Sustainable Finance in the EU

Edited by
JENS EKKENGA and
MARTIN WINNER

Jus Internationale et Europaeum
206

Mohr Siebeck

Jus Internationale et Europaeum

herausgegeben von

Thilo Marauhn und Christian Walter

206

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ISBN 978-3-16-163722-3 / eISBN 978-3-16-163723-0
DOI 10.1628/978-3-16-163723-0

ISSN 1861-1893 / eISSN 2568-8464 (Jus Internationale et Europaeum)

The Deutsche Nationalbibliothek lists this publication in the Deutsche Nationalbibliographie; detailed bibliographic data are available at *https://dnb.dnb.de*.

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The book was typeset by Martin Fischer in Tübingen using Minion typeface, printed on non-aging paper by Laupp & Göbel in Gomaringen, and bound by Nädele in Nehren.

Printed in Germany.

Preface

It is with great pleasure and enthusiasm that we present this conference volume, the culmination of an ambitious and collaborative endeavor about the regulation of sustainable finance in the EU. Bringing together academic expertise from universities across 14 different European Union countries, this project sought to explore the multifaceted dimensions of sustainable finance within the regulatory framework of the European Union.

The motivation behind this project was to delve into critical aspects of sustainable finance that are reshaping the financial landscape in the EU. Our focus extended across diverse domains, encompassing the integration of sustainability into corporate governance structures (Sustainable Corporate Governance), the role of shareholders in promoting sustainability (Sustainable Shareholder Governance), and the incorporation of sustainability considerations into the decision-making processes of investment funds (Sustainable Fund Governance). Furthermore, the project delved into the development, marketing, and management of financial products with sustainability at their core (Sustainable Product Governance), as well as the interface between financial institutions and their customers in delivering sustainable financial services (Sustainable Financial Services in Customer Business).

Each participating university contributed a comprehensive country report, offering unique insights into the distinct challenges and opportunities faced in their respective regions. A key aspect of our exploration involved a thorough legal comparison, shedding light on the intricacies and implications of relevant EU legislation. Specifically, we delved into the Sustainable Finance Disclosure Regulation (SFDR), the Markets in Financial Instruments Directive II (MiFID II), and the Shareholder Rights Directive II (SRD II). Through this legal lens, we aimed to unravel the complexities and highlight the evolving landscape of sustainable finance within the member states of the EU. As the global community grapples with the imperative of addressing environmental, social, and governance (ESG) considerations in financial decision-making, the insights generated by this project hold significant relevance. Sustainable finance is not merely a trend but a paradigm shift, and understanding its nuances is crucial for academics, practitioners, policymakers, and stakeholders alike.

We express our deepest gratitude to all the participating universities, researchers, and contributors who dedicated their time and expertise to this collaborative effort. The diversity of perspectives and experiences reflected in the country reports enriches the discourse on sustainable finance and provides a comprehen-

sive panorama of its implementation across the EU. May this conference volume serve as a valuable resource, fostering ongoing dialogue, research, and action towards a more sustainable and resilient financial future in the European Union.

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Sustainable Finance in the EU – An Introduction

Jens Ekkenga

A. Sustainable Finance According to the Action Plan of the EU Commission from 8/3/2018

The acronym "ESG" (Environment, Social, Governance) is associated with current legal policy objectives which the EU Commission formulated in its "*Action Plan: Financing Sustainable Growth*" of 8/3/2018.[1] The plan is divided into 10 sections including announcements of measures, some of which have already been implemented.[2] Among the key regulations is Taxonomy Regulation (EU) 2020/852, which establishes criteria for qualifying an economic activity as environmentally sustainable "to which an investment is environmentally sustainable" (Art. 1 para. 1). As of November 2019, corporate finance issues have been regulated by the Sustainable Finance Disclosure Regulation (SFDR) 2019/2088. It refers to Measure 10 of the Action Plan, which is entitled "Fostering sustainable corporate governance and attenuating short-termism in capital markets".

B. The Optimization Target: ESG

The sustainability postulate goes back to a report by the UN World Commission on Environment and Development in 1987 (the so-called Brundtland Report). It was originally based on the idea of *intergenerational justice*, thus aiming to create, develop and secure the legal framework for ecologically, socially and economically stable conditions.[3] The ESG acronym reflects these three elements. Clear ideas about mutual functionalities within this "triple bottom line" do not yet exist. The legal idea as such is apparently supported by the basic conviction that the optimization of one sub-goal simultaneously increases the degree of goal achievement of another sub-goal. In other words, what serves to improve environmental sustainability is at the same time social progress, and whatconstitutes social progress serves at the same time to promote economic consolidation.[4] Less

[1] COM(2018)97 final.
[2] Good overview at *Glander/Lühmann* RdF 2020, 12, 13 f.
[3] *Bruns/Meyer-Bullerdiek,* Professionelles Portfoliomanagement, 6th edition 2020, p. 320 f.
[4] *Bruns/Meyer-Bullerdiek,* Professionelles Portfoliomanagement, 6th edition 2020, p. 321.

emphasis is placed on the fact that, conversely, the creation and preservation of ecologically and socially sustainable framework conditions of an economic community are inconceivable without micro and macroeconomic stability. A certain asymmetry of values becomes visible here, which is also indicated by the order of enumeration – the economic element of corporate governance is only mentioned in the third place.[5]

The existence of ESG-immanent *conflicting goals,* moreover, is not denied from the outset, but is largely ignored in terms of legal policy. In the field of fund management, this is achieved by the declared *renunciation of regulatory target optimization*. The goal is not an environmental, social or economic welfare maximum, but an "optimal balance" based on the lowest common denominator.[6] As a consequence of this consensus-oriented strategy, developments in empirical research have been regressive recently as far as the search for meaningful *target definitions* is concerned. There is uncertainty everywhere about the core question of what "sustainability" in the sense of the Sustainable Finance Doctrine actually is and what exactly it is measured by.[7] Regulation under minimalist auspices entails likewise the risk that the regulatory yield will be too low in relation to the regulatory burden. That is, those who aim to please everyone will not achieve anything significant in the end.

In the broader frame of reference of the EU Taxonomy Regulation, the environmental concept dominates, behind which social and economic concerns take a back seat when necessary, i.e. in case of doubt. In contrast to the traditional ESG strategy and probably also against the principles of sustainable risk management, this is a clear decision on the direction to be taken, which at the same time reveals the EU Commission's commitment to using sustainability rules as a political steering tool. The imbalance in the weighing of objectives implies a consistent enforcement of the agenda, while the legal impulse of balancing interests to smooth out conflicting objectives recedes into the background. Admittedly, the Commission certainly ties its action plan to the expectation that allocative advantages in the financial markets are ultimately achieved by the freely chosen decisions of investors.[8] Whether the framework conditions set for this are limited to promoting the market functions of supply and demand or are centrally prescribed by the administrative power of the state, however, remains an open question for the time being. In the literature, there is already talk of an "inefficient planning economy".[9]

[5] *Bruns/Meyer-Bullerdiek,* Professionelles Portfoliomanagement, 6th edition 2020, p. 819 f.
[6] *Bruns/Meyer-Bullerdiek,* Professionelles Portfoliomanagement, 6th edition 2020, p. 321.
[7] *Bueren* ZGR 2019, 813, 859.
[8] *Commission,* Action plan p. 4.
[9] *Möslein/Sorensen* Europ. Comp. L. J. 15 (2018), 221, 224; *Ekkenga* ZHR 187 (2023), 228, 243.

C. The Object of Optimization: Sustainable Finance

I. The scope of the study: financing or investing or both?

The term "sustainable finance" does not quite capture the essence of what the action plan primarily aims to do. In order to – as the Commission puts it – "reorient[...] private capital to more sustainable investments" (Commission, Action Plan p. 1), it would be necessary above all to influence the *use of funds in companies*, i. e. the investment of existing capital. In contrast, influence on the *supply of funds* ("financing") can, as far as the circular economy on the performance markets is concerned, at best be exerted via the tried and tested steering and channeling mechanisms on the free capital markets. Legal systems may use publicity regulations to ensure that investors are made more aware than before of the ESG ambitions and successes of companies seeking capital, and couple this with the expectation that this will favor capital offers for ESG-affine companies. In this way, it may also be possible in the medium term to enhance the value of sustainability aspects as a parameter for action in competition and to give them more weight than conventional return targets. However, the Commission leaves this legal idea of function-protecting market promotion far behind by claiming for itself in its action plan the task of classifying economic activities in a binary way as sustainable or non-sustainable.[10] Whether this plan is realistic is open to interpretation. After all, the profit-oriented companies in the performance markets for services, production or trade goods have so far evaded the desired classification in case of a certain degree of diversification or when the use of their resources does not permit a clear classification according to ESG criteria.[11] The situation may be different in certain market niches for non-governmental organizations (NGOs) whose capital is earmarked for one or more ESG sub-goals.

The frequently encountered labeling of reform efforts with the more or less synonymously used abbreviation *SRI (Socially Responsible Investment)*, however, suggests that the Commission's plans do not stop at the mere reflection of conditions and processes through classification, but rather, aim to further influence those conditions and processes through the legalization of asset management in the sense of sustainability in planning and design. Professional financial investors such as investment funds are expected to play a key role here, seeing as they are primarily expected to review the business plans and measures of the companies seeking capital within the association for their reasonableness and to judge them competently accordingly.[12] As a further consequence, they are expected to use the voting power of their membership in an activist manner in the

[10] *Bueren,* ZGR 2019, 813, 861; *Ekkenga/Posch* WM 2021, 205, 206 f.
[11] *Stump* ZBB 2019, 71, 76 f.; *Möslein/Sorensen* Europ. Comp. L. J. 15 (2018), 221, 224 f.
[12] *Bueren* ZGR 2019, 813, 858; *Ekkenga* WM 2020, 1668 ff..

spirit of the SRI doctrine and thus assume the role of a social control authority within the portfolio companies.

II. Open questions

The completely novel legal figure of the *activist investor as an ESG/SRI agent on a governmental mission*, which is thus launched, raises a multitude of unresolved conceptual and implementation issues. In detail, these include:

Still in the development stage and arguably still far from consolidated concepts are those legislative approaches that aim to directly promote "*sustainable corporate governance*" by imposing binding standards on board behavior. They touch on the subject of "investment business" insofar as the inclusion of funds as control activists only promises success where the structure of the shareholder base leaves room for the influence of individual shareholders including voting and communicatory impact. Less attention has so far been paid to the fundamental question of whether and under what conditions investment funds are in any way institutionally suitable for the task of ESG/SRI-compliant management control – a framing issue that can be referred to as "*shareholder governance*" in line with the proliferating terminological practices (see D., E.).

Within the given institutional design framework, the question arises as to the existence and (further) development of sufficiently efficient regulations in the sense of the ESG/SRI doctrine which relate to fund management as such and are widely discussed under the collective term "*fund governance*". The issue is characterized by an area of tension in which funds, as *financial intermediaries*, have a dual function of both product demand (shares) and product supply (fund units). That is, while they are supposed to guard the interests of the common good vis-à-vis the portfolio companies, they also have to represent the interests of investors in relation to their customers, the purchasers of fund shares (see F. below).

Comparatively new and hitherto scarcely discussed is a third level of consideration for this whole equation, which is currently only a contemplation in the Commission's 10-point agenda. This matter is the question of whether and to what extent the legal system is in any way equipped to facilitate progress in sustainable corporate governance at the downstream market level for the placement of fund shares with the investing public. This requires the orderly distribution of fund shares within the goal of promoting the marketing of ESG-compliant fund shares in a regulatory manner. The matter has been discussed for some time under the heading of "*product governance*" (see G. below).

The final link between fund share sales and fund share purchasers, insofar as the shares are not sold directly to the customer by the fund sponsor or, more frequently, by a sales intermediary, is formed by securities services companies such as, in particular, banks, savings banks and financial services institutions, which act as intermediaries or service providers on behalf of the ultimate bene-

ficiary end customers. Art. 2 No. 11 SFDR refers to securities service companies in the customer business with fund shares as "*financial advisors*". As client representatives in the financial service, they are strictly and uncompromisingly bound to the individual interests of their clients. For the development of "sustainable" financial service governance, the question of how to reconcile the protection of these individual interests with the service of general public interests is therefore particularly urgent (see H. below).

D. Discussion Level 1: Sustainable Corporate Governance

I. Initial situation in the portfolio companies

The institutional framework for the 10-point agenda is partly predetermined by competition on capital markets. Whether and to what extent sustainability goals can be implemented through the use of membership voting rights and the access to communication channels is determined by the *degree of independence of the portfolio company*, which, in turn, depends on trading activity on the stock markets. Paradigmatic for the ideal type of a portfolio company controlled by grassroots democracy, as apparently envisaged by the EU Commission, is the listed stock corporation in free float, whose shares are managed according to the "voice or exit" strategy, i. e. are either continuously restructured in daily stock market trading or are held for the longer term by "*anchor shareholders*" with the contribution of their own shareholder interests. The opposite type is the listed but group-dependent AG, whose shares are majority-owned by an unlisted company and whose business policy cannot be decisively influenced via voting rights without cooperation with the parent company. In between, there is a whole range of possible condensation and blocking maneuvers, which may also be flanked by contractually generated rights of influence on the part of members or third parties.

II. Possibilities of influence at the membership level

The problems raised here concern, on the one hand, the level of influence and design of the members of a target company. Here, the main question is what structural fitness conditions the *shareholder base of a portfolio company* must meet in order to become receptive to membership influence for promoting "sustainable" corporate governance. From a comparative law perspective, the focus shifts to what conclusions can be drawn in this context about the legally ascertainable distribution of membership in listed companies in the individual EU member states. On the other hand, questions arise from the perspective of the management of a portfolio company. They concern, for example, strategies

aimed at taking defensive measures against activist ESG/SRI controllers, e.g., by equipping the articles of association with transferability clauses that prevent outside investors from being able to enter the membership circle. Furthermore, *contractual obligations of the portfolio companies* vis-à-vis shareholders or third parties (company agreements, voluntary commitments vis-à-vis lenders or mezzanine capital providers via covenants) deserve attention, which could serve to hinder the implementation of ESG/SRI objectives via voting rights in whole or in part. Further options for exerting influence arise in the relationship between the shareholders. The focus of interest here is the practice of *voting rights agreements* including relaxed cooperation schemes in the manner of "acting in concert".

E. Discussion Level 2: Sustainable Shareholder Governance

I. The actors: investment funds as financial intermediaries

Institutional limits are imposed on the Commission's sustainability program not only in the capital markets, but also by the regulatory *function of investment funds* as financial intermediaries. Their singular influence potential in the general meetings and internal decision-making bodies of the portfolio companies is initially similar to that of small activist shareholders, since the funds' distribution task calls for a balanced diversification of their assets in order to avoid cluster risks. However, the more comprehensive and detailed the ESG/SRI standards for funds become, the more holistic measurement data becomes meaningful in the future. In any case, the behavior of funds in their capacity as shareholders can be expected to provide information on the maximum frame of reference for ESG/SRI-driven shareholder governance, especially in an international context. In terms of legal statistics, this raises the question of what proportion of the total volume of membership stakes in listed companies is attributable to institutional investors, and what differences can be identified in a cross-country comparison. In this context, we are also interested in the ratio of such holdings to the free float of private households on the one hand, and to the group holdings of unlisted companies, on the other.

The *suitability of investment funds* for carrying out the management and control tasks assigned to them is determined not only by their high level of expertise in exercising shareholder rights, but also, above all, by the scope of action institutionally assigned to them. This is subject to an *a priori* inviolable limit, since the funds can only fulfill their function as financial intermediaries in any way if – unlike the "anchor shareholders" – they do not pursue any entrepreneurial goals. Seen in this light, the almost proverbial passivity of the exercise of voting

rights by professional investors is not a systemic or developmental flaw[13] but, on the contrary, a system-supporting element of market-mediating organisms with a capital accumulation function. On the other hand, it is not only in line with the system, but likewise required of the fund companies by supervisory law that the voting rights of shares held be handled appropriately in the interest of the final beneficiary fund investors (cf. Art. 37 of Delegated Regulation 231/2013/EU). However, it is hardly possible to speak of shareholder governance in the sense of the ESG doctrine in this respect; rather, under previous EU law, it was essentially a matter of the third-party management of individual positions to maximize shareholder value (rather than stakeholder interests at association level), such as in case of the use of pre-emptive rights in the event of capital increases or dividend prospects. Where the boundary lines run in this context between return-oriented management of individual memberships and (no longer permissible) corporate influence on management is one of the key questions requiring clarification.

II. The instruments: "ESG-Oriented Participation Policy"

In clear contrast to the "best practice" principles of investment law according to the previous model, the obligation of professional investors *as representatives of a publicly accountable* "*engagement policy*" according to Art. 3 g of EU Directive 2007/36 on the exercise of certain rights of shareholders in listed companies as amended by EU Directive 2017/828, requires the addressees to explain their shareholder governance according to the tried and tested regulatory pattern of a "comply-or-explain" policy. Meanwhile, "engagement policy" refers to influencing internal association processes in portfolio companies through certain channels of influence, including the exercise of shareholder rights, in particular, voting rights. The non-corporate location of the funds in the regulatory structure of financial service providers may give rise to the idea that institutional investors should be obliged in future to look after "soft" public interests to the point of interference of "hard" return targets, and thus to a certain extent be assigned the role of an opposition in the associations that are concerned with ESG issues. Apart from the fact that this target weighting is hardly likely to be compatible with the likewise institutionally anchored commitment of the funds to the investor interests of their customers,[14] however, the broadly conceived and quite strikingly formulated regulations in the new version of EU Directive 2007/36 do not permit a safe conclusion, but nevertheless expressly include "hard" factors as well.[15] The relationship between the two sets of regulations thus remains in need

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[13] But this way *Tröger* ZGR 2019, 126, 136: "Marktversagen".
[14] *Volhard/Jang*, in: Weitnauer/Boxberger/Anders, KAGB, 2nd edition 2017, § 1 mn. 25.
[15] *Tröger* ZGR 2019, 126, 151 f.

of clarification. In particular, a closer look is needed to determine whether the content of the "comply-or-explain approach" overlaps with fund management under the regulatory provisions, which would result in a less desirable and hardly intended mixing of mandatory and permissive norm content.[16]

III. Possible sources of error

Less encouraging experiences with the "comply-or-explain" rules in Anglo-Saxon countries have led to the realization quite early on that, in order to maintain a control-effective voting management system, professional investors need the support of *professional proxy advisors*, who act as information intermediaries in corporate governance matters (proxies) linking the management and membership levels. Regardless of the still unmet empirical backlog,[17] the EU has adopted this concept in Art. 3 j of the amended EU Directive 2007/36. The matter as such has long been an integral part of Anglo-Saxon association constitutions. In view of the widespread reception of codes of conduct and their formability in the spirit of the ESG/SRI doctrine, it deserves updated consideration.[18]

The key question thus raised is generalizable; it also relates to other activists who influence the voting behavior of professional investors. What is meant is the danger of misdirection of shareholder governance through such means as deliberate misinformation or signals of all kinds generated by actors with goals or motives that are alien to or hostile to sustainability. The issue boils down to the theoretical and legal-practical *demarcation of cooperation and collaboration*. Two aspects are worth emphasizing on that note. First, as far as voting advisors are concerned, there is a risk of neglecting action parameters that serve the common good by being too close to the management level. According to Anglo-Saxon experience, the latter results from the dual function that proxy advisers hold as operators of professional *corporate governance ratings*. Many of them are prompters of both investors and advisors in the service of the issuing company. The conflicts of interest rooted here are numerous and varied; they fundamentally call into question the enforceability of ESG/SRI objectives by way of shareholder governance.[19]

The second aspect relates to activist investors without a long-term equity interest whose influence on corporate governance sends out pre-determining signals to fellow shareholders with a free-rider attitude. *Hedge funds* in particular are reported to frequently act as a guide for mutual funds, which align their voting and communicatory behavior more or less synchronously for cost-saving

[16] *Baums* ZHR 183 (2019), 605, 609.
[17] *Tröger* ZHR 2019, 126, 152.
[18] In detail *Zetzsche*, in: KölnKommAkt, 3rd edition 2016, Nach § 135 mn. 1 f.
[19] *Tröger* ZGR 2019, 126, 151 f.

reasons.[20] So far, the question is open as to whether this trend will continue or be allowed to continue under the new regulations. The answer depends on whether the proper perception of ESG/SRI-affine voting management entails a minimum level of autonomy. In any case, the obvious thesis that the whole system could falter unless the current trend is reversed is unlikely to be based on the orientation of hedge funds alone. Finally, it is also conceivable that the M&A business of the future will trigger positive sustainability effects because ESG/SRI-affine companies will prevail in competition as attractive acquisition targets. In No. 10 of the Action Plan, however, the Commission indicates that it does not intend *a priori* to consider this possibility in further initiatives in exploring the legal environment.

F. Discussion Level 3: Sustainable Fund Governance for Asset Managers

I. The subject of regulation: investment strategies of investment funds

With the "Regulation (EU) 2019/2088 of the European Parliament and of the Council of 27 November 2019 on sustainability-related disclosures in the financial services sector" (OJEU of 9.12.2019, L 317/1), the Commission had item 7 of its 10-point action plan transposed into applicable law. Article 3(1) of the Regulation requires investment funds in addition to other financial market participants, to publish information on their "policies on the integration of sustainability risks in their investment decision-making process." There is no provision for curtailing the scope for decision-making by means of prohibitions or restrictions on conduct; instead, the legislator uses the indirectly effective means of exerting pressure – as it did previously in the context of the CSR regulations – by imposing an obligation to make a negative declaration whether and to what the extent "sustainability factors" are taken into account in investment decisions (Art. 4 (1) a) of the Regulation). The regulation supplements and modifies the provisions introduced on the basis of Art. 3 lit. i ff. of the amended EU Directive 2007/36 on the obligation of professional investors to *disclose their investment strategies.*

In terms of content, the aim is to consolidate the concept of a *sustainable engagement policy* in voting and dialog management, which was also implemented with the Shareholder Rights Directive, or at minimum, introduce it into practice in the first place. This is because continuously circulating shares are hardly associated with incentives to participate constructively in the issuer's decision-making processes. Actionist ("predatory") small shareholders are known to have a tendency to put pressure on management by bringing actions for defective

[20] *Tröger* ZGR 2019, 126, 139.

resolutions. However, this is always done with the intention of blocking action and for self-interested purposes; the interests of the common good are unlikely to play a role here. "Sustainability" within the meaning of the new Disclosure Regulation consequently encompasses the *long-term holding of shares* while accepting real price losses and opportunity losses resulting from the omission of profit-taking through short-term selling. Going further, it can be inferred from the EU's overall regulations that shares and other trading objects circulating on organized capital markets, as so-called "short term" securities, are classified as more environmentally and socially damaging than unlisted "long-term" securities. Recital 49 to EU Regulation 2019/1238 of 20 June 2019 on a Pan-European Private Pension Product (PEPP) literally states:

"In the context of deepening the CMU, the understanding of what constitutes instruments with a long-term economic profile is broad. Such instruments are non-transferable securities and therefore do not have access to the liquidity of secondary markets. They often require fixed term commitments which restrict their marketability and should be understood to include participation and debt instruments in, and loans provided to, non-listed undertakings. Non-listed undertakings include infrastructure projects, unlisted companies seeking growth, real estate or other assets that could be suitable for long-term investment purposes. Low-carbon and climate-resilient infrastructure projects are often non-listed assets and rely on long-term credits for project financing. Considering the long-term nature of their liabilities, PEPP providers are encouraged to allocate a sufficient part of their asset portfolio to sustainable investments in the real economy with long-term economic benefits, in particular to infrastructure projects and corporates."

II. Possible sources of error

In view of the undisputed importance of professional investors as functionaries and guarantors of smooth securities trading, this regulation – with its intention directed against the capital market – has the potential of a break with economic-historical implications. A first, obvious assumption is that the systematic prevention or obstruction of short-term buying and selling decisions could noticeably weaken the *liquidity of secondary trading* – with the foreseeable consequence that the supply quantity gradually freezes and the increasing market tightness leads to notoriously excessive price formation. The allocation mechanism for individual stocks in the organized markets could thus be undermined across a broad front, which would be reflected above all in equally excessive subscription bids for new issues. Since the parameters of action in the struggle for a more environmentally or socially friendly financial product are not determined in free quality competition but by the authorities in accordance with the Taxonomy Regulation, well known research questions ultimately arise in a new guise, revolving around the alternative of "*decentralized market control through competition versus centralized market control through planned economic influences*". Within the market segment for collective capital investments, the forced concentration on long-