in their analysis across all asset classes. Robust, comparable and comprehensive information on material ESG issues can help investors form a complete view of long-term corporate performance and gain insight into how exposed a company is to risks and how effective it is in identifying and leveraging opportunities.

Under a recent study by DG FISMA (Note 10), there is an overall demand for greater transparency of objectives sought, methodologies adopted and quality assurance processes in place by sustainability-related rating and data providers. Company sustainability disclosures are considered to lack comparability, consistency and completeness, despite the growth in uptake of the numerous sustainability reporting standards that exist. Moreover, there is a lack of clear and consistent terminology used and a need for clearer and standardized definitions for sustainability-related products and services. This includes key terms such as ESG, sustainability and responsible investment. <u>There is no consensus on a set of standards, metrics and principles for sustainability-related products and services, or how to measure and verify the implementation of them.</u>

DG FISMA, under a recent Consultation Document (Note 11), will directly feed into an impact assessment that the Commission will prepare in the year 2022 in order to assess in detail the impacts, costs and options of a possible EU intervention. This consultation should help further clarifying and quantifying the main findings from the study and input received from market participants.

We must underline, that organisations that improve their performance on environmental, social and governance **(ESG) issues** which are material for their industry, they have improved access to capital and the opportunity to innovate and fill demand for products and services with more positive **social and environmental impact** (Serafeim, 2018, Note 12). Therefore, there is a need implied for SII to use "*<u>agreed standards"</u>* the ESGs metrics (later discussed in details). In other words, this need has to be commonly accepted as a legal framework/demand for the SII.

Regarding recent specific developments in the SII market across the EU, there are five noteworthy trends.

- **Emerging criteria for defining SII**. There is an ongoing discussion between experts, policy makers, and SII actors about the types of investment that can be interpreted as SII.

- **Growing investments**. SII funds are becoming progressively larger. This is leading to a larger supply in funds compared to direct investments. This evolution is happening because funds aim to generate higher management fees on their managed assets (Harris et al. 2014, Note 13).
- **Cross-border investments**. Some investors, who until now have primarily relied on national investments (cross-border investments being the exception in this field), start to look beyond their borders for suitable social enterprises.
- **A trend towards integrated business models**. Many investment-readiness programs (a type of intermediary) are currently enlarging their field of activities.
- There is also an active discussion on **whether SII is most needed for very early start-ups or for the scale-up** of proven problem-solving approaches.

These trends call for the creation of a "*guidance*" for the SII, in order to:

a) Prove and set the proper criteria that the SIIs are actually "*social*", with the meaning that it is about investing in people. This means policies designed to strengthen people's skills and capacities and support them to participate fully in employment and social life. Key policy areas include education, quality childcare, healthcare, training, job-search assistance and rehabilitation.

b) To estimate the trade-off between financial returns to investors vs 'social' impact.

c) To protecting investors' rights against '***social washing***' (see later issues on investors' protection).

3. The Sustainable Financial Instruments and Their Link to Financial Markets

Regarding the supply side, an overall funding gap for SII still exists in Europe. Initially, the attractiveness of the SII approach remains limited looking at it from the perspective of private investors. Second, institutional investors dispose of large funds, but play only a negligible role. Third, the involvement of the banking sector as financial intermediaries, which offer to investors a bilateral approach for funding. At the same time, there is a lack of offering financial instruments raising funds from IPOs and therefore introduce and list them in the Capital markets.

A wide array of mechanisms are embedded in the 2021-2027 Multiannual Financial Framework (MFF), which complements the supply side. They play the role of subsidies and financing.

The most significant of which are:

• *Invest-EU* (financing and repayable, namely provides a budgetary guarantee fund that facilitates access to finance for risker projects that are commercially viable and leverage private investments)

The program will complement all existing financial instruments at the EU level and aims to further develop investment, innovation and job creation, reaching more than 650 billion euros of additional investments (European Commission 2021, Note 14). The EU provides a 75 billion guarantee. The InvestEU Fund will support four main policy areas: sustainable infrastructure; research, innovation and digitisation; small and medium businesses; and social investment and skills. With InvestEU, EIF is able to offer targeted finance for smaller companies and other beneficiaries across the key policy areas and at different stages of development. For ***financial intermediaries*** interested in collaborating with the EIF under InvestEU, we will publish the open call for expression of interest on our website. The EIF selects ***financial intermediaries*** based on the applications to the open call and following a standard selection process including due diligence. EIF leveraging €11bn of InvestEU Fund resources and attract additional private investments through *guarantee* and *equity risk sharing instruments* aiming to mobilise €145bn in investments benefiting SMEs, small mid-caps and mid-caps, infrastructure projects, individuals.

• *The European Structural and Investment Funds (ESIF 2021-2027)* (subsidies and grants)

ESIF invests in local and regional projects that contribute to solving the social and economic challenges of EU Member States through three financial mechanisms: grants, repayable assistance, and financial instruments. ESIF financial instruments that target 'social projects' are based on the logic of SII, and thus, directly contribute to the development of the SII market. The European Social Fund (ESF) is the ESIF fund that is most relevant for the SII market because it is Europe's main tool for promoting employment and social inclusion (European Social Fund). During the 2014-2020 Multiannual Financial Framework, the ESIF contributed to the creation and implementation of several SII mechanisms. One example is the Social Impact Investing Fund in Sardinia (Italy) which was partly supported by the ESIF: €2 million were allocated from the European Regional Development Fund (ERDF) budget and €6 million from the ESF budget. Regarding the period 2021 – 2027 there are 5 policy objectives breaking sectoral silos, fewer and shorter specific objectives and has also as a priority the capacity building and cooperation with partners within and outside MS as horizontal actions.

• *The Structural Reform Support Program (SRSP)*

SRSP is an EU program that provides tailor-made support to all EU countries for their institutional, administrative and growth-enhancing reforms. SRSP support covers the entire reform process from its preparation and design to the implementation of the reforms. It is demand driven and does not require co-financing from EU countries. SRSP support can be called on by EU countries to implement: reforms undertaken at their own initiative; economic adjustment programs; growth-sustaining reforms in the context of EU economic governance (e.g. Country-Specific Recommendations under the European Semester and implementation of EU law).

These mechanisms intended, also, to prevent from a *market failure*, which actually, demands a kind of a **public (EU-level) intervention**. Nevertheless, the potential of EU financial funds, mechanisms and programs in fostering the SII market from the MFF, has not yet been fully realised. The implementation of these EU funds, mechanisms and programs, contribute to the SII's market development and prevent from market failures. However, the EU institutions *intervene* not only in cases of *market failure*. For instance, in the case of EFSI, the EIB has repeatedly operated within viable market conditions. This can be justified and can create added value if social impact is interpreted as the key condition and reason for action. The promotion of societal impact as a key condition for EU action may support the emergence of a European impact investing market and induce market operators to aim to create positive social impact, or increase effectiveness of all EU-level interventions.

With the establishment of the *Social Economy Action Plan-SEAP* (launched on 9th December 2021), the Commission put forward concrete measures to help mobilise the full potential of the social economy. Under the SEAP, EC will improve the right framework conditions for the social economy across Europe, including improved visibility and recognition and access to finance and markets which are key aspects of the action plan (to financing the needs for the social economy, the inclusive entrepreneurship and the *social enterprises*).

Regarding the demand side, there is a *lack of social enterprises - organisations* that solve societal challenges through market mechanisms and are thus suitable candidates for SII. Second, the *legal definitions* of social enterprises or SII demand side actors in general often exclude some organisations that prevent them from receiving SII (for more details see 'Enabling environment-related challenges'). Third, the *low investment-readiness* of potential investees is amongst the key challenges for a rapid development of the SII market (GIIN 2018, Note 15). Many social enterprises and other demand side actors have limited organisational capacity to receive SII. SII demand side actors often lack the human resources necessary for managing investments on their side. Moreover, employees often lack the knowledge and skills necessary to attract and manage investments in their organisation. Finally, many of SII demand side actors *are small organisations* that are usually not investment-ready for the larger ticket sizes preferred by the majority of investors.

However, only a few national governments take any initiatives or active roles as SII market 'steerers'. The majority of EU countries do not have comprehensive national strategies presenting the guidelines and objectives of SII in their countries. There are also very few (government) entities whose missions are focused on the development of SII (Mackevičiūtė, R. et al., 2020, Note 16). Since grants remain the main key mechanism for the distribution of European funds (ESIF, Recovery Funds), while financial instruments, tailored to the logic of SII, remain scarce. Unprecedented financial resources are circulating through the European funds. Thus, they have a lot of potential to contribute to the development of the SII market. For this reason, an active introduction of the SII approach in the context of EU funds is quite important.

The EIF deploying 11bl€ from InvestEU aiming to mobilise 145bn€ in investments for financing SMEs (also individuals and infrastructure projects), will use EU Guarantees and Equity schemes for the investment support (in thematic as: Innovations, Digitalisation, Growth, Social Impact, Skills). Equity actually is implied: venture capital, private equity or infrastructure funds. Guarantees are for banks, leasing companies, microfinance lenders for financing SMEs mainly.

<u>Guarantee products</u>

Among all Guarantee products the most important are: Sustainability guarantee, Innovation & digitalisation guarantee, SME competitiveness guarantee, Micro, Social & Skills guarantee, Cultural & Creative guarantee.

<u>Equity products and goals</u>

Among all Equity products the most important are: private equity, venture capital & climate & infrastructure funds to back startups, scale-ups and projects. Important goals are: Cohesion, Scale-up, to improve the fund-level support to companies pre/IPO and post IPO stages.

From Guarantee products at EU level to the local National Banking market.

Convertible bonds, convertible debt, Flexible low yield (FLY) paper instruments (analysed further below).

From Equity products at EU level to the local National Capital market.

Corporate bonds, Green/Social bonds, Preferred shares and mainly new and/or already listed companies in ESG sectors (in European Stock Exchanges).

In the above two last categories the investing idea is based on the ***social investment*** principle: a way of thinking about social spending, and therefore, if you spend today under this perception you will pay-off tomorrow, through greater economic growth and employment. Actually, the above two categories can be considered, initially, that can meet the demand side by investors regarding sustainable financial products in the ESG landscape.

4. The Social Impact Investment and the Value for the Investors: Advantages and Obstacles

A number of key challenges prevent rapid SII market development across the EU. Three challenges have been distinguished as having the largest negative impact. First, few national governments take the initiative and playing an active role as SII market 'steerers'. The majority of EU countries do not deployed comprehensive national strategies presenting the guidelines and objectives of SII in the country.

There are also very few (government) entities whose missions are focused on the development of SII. Second, EU and national supply side policy initiatives that provide SII funds directly or support other supply side actors through financial schemes, funds or fiscal incentives dominate over the initiatives strengthening the demand side or intermediaries. This has created a situation where few demand side actors are investment-ready. Third, grants remain the key mechanism for the distribution of European funds (ESIF, Recovery funds) while financial instruments, tailored to the logic of SII, remain scarce.

When it comes to the *supply side*, an overall funding gap for SII still exists in Europe. For instance, the need for debt as well as equity impact capital for social enterprises across Europe is estimated at an average of €6.7 billion for the period from 2021 to 2027. This overall funding gap exists for several reasons. First, **the attractiveness of the SII approach remains limited looking at it from the perspective of private investors.** Second, **institutional investors dispose of large funds**, **but play only a negligible role.**

Demand side related challenges in Europe are even more daunting. First and foremost, there are not enough demand side actors that are able to receive SII investments. This general challenge is determined by several specific issues. First, public sector institutions still remain the main providers of social services in the EU and there is a lack of social enterprises - organisations that solve societal challenges through market mechanisms and are thus suitable candidates for SII. Second, the legal definitions of social enterprises or SII demand side actors in general often exclude some organisations that prevent them from receiving SII. Third, the low investment-readiness of potential investees is amongst the key challenges for a rapid development of the SII market. Many social enterprises and other demand side actors have **limited organisational capacity** to receive SII.

The key condition for the creation of a SII enabling environment in a country is the government taking on the role of a SII market 'steerer' by establishing responsible policy bodies and introducing SII facilitation strategies. Employing or reforming government structures to ensure the rapid development of the SII market can take many forms and be adapted to different contexts. Although some EU Member States have established procedures or support the ‘SII market’ in some way, in the majority of EU countries, there are no entities that focus specifically on SII. SII is often perceived as one of the many responsibilities of central government institutions (e.g. ministries of social affairs). As a result, the approach does not receive sufficient attention (Mackevičiūtė, R. et al., 2020).

The local governments in EU Member States in order to support the SII market and essentially the demand side, they have to take specific measures to promote the link of the sustainable financial instruments to the financial markets (Banking and Capital Market). It is a responsibility of Ministries of Finance and Labor Policies to establish national procedures, in order the local market to exploit the available funds from the EU funding mechanisms, to mobilise these funds, leverage them, attracting investors and producing a social positive impact. The returns of the social investments are appeared and measured under a different horizon and way, as opposed to the classical investing instruments.

A more robust level-playing field will support the potential of SII (especially the SISW of InvestEU) and therefore fulfil some of the objectives of the *Social Economy Action Plan* (and the European Pillar of Social Rights). The wide variety of users is expanded from local governments, regional authorities, financial intermediaries, institutional and individual investors and households, local PES, etc. Therefore, it is important to realize the connection of all important factors, here :

European Pillar of Social Rights - European Social Economy Action Plan – SII – InvestEU – SISW – sustainable financial instruments – banking sector / capital market products.

The use of such financial instruments has a twofold perspective: to mobilize funds to social needs (employment, households, childcare, education, health, infrastructure) and to make material returns to the investors. Such investors can be of two kinds: (a) the *'real' investors* who wish to put their money on specific financial instruments for social needs and purposes speculating for a future return and (b) the *'social' investors* (ie, governments, regional governments, a prefecture of a member state, a PES, etc) who use these instruments and actually 'invest' of the improvement of the society and the wellbeing of households, families, unemployed people, marginalized society groups, etc. Under the use of the sustainable financial instruments from 'social' investors, the improvement signs will be also depicted on the improvement of the local environment, social services, motives to the local population to remain at their places, etc.

The investing horizon is different and so the results from the positive environment, social and governance (ESG) investments have to be seen under the social impact point of view. Therefore, the local governments have to embrace these opportunities and establish procedures to integrate sustainable financial instruments into the local markets, in order to avail themselves from the SII.

The collaboration of the relevant authorities (i.e. Ministries, Central Banks and Capital Market Committees-NCAs) with the Banking Sector and the local Stock Exchanges is the key which makes this link. The use of some financial instruments as grants which might be given to specific and targeted vulnerable groups by local or regional authorities, is surely one important tool.

Regarding *Banking Sector*, Banks have to introduce "new", "efficient" and "innovative" products (as referenced later) addressed not only to specific groups but also to investors, under the EC guarantee. These instruments should have a very high notch (Note 17) from CRAs, as guaranteed by the European Commission (or the cooperative EIB). Banks could also create *structured financial products* (i.e, OTC derivatives or bonds) based on these sustainable financial products given by EC (or through the local governments). These products might be offered to specific investors persuading them about the Social Impact of the Investment will be produced, from investors' funds. Another example can be a corporate bond issued by a company, which applies ESG policies and the banks will have the role of the Book-runner or the Underwriter (Note 18). Monitoring, evaluating, reporting disclosures and investors' protection issues are emerged here and the relevant supervisory authorities have to provide solutions. Under a recent study (Dokas I., et al, Note 19), it seems that the regulatory framework and the macroeconomic environment play a crucial role in the banks' efficiency configuration. In the light of this evidence, the policy design in micro and macro level could be more compatible and flexible in relation with the issues raised. Under this reasoning, it is crucial regarding the stability of the European and global banking sector, the evaluation and supervision of the sustainable financial banking instruments. Especially from a Global Surveillance Authority and under a Global Framework.

Similarly, regarding the *Capital Markets and Stock Exchanges*, a 'new' perception of sustainable financial instruments could be also considered. These products under ESG metrics will give the investors the opportunity to contribute to the enhancement of the Social Impact Investment. The relevant Stock Exchanges (S.E.) can create separate markets, indices and trading mechanisms for such products. Although these products might be shares or listed bonds (or even *derivatives with sustainable products underlying*), they can be considered either ***as 'new' products created by the S.E. themselves*** or ***as already listed products (existed shares and bonds) from companies, which apply ESG standards*** (see to the relevant chapter, some ESG metrics regarding the '*Social*' parameter). Once again, monitoring, real time evaluating, reporting disclosures and investors' protection issues are important here and the relevant supervisory authorities (NCAs) have to be engaged (even at European level, i.e. ESMA).

The difference use between the above markets regarding these products is mainly related to factors, as:

- product and market risk in capital markets and banking sector
- supervisory cover, monitoring, surveillance and complexity
- liquidity options and/or returns

- product design, type of investors, funds demanded

It is obvious that in every market proper investors can find reasons to invest and even more to hedge their ‘sustainable portfolio’.

As a third alternative of the implementation of the sustainable financial instruments, it is the *National/Regional and P.E.S. level.* At this level, PESs can implement and fund employment programs for the (inclusive) entrepreneurship, for their active employment policies. Moreover, at a national/regional/municipal level a sustainable financial instrument may have the structure of a bond (green, social), or a grant. In case of a bond, the authority can issue the instrument, using a credit institution for the offering (can be public offering through a Stock Exchange or just a selling to autonomous investors). The state bond (debt) can have the guarantee of the EU and an ‘*investing notch*’ by a CRA.

4.1 Advantages of the ‘Innovative’ Sustainable Financial Instruments and Possible Obstacles

It is also quite important here to analyse, why a sophisticated investor/entrepreneur will enter any market (banking or capital market), buying-selling and constructing ‘sustainable’ portfolios, using such ‘innovative’ instruments and why not to remain ‘passive’ by using the classical financial instruments set (loans, microfinance, guarantees, etc). Or, to put it in another way, how the introduction of these financial instruments with social impact can attract investors and ethical banks (Note 20), in order to create added value for them.

The **first reason** is related with the general perception of the investing opportunities in ‘new’ instruments. Since, the whole construction: is guaranteed (up to point) from EC, is monitored in different levels (EU, local), there is relevant legislation for protecting from market abuse practises, there are benchmarks, credit ratings indices, settlement procedures, etc., therefore a sophisticated investor has nothing to afraid. We have to remind here that we do not live and invest in perfect markets and that every investment has its relevant risk. The above approach have to promoted (*technical demand*) also by the local governments, since under this way a greater part of the relevant EU funds, allocated to every Member State, will be absorbed. ***Essentially, a technical additional supply will be created, in order to match the demand, as much as possible.***

The **second reason** is related to the investment of such products/companies, which follow and obey to ESG principles (and metrics). It has been proven that companies, which take care of the staff, their employees, their remuneration, collective bargaining agreements, the gender approach to promotion, etc. (‘*Social*’ parameter) will offer indirectly to the people working for them, an excellent environment. The perception of the employees for their employers is reflected to their working performance and therefore to the improvement of the financial results of the company. Moreover, matters as the gender composition of the Board of Directors, Bonus policies, Ethics policy, personal data policy, zero labour law violations, (*‘Governance’* parameter) constitute the business behaviour of the company as of high respect. High respected companies, means better cooperation with suppliers, banks and funding resources and a higher sense of being part of it. This in turn, can bring greater employees’ devotion and enthusiasm. All these also reflected to the financials of the company, since they create high confidence to the market. Also, the environmental behaviour of the company and how it handles issues as the emission, the waste management, the pollution (‘*Environment*’ parameter) can create an impression to the public about the intentions of the company about the future, which will deliver to the next generations. If it does not harm the environment, this can create a positive perception to the public for its activities and for the products/services producing. This is turn can be depicted in the sales performance of the company and its current and future financials. Therefore, if a company follows ESG principles, this will be depicted in its financial performance creating value for the investors.

The **third reason** is related to today’s competitive environment. In this environment, leading companies recognise that human, natural and social capital in addition to financial capital needs to be measured and managed diligently. Organisations that improve their performance on environmental, social and governance (ESG) issues that are material for their industry have improved access to capital and the opportunity to innovate and fill demand for products and services with more positive social and environmental impact. More broadly, the business community has come to the realisation that sustainable business growth can only be achieved in an environment where local communities and the broader society thrive.

Moving to operational transformation to an ESG adjusted environment, might have some implications and obstacles.

A listed company to be complied with ESG environment is obliged to adjust its working, organizational, technical and business environment, as well as, its culture. Employees have to be reskilled and upskilled, especially in ‘green skills’. Many changes have to be in place across the company, regarding: BoD, structure of departments, procedures, daily activities, mentality, culture, etc. A proposed analysis for the ESG metrics (regarding the ‘*Social*’ environment, for the time being) is presented later in this study. These ESG metrics/indices indicate essentially how the company is ESG compliant. These changes require a great amount of time, funds, changes in daily procedures, in systems, disclosures and staff. It is a great issue how to overcome the '*resistance to change*' from the staff. Moreover, a company might consider that these additional disclosures, which is obliged to do under ESG obligations, will unveil some future business plans.

However, it is important to remind here, that a company that wishes to participate and invest towards the ESG environment and therefore to benefit from the sustainable financial instruments, undertakes theoretically an investing risk with a trade-off opportunity to receive financial gains, in the mid-term.

4.2 Categories of Investors and Actors and Their Roles in the Sustainable Financial Instruments Industry

Apart from the institutional and individual investors, there are a list of involved actors in the sustainable financial instruments market, which can be benefited.

(i) Social organizations and enterprises

Since, a social enterprise or social business is defined as a business with specific social objectives that serve its primary purpose, we can consider that a part of its investing purposes can be relied on the use of sustainable financial instruments. Social enterprises seek to maximize profits while maximizing benefits to society and the environment, and the profits are principally used to fund social programs.

While earning profits is not the primary motivation behind a social enterprise, revenue still plays an essential role in the venture's sustainability. Sustainable revenue differentiates a social enterprise from a traditional charity that relies on on external funding to fulfil its social mission. This goal does not mean social enterprises cannot be profitable. Instead, it is simply that their priority is to reinvest profits into their social mission rather than fund payouts to shareholders.

Moreover, social enterprises have proved themselves capable of developing innovative approaches to complex and dynamic social problems that classic welfare providers or public entities are otherwise too slow or too 'sluggish' to respond to. Financial support may be provided by using traditional or innovative sustainable financial instruments. Traditional financial instruments rely on well-known financing products such as public contributions, tax breaks, generated income, donations/grants, guarantees, loans, equity, convertible bonds, and mezzanine/subordinate debt (see below (viii)). Innovative financial instruments have emerged in response to specific social enterprise needs, namely the difficulty in accessing traditional funding. Many innovative sustainable financial instruments fall under the so-called 'pay-for-success' or 'pay by result' instrument category because payments to service providers are made in accordance to their achievements that are measured by their social outcomes and impact. Some of them are presented later in the study, related to the banking and capital market sector.

(ii) Public Employment Service (PES) organizations using social bonds with rewarding clauses or convertible covenants

A special case of a *social organization*, is a PES (Public Employment Service) of a Member State, which has as its policy the reduction of the unemployment in a Member State applying 'passive' and 'active' labour policies, but also has a (inclusive) '*housing policy*' as a mandate, especially for the marginalized people and the youth. Of course, it is a matter of the national legislation to endorse such policies to the specific PES, namely to cooperate, to participate and to contribute for example with the private and public sector for the funding and constructing houses for these groups of people (i.e. to rent to young couple at a low monthly rent). This kind of cooperation is '*a partnership of the public PES and the private sector (public-private partnership-PPP)*'. In this case, the PES can use any funds from the local government (i.e. the recently adopted RRF, the Public Investment Program, etc.) or incoming funds from the InvestEU ('Sustainable Infrastructure' pillar). The innovative case for a PES, when applying a housing policy under this specific partnership with the private sector is *how to mobilize the received funds* as much as it can. Of course, the contribution of the private sector will have importance but the leverage of the funds it is also important. Initially, we have to underline that the motive of the private sector (i.e. a construction company) to enter to this partnership with a public PES for a housing policy project, is definitely relied on the rewards, which will receive at the long horizon from this investment (i.e., the rentals from the tenants).

Then, the partnership (PES and the construction company) may proceed to a specific *financial and strategic plan*. They can propose (under this legal scheme, namely the partnership) the issuing of a social/public bond (the underwriter will be a financial institution and guaranteed by the EU) to be funded by the investors (individual and institutional).

Although a conversion feature or rewarding clause and covenant usually allows bonds to be attractive with a lower yield than non-convertible market equivalents, we believe an even lower rate is desirable for convertible bonds offered by social enterprises. Most importantly, investors' willingness to accept a low yield provides an additional measure of reassurance to entrepreneurs. Therefore, the partnership scheme between a PES and a private company (i.e., equity fund, Construction Company, conglomerate, etc.) may use such a (social) bond with rewarding clauses. The bondholders will also be benefited because this issue will be of a low risk.

(iii) "Business angels" with sustainable development goals

Since, a business angel is a private individual, often with a high net-worth, and usually with business experience, will directly invest part of their assets in new and growing private businesses. Business angels can invest individually or as part of a syndicate where one angel typically takes the lead role.

Besides capital, angel investors provide business management experience, skills and contacts for the entrepreneur. Experienced angels also know that they may have to wait for a return on their investment. They can be a good source of 'smart and patient' capital and sustainable financial instruments. Business angels play an important role in the economy. In many countries, they constitute the second-largest source of external funding in newly established ventures, after family and friends. They are increasingly important as providers of risk capital and contributors to economic growth and technological advances. Especially, a business angle investing on sustainable financial instruments and therefore for social needs will perform returns for its investors. Therefore, the business angels can be evolved as innovative investment mechanisms, with which an investor can indirectly invest on sustainable financial instruments using their investing knowhow.

Tools to promote *business angel investment* are the responsibility of EU countries. They should create incentives for private individuals who are willing to invest in enterprises. This should include the use of public funds for co-investment with business angels. The European Commission encourages EU countries to learn from good practices by supporting business angel investments, particularly across borders, and by cooperating with venture capital funds. The Commission is also supporting good practice in investment readiness training. Business angels, can direct their sustainable financial instruments investments through other banking sector or capital market products and generally to work as a business promoter.

(iv) Financial entities

Banks and investment funds in local, regional, national, supranational and global level can also benefit from the use of sustainable financial instruments. Even at EU level (i.e., EIF, Banks, guarantee societies, microfinance providers, venture capital, equity funds, etc.) or at a member state level, a financial entity (as defined in MiFID I, II) can play an important twofold role:

(a) as an investor itself. For example, it can buy social bonds issued by a regional authority or the government of a member state, with the ultimate target to gain profits and at the same time to fund the social purpose of the issue (i.e., transport infrastructure, constructions for public health, etc);

(b) operate as an investing platform by designing and launching innovative sustainable financial products or as a consulting partner to their clients, in order to help them to invest in such financial instruments. As an investing platform it can use funds from the InvestEU (or through the local government) and to launch structured sustainable financial instruments, which in turn can be used by investors.

(v) Authorities

The local NCAs (National Competent Authorities, local Capital market Committees, etc) and Central Banks of member states, become a vital factor in the new industry of the sustainable financial instruments. Together with supranational Regulators, are also responsible for the smooth operation of the financial instruments. Since, new sustainable financial instruments come in place in the banking sector (even cross-border) and in the Capital Market, these entities are also responsible to monitor: the transactions, the new issues of the products and the authorization of their prospectus, reporting of the involved parts, the settlement of the titles and mainly the protection of any kind of investors.

(vi) Regulators and other EU bodies

All responsible EU financial market regulators and other bodies (i.e., SRB, ESMA, ECB) must have the role of the institutional protection of the legal framework of these innovative sustainable financial instruments. At the same time, they can use their legal powers and endorsed responsibilities to any statutory acts and to suggest to the superior legislative bodies of the EU, the issuing of any legal tools (Regulations, Directives, Decisions, etc.), relevant to the new market of the sustainable financial instruments. The establishment of a legal framework for these products will also give the opportunity to other financial investors (from third countries outside EU) to invest to EU and transfer funds. Under this reasoning, a new financial market can be created for these international investors, aiming for the hedging of their portfolios and assets. *The mobility of their funds to the new EU market of sustainable financial instruments can be a further advantage to the already provisional leveraged amount from the InvestEU (SISW).*

(vii) Trading venues

Mainly, Stock Exchanges as platforms can operate as the implementation of the actual multilateral trading of any sustainable financial instruments listed in the Capital markets. Such instruments can be: government and regional bonds, social bonds, Exchange Trading Funds (created by UCITS) and shares of listed companies which operate in specific sectors under the ESG profile. A Stock Exchange can also create specific indices for these instruments and sectors. For example, it can create a secondary market with listed shares only from companies, which obey the ESG rules and apply specific ESG metrics to their daily operations (see below 'economy-wide ESG metrics').

(viii) Credit Rating Agencies (CRAs) and International Organizations

In the financial industry of the sustainable instruments, the need of the evaluation of the creditworthiness of the relevant instruments is a necessity. Not only to attract new investors from third countries, but also to protect EU investors and consumers. CRAs will play their role here, certifying new issues, which will have as underlying funding source money from the InvestEU (for example; a *social bond* issued by a bank or by a member state or a regional authority and *guaranteed* from EU, or a *subordinated mezzanine (Note 21)* or a *debenture (Note 22)*).

Other international organizations (such as IOSCO, ISDA, BIS, etc.) may engage in their consulting role, in the use of the sustainable financial instruments. For example, ISDA (Note 23) may introduce new agreement templates (or new clauses in the existent templates) for the smooth trading of OTC products, used by its members (mainly banks), which trade each other bilaterally non-listed derivatives (based on many other simple or structured financial instruments).

(ix) Incubators and Inclusive entrepreneurs

Business incubators and business accelerators provide a range of support services to entrepreneurs in business creation and during the early stages of the business lifecycle. Business incubators and business accelerators that seek to make entrepreneurship more inclusive should offer strong pre-incubation support to help entrepreneurs develop quality business ideas that have a reasonable chance of growing into a sustainable business. This phase of support should also act as a filter for determining which entrepreneurs will receive more support upon completion of the pre-incubation phase (Note 24).

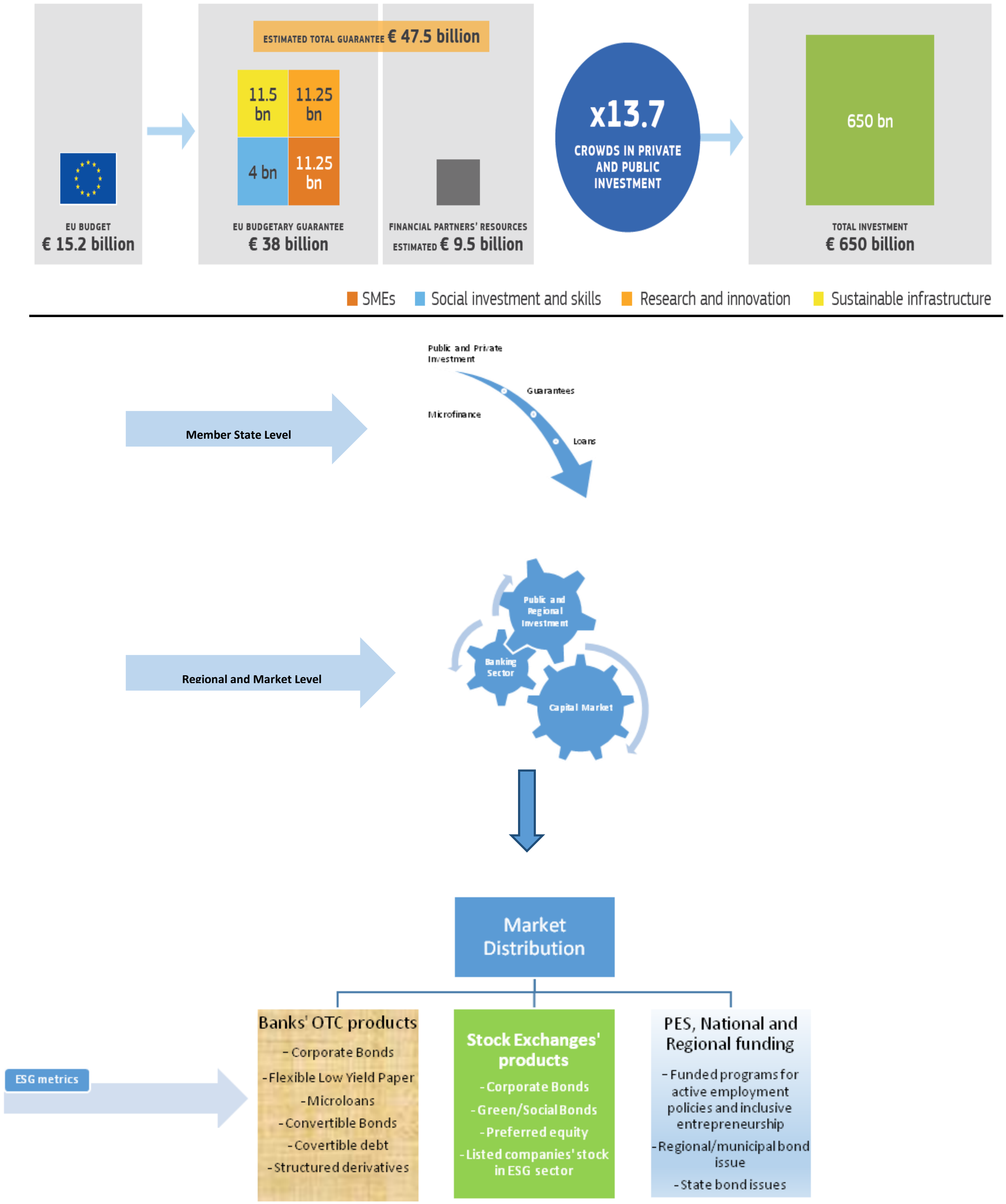

Figure 1. Top-down structure of financial instruments

5. The Introduction of Financial Instruments and Their Use Into the EU Banking Sector

Banks and credit institutions are engaged by offering financial instruments for the sustainability of the social economy with traditional financial instruments, such as, public contributions, tax breaks, generated income, donations/grants, loans, equity, convertible bonds, and mezzanine/ subordinate debt.

Innovative financial instruments have emerged in response to specific social enterprise needs, namely the difficulty in accessing traditional funding. Many innovative instruments fall under the so-called 'pay-for-success' or 'pay by result' instrument category because payments to service providers are made in accordance to their achievements that are measured by their social outcomes and impact. Moreover, the hybrid organizational forms designed with social enterprises in mind have proven to be hothouse flowers. Flourishing in state legislatures, even those with the most distinguished pedigrees have so far failed to thrive in the marketplace. Fortunately, hybrid financial instruments offer a source of strength and stability that can help social enterprise to take root.

In addition, additional financial instruments can be offered by banks:

5.1 ESG Convertible Bonds With Conversion Features

Convertible bonds or notes are one such important, existing hybrid. A convertible bond is ultimately a debt instrument, which pays interest to holders and promises repayment of principal at the conclusion of its term. These products hold a position senior to all equity investments, and they will entitle holders to payment before shareholders of any class and, thus, provide protection from downside risk. The conversion feature, however, edges these debt products closer to equity as their holders can become equity investors if they so wish. Convertible debt has long been a favourite tool of angel investors, who prize it in part for this ability to cash in on the upside of successful them to delay valuation. Valuing the issuing company is a necessary part of an equity transaction. Debt issues do not require investors and founders to agree on a valuation in advance and allow them to put off this complicated and risky proposition until later in an early-stage company's life cycle.

Convertible debt can also be useful outside the startup context. It can be a bargain for issuers when contrasted with straight debt issues, as the conversion feature offers added value to investors without increasing issuers' borrowing costs. Convertible bonds can also compare favourably to additional issues of common stock from an already-public company; such issues can come with reputational risk, as they sometimes fuel a perception that existing share prices are inflated. The most powerful component of convertible debt is, obviously, the conversion feature. It allows investors to essentially have it both ways, the security of debt with the upside potential of equity. To harness this power, this conversion feature must be both priced and timed. Convertible bonds must contain a conversion ratio—the number of shares into which each bond may be converted. For example, a convertible bond may entitle the holder to transform it into 10 shares, 100 shares, or 1,000 shares. The ratio selected, combined with one's predictions about the direction and magnitude of likely changes in the company's stock price, will determine the value of the conversion component to investors.

The ratio selected, combined with one's predictions about the direction and magnitude of likely changes in the company's stock price, will determine the value of the conversion component to investors. *In the specific case of an 'ESG convertible bond', a triggering factor for the conversion can be a specific ESG metric, which if moves up or down out of a specific range, the bond can be converted to a number of shares of the listed company or by rewarding the investor with additional money (under this specific conversion factor and a specific price).*

In addition to setting interest rates, convertible debt issuers must also choose a term for these securities, at the end of which principal will be repaid to investors (unless they have converted prior to its completion). The term selected will again depend on capital structure, the risk profile of the underlying company and the pool of targeted investors. The most obvious example of this is that if a company's survival prospects are slim, few investors will purchase long-term bonds from it (at least not without very high interest payments and perhaps other protections). To the extent it can secure debt financing at all, such a company will need to issue short term notes. On the other hand, long-term bonds can be a very attractive investment if issued by a company with solid long-term prospects. Convertibility can further enhance such a bargain—especially if the strike price and conversion are set favourably by investors.

Convertible bonds might also incorporate a call feature, allowing the company to elect to repurchase them by paying their principal and accrued interest before their term expires, perhaps along with an additional premium to compensate bondholders. The call feature imposes a practical limit on the value of conversion—and the resulting value of the underlying bond. Bondholders cannot continue observing a stock price rise indefinitely and bank on their ability to turn their bond into shares at any time. Instead, the company can choose to stop the party at any point and offer the call price or (more likely) force conversion.

Finally, convertible debt, like other debt products, can include endlessly customizable contractual components. These promises, often called covenants, can provide debt holders (who do not have statutory governance rights) substantial control over issuers' business decisions. Of course, for a convertible debt issue to include such covenants, company leaders must be willing to part with this control—potentially undermining the value of adding debt to its capital structure in lieu of equity.

Example of using ESG convertible bonds as a sustainable financial instrument by an investor

A company, which use ESG standards or has an ESG profile, can issue (using a Bank as an underwriter) a medium-term convertible bond to raise funds from the public for social investing purposes (the company may be listed in a Stock Exchange). The company can use its ESG profile and standards to attract 'social' or 'green' investors or other investors and receive funds to invest their money in turn, in social and environmental purposes. To make the product more attractive, it can add a specific clause to make it convertible: if a specific ESG metric moves up or below from a specific range, the bond can be converted to a number of shares of the listed company (under a specific conversion factor and a specific price). This bond can also be traded and listed in the same Stock Exchange, as the shares of the company.

The investor (individual, institutional, a social enterprise, etc.) benefit by the returning amount of the standards flows of the coupons of the bond and at the same time, it can be protected from the *non-abiding behaviour of the company regarding the ESG standards* by rewarding it with shares. The investor can combine the company shares which maybe has already held in its portfolio before buying the convertible bond, together with the new received shares from the conversion and estimates alternative hedging moves (see also '*Advantages of the 'innovative' sustainable financial instruments and possible obstacles*', earlier in this study).

The issuer also can benefit from this kind of bond, since it receives a remarkable amount of money for its social and environmental purposes. At the same time, the issuer has a 'green' or 'sustainable' or 'social' obligation to abide to specific ESG standards and metrics (spanning the life of the bond), in order to invest on social and sustainable projects and remaining and focused on them (otherwise, he will deliver shares to bondholders). This obligation helps him, indirectly, to persist on the social purposes of his company and bond's targets.

5.2 The Flexible-Low-Yield Paper Instrument (FLY Paper)

The flexible-low-yield paper instrument (FLY Paper) which it is proposed makes conversion rights contingent on sale of the entrepreneur's stock to serve both purposes. A contingency whereby a founder's agreement to sell its shares triggers bondholders' right to convert to common stock will influence the incentives of both parties. Having to share the spoils of a sell-out with the former bondholders, it can reduce the attractiveness of such a sale in the first place. Accordingly, fewer such sales should take place. FLY Paper makes social mission sticky, but it does not preclude sale altogether. When sales do happen, though, conversion to equity at least allows former debt holders to share in any financial upside of a shift to a more singularly profit-motivated orientation.

Convertibility is a pivotal feature, but not the only design element that can help social entrepreneurs and investors overcome the assurance game they face in benefit corporations and other social enterprises. The "flexible, low-yield" components of the FLY Paper moniker refer to the additional attributes that we advocate. Most importantly, investors' willingness to accept a low yield provides an additional measure of reassurance to entrepreneurs. Like a hunter publicly leaving his hare traps at home, investors who choose FLY Paper, rather than a comparable, higher-yielding bond, leave financial value on the table. The very purchase of a below-market-yield bond acts as a signal of investors' commitment to achieve nonfinancial gains.

This signaling effect can also be important to investors. Depending on the body of investors to be taken on, individual investors have reason to worry not only about the commitments of a benefit corporation's founders but also those of their fellow investors. One FLY Paper investor can be reassured of parallel investors' dedication to their enterprise's social goals by these other investors' willingness to take a below-market yield as well.

Example of using a flexible-low-yield paper instrument (FLY Paper) as a sustainable financial instrument, by an investor.

A low yield offers benefits to the entrepreneur by reducing the cash flow it needs to service the debt. The other features we recommend—long term and payment-in-kind rights—enhance this benefit and make FLY Paper investments patient capital. The longer term speaks for itself, and if it again compares negatively with market substitutes, investors accepting it further signal their desire to achieve something beyond financial return from their investment, reassuring entrepreneurs and each other. A FLY paper, may have conversion factors, as the convertible bond, which under a specific trigger event can be implemented.

From the investor (institutional or individual) side, these triggers could be keyed to ESG metrics events, like failure to meet required ‘*Social*’ and ‘*Governance*’ metrics (these ESG performance metrics are already be incorporated).

Though doing so raises risks due to the inherent difficulty in measuring social performance and concerns about managers pushing to avoid triggers by means that could undermine the social mission of the organization. For example, a FLY paper (as a convertible note) issued by a benefit corporation engaged in microfinance might be made contingent on failures to enter particular new markets by agreed-upon dates or maintain a targeted ‘*Social*’ metric rate for its employees. But, either contingency might be criticized as insufficiently indicative of mission drift and subject to manipulation by managers.

5.3 Government Bond With a Social Macro-indicator Clause

In this case, such banking instrument/financial product can be issued by governments and launched by financial institutions (with i.e. tax incentives) with underlying macro indicators as *the unemployment rate of a Member State (MS)*. In this case, a **clause** of this product might foresees that the bond can bring more payments than the usual monthly (or semiannually) payments, as a reward additional to the usual coupon payments. For example, if the unemployment rate of the MS (in our example) during a specific period is moving over a specific target-price, then an additional payment reward will be given to investors. At the same time, the collected funds from the investors who bought the bonds, together with the amount provided by EC (under the InvestEU tool) might be distributed by the government for social purposes and to marginalized groups. So, the achieved target is twofold: *usage for social needs* and *returns for investors*, too.

5.4 Social Bond Issued by a Partnership (Cooperation Public and Private Sector)

This might be a long term (i.e. 10 years) *social bond* with a low yield (see also above analysis for the convertible bond or bonds with rewarding clauses) which will combine the received funds from InvestEU and from the private investors-bondholders (from the bond issue).

Such bond might have incorporated some covenants (clauses) in order to be more attractive to the investors. Essentially, apart from the usual periodic coupon payments, *the bond will reward the bondholders with additional amount (i.e. once per year) if, for example, a macroeconomic incorporated index (i.e., ‘official unemployment rate’) will remain between a specific range or it is below a target-price*. That clause will be an additional motive for the investors and for the PES, in order to achieve a government target regarding the unemployment rate. The required funds for repaying the outflows for the aforementioned clause will be sufficient due to the successful issue.

Example of using a Social Bond as a sustainable financial instrument, by a partnership of a Social Organization (PES) and a private investor (public-private partnership).

As an example, we can suggest that the Hellenic PES (ex. OAED) can enter in *a partnership with private sector* (PPP) for implementing housing policies (under the recent law of the Hellenic State, Law 4921/2022, art. 44). The housing policy and its implementation aimed by the private sector is: to rent, to construct, to buy, to invest, to exploit and to provide properties to specific groups (or marginalized people). *It is now feasible under this specific legislation*. The partnership can benefit from the new legislation and issue a ‘social bond’ (with the aforementioned rewarding clause) with the combined funds (a) from InvestEU (SISW) and (b) from the bondholders. Therefore, an advantage (‘leverage effect’) will increase the initial amount received by the partnership, from the InvestEU.

6. The EU Capital Markets’ Approach and ESG Metrics

Capital Market as in the supply side can be considered as a channel of raising funds from the sustainable investors and diffusing the investing idea more widely.

As policy recommendations, we can refer the establishment of Focus groups, Discussions, Consultation with involved groups and Trials. Studies should be conducted before the IPOs/launching on: viable (business/financial), impact (work as it is intended), value (demand), feasible (technology, product design), scalable (it will be scaled).

The proposed process for the introduction of a sustainable financial instrument into the Capital Market:

a) *Innovation* phase (identify options, feasible options, shortlist, solution) and

b) *Mainstream* phase (business model, commercial feasibility, formation, mainstreaming).

6.1 Economics of Impact

1. Motivations of investors. There have been hundreds of surveys analysing the pro-social motivations of investors and their socio-demographic characteristics.

2. Relationship of impact and return: There are different schools of thought when it comes to the relationship of impact and return. Some argue that there is a natural trade-off, while others look at models, which reinforce each other.

6.2 Stock Exchanges, as Long as, MTFs and Other Platforms Can Be Used as Channels for Fund Raising

Regarding Sectors and Indices in European Capital Markets for the sustainable financial instruments, we can consider that the creation of these specific sectors in European Capital Markets should be useful. For example, a *'sustainable financial instruments' sector* in a Capital Market, will define the importance of these instruments. This has to be accompanied by a set of sectorial indices, for which a daily monitoring procedure has to be also implemented.

These products should be rated by CRAs. It is also important to be examined in depth the role the settlement of these products by CSD and repositories. The prospectuses regarding the IPO of these products should also be carefully examined by NCAs. In addition, ESMA has to publish technical standards. A half-year reporting obligation by the issuers to the NCAs, should be considered.

6.3 Trading Venues' Listed Social and Green Bonds, Issued by Banks and Corporations. An Innovative Perspective for Financial Instruments

Green bonds (also known as *climate bonds*) are fixed-income financial instruments (bonds) which are used to fund projects that have positive environmental and/or climate benefits. They follow the Green Bond Principles stated by the International Capital Market Association (ICMA), and the proceeds from the issuance of which are to be used for the pre-specified types of projects. They differ from *Sustainability Bonds* in that the latter also need to have a positive social outcome, besides simply having a positive impact on the environment.

Climate bonds are issued in order to raise finance for climate change solutions: climate change mitigation or adaptation related projects or programs. These might be greenhouse gas emission reduction projects ranging from clean energy to energy efficiency, or climate change adaptation projects. Like normal bonds, climate bonds can be issued by governments, multi-national banks or corporations (Note 25). The issuing entity guarantees to repay the bond over a certain period of time, plus either a fixed or variable rate of return. Most climate bonds are asset-backed, with investors being promised that all funds raised will only go to specified climate-related programs or assets, such as renewable energy plants or climate mitigation focused funding programs.

Social bonds are bonds that raise funds for new and existing projects with positive social outcomes. The Social Bond Principles (SBP) seek to support issuers in financing socially sound and sustainable projects that achieve greater social benefits. SBP-aligned issuance should provide transparent social credentials alongside an investment opportunity. SBP-aligned issuance should provide transparent social credentials alongside an investment opportunity. By recommending that issuers report on the use of Social Bond proceeds, the SBP promote a step change in transparency that facilitates the tracking of funds to social projects, while simultaneously aiming to improve insight into their estimated impact.

Corporate Bonds for ESG purposes should be monitored regarding the flow of the raised funds from the investors.

Preferred shares offer another route to align entrepreneurs and investors through an instrument that is a kind of mirror image of convertible debt. While convertible bonds are debt enhanced by equity-like features, preferred stock is equity embroidered with attributes reminiscent of debt. As equity, preferred stock provides investors with claims on a firm's residual value. However, the preferences that give the instrument its name come paired with limitations. Preferred stock generally provides investors with a significant and predictable midstream return along with the security that comes with a liquidation preference.

Like debt, preferred stockholders' claims have priority over those of common shareholders. Each instance adds debt-like features of various kinds into an equity product to strike a deal offering investors their desired blend of risk and return. The most basic element of these preferred stock deals is a liquidation preference. On liquidation, preferred shareholders receive their share of company assets before common stockholders. Of course, debtholders have even higher priority and will be paid before any shareholders—common or preferred alike. Nevertheless, if assets remain, following satisfaction of creditors, a liquidation preference gives preferred shareholders an advantage and limits the preferred shareholders' downside risk.

Preferred shares are, essentially, creatures of contract, and parties to them can select from among these many permutations in their negotiations for investment. This system also means that companies and potential investors can negotiate individually tailored contractual provisions to suit their needs. For example, Venture Capital (VC) firms' preferred share investments may include contractual rights to appoint specific directors and for these director representatives to approve major financial or personnel decisions by the company. Such provisions provide VC funds holding preferred shares with significant control over investee companies' present actions and future choices.

Social enterprises could use the malleable features of preferred stock to structure an investment vehicle to respond to the assurance game faced by their founders and investors. Social entrepreneurs wary of ceding control to investors could be made comfortable with taking them on by the use of preferred shares with no voting rights. The preferences that enhance convertible shares' upside, especially if structured to be payable only at liquidation, can provide comfort to investors leery of bankrolling entrepreneurs' blended mission ideas without the ability to share in a financial upside if one should materialize. Preferred shares can also be affordable and patient capital, as they come with no promise of return of investors' principal, no dividends issue until directors declare them, and their promised preferences can increase the per-share price investors will pay.

6.4 The Use of Sustainable Financial Instruments in Portfolio of Mutual Funds (and Other UCITS Entities)

The way companies manage environmental, social and governance (ESG) factors affects not only their financial results but also the long-term viability of our environment and way of life. *Sustainable investing funds* enable investors to pursue their financial goals while supporting a better future for all of us. Sustainability is now a key consideration when it comes to assessing financial performance and investment risk. Attractive environmental, social and governance (ESG) opportunities are emerging across all asset classes. The chief investment officers for equities and fixed income portfolios in mutual funds should focus on how sustainability is shaping global markets.

Although they prefer to invest in high quality, well managed companies that make money and return cash to shareholders, a lot of the value now can be found in forward-thinking established companies that are embracing change, or that are investing in their businesses to stay relevant. That is where the best risk-reward trade-off is likely to be found.

The investor's appetite for sustainable fixed income is strong and growing. In 2021, there was nearly $1 trillion issued across green, social, sustainable and sustainability-linked debt – double 2020 levels. In 2022, issuance could double again, presenting a wealth of opportunities for investors (Note 26).

However, the dynamics of sustainable investing are a little different in the bond markets. From an equity perspective, companies with the best sustainability behaviour should be able to fund themselves at a lower rate. Being able to demonstrate strong sustainability or ESG credentials to equity investors is increasingly seen as an indicator of good management. In fixed income markets, issuers with strong ESG characteristics are *increasingly seen to present a lower credit risk*, which translates into a lower coupon and lower yield for bond market participants.

Conversely, issuers that are ESG laggards are likely to be penalised with a higher cost of funding. One of the things we know about the bond market is that, over time, a higher yield leads to a higher return. Therefore, as we collectively focus on doing the right thing, fixed income investors looking to fund sustainability and green-linked issuance will have to be willing to accept slightly lower yields and a slightly lower return.

6.5 Capital Markets and ESG

The term ESG encompasses the wide set of environmental, social and corporate governance considerations that can affect a company's ability to generate value. In a corporate context, it is used to refer to the incorporation of non-financial considerations into business strategy and decision-making. While ESG factors are sometimes considered nonfinancial, they are linked to business competitiveness and the way in which a company manages them can result in financial consequences.

Investors use ESG information to measure how resilient and well-equipped a company is to manage changes in the environment in which it operates. PRI traditional financial reporting, ESG data can paint a complete picture of a company, helping investors understand its competitive positioning and the efficiency with which it can benefit from new opportunities. Beyond satisfying investor information needs and reducing information asymmetries, ESG disclosure and effective management can yield significant benefits for companies.

Indicatively it can result in:

<u>*Improved access to capital*</u>

Research has shown that firms that are more transparent and perform well on material ESG issues have greater access to capital with a lower cost (Note 27). Transparency on a firm's ESG performance and how it relates to long-term value creation can enhance a company's ability to attract long-term investors, especially institutional investors whose policies mandate the incorporation of ESG information into their capital allocation decisions. As part of the process for integrating ESG topics in decision making processes, which is becoming mandatory within certain companies, investors are increasingly using ESG data to either screen out low ESG performance companies or to seek high ESG or "green" performers.

Complying with regulatory changes

The need for enhanced disclosure on sustainability matters is also driven by governments, which are increasingly adopting a variety of mandatory requirements for corporate ESG disclosure, like the European Union's Non-Financial Reporting Directive (NFRD) 2014/95/EU, the EU Taxonomy and the upcoming Corporate Sustainability Reporting Directive (CSRD). Disclosure requirements have already begun to rapidly evolve and expand to meet the growing appetite for ESG and transparency within the market. Companies that establish clear processes for identifying, measuring and managing ESG factors will quickly respond to regulatory developments, reduce compliance risks and secure their license to operate within a changing environment.

Strengthening corporate performance

Recent research (Note 28) has made a strong business case for embedding sustainability into a company's strategy. Good performance on material ESG indicators can generate value for shareholders and improve long-term corporate performance. Companies that exhibit strong performance on material ESG issues display improved operational efficiency and perform better than firms with poor ESG performance in terms of stock returns and future profitability.

Enhancing corporate reputation and stakeholder engagement

Disclosing ESG information and improving performance on material factors demonstrate a company's ethical alignment with international frameworks like the Sustainable Development Goals (SDGs), and a commitment to long-term value creation. Providing information on material non-financial topics enables effective communication with both internal and external stakeholders and offers opportunities for meaningful engagement during the reporting process.

6.6 ESG Metrics

We suggest that the metric structure comprises of *economy-wide* and *sector-specific metrics*. Economy-wide metrics are divided into *core* and *advanced metrics (Note 29)*. Each metric is supplemented with a respective reporting guide to help companies understand the type of information they need to disclose. Taking into consideration that companies with strong performance on material ESG topics outperform companies with poor performance on material topics, we recognise the importance of sector-specific reporting metrics. Analysts and investors use sector-specific criteria to evaluate company portfolios, since different issues are material across different sectors. Therefore, we have developed *sector-specific metrics* to assist listed companies to understand which issues are considered strategically important for their sector and that reporting and improving performance on such issues are likely to result in better financial performance. The following suggested ESG metrics are based on ESG reporting practices outlined in international sustainability guidelines and standards like SASB's industry-specific standards.

Economy-wide metrics

1. Core metrics

They are metrics that all companies are advised to report on. These metrics suggested are based on the prevalence of the corresponding ESG issues and the universality of their application.

2. Advanced metrics

They are metrics that focus on advanced ESG performance. This set of metrics has been suggested to allow high-performing ESG companies to display their work and to establish the emerging topics that companies in a Member State should understand, report and improve in the future.

3. Sector-specific metrics

They are metrics that are specifically suggested for industry sectors. Sector-specific metrics can provide a clear view of the sustainability risks that companies are prone to, as most material issues differ across industries and sectors.

The metrics are accompanied by: a definition, measure and relevant framework (see *Annex*)

We will narrow our study only to "*Social" classification-parameter* and we will let the '*Environment*' and '*Government*' (from ESG) classifications to a **future study**. In addition, our study will include and suggest Core (C) metrics, Advanced (A) metrics and Sector Specific (SS) metrics.

Core metrics

The core set (for the *Social* part-classification), as depicted below, contains eight (8) metrics that all companies are suggested to report on (since have introduced financial instruments for trading purposes to Capital Markets and Stock Exchanges):

C-S1 Stakeholder engagement

C-S2 Female employees

C-S3 Female employees in management positions

C-S4 Employee turnover

C-S5 Employee training

C-S6 Human rights policy

C-S7 Collective bargaining agreements

C-S8 Supplier assessment

Advanced metrics

The advanced set, as depicted below, contains four (4) metrics (for the *Social* part), that focus on advanced ESG performance.

A-S1 Sustainable economic activity

A-S2 Employee training expenditure

A-S3 Gender pay gap

A-S4 CEO pay ratio

Sector specific metrics

The sector-specific set, as depicted below, includes ten (1)0 metrics (for the *Social* part), that are specifically created for each of the sectors.

SS-S1 Product quality and safety

SS-S2 Customer privacy

SS-S3 Legal requests of user data

SS-S4 Labor law violations

SS-S5 Data security and privacy fines

SS-S6 Health and safety performance

SS-S7 Marketing practices

SS-S8 Customer satisfaction

SS-S9 Customer grievance mechanism

SS-S10 ESG integration in business activity

It is also important to mention that a set of metrics (core, advanced and sector specific) regarding the *Environmental* and *Governance* classification have to be prepared. For example, we can refer as *core* metrics the "Emissions" and "Energy consumption" (Environmental) or "Sustainability oversight" and "Business ethics" (Governance). Moreover, as *advanced* metrics, the "Climate change risks" and "Waste management" (Environmental) or "Business model", "Employees' % with Green Skills" and "External assurance" (Governance). Finally, as *sector specific* metrics, the "Water management" and "Chemicals in products" (Environmental) or the "Critical risk management" and "Whistleblower policy" (Governance).

7. The Investor Perspective

A key consideration in successful ESG reporting is determining the factors that are linked to a company's ability to generate value, and are thus material to the business and its stakeholders. Companies need to identify, prioritise and disclose the ESG issues most relevant to them, and form an understanding of how those issues affect their corporate performance and their ability to implement their strategy.

According to the International Accounting Standards Board, the concept of materiality is used to refer to information whose omission or misstatement could influence the economic decisions of those relying on financial statements.

Different sustainability issues are material for different companies, depending on their business model, their stakeholders and the industry in which they operate. To effectively address investor information needs, companies should disclose their performance on material issues that are most likely to impact their financial and operational performance.

To ensure more comprehensive ESG reporting and help issuers enhance the quality of their disclosure by focusing on material ESG issues that are relevant to investors, issuers have to apply, effectively, the concept of materiality and gain a clearer understanding of the material issues in their industry, achieving greater transparency and realising benefits from their improved ESG performance.

7.1 SII Investments, ESG Data Performance and Trends

As already known the 'investment performance' is the return on an investment portfolio. The investment portfolio can contain a single asset or multiple assets. The investment performance is measured over a specific period of time and in a specific currency. Investors often distinguish different types of returns and as other investments, SII investments, involve risks, as a result of their nature. *Moreover, an SII investment can be considered as a long-term oriented investment approach that integrates Environmental, Social & Governance (ESG) factors in the research, analysis and selection process of securities within an investment portfolio.*

SII investments are used to achieve ESG goals. For example, to achieve the goals of the Paris Agreement and limit global temperature rise to no more than 1.5-degrees Celsius above pre-industrial levels, it is necessary to significantly increase the level of new investment in low-carbon technologies and energy efficiency, and to reduce investments in high-emitting sectors and activities, including the extraction and use of fossil fuels. In 2018, the Intergovernmental Panel on Climate Change (IPCC) announced that the world must invest an average of US $2.4 trillion in clean energy every year through to 2035 in order to prevent global temperature increases from exceeding 1.5-degrees Celsius. The use of coal should be reduced to almost nothing by 2050, according to the IPCC (Note 30).

Although the empirical evidence on returns has been mixed in the past decade, there is a growing body of academic literature and industry research showing that ESG funds can perform as well as – or, under certain circumstances, exceed – traditional market-weighted investments (Boffo and Patalano, 2020, Note 31). Against this background, the COVID-19 pandemic uncovered the fragility of national economic systems and exposed the growing resilience of ESG funds and sustainable business models (Barbéris and Brière, 2020). Some evidence suggests that, at least during the pandemic, ESG risks matter for investment performance, and sustainable investing can perform and deliver stronger risk-adjusted returns (Whieldon and Clark, 2021, Note 32). As a result, in the first quarter of 2021 alone, capital investments in **European sustainable funds** reached EUR 120 billion, 18% more compared to the same period in 2020, representing 51% of all European fund inflows (Graph 1). The number of available sustainable funds also increased substantially, reaching 3,444 by March 2021 compared to 3,196 at the end of 2020 (Note 33).

Graph 1. European Sustainable fund flows (EUR billion)

Source: Morningstar Direct, Manager Research. Data as at March 2021

Investors are encouraged to make SII and low-carbon investments and commitments including phasing out investments in sustainable financial instruments. Investors should also integrate climate change into their long-term investment decision-making process and portfolio analysis.

Governments and investors began to take notice of SII only around a decade ago. Ever since then, the SII market has grown rapidly. To illustrate this fact, in 2017, the SII market in nominal terms was over 12 times larger than it had been in 2011. SII showed the most rapid market growth throughout 2014-2015, even though growth has been more modest in the last few years (Note 34).

Several drivers encouraged this rapid development of the SII market across the EU. *First of all*, the higher profile of the SDGs (Sustainable Development Goals) fuelled interest in this investment approach. Public and philanthropic funds are expected to cover only about one third of the funding needed to achieve the SDGs in developing countries worldwide, which leaves an annual funding gap of €2 trillion. Europe will need approximately €180 billion in additional investments in energy efficiency and renewable energy per year in order to meet the targets of the Paris Agreement (European Commission 2018). These gaps emphasise the demand for mobilising private capital to meet social and environmental needs. *Second*, a strong push for SII came after the 2013 G8 Summit in Dublin. *Third*, the current low-interest rate environment has prompted investors to search for other investment opportunities including social and/or environmental returns. *Lastly*, there is growing evidence of the success of impact investing which advocates to an increasing awareness of the field with success stories.

Regarding recent specific developments in the SII market across the EU, there are some noteworthy *trends* (Harris et al. 2014):

- **Emerging criteria for defining SII**. There is an ongoing discussion between experts, policy makers, and SII actors about the types of investment that can be interpreted as SII. During the early stages of SII, a majority of countries and international organisations relied on a rather inclusive 'big tent' approach, and welcomed every type of investor joining the field. Thus, the SII market was based on a relatively broad and 'flexible' interpretation of SII. Nowadays, some experts claim that the definition of SII should be clarified with strict criteria in terms of social impact intentionality, impact measurement and profit orientation. They justify this position by paying attention to the very high return expectations of some investors (up to or even above a 20% Internal Rate of Return (IRR) for a fund).
- **Growing investments**. First, SII funds are becoming progressively larger. This is leading to a larger supply in funds compared to direct investments. This evolution happens because funds aim to generate higher management fees on their managed assets. Second, although the 'ticket-sizes' of most impact investments remain quite small (averaging between €200,000 and €5 million) they are constantly growing.
- **Cross-border investments**. Some investors, who until now have primarily relied on national investments (cross-border investments being the exception in this field), are starting to look beyond their borders for suitable social enterprises.
- **A trend towards integrated business models**. Many investment-readiness programs (a type of intermediary) are currently enlarging their field of activities. This means that some investment-readiness programs have already started investigating the idea of their own dedicated impact funds and are thus taking on the role of intermediaries and supply side actors at the same time.

7.2 Reporting Considerations

Once a company listed in a Stock Exchange has determined the ESG factors it should track and report on, relevant metrics and indicators which should be selected in order to communicate this information effectively. Where possible, companies should provide quantitative, comparable and forward-looking performance metrics to facilitate ESG integration. It is recommended that companies use credible indicators included in internationally recognised reporting frameworks like GRI, SASB, IIRC, TCFD, CDP or UNGC. Companies should disclose their methodology and provide explanations to support quantitative indicators, establishing the link between ESG and financial performance.

Companies should ensure that the data they provide is objective and includes not only indicators on which they perform well. In their disclosures, reporters should not obscure less favourable information. Instead, they are encouraged to provide explanation and demonstrate how they intend to improve and mitigate any negative impacts in the future.

Companies are advised to report on data covering the whole spectrum of their operations. Where data is not available, companies must clearly state which segments of their operations are covered in their disclosures. Group companies are encouraged to provide data covering the whole organisation, i.e. both the parent company and its subsidiaries that are included in the group's consolidated financial statements or equivalent documents. If data is not available for all entities, they are advised to start by reporting data regarding the parent company and proceeding with any other entity for which data is available. It should be clearly stated which subsidiaries are included in the reporting scope.

Effective ESG integration must start at the top levels of a company. Determining material ESG issues that are strategically relevant and setting KPIs requires the involvement of the company's Board and upper management. Companies should track ESG performance and provide communication to the board to facilitate effective oversight. We recommend that annual non-financial disclosures are approved by the Board.

Generally, it is currently not mandatory for companies to obtain external assurance for their ESG disclosures, however it is recommended that issuers obtain assurance to ensure the credibility of their reports. In the future, it is expected that assurance/audit of non-financial information will be required according to the CSRD.

To reach their intended audience, ESG information should be available through an array of channels, including corporate websites, annual reports, sustainability reports or other forms of reporting. Companies can choose to provide this information through:

a) A standalone sustainability report;

b) Disclosure of material ESG factors in the organisation's financial reports; and/or

c) An integrated report that focuses on how the organisation creates value through its strategy, governance and performance.

Companies should disclose their ESG reports on an annual basis within six months from the end of their annual financial cycle.

It is also important that the '*proportionality'* principle must be considered. As the aforementioned reports are financial reports, common standards are necessary to ensure that reported information is comparable and relevant. This proposal takes a proportionate approach to determining which companies will be subject to mandatory reporting requirements. It does not impose new requirements on small and medium-sized enterprises (SMEs), except SMEs listed on *EU regulated Capital markets (Note 35).* The Commission will adopt standards for large companies and separate, proportionate standards for SMEs.

Transparency rules are also necessary to ensure investor protection and financial stability across the EU. Common rules on sustainability reporting and its assurance ensure a level playing field for companies established in the different Member States ('*subsidiarity'* principle).

7.3 Important Is the MAD and MAR, in Order to Prevent Market Abuse and Market Manipulation

The MAR Regulation governs all deterrents mentioned in the MAD, including publishers' obligations to publish privileged information and a list of obligors. However, in order to reduce the management costs and burdens for the SMEs, MAR adopts measures for issuers whose securities are traded in emerging markets (based on MiFID II). In particular, they are not required to compile a list of responsible persons, but they have to take all necessary measures to ensure that every person with access to *privileged information* is aware of his legal obligations and criminal penalties, regarding the use of *privileged information* and transactions.

Under MAD II, Member States take the necessary measures to ensure that offenses of market manipulation and misuse of privileged information are punishable by a term of imprisonment.

Additionally, under MAD I, II and MAR, the Capital Market (multilateral stock market) and the Over-The-Counter market (Banking market bilaterally traded instruments) are both jointly supervised for *market abuse* issues, through unacceptable practices and illegal use of confidential information, using all of the securities, referenced in MiFID I and II. The supervision of both markets is not yet fully achieved (Panagopoulos A. et al., 2018, Note 36). It appears that a significant progress has been made in consolidating the financial markets and less so in the capital markets, mainly in shares and investments through collective investment undertakings.

Since the listed sustainable financial instruments include the technical specs of the instruments referenced in the above legislation, we can say that there is the appropriate investor protection from investing fraud, market abuse practices and market manipulation. *Of course, the rating of these instruments (or the company which issued them) by*

CRAs are necessary, in addition to their Prospectus, before their listing in Stock Exchanges. Here, we have to add, the enhanced reporting necessity regarding ESG metrics for the sustainable financial products.

Similarly, regarding Banking sector sustainable financial instruments (bilaterally traded) a similar set of necessary reporting have to be in place (ESG metrics, CRA rating, etc.). At the same time, an often reporting to the relevant Central Banks in MS it is necessary, as they are the local supervising authorities.

One important challenge regarding the investors' protection is **the lack of a unified and precise definition of SII.** Although the question as to whether the definition of SII should be narrower or more inclusive remains controversial, most SII actors agree that establishing a single definition instead of relying on a variety of interpretations is absolutely necessary. Varying SII interpretations result in other, even more specific issues. *First*, monitoring the SII market becomes highly complex. For instance, it is impossible to identify whether spending on SII differs across countries due to differences in definitions or for other reasons. *Secondly*, instances when investments that are definitely not SII (e.g. ESG) are still interpreted as such or when investments that meet SII criteria are interpreted as something else, create the risk of eradicating the transformational power of SII. *Finally*, the lack of a unified definition increases the risk of ***'impact and social washing'.*** Some providers have started labelling their products as SII products due to tighter regulations on sustainable investment criteria even though their funding sources do not adhere to SII standards. SII may unwittingly encourage enterprises to exploit their activities as a marketing strategy instead of seeking actual commitment and a positive impact (**Risk of impact washing**).

Therefore, the lack of clarity among investors regarding what constitutes a *socially sustainable investment* may therefore be one of the issues hampering social investments, representing an obstacle to further finance activities contributing to social sustainability. This uncertainty leads to the risk of *'social washing'* practices being ever-present. For example, poor working conditions violate fundamental rights and can have concrete consequences for financial institutions, such as legal and reputational damages, which may ultimately lead to financial losses.

8. Conclusion and Further Research

Several of the objectives of the *Social Economy Action Plan* (*SEAP*) and especially social policy objectives, will be achieved and/or supported by the SII innovative financial instruments. This potential can be achieved by combining the traditional financial instruments by InvestEU combined by banking and/or capital market financial tools. Under this way, a more leveraged amount of funds will be provided to the final recipients for social purposes. At the same time, a wider number of investors (public and private) will be involved, since they can use these instruments for a more 'green' and 'social' portfolio, which will reward them not only financially speaking but also contributing to the improvement of the social and environmental aspect of our future. However, there is still a need for a '*demand and supply call*' in order to improve further and enrich the EU financial market structure

An important matter is the framework of MAD and MAR, in order to prevent market abuse and market manipulation, when sustainable financial instruments are used by investors. A further research should be conducted on: the measurement, the performance of the use of the sustainable investment instruments, the reporting disclosures, the monitoring, the settlement, the rating and the investors' protection in the Banking sector and in the Capital markets.

Given the robust relation between investments on material sustainability issues and future financial performance, it would be important to examine the structural relations that lead to this association. How do investments on material issues influence customer loyalty and satisfaction, employee engagement, brand and reputation, or access to finance? Another fruitful area for future research would be examining why firms choose to make different types of investments as well as why and how firms choose to make different types of disclosures around those investments.

Moreover, investors expect that ESG styles related to positive screening and active ownership will become more important in the future. This creates interesting opportunities for research in both valuation and corporate governance. How does increasing positive screening affect the cost of capital and market valuation of firms that perform well on material ESG issues? Similarly, how does active ownership change firms' governance, managerial practices and performance on ESG issues as well as their financial performance? What does active ownership mean in the face of increasing indexing? We also document that the vast majority of investors are motivated by financial reasons rather than ethical reasons in using ESG data. The majority of the respondents suggests that ESG information is material to investment performance. However, material information varies systematically across countries (e.g. a country where water pollution is a more serious issue versus a country where corruption is a more serious issue), industries (e.g. an industry affected dramatically by climate change versus an industry affected by violations of human rights in the supply chain) and even firm strategies (e.g. firms that follow differentiation versus a low price strategy).

For example, Khan et al. (2016) show that the vast majority of ESG data for any given industry is immaterial to investment performance and that the material information varies across industries within a sample of US stocks. Understanding how the materiality of ESG information varies across countries, industries and firm strategies therefore is of primary importance.

A large number of investors use ESG information because of client demand or as part of their product development process. This raises interesting questions about new products that use ESG information. A good example is green bonds where the proceeds of those bonds are to be allocated for projects that improve environmental outcomes. Understanding the structure and pricing of those contracts could shed light into investor preferences and how such financial instruments improve societal outcomes.

Concluding the *opportunities,* we can refer the wider use from a number of investors of these instruments, who can include innovative sustainable financial tools in their portfolios, hoping for a reward at a later stage and investing on the social and environmental dimension of the companies. The banking sector and the capital market must enrich their financing instruments and can suggest to their clients different ways of investing and hedging money. Moreover, investing in sustainable companies, can help them (the companies) to release their social impact on the employees, environment and generally to a direct their culture closer to the objectives of the EU Pillar of social rights.

These opportunities will also *strengthen* the EU financial system, since the investors will engage in more sophisticated financial tools and therefore hedge their existed portfolios. At the same time, the EU financial market will be more attractive to third countries' institutional investors, who will wish to transfer more funds to invest in the EU financial market.

Concerning the *risks*, we can refer the non-wise use of the sustainable financial tools by the investors and the non-abiding behaviour of the companies (which have issued sustainable financial instruments) to the ESG metrics/standards or other standards regarding the 'social' and 'environmental' purposes of the money they receive. The market abuse and the market manipulation regarding these instruments are also additional risks for the investors.

These risks must be adequately avoided by the necessary surveillance from the respected supervisory authorities in order to protect the EU financial system from *weakening* of its targets.

This study is the first attempt to expand the current sustainable financial instruments, which have an SII under the ESG landscape to a set of banking and capital market instruments (in order to mobilize funds and leverage the available money). Under this reasoning, only a set of ESG metrics was proposed and especially focused on the '*Social*' parameter. The development of a second study and proposal of a new set of ESG metrics regarding to the '*Environment*' and *'Governance*' parameters, will have the same importance. However, this will be addressed by the positive response of the financial community.

Since, there are significant barriers to sustainable investments that limit the potential of investors to achieve real impact and since investors are increasingly conscious about what public policies and public financing tools will be required to render sustainable investments more viable, another research should also be conducted.

Finally, the study has the ambition to operate also as a fuse and guidance for the involved parts and DGs of the EC (namely FISMA, EMPL, ECFIN, EIF, etc) to work closely for the promotion and the development of innovative sustainable financial instruments and EU's willingness to become the global financial centre under a social and environmental dimension. Therefore, sustainable investments can be a driver of transformative change in the real economy.

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Note 2. Deloitte (2018), Social Investment Leveraging Index Investing for Impact in Central and Eastern Europe, available at: https://evpa.eu.com/uploads/documents/Deloitte_EVPA_GSEN_DSILI_Final_Online.pdf.

Note 3. Scheck, B., Spiess-Knafl, W. (2020), Impact investing in the framework of business and human rights.

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Note 5. Bloomberg (2021). ESG Assets Rising to $50 Trillion Will Reshape $140.5 Trillion of Global AUM by 2025, Finds Bloomberg Intelligence.

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Note 9. Amir Amel-Zadeh and George Serafeim. Financial Analysts Journal, 2018, Volume 74 Issue 3, pp. 87-103 (July 1 2017). Why and How Investors Use ESG Information: Evidence from a Global Survey.

Note 10. “Study on Sustainability-Related Ratings, Data and Research”, November 2020, DG FISMA, European Commission

Note 11. “Targeted consultation on the functioning of the ESG ratings market in the European Union and on the consideration of ESG factors in credit ratings”, April 2022, DG FISMA, European Commission

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Note 13. Harris, R. S., Jenkinson, T., Kaplan, S.N. (2014), “Private equity performance: What do we know?”, The Journal of Finance 69.5.

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Note 16. Mackevičiūtė, R. et al., Social Impact Investment - Best practices and recommendations for the next generation, Publication for the Committee on Employment and Social Affairs, Policy Department for Economic, Scientific and Quality of Life Policies, European Parliament, Luxembourg, 2020.

Note 17. As ‘Notch’ is defined the Investing degree given by a CRA to an instrument (or to a Sovereign Debt) based on an own and predefined scale of investing evaluations (for example: AAA, AA+, Ba2, BBB-, BB3, etc)

Note 18. ‘Book runner’ and ‘Underwriter’ are roles a Financial Intermediary can undertake when engaged in debt or bond or other instruments’ issues.

Note 19. Christopoulos, A., Dokas, I., Katsimardou, S., Spyromitros, E. (2020) “Assessing banking sectors’ efficiency of financially troubled Eurozone countries”. Research in International Business and Finance, 52 (101121), Elsevier (ABS 2). https://doi.org/10.1016/j.ribaf.2019.101121

Note 20. An ethical bank, also known as a social, alternative, civic, or sustainable bank, is a bank concerned with the social and environmental impacts of its investments and loans. The ethical banking movement includes: ethical investment, impact investment, socially responsible investment, corporate social responsibility, and is also related to such movements as the fair trade movement, ethical consumerism, and social enterprise.

Note 21. Subordinated debt, “sub-debt” or “mezzanine”, is capital that is located between debt and equity on the right hand side of the balance sheet. It is more risky than traditional bank debt, but more senior than equity in its liquidation preference (in bankruptcy).

Note 22. A subordinated debenture is a bond classified lower than more senior debt in the event of a default. This means that the holders of more senior securities are paid first, before any residual funds are made available to the holder of the subordinated debenture

Note 23. International Swap and Derivatives Association (ISDA) is an organization, which fosters safe and efficient derivatives markets to facilitate effective risk management for all users of derivative products.

Note 24. More info could be retrieved from the study : “Policy Brief on Incubators and Accelerators that Support Inclusive Entrepreneurship”, OECD and European Commission, 2019, Luxembourg: Publications Office of the European Union, ISBN 978-92-79-96682-8, doi:10.2767/092345

Note 25. The Pioneer market and corporation in Green Finance was LuxSE (Luxembourg Stock Exchange), in 2007, when listed the first (ever) green bond to enter the market: the European Investment Bank’s “Climate Awareness Bond”.

Note 26. J.P. Morgan Asset Management : ESG Outlook 2022, Asset class views, March 2022

Note 27. ‘ESG Reporting Guide’, Athens Stock Exchange, March 2022

Note 28. Grewal, Jody, Edward J. Riedl, and George Serafeim, Management Science 65, no. 7, pp. 3061–3084 (July 2019), ‘Market Reaction to Mandatory Non-financial Disclosure’.

Note 29. See also, “ESG Reporting Guide”, Athens Stock Exchange, March 2022.

Note 30. See also Investment | The Investor Agenda and “Eurosif Report 2021 Fostering Investor Impact”

Note 31. Boffo, R., C. Marshall and R. Patalano (2020), “ESG Investing: Environmental Pillar Scoring and Reporting”, OECD Paris, www.oecd.org/finance/esg-investing-environmental-pillar-scoring-and-reporting.pdf.

Note 32. Clark, R. and Whieldon, E. (2021) ESG funds beat out S&P 500 in 1st year of covid-19; how 1 fund shot to the top, S&P Global. Available at: https://www.spglobal.com/marketintelligence/en/news-insights/latest-news-headlines/esg-funds-beat-out-s-p-500-in-1st-year-of-covid-19-how-1-fund-shot-to-the-top-63224550 (Accessed: October 31, 2022).

Note 33. Agnes Sipiczki, “A critical look at the ESG market”, CEPS Policy Insights, n. 2022-15, April 2022, p. 1-2

Note 34. “Eurosif Report 2018 Fostering Investor Impact”

Note 35. See CSRD_proposal_CELEX_52021PC0189_EN_TXT

Note 36. Panagopoulos,A. et al. (2018), “The Global Single and Regulated Market Framework of Financial Products and the International Economic Policies: Mathematical Approach of the Model”. International Journal of Financial Research, 9(2), 1-22. https://doi.org/10.5430/ijfr.v9n2p1.

Note 37. We will use the term “organization” instead of “company” and vice-versa.

Annex

1. Relevant frameworks, standards and legislations

GRI, SASB, CDP, NFRD, SFDR

2. Suggested 'Social' parameter metrics

C-S1 Stakeholder engagement

Definition

Stakeholder engagement is defined as the process of communication, consultation and interaction with stakeholders.

What to measure?

Indicator C-S1 requires the reporting organization/company (Note 37) to disclose its main stakeholders and its approach to key stakeholder engagement.

The company should disclose:

— The organisation's identified main stakeholder groups and the process by which they were identified

— The level at which stakeholder engagement takes place amongst management and whether the interests of key stakeholders are considered in discussions and decision-making of the BoD

— The purpose of the stakeholder engagement and how the organisation seeks to produce meaningful engagement

— The key topics and concerns raised per stakeholder group

— The organisation's response and actions taken for the issues raised

C-S2 Female employees

Definition

Number of female employees in the organisation is defined as the total number of female employees, by headcount.

What to measure?

Indicator C-S2 requires the reporting organisation to disclose the total number of women employees throughout the organisation, in percentage (%).

This indicator is derived by dividing the total number of women throughout the organization with the average total number of employees (male and female) throughout the organisation and multiplying the result by 100 producing the number as a percentage.

C-S3 Female employees in management positions

Definition

Number of female employees in management positions is defined as the number of female employees who are at the top 10% of employees by total compensation.

What to measure?

Indicator C-S3 requires the reporting organisation to disclose the percentage of women in managerial positions (i.e. female employees at the top 10% of employees by total compensation), in percentage (%).

This indicator is derived by dividing the number of female employees at the top 10% of employees by total compensation with the total number of employees at the top 10% of employees by total compensation and multiplying it by 100 to give the number in a percentage.

C-S4 Employee turnover

Definition

Employee turnover rates refer to voluntary and involuntary turnover rates that occur when employees leave an organisation.

— Voluntary turnover rate is the rate at which employees leave the organisation at their own

discretion within a time period.

— Involuntary turnover rate is the rate at which an organisation lays-off or discharges employees within a time period, due to reasons such as an employee's poor job performance, inappropriate behaviour and violation of workplace policies or an organisation's decisions to downsize.

What to measure?

Indicator C-S4 requires the reporting organisation to disclose its annual voluntary and involuntary full-time employee turnover, in percentage (%).

The voluntary turnover is calculated by dividing the total amount of voluntary employee exists

within a year with the average number of employees within a year and multiplying it by 100 to give the number in a percentage.

The involuntary turnover is calculated by dividing the total amount of forced employee exists

within a year with the average number of employees within a year and multiplying it by 100 to give the number in a percentage.

C-S5 Employee training

Definition

Employee training is defined as a formal type of programme that aims to increase or enhance the technical skills, knowledge, efficiency and value creation of an organisation's employees.

What to measure?

Indicator C-S5 requires the reporting organisation to disclose the average hours of training that the organisation's employees have undertaken during the reporting period, by employee seniority.

Employee seniority is defined by two employee categories, namely:

— Employees in the top 10% of employees by total compensation

— Employees in the bottom 90% of employees by total compensation

The average training hours for the top 10% of employees by total compensation is calculated

by dividing the total number of training hours provided to the top 10% of employees by total compensation by the total number of employees in the top 10% of employees by total compensation.

Average training hours (top 10%) =

Total number of training hours provided to each employee in the top 10% of employees by total compensation / Total number of employees included in the top 10% of employees by total compensation

Similarly, the average training hours for the bottom 90% of employees by total compensation is calculated by dividing the total number of training hours provided to the bottom 90% of employees by total compensation by the total number of employees in the bottom 90% of employees by total compensation.

Average training hours (bottom 90%) =

Total number of training hours provided to each employee in the bottom 90% of employees by total compensation / Total number of employees included in the bottom 90% of employees by total compensation

Employee training can refer to:

— all types of vocational training and instructions

— paid educational leave provided by an organisation for its employees

— training or education pursued externally and paid for in whole or in part by an organisation

— training on specific topics.

These 2 indicators are quite important to realize, whether and to whom the company provides training and if this is also balanced to all its employees, irrelevant to their compensation.

C-S6 Human rights policy

Definition

A human rights policy is a piece of formal company documentation that outlines the practices and commitment that an organisation takes to meet its responsibility to respect the internationally recognized human rights standards.

What to measure?

Indicator C-S6 requires the reporting organisation to disclose whether it holds a Human rights policy or not.

The reporting organisation should disclose the international or domestic human rights standards it recognises and/or commits to (e.g. International bill of rights and ILO's declaration on the fundamental principles and rights at work), the organisation's expectations from its personnel and business partners and the fundamental principles of the policy concerning its practices and operations.

C-S7 Collective bargaining agreements

Definition

Collective bargaining is defined as the process of negotiation between an employer or a Union of employers and a labor union or a group of trade Unions regarding the terms and conditions of employment such as wages, benefits, safe working conditions.

What to measure?

Indicator C-S7 requires the reporting organisation to disclose the total number of active employees covered by collective bargaining agreements, in percentage (%).

To calculate the percentage, the total number of active employees covered by collective bargaining agreement must be divided by the total number of active employees, and multiplied by 100 to give the number in a percentage.

C-S8 Supplier assessment

Definition

Supplier assessment is defined as the process of evaluating supplier performance. Supplier assessments are carried out on a regular basis, since they can help companies to reduce costs, improve business performance, alleviate reputational costs and produce more cost-effective products.

What to measure?

Indicator C-S8 requires the reporting organisation to disclose whether it screens its suppliers using Environmental, Social and Governance (ESG) criteria. Issues that companies examine when assessing suppliers using ESG criteria include:

Environment

— Management of environmental issues (policy, procedures, management system etc.)

— Greenhouse gases emitted

— Energy and water consumed

— Hazardous and non-hazardous waste generated

— Environmental fines

Social

— Labour standards

— Diversity and equal opportunity

— Occupational health and safety

— Child and forced or compulsory labour

Governance

— Board composition

— Corporate governance practices

— Code of conduct

A-S1 Sustainable economic activity

Definition

Sustainable economic activity refers to an organisation's assets, products and services which are considered sustainable by contributing positively to the environment and society.

What to measure?

Indicator A-S1 requires the reporting organisation to disclose its sustainable economic activity, more specifically its turnover, CapEx and OpEx, generated from assets, products and services which qualify as environmentally sustainable under Articles 3 and 9 of the Taxonomy Regulation, in percentage (%).

Under the Taxonomy, assets, products and services qualify as environmentally sustainable where economic activity meets taxonomy criteria for substantial contribution to one of six environmental objectives and does no serious harm to the others (DNSH criteria) while also meeting minimum safeguards (e.g., OECD Guidelines on Multinational Enterprises and the UN Guiding Principles on Business and Human Rights).

The organisation should elaborate on the assets, products and services it has identified as those with environmental and/or social benefits. These could include activities that substantially contribute to circular economy, achievement of the SDGs, mitigation of or adaptation to climate change, etc. In defining sustainable products and services, organisations may refer to green and sustainability taxonomies and definitions outlined by institutions, international initiatives and industries, such as the EU classification system for environmentally sustainable economic activities (Taxonomy) and the Climate Bonds Taxonomy developed by the Climate Bonds Initiative.

The formula for the percentage of sustainable revenue is as follows:

Sustainable turnover (%) =

Turnover from sustainable assets, products and services / Total turnover x 100

The formula for the percentage of sustainable CapEx is as follows:

Sustainable CapEx (%) =

CapEx from sustainable assets, products and services / Total CapEx x 100

The formula for the percentage of sustainable OpEx is as follows:

Sustainable OpEx (%) =

OpEx from sustainable assets, products and services / Total OpEx x 100

A-S2 Employee training expenditure

Definition

Employee training is defined as a formal type of programme that aims to increase or enhance the technical skills, knowledge, efficiency and value creation of an organisation's employees.

What to measure?

Indicator A-S2 requires the reporting organisation to disclose the total amount of expenditure on employee training purposes, in Euros (€).

A-S3 Gender pay gap

Definition

Gender pay gap is defined as the difference between the average female and male base salary.

What to measure?

Indicator A-S3 requires the reporting organisation to disclose the organisation's gender pay gap, in percentage (%). Initially the reporting organisation should calculate the average yearly pay for both male and female full-time employees, in Euros (€).

The formulas of the average yearly pay for male and female full-time employees are as follows:

Average yearly pay for male full-time employees=

Sum of all yearly base salaries of all male full – time employees (including bonuses) /

Total number of male full-time employees (a)

Average yearly pay for female full-time employees=

Sum of all yearly base salaries of all female full – time employees (including bonuses) /

Total number of female full-time employees (b)

Hence the formula for the gender pay gap is as follows:

Gender pay gap (%) = (a – b) / a x 100

This gives you the average gender pay gap in yearly salaries as a percentage of men's pay.

A "negative" gender pay gap indicates that women earn more than men.

A-S4 CEO pay ratio

Definition

CEO pay ratio is defined as the difference between a CEO's annual total compensation to the organisation's median employee annual total compensation.

What to measure?

Indicator A-S4 requires the reporting organisation to disclose the CEO's annual total compensation as well as a ratio of the CEO's annual total compensation to the median annual total compensation for all employees.

The formula to derive the CEO pay ratio is as follows:

CEO pay ratio =

CEO' s annual total compensation (a) /

Median annual total compensation for all employees (excluding CEO' s compensation) (b)

This number should be presented as a ratio to demonstrate how many times greater is the CEO's annual total compensation compared to the organisation's median annual total compensation for all employees as follows:

[(a)/(b)]:1

Organisations should report any contextual information necessary to understand the data and how it has been compiled.

SS-S1 Product quality and safety

Definition

Product quality and safety refers to the processes in place to monitor and mitigate the unintended health or safety risks of a product to end-users. Recalls, commonly used to address quality and safety, refer to the process of reclaiming a product from a customer due to issues of malfunction and deformity while providing some sort of compensation.

What to measure?

Indicator SS-S1 requires the reporting organisation to disclose its approach to managing product quality and safety issues. Furthermore, it should also disclose the total number of product recalls issued.

It is strongly suggested that the reporting organisation discloses information on the top three recall issues that took place in the reporting year.

Sector coverage

Food and Beverage, Health Care, Resource Transformation

SS-S2 Customer privacy

Definition

Customer privacy is defined as the handling and protection of customers' personal information that has been provided by them for the purposes of everyday transactions.

What to measure?

Indicator SS-S2 requires the reporting organisation to disclose the total number of users whose information has been used for secondary purposes.

According to the European Commission, data can be used for secondary purposes only if the data has been collected on the basis of legitimate interest, a contract or vital interest and has been checked that the new purpose is compatible with the original purpose.

Examples of secondary use of data include, but are not limited to:

— selling targeting ads

— improving the entity's products or service offerings

— transferring data or information to a third-party through sale, rental, or sharing.

Sector coverage

Technology and Communication

SS-S3 Legal request of user data

Definition

Legal requests of user data are defined as the action whereby governments or legal enforcement agencies request user-information from an organisation.

What to measure?

Indicator SS-S3 requires the reporting organisation to disclose:

— the total number of unique requests for user information, including user content and non content data, from government or law enforcement agencies.

— total number of unique users whose information was requested by government or law

enforcement agencies.

— the percentage of government and law enforcement requests that resulted in disclosure to the requesting party, in percentage (%).

To calculate the percentage, the total number of government and law enforcement requests that resulted in disclosure to the requesting party must be divided by the total number of submitted government and law enforcement requests.

Sector coverage

Technology and Communication

SS-S4 Labour law violations

Definition

Labour law violations are defined as actions that have or intend to violate working provisions established by national or international labour standards on topics such as wages, working hours and overtime plus work accidents.

What to measure?

Indicator SS-S4 requires the reporting organisation to disclose the total amount of monetary losses as a result of legal proceedings associated with labour law violations, in Euros (€).

Example of labour law violations include but are not limited to:

— refraining from paying required overtime

— paying sub-minimum wages

— failing to ensure a safe work place according the occupational safety and health act

— failing to cover workers' injuries.

More information on the labour law violations in relation with the business operations

of the Transportation sector are addressed by the Regulation (EC) No 561/2006.

Sector coverage

Transportation

SS-S5 Data security and privacy fines

Definition

Data security and privacy fines are defined as the monetary amounts imposed on organisations due to the violations of data security and privacy rules enacted by national and international standards.

What to measure?

Indicator SS-S5 requires the reporting organisation to disclose the total amount of monetary losses as a result of legal proceedings associated with data security and privacy, in Euros.

Sector coverage

Health Care, Technology and Communication

SS-S6 Health and safety performance

Definition

Health and safety performance is defined as the outcome of an organisation's approach, systems and procedures to prevent accidents and injuries in workplaces.

What to measure?

Indicator SS-S6 requires the reporting organisation to disclose the total recordable:

— number of injuries

— number of work-related fatalities

— accident frequency rate

— accident severity rate

The formula for the accident frequency rate is as follows:

Accident frequency rate =

Number of recordable injuries x 200,000 /*

Number of hours worked by all employees in calendar year

The formula for the accident severity rate is as follows:

Accident severity rate=

Number of work days lost due to work-related accidents x 200,000 /*

Number of hours worked by all employees in calendar year

* The factor 200,000 denotes the number of hours worked by 100 full-time employees, 40 hours per week for 50 weeks per year.

Sector coverage

Extractives and Minerals Processing, Infrastructure, Renewable Resources and Alternative Energy, Resource Transformation

SS-S7 Marketing practices

Definition

Marketing practices are defined as the actions carried out by an organisation for the communication and promotion of the attributes and features of its products and services.

What to measure?

Indicator SS-S7 requires the reporting organisation to disclose its approach in providing transparent product and service information including marketing and labelling practices.

Financial Sector

Any reporting organisation in the financial sector should clearly discuss its approach in communicating relevant information about its products and services to its customers as well as any policies or procedures related to the marketing and communication of its products and services.

Food and Beverage

Any reporting organisation in the food and beverage sector should clearly disclose the following types of information regarding its products:

— Product component source

— List of product content with a particular focus on substances or components that can cause harm either to a customer or to the environment

— Information on the safe use of product

— Correct disposal of product, including clear recycling labelling if applicable.

Sector coverage

Financials, Food and Beverage

SS-S8 Customer satisfaction

Definition

Customer satisfaction is defined as the qualitative measure of satisfaction that customers attribute to an organisation as a whole or for the quality of their products and services (category or specific item).

What to measure?

Indicator SS-S8 requires the reporting organisation to disclose the results from its customer satisfaction surveys.

Customer satisfaction is predominately measured via the use of surveys. The surveys include, but are not limited to, one-on-one interviews, phone interviews, email or online questionnaires. The reporting organisation should separately disclose customer satisfaction results from surveys regarding the organisation's overall performance and surveys regarding customers' satisfaction with the organisation's particular product or service.

Sector coverage

Services

SS-S9 Customer grievance mechanism

Definition

Customer grievance mechanism is defined as the process whereby customers can formally submit their complaints, issues or concerns about the behaviour or performance of an organisation.

What to measure?

Indicator SS-S9 requires the reporting organisation to disclose whether it provides a customer grievance mechanism and, if yes, the organisation should also provide a description of the key operations and procedures of the mechanism.

Sector coverage

Services