

Theoretical Insights on Financial Sustainability Regulations in the European Union

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Theoretical Insights on Financial Sustainability Regulations in the European Union

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This article explores the legal challenges of the regulation of financial service providers' activities in the context of climate change. The European Union's commitment to sustainability, first embodied in the European Green Deal, has led to increased compliance challenges for financial institutions, including new rules on *Environmental, Social, and Governance* (ESG) disclosures. While these legal regulations aim to mitigate climate change risks, they raise questions about the changing paradigm, particularly regarding the freedom of economic activity and the proportionality of such new legal requirements. This article examines how legal regulations pertaining to sustainability are embedded in the legal juncture, in terms of a balance between long-term societal benefits and the compliance burdens on financial service providers. It also examines recent innovations in legal structures, such as the *Sustainable Finance Disclosure Regulation* (SFDR) and the Corporate Sustainability Reporting Directive (CSRD), and how these changes impact the balance between profitability and compliance for financial service providers. The analysis highlights the need for ESG compliance, while emphasizing proportionality and state support, in order to ensure financial stability and the continued viability of the financial sector in the face of changing regulatory requirements.

Keywords: Climate change, financial service provider, legal regulatory compliance, sustainability.

Teorinės įžvalgos apie finansinio tvarumo reglamentavimą Europos Sąjungoje

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Šiame straipsnyje nagrinėjamos teisinės problemos, susijusios su finansinių paslaugų teikėjų veiklos reglamentavimu klimato kaitos kontekste. Europos Sąjungos įsipareigojimas siekti tvarumo, pirmą kartą išreikštas „Europos žaliajame kurse“, sukėlė finansų institucijoms papildomų iššūkių dėl šios atitikties, įskaitant naujus reikalavimus dėl aplinkos, socialinių ir valdymo (angl. ESG) informacijos atskleidimo. Nors atitinkamomis teisinėmis nuostatomis siekiama mažinti klimato kaitos riziką, jos kelia klausimų apie paradigmų pokytį, ypač dėl ekonominės veiklos laisvės ir naujų teisinių reikalavimų proporcingumo. Straipsnyje analizuojama, kaip tvarumo teisiniai reglamentai įtvirtinami teisės sankirtoje, kaip derinami ilgalaikiai visuomenės interesai su finansinių paslaugų teikėjų atitikties tvarumui našta. Taip pat nagrinėjamos naujausios

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teisinių struktūrų naujovės, tarp jų Tvaraus finansų atskleidimo reglamentas (SFDR) ir Įmonių tvarumo ataskaitų teikimo direktyva (CSRD), bei kokį šie pokyčiai turi poveikį finansinių paslaugų teikėjų pelningumui, atsižvelgiant į atitikties tvarumui reikalavimus. Analizėje pabrėžiama ESG atitikties būtinybė kartu akcentuojant proporcingumą ir valstybės paramą, siekiant užtikrinti finansinį stabilumą ir finansų sektoriaus gyvybingumą besikeičiančių reglamentavimo reikalavimų akivaizdoje.

Pagrindiniai žodžiai: klimato kaita, finansinių paslaugų teikėjas, teisinė atitiktis, tvarumas

Introduction

In present times, climate change is becoming increasingly evident. Its negative effects pose significant risks not only to individuals or businesses but also to the economic stability of countries, regions, and the global economy. This makes the implementation of measures to mitigate climate change and its consequences especially critical. To address this, the European Union (hereinafter – EU) has initiated a comprehensive strategy directed towards sustainability, the so-called “*European Green Deal*”¹ which is aimed to achieve climate neutrality by 2050 by reducing CO₂ emissions, increasing investment in sustainable activities, and promoting economic growth through environmentally friendly practices, thereby fostering a transition to a sustainable and resilient economy. To put it in greater detail, the European Green Deal policy considers that public funds alone are insufficient to achieve these ambitious goals, and therefore, private sector contributions are seen as an essential complement to the EU green policy objectives². Moreover, it is believed that the financial sector can play a fundamentally important role in helping to finance the necessary changes to direct private capital to green projects and to eliminate the so-called ‘green finance gap’³ (i.e., financial resources, which could be channeled into green investments). In pursuit of this objective, the EU has enacted numerous regulations aimed at governing sustainable activities across different sectors, including the financial services industry. Investment services are part of the financial services sector. Under EU and national laws, investment activities can broadly be defined as the professional provision of one or more investment services to third parties and/or the conduct of one or more investment activities. This involves collecting individuals’ funds and investing them into assets as specified in legally approved documents⁴. Investment activities are carried out by entities such as credit institutions, insurance companies, pension fund management companies, and management companies. These participants in the financial market operate under a framework regulated by both EU and national laws. Their activities require licensing and are supervised by EU and national regulatory authorities. Considering that the regulation of investment activities affects a variety of financial service providers, with regulations differing across financial sectors, the issue of the article will be analyzed through the lens of financial service providers – notably, asset management companies, the entities that are authorized to manage investment funds or client portfolios and execute investment strategies⁵.

The freedom of economic activity for financial service providers, including asset management companies, is typically understood as an individual’s right to operate freely, compete with other eco-

¹ European Commission, 11 December 2019 Communication COM(2019) 640 The European Green Deal, p. 1–24.

² European Commission, 11 December 2019 Communication COM(2019) 640 The European Green Deal, p. 1–24.

³ DESALEGN, Goshu; TANGL, Anita (2022). Enhancing Green Finance for Inclusive Green Growth: A Systematic Approach. *Sustainability*, 14(12), 7416, 2 [online]. <https://doi.org/10.3390/su14127416>

⁴ European Parliament and Council 15 May 2014 Directive 2014/65/EU on markets in financial instruments and amending Directive 2002/92/EC and Directive 2011/61/EU. *OJ L* 173, 2014, p. 349–496

⁵ European Parliament and Council 8 June 2011 Directive 2011/61/EU on Alternative Investment Fund Managers and amending Directives 2003/41/EC and 2009/65/EC and Regulations (EC) No 1060/2009 and (EU) No 1095/2010. *OJ L* 174, 2011, p. 1–87.

conomic entities, and make a profit. In analyzing this freedom in the context of positive law, it becomes clear that the content of the rights and obligations of legal persons – just like the rights and obligations of natural persons – relies on human conduct, and, as such, these are human rights and obligations⁶. Therefore, economic freedom is fundamentally linked to individual freedom and is, at its core, a fundamental human right, which includes the right to own, manage, and use property⁷. The right to economic freedom has been extensively analyzed by a number of Lithuanian legal scholars, including E. Kūris, G. Lastauskienė, and A. Juškevičiūtė-Vilienė, E. Šileikis, and J. Paužaitė-Kulvinskienė as well as by foreign researchers such as K. Boudreaux, P. D. Aligica, and R. Pilon. Therefore, this article will not provide an in-depth discussion of an individual's right to economic freedom. In conducting the analysis, it is considered that the right to economic freedom is equated to a fundamental individual right – the right to property⁸. However, this right is not absolute and may be subject to limitations⁹. The implementation of economic freedom must not contradict other constitutional principles, infringe upon the equality of entities, or compromise the common good (the welfare of the nation) that the economic activity is intended to serve¹⁰.

Moreover, a decade or two ago, legal scientists were primarily focusing on analyzing environmental rights within the broader context of constitutional and human rights frameworks, critically examining their hierarchical positioning and the extent to which these rights prevail or are prioritized in relation to other fundamental rights¹¹. This focus was largely due to the limited global recognition of the severe consequences of climate change, which, at the time, had not yet gained the urgency they hold in contemporary legal discourses. At present, due to climate change, the scope of environmental laws in EU regulation has been expanded, and sustainability regulations in financial sector now address a broader range of risks, with financial stability emerging as a key priority.

The existing academic literature indicates that sustainability regulation and compliance in the financial sector has been extensively examined at the European level (see the works of V. Colaert; C. Alexandraki; P. D'Orazio; L. Popoyan). In parallel with academic developments, financial supervisory authorities and legal scholars now highlight that legislative changes in the financial sector are essential not only for mitigating climate change but also for ensuring the stability¹² of the entire financial market – both of which are closely interconnected. Nonetheless, efforts to comply with sustainability regulation requirements may limit the market's pursuit of profitability and restrict its operational freedom.

While European legal scholarship on sustainable finance is extensive, Lithuanian research in this area is also expanding. Agnė Juškevičiūtė-Vilienė argues that Germany constitutionally balances economic freedom and environmental protection, and highlights that environmental objectives can constitutionally justify restrictions on business freedoms when supported by legitimate public interest

⁶ KELSENAS, Hans (2002). *Grynoji teisės teorija*. Vilnius: Eugrimas, p.159.

⁷ KŪRIS, Egidijus (2005). Ūkinės veiklos laisvė, sąžininga konkurencija ir bendra tautos gerovė (Konstitucijos 46 straipsnio jurisprudencinis komentaras). *Jurisprudencija*, 64(56), p. 58

⁸ KŪRIS, Egidijus (2005). Ūkinės veiklos laisvė, sąžininga konkurencija ir bendra tautos gerovė (Konstitucijos 46 straipsnio jurisprudencinis komentaras). *Jurisprudencija*, 64(56), p. 58

⁹ KŪRIS, Egidijus (2005). Ūkinės veiklos laisvė, sąžininga konkurencija ir bendra tautos gerovė (Konstitucijos 46 straipsnio jurisprudencinis komentaras). *Jurisprudencija*, 64(56), p. 60

¹⁰ BEINORAVIČIUS, Darius; BIRMONTIENĖ, Toma; BUTVILAVIČIUS, Darius *et al.* (2017). *Lietuvos konstitucinė teisė*. Vilnius: VĮ Registrų centras, p. 709.

¹¹ GAIDYS, Gintaras (2007). Žmogaus teisė į sveiką aplinką: šios teisės atsiradimo ir formavimosi teisinės prielaidos Europos Sąjungoje. *Jurisprudencija*, 3(93), p. 63

¹² COLAERT, Veerle (2022). The changing nature of financial regulation: sustainable finance as a new policy goal. *Jean Monnet Chair for Company and Financial Law Working Paper Series*, 2022/04, p. 5 [online]. <https://doi.org/10.2139/ssrn.4087166>.

and proportionality¹³. Tadas Zukas observes that the effectiveness of the EU's sustainable finance framework also depends on the availability of reliable ESG data, which, while now more abundant due to new reporting obligations, may either enhance investment decision-making, or lead to risk of information overload¹⁴. In his later work, the author describes that the EU's sustainable finance landscape is focused on scrutinizing impact claims, yet regulatory interventions remain indirect and selective, thereby leaving some uncertainty. The author argues that the participants of the financial market should deepen their understanding of impact investing and keep closely monitoring and analyzing the ongoing regulatory and supervisory developments. Financial market participants should center their efforts on investors by educating them on what impact investing is, and that should be a core part of financial market participant's long-term sustainability strategies¹⁵.

The aim of this article is to explore how the normative regulation of sustainability in the EU financial sector reflects a changing regulatory paradigm and how it may affect the balance between the financial market participants' economic activity and regulatory compliance. The analysis focuses on the theoretical and legal framework of this transformation. To achieve this goal, the article sets forth the following objectives: first, to review the theoretical aspects of the new paradigm in terms of the way how sustainability legal regulations appear in the legal framework; second, to discuss recent innovations in the EU sustainability regulation applicable to management companies, especially in light of SFDR, CSRD, and the Taxonomy Regulation; and third, to explore how financial goals can be balanced with legal sustainability regulations, considering the principle of proportionality and other supportive legal and policy measures. The subject of this article is maintaining the balance between the evolving sustainability regulatory framework and the ability of financial market participants to conduct their business activities.

In the first part of the article, the theoretical aspects of sustainability regulations will be examined. This section will explore the concept of financial sustainability, investigate why the integrity of sustainability practices is often questioned, and evaluate whether regulations designed to address climate change and its impacts are proportional and effective. The analysis in this section will draw on articles and publications by both Lithuanian and foreign scholars, as well as legal documents. In the second part, the new sustainable finance regulations applicable to management companies will be discussed, highlighting the key aspects of these regulations. The third part will analyze the prerequisites for balancing the freedom of investment activity with the new regulatory requirements imposed on management companies.

The article uses a qualitative approach based on general scientific research methods. Logical-analytical methods are applied to examine the topic in detail, whereas text analysis (in a linguistic sense) is used to interpret legal concepts. A review of legal documents helps assess the currently existing regulatory framework.

The relevance and degree of investigation of the topic (problem) being studied: in the legal discourse on the sustainability regulation and compliance in the financial sector at the EU level, many insights and conclusions have been offered (Iris H.-Y. Chiu I, Dirk A. Zetzschel, C. Alexandraki; P. D'Orazio; L. Popoyan). However, there are few studies by legal scholars addressing the issue of restrictions on the

¹³ JUŠKEVIČIŪTĖ-VILIENĖ, Agnė (2023). Challenges of the green economy for the European Convention on Human Rights and the Charter of Fundamental Rights of the European Union. *Teisė*, 128, p. 51 [online]. <https://doi.org/10.15388/Teise.2023.128.3>.

¹⁴ ZUKAS, Tadas; TRAFKOWSKI, Ulrich (2022). Sustainable finance: the regulatory concept of greenwashing under EU law. *EuZ – Zeitschrift für Europarecht*, 02(2022), C29 [online]. <https://doi.org/10.36862/eiz-euz003>.

¹⁵ ZUKAS, Tadas (2025). Sustainable finance 3.0: the emerging regulatory framework for impact investing under EU law. *EuZ – Zeitschrift für Europarecht*, 03(2025), C44 [online]. <https://doi.org/10.36862/eiz-euz2025-03>.

freedom of economic activity of financial market participants, in the context of climate change – which is a highly relevant topic today (works by Colaert, Juškevičiūtė-Vilienė, and Zukas are notable in this context). As the climate change issue is relatively new, retrospective research is still developing, and it is likely that more analyses on this topic will emerge at both the national and international levels in the future. The originality of this article lies in its examination of the relationship between the sustainability regulation's values and legal regulations aimed at reducing the effects of climate change, specifically through the lens of financial sector regulation.

1. What is Financial Sustainability?

The word 'sustainability' is derived from the verb 'sustain', and, in a general sense, it means something's ability to continue for a period of time¹⁶. As the transition to a green economy and the legislature increasingly regulate the financial sector to that end, the term has taken on a much broader meaning to include environmental, social and governance considerations (i.e., ESG)¹⁷. It would seem that the very idea of sustainability is correct, as it promotes the conservation of nature and social well-being. As it is noted by J. Tuyon, sustainable financial sector practice is ideally seen as a mechanism for accelerating positive change in ensuring healthy people and a healthy planet for a sustainable future¹⁸. However, the work of today's legal scholars raises the question of whether sustainability as a paradigm of a new policy objective and legal regulation is ethical and fair in relation to financial market participants¹⁹. Is it finance that will be profitable in the long term and hence be itself sustainable? Is it finance that is justifiable to society?²⁰. At the same time, the new sustainability regulation imposes additional requirements on financial service providers and hence may limit economic activity, since the activities of the latter are already regulated in detail. As a consequence, sustainability regulation further restricts individual and corporate pursuit of broader, long-term societal benefits.

Some legal scholars question if sustainability regulation in the financial sector is essentially useful for the several reasons. Firstly, they highlight the excessive regulatory burden it places on financial service providers²¹, which are already subject to extensive compliance obligations. Adding sustainability requirements creates an undue burden, especially on smaller companies²². Such regulations

¹⁶ *Cambridge Dictionary* (2024) [online]. <https://dictionary.cambridge.org/dictionary/english/sustain>.

¹⁷ The first use of 'ESG' is considered to date back to 2004 when the United Nations Secretary General Kofi Annan approached the largest institutional investors and invited to integrate environmental, social and corporate governance (ESG) considerations into their investment activities (United Nations, 2006). When, in 2015, the United Nations Summit Sustainable Development Goals (SDGs) were introduced, many of the SDGs resounded the ESG considerations, notably, SDGs can be achieved through ESG practices, such as reducing carbon emissions, and, in turn, ESG investing can help to accelerate the achievement of the SDGs. Therefore, in the financial market and legal discourse, SDGs and ESG considerations are closely related and sometimes even unified.

¹⁸ TUYON, Jasman; ONYIA, Okey Peter; AHMI, Aidi; HUANG, Chia-Hsing (2023). Sustainable financial services: reflection and future perspectives. *Journal of Financial Services Marketing*, 28(4), 666 [online]. <https://doi.org/10.1057/s41264-022-00187-4>.

¹⁹ COLAERT, Veerle (2022). The changing nature of financial regulation: sustainable finance as a new policy goal. *Jean Monnet Chair for Company and Financial Law Working Paper Series*, 2022/04, 4 [online]. <https://doi.org/10.2139/ssrn.4087166>.

²⁰ CHIU, Iris H.-Y.; LIN, Lin; ROUCH, David (2022). Law and regulation for sustainable finance. *European Business Organization Law Review*, 23, 1 [online]. <https://doi.org/10.1007/s40804-021-00230-2>.

²¹ MEZZANOTTE, Federico E. (2023). EU sustainable finance: complex rules and compliance problems. *Review of Banking and Financial Law*, 42(2), 854–856 [online]. https://papers.ssrn.com/sol3/papers.cfm?abstract_id=4344100.

²² SAVOUREY, Elsa; LITWIN, Daniel (16 October 2024). *The Financial Sector and the Corporate Sustainability Due Diligence Directive (CSDDD): in or out?* [online]. <https://blogs.law.ox.ac.uk/oblb/blog-post/2024/10/financial-sector-and-corporate-sustainability-due-diligence-directive-csddd>.

may overwhelm businesses with compliance costs²³, thereby reducing their competitive edge, or even leading to insolvency in extreme cases. It is suggested that this cannot be justified, as it disproportionately harms certain sectors of the economy. It is argued that imposing sustainability regulations, while well-intentioned, can cause inefficiencies and limit a financial service provider's ability to innovate²⁴.

Secondly, they point to the unclear responsibility for global problems – whether it is useful to place such a significant share of responsibility for global issues like climate change on the financial sector, rather than distributing this burden more evenly across industries. It is discussed that financial service providers are indirectly involved in these issues, and holding them responsible for driving sustainability might not be the most effective or ethical approach²⁵. Imposing sustainability regulations disproportionately on the financial sector may fail to lead to meaningful environmental change and could thus be seen as unfair²⁶.

Thirdly, some scholars worry that sustainability regulations could lead to market distortions, where the pressure to meet sustainability criteria leads to investment decisions that are not aligned with market efficiency or profitability^{27, 28}. The ethics of requiring that financial service providers should prioritize sustainability factors are questioned, as this could lead them to neglect their primary responsibility to create value for shareholders. The increasing focus on sustainability could distort investment priorities if financial service providers excessively focus on non-financial factors²⁹.

Finally, concerns are raised about unintended consequences for financial stability – these are concerns that stringent sustainability regulations could destabilize the financial sector by imposing high costs or redirecting capital flows in ways that harm market liquidity³⁰. Scholars raising this issue question whether the long-term benefits of sustainability justify the risks to financial stability, especially in times of economic uncertainty³¹. In addition, the effectiveness and fairness of sustainability regulation depend on whether such rules are adapted to the actual conditions under which financial service providers are operating. These conditions are not static: financial service providers must function

²³ ZETZSCHE, Dirk A.; ANKER-SØRENSEN, Lise (2022). Regulating sustainable finance in the dark. *European Business Organization Law Review*, 23(1), 79 [online]. <https://doi.org/10.1007/s40804-021-00237-9>.

²⁴ AHLSTRÖM, Hanna; MONCIARDINI, David (2021). The regulatory dynamics of sustainable finance: paradoxical success and limitations of EU reforms. *Journal of Business Ethics*, 174(1), p. 93–94 [online]. <https://doi.org/10.1007/s10551-021-04763-x>.

²⁵ PANTAZI, Tania (2024). The introduction of mandatory corporate sustainability reporting in the EU and the question of enforcement. *European Business Organization Law Review*, 25(1), p. 513–514 [online]. <https://doi.org/10.1007/s40804-024-00320-x>.

²⁶ HUMENIK, Stephen M.; LEE, Michael G. (21 October 2021). *Environmental Considerations in Financial Regulation* [online]. <https://businesslawtoday.org/2021/10/environmental-considerations-in-financial-regulation/>.

²⁷ NIPPER, Michael; OSTERMAIER, Andreas; THEIS, Julian (2024). Mandatory disclosure of standardized sustainability metrics: the case of the EU Taxonomy Regulation. *Wiley Online Library*, 32(2), p. 2182–2183 [online]. <https://doi.org/10.1002/csr.3046>.

²⁸ YÉBENES, Marta Ortega (2023). Climate change, ESG criteria and recent regulation: challenges and opportunities. *European Journal of Risk Regulation*, 14(2), p. 100–101 [online]. <https://doi.org/10.1007/s40822-023-00251-x>.

²⁹ KRUEGER, Philipp; SAUTNER, Zacharias; STARKS, Laura T. (2019). The Importance of Climate Risks for Institutional Investors. *Finance Working Paper No. 610/2019*, p. 14 [online]. https://www.ecgi.global/sites/default/files/working_papers/documents/finalkruegersautnerstarks_0.pdf.

³⁰ DEMEKAS, Dimitri; GRIPPA, Pierpaolo (2022). Walking a tightrope: financial regulation, climate change, and the transition to a low-carbon economy. *Journal of Financial Regulation*, 8(2), p. 204 [online]. <https://doi.org/10.1093/jfr/fjac010>.

³¹ ALEXANDER, Kern; FISHER, Paul G. (2019). *Banking Regulation and Sustainability*. University of Zurich Faculty of Law Working Paper. Zürich: University of Zurich, 1–2 [online]. [https://www.ius.uzh.ch/dam/jcr:l60a2801-3a45-45ce-ad91-9d3e58b38607/K.%20Alexander%20and%20P.%20Fisher%20\(2019\),%20'Banking%20Regulation%20and%20Sustainability'.pdf](https://www.ius.uzh.ch/dam/jcr:l60a2801-3a45-45ce-ad91-9d3e58b38607/K.%20Alexander%20and%20P.%20Fisher%20(2019),%20'Banking%20Regulation%20and%20Sustainability'.pdf).

under uncertainty, including periods of war, pandemics, economic crises, liquidity shocks, and other systemic disruptions. Therefore, sustainability obligations should be designed with these fluctuating risk environments in mind, ensuring that regulatory expectations remain realistic and feasible even during periods of market stress. As has been stated by the Constitutional Court of the Republic of Lithuania, the requirement applies that the exercise of an individual's rights and freedoms must not be restricted by law more than is necessary to achieve legitimate and socially important objectives implies, *inter alia*, an obligation on the legislator to establish a legal regulation that enables a sufficient degree of individualization of such restrictions³². As mentioned by V. Colaert, from an economic perspective, a non-sustainable economy would, in the long term, arguably cause more damage than even a systemic crisis. Sustainable finance ultimately stands in the service of achieving a more sustainable economy and is, indeed, just one of the tools to that end³³. Furthermore, reflecting to this idea, it is worth mentioning that the European Central Bank (ECB) has also expressed its position that it is crucial to integrate sustainability considerations into financial regulations, however, in case of a collision of values, the financial stability purpose should prevail: the risk of not delivering on ECB mandate is real if ECB does not take climate and nature into consideration. Preserving price stability means preserving climate and nature stability³⁴. While sustainability is important, a balanced approach is necessary to avoid unintended harm to the financial system.

On the contrary, other legal scholars believe that financial sustainability regulation actually introduces greater stability into the market and regulatory frameworks. It is justifiable to impose additional sustainability regulations on financial service providers for several reasons. First, as indicated in the “*European Green Deal*”, financial service providers exert significant influence on the broader economy, and their investment decisions can either promote or undermine sustainability efforts³⁵. Given the scale of climate change and social inequality, their participation in addressing these challenges is crucial for a greater public good. In line with this, A. Juškevičiūtė-Vilienė supports this idea as business has changed its direction long time ago and accepted the challenge of sustainability, implementing sustainable technologies and creating socially responsible businesses for the future, becoming catalysts for innovation and change³⁶. Second, by incorporating sustainability regulations, financial service providers help manage long-term risks, such as environmental degradation, which could lead to more significant economic instability in the future. This approach ensures that today's financial activities would not make significant harm for future generations³⁷. Similarly, finance is good at pricing risk for valuation purposes and can thus help deal with the inherent uncertainty about environmental issues, such as the

³² Constitutional Court of the Republic of Lithuania, 17 June 2025 Ruling. *The Register of Legal Acts*, 2025-10964.

³³ COLAERT, Veerle (2022). The changing nature of financial regulation: sustainable finance as a new policy goal. *Jean Monnet Chair for Company and Financial Law Working Paper Series*, 2022/04, p. 27 [online]. <https://doi.org/10.2139/ssrn.4087166>.

³⁴ ELDERSON, Frank (22 November 2023). Monetary policy in the climate and nature crises: preserving a “Stabilitätskultur”. *European Central Bank (ECB)* [online]. <https://www.ecb.europa.eu/press/key/date/2023/html/ecb.sp231122~e12db02da3.en.html>.

³⁵ European Parliament and Council, 28 February 2024 Directive (EU) 2024/825 amending Directives 2005/29/EC and 2011/83/EU as regards empowering consumers for the green transition through better protection against unfair practices and through better information. *OJ L* 82, 2024, p. 1–16.

³⁶ JUŠKEVIČIŪTĖ-VILIENĖ, Agnė (2023). Challenges of the green economy for the European Convention on Human Rights and the Charter of Fundamental Rights of the European Union. *Teisė*, 128, p. 42 [online]. <https://doi.org/10.15388/Teise.2023.128.3>.

³⁷ European Parliament and Council, 18 June 2020 Regulation (EU) 2020/852 on the establishment of a framework to facilitate sustainable investment, and amending Regulation (EU) 2019/2088. *OJ L* 198, 2020, p. 13–43.

impact of carbon emissions on climate change. Finance and sustainability both look at the future³⁸. Third, while sustainability regulations may impose short-term costs, they foster responsible corporate behavior that can enhance overall societal well-being³⁹. Finally, it should be said that sustainability regulations promote ethical corporate governance by ensuring that businesses contribute to solving critical global issues, such as climate change, rather than making them worse.

In conclusion, financial sustainability is a critical yet complex paradigm that integrates environmental, social, and governance considerations into the financial sector. While a growing number of supporting researchers argue that sustainability regulations enhance market stability, manage long-term risks, and ensure corporate responsibility for global challenges like climate change, critics raise concerns nevertheless. Opponents highlight the potential for excessive regulatory burdens, market distortions, and risks to financial stability, suggesting that such mandates may harm innovation and unfairly concentrate responsibility on the financial sector. In addition, the legitimacy of financial sustainability as a regulatory paradigm also depends on whether these obligations remain enforceable under the real and uncertain market conditions, including periods of economic stress, crises, and systemic shocks. It is considered that sustainability regulation can indeed be ethical and fair – provided that it is proportionate, does not impose excessive burdens, and adequately reflects the operational realities. By respecting these limits, both the legitimate societal aim of addressing climate change and the economic freedom of financial market participants might be supported.

2. European Union Sustainability Requirements for Financial Service Providers

The main legal acts governing sustainability, applicable to investment activities, can be singled out as follows: Regulation on Sustainability-Related Disclosures in the Financial Services Sector⁴⁰ (SFDR), Regulation on the Establishment of a Framework to Facilitate Sustainable Investment⁴¹ (Taxonomy Regulation), Directive regards Corporate Sustainability Reporting⁴² (CSRD), and Commission Delegated Regulation regards Sustainability Reporting Standards⁴³ (ESRS). The SFDR and the Taxonomy Regulation basically apply to financial market participants providing investment services, while the CSRD, its supplementary technical standards ESRS, and the Greenwashing Directive apply to all entities, including financial market participants.

First, as its name suggests, the SFDR requires financial market participants to disclose information about sustainability risks related to investment products (e.g., life insurance) and services (e.g., financial advice), promote comparability of financial products, and ensure transparency. In accordance to

³⁸ SCHOENMAKER, Dirk; SCHRAMADE, Willem (2019). Principles of sustainable finance (2019). *Oxford: Oxford University Press*, p. 5 [online]. https://papers.ssrn.com/sol3/papers.cfm?abstract_id=3282699.

³⁹ BOFINGER, Yvonne (2021). *Essays on Sustainable Finance and Corporate Social Responsibility*. Doctoral dissertation, Economics and Business Studies, Justus Liebig University Giessen. Giessen: Justus Liebig University Giessen, <https://doi.org/10.22029/jlupub-629>.

⁴⁰ European Parliament and Council 27 November 2019 Regulation (EU) 2019/2088 on sustainability-related disclosures in the financial services sector. *OJ L 317*, 2019, p. 1–16.

⁴¹ European Parliament and Council 18 June 2020 Regulation (EU) 2020/852 on the establishment of a framework to facilitate sustainable investment, and amending Regulation (EU) 2019/2088. *OJ L 198*, 2020, p. 13–43.

⁴² European Parliament and Council, 14 December 2022 Directive (EU) 2022/2464 amending Regulation (EU) No 537/2014, Directive 2004/109/EC, Directive 2006/43/EC and Directive 2013/34/EU, as regards corporate sustainability reporting. *OJ L 322*, 2022, p. 15–80.

⁴³ Commission, 31 July 2023 Delegated Regulation (EU) 2023/2772 supplementing Directive 2013/34/EU of the European Parliament and of the Council as regards sustainability reporting standards. *OJ L 277*, 2023, p. 1–284.

Article 2 of SFDR, the requirements of regulation apply to entities engaged in investment activities. In accordance to Article 3, financial market participants have to prepare a sustainability policy, state how they integrate sustainability risks in their investment decision-making process, and make it public. This legal act also requires transparency in other areas – including disclosure of information about salaries (Article 5), supplementing services and products documentation with sustainability information (Articles 8–9), marketing information (Article 13), and some other aspects. Legal scholars have noted that, since its adoption, the SFDR has led to the categorization of financial products into ‘light green’ and ‘dark green’ categories, based on the level of the sustainability criteria they meet. ‘Light green’ products (Article 8) promote environmental or social characteristics, while ‘dark green’ products (Article 9) have sustainable investment as their primary objective⁴⁴.

The SFDR and Taxonomy Regulation complement each other but serve distinct roles within the EU’s sustainable finance framework. The SFDR focuses on increasing transparency by integrating sustainability risks into a financial service provider’s operations and products; meanwhile, Taxonomy Regulation establishes a classification system (taxonomy) to define what constitutes an environmentally sustainable economic activity. The Taxonomy Regulation applies to all financial market participants, as defined in the SFDR, and to large non-financial companies (Article 2). It establishes a common understanding of what constitutes (an) environmentally sustainable investment (Article 2) and requires the implementation of the ‘do no significant harm’ principle (Article 17). This principle ensures that an economic activity claiming to be environmentally sustainable does not significantly harm environmental or social objectives. Additionally, the Taxonomy Regulation is the first document to reference concerns about ‘greenwashing’ in Preamble (11). Additionally, this regulation defines six environmental objectives (Article 9). Subject financial service providers offering sustainability-related products are required to report on the extent to which their economic activities are aligned with these objectives.

In addition to these requirements, the European Commission and EU institutions have introduced specific measures, such as the Greenwashing Directive⁴⁵, the EU Ecolabel⁴⁶, and guidelines on the use of ESG or sustainability-related terms in fund names⁴⁷. These measures aim to ensure accurate names, labeling practices, and clear sustainability claims, all of which are critical for preventing greenwashing activities.

In terms of sustainability reporting, financial service providers are subject to the requirements of the CSRD, if they meet certain thresholds. This regulation obliges companies, depending on their size and classification, to collect and assess sustainability data, as defined by the technical standards in the ESRS and to include this information in an annual sustainability report, which forms part of annual financial reporting (Article 26). This report must be audited by a designated independent auditor.

From the above, it is clear that the new sustainability requirements go beyond the mere addition of sustainability related information to existing documents. They often involve creating an extensive infrastructure for legal compliance, ranging from preparing comprehensive sustainability policies to

⁴⁴ BUSCH, Danny (2023). EU Sustainable Finance Disclosure Regulation. *Capital Markets Law Journal*, 18(3), p. 307 [online]. <https://doi.org/10.1093/cmlj/kmad005>.

⁴⁵ European Parliament and Council 28 February 2024 Directive (EU) 2024/825 amending Directives 2005/29/EC and 2011/83/EU as regards empowering consumers for the green transition through better protection against unfair practices and through better information. *OJ L* 82, 2024, p. 1–16.

⁴⁶ European Parliament and Council 25 November 2009 Regulation (EC) No 66/2010 on the EU Ecolabel. *OJ L* 27, 2010, p. 1–19.

⁴⁷ European Securities and Markets Authority (2024-05-14). *Final Report: Guidelines on Funds’ Names* [online]. https://www.esma.europa.eu/sites/default/files/2024-05/ESMA34-472-440_Final_Report_Guidelines_on_funds_names.pdf

aligning investment activities with the Taxonomy regulation's environmental objectives. This may necessitate significant resource allocation, the establishment of dedicated sustainability teams, or even a shift in business models to ensure alignment with evolving regulatory requirements. As such, these regulations aim not only to ensure transparency but also to embed sustainability into the core operations of financial service providers.

3. Balancing Financial Activity and Financial Sustainability Regulations

Society is undergoing a paradigm shift, with sustainability emerging as a key focus of legislation. This transformation imposes an additional regulatory burden on the financial market participants as well, which, for some, may become too difficult to sustain their business operations. The financial sector is already subject to detailed regulations and oversight designed to protect investor interests and prevent illegal activities. The challenge lies in maintaining a balance during this transition: aligning the intended social and environmental benefits of sustainability with the need to ensure that financial service providers can continue their business operations and uphold their right to economic freedom. Importantly, legal studies have highlighted that the financial sustainability paradigm lacks sufficient scientific research and empirical findings to substantiate its full benefits or justify the associated burdens⁴⁸. Moreover, the constitutional principle of proportionality requires that the measures provided for in legal acts correspond to legitimate and socially important aims, that they be necessary to achieve those aims, and that they do not restrict an individual's rights and freedoms more than is clearly required to attain them⁴⁹. This implies the conclusion that, in the absence of robust evidence on the actual impact and effectiveness of sustainability-related requirements, there is a genuine risk that the regulatory burden may become disproportionate or even excessive. Without adequate research, the risk remains that the financial market participants are overburdened with responsibilities that could compromise their ability to operate effectively and competitively. Nevertheless, when analyzing this matter, one could see the following directions of the balance between the regulatory burden and economic activity, primarily, compliance and profitability. While sustainability regulations serve the broader goal of promoting sustainability, they should be balanced against the need for profitability. Financial service providers should remain financially viable to continue operating, and sustainability initiatives, though important, can be costly to implement. Legal scholars argue that financial stability should take precedence in cases where sustainability regulations conflict with the traditional financial objectives⁵⁰. This is particularly relevant in sectors where margins are tight, and the additional costs of compliance with sustainability regulations could drive companies to financial distress. The challenge lies in integrating these requirements without compromising investment returns. Institutions must find ways to align sustainability goals with their business performance so that to avoid potential losses⁵¹.

The second point concerns public sector support and incentives. The role of public sector involve-

⁴⁸ ZAIRIS, Georgios; LIARGOVAS, Panagiotis; APOSTOLOPOULOS, Nikolaos (2024). Sustainable finance and ESG importance: a systematic literature review and research agenda. *Sustainability*, 16(7), 2878, p. 9–10 [online]. <https://doi.org/10.3390/su16072878>.

⁴⁹ Constitutional Court of the Republic of Lithuania, 21 May 2025 Conclusion. *The Register of Legal Acts*, 2025-09007.

⁵⁰ COLAERT, Veerle (2022). The changing nature of financial regulation: sustainable finance as a new policy goal. *Jean Monnet Chair for Company and Financial Law Working Paper Series*, 2022/04, p. 26 [online]. <https://doi.org/10.2139/ssrn.4087166>.

⁵¹ ZETZSCHE, Dirk A.; ANKER-SØRENSEN, Lise (2022). Regulating sustainable finance in the dark. *European Business Organization Law Review*, 23(1), p. 77 [online]. <https://doi.org/10.1007/s40804-021-00237-9>

ment is critical in ensuring that the burden of sustainability compliance does not fall solely on companies. Governments should support businesses by providing financial incentives, such as tax breaks, grants, or subsidies – or else, create experimental sand boxes⁵² – to help comply with sustainability regulations while continuing to pursue their investment goals. Additionally, the importance of designing regulations that are fair and proportional, ensuring that companies are not penalized excessively for noncompliance while also driving progress toward sustainability goals should be highlighted in the legislative process. This would ensure a smoother balance between the regulatory demands and business activity.

The third aspect of relevance is the proportionality of regulation. One of the legislative principles is the principle of proportionality, which shall ensure that any new rule that aims to regulate certain relationships must also ensure that other interests of the subjects of the relationship are not violated, or that any limitation of rights is balanced with other subjects' rights. The principle of proportionality is a recognized general principle of the EU law, which is important not only in Community case law, but also in the areas of law-making and law application⁵³. The principle of proportionality in sustainability regulations is not an exemption. The legislators should ensure that sustainability regulations are fair, and that they do not disproportionately (over)burden smaller financial service providers. There should be a balance where large companies that can bear more responsibility should not crush smaller ones, and the supporting mechanisms (e.g., subsidies, test environment) could help ease the compliance burden. An example of this approach can be seen in the recent European Commission's initiative "Omnibus II", aiming to simplify the EU legislation in the field of sustainability⁵⁴. By reducing the sustainability reporting complexity, the initiative reflects an attempt to uphold proportionality and ensure that sustainability regulations remain feasible across all market segments.

The final direction of the balance between the regulatory burden and economic activity to mention is risk management. The balance between investment activities and legal regulations requires companies to incorporate sustainability into their core business strategies. This involves not only meeting regulatory requirements but also recognizing sustainability as a long-term value driver that can enhance a company's reputation, reduce risks, and attract sustainable investments. A higher ESG performance has a positive impact on various company-related factors, which have a consequent positive influence on shareholders' value in the company⁵⁵. This means adopting a holistic approach to investment that aligns financial objectives with sustainability goals, ensuring compliance while promoting profitability.

The financial sector faces the challenge of balancing sustainability rules with economic viability. While sustainability regulations promote environmental, social and fair governance objectives, they can impose burdens on financial service providers, especially smaller companies. Proportionality and fairness in setting financial sustainability regulations are crucial to ensure that rules do not stifle competition or profitability. Moreover, policymakers should provide support mechanisms, such as subsidies and tax incentives, in order to facilitate compliance. Public-private cooperation could be an

⁵² ZETZSCHE, Dirk A.; ANKER-SØRENSEN, Lise (2022). Regulating sustainable finance in the dark. *European Business Organization Law Review*, 23(1), 81 [online]. <https://doi.org/10.1007/s40804-021-00237-9>

⁵³ DANĖLIENĖ, Ingrida (2009). Proporcingumo principo taikymas administracinėje ir aplinkos teisėje. *Teisė*, 72, p. 113 [interactive]. <https://doi.org/10.15388/Teise.2009.0.280>.

⁵⁴ *European Commission 16 April 2025 Proposal COM/2025/80 for a directive amending Directives (EU) 2022/2464 and (EU) 2024/1760 as regards the dates from which Member States are to apply certain corporate sustainability reporting and due diligence requirements (2025/0044(COD))* [online]. <https://eur-lex.europa.eu/legal-content/EN/TXT/?uri=celex:52025PC0080>

⁵⁵ ZUMENTE, Ilze; BISTROVA, Jelena (2021). ESG importance for long-term shareholder value creation: literature vs. practice. *Journal of Open Innovation: Technology, Market, and Complexity*, 7(2), p. 6 [online]. <https://doi.org/10.3390/joitmc7020127>.

essential way to achieve a balanced common approach. What is more, policymakers should consider how environmental objectives are aligned with financial stability. Financial service providers, in turn, should integrate sustainability into their strategies, by recognizing it as a driver of long-term value and risk reduction. They should view sustainability as an opportunity, and not as a burden.

Conclusion

1. The new paradigm of sustainability regulations in the financial sector integrates environmental, social, and governance (ESG) principles into the legal framework, as seen in initiatives like the *European Green Deal*. This shift emphasizes balancing long-term societal benefits with economic stability and growth. Sustainability regulations for financial service providers aim to align their economic activities with the global sustainability goals and mitigate climate risks. Yet, the additional compliance requirements burden their economic activities. However, when designed proportionally, sustainability regulations can enhance market stability and long-term resilience; however, when designed excessively, they risk causing market distortions and undermining innovation. Sustainability-oriented regulatory requirements can be justified when they are aligned with the actual functions, capacities, and market risk conditions under which the financial market participants are operating.
2. The introduction of regulations such as the *Sustainable Finance Disclosure Regulation* (SFDR), the *Corporate Sustainability Reporting Directive* (CSRD), and the Taxonomy Regulation has brought significant changes to how management companies operate. For management companies, this shift entails new legally binding duties to classify products, integrate sustainability risks, align investment strategies with the Taxonomy Regulation criteria, ensure compliance with detailed reporting standards, and prevent greenwashing through consistent transparency requirements. As a result, sustainability regulation is no longer merely an additional requirement but, instead, a structural part of organizational governance, requiring new internal procedures, specialized expertise, and adjustments to operational functions. The management companies are required to redesign compliance structure, update investment documentation, and implement internal control mechanisms that they could evidence compliance with sustainability regulatory requirements.
3. Achieving sustainability in the financial sector requires not only balanced regulation but also continuous research to evaluate whether such measures remain proportionate, necessary, and effective. The lack of sufficient evidence on the actual impact of sustainability obligations raises concerns that financial service providers may be subjected to compliance burdens that, in practice, could undermine operational efficiency, reduce competitiveness, or disproportionately restrict economic freedom. To prevent this, it is essential to ensure continuous research and periodic evaluation of regulatory impacts, and to provide appropriate public-sector support mechanisms that facilitate a practical balance between financial objectives and legal sustainability requirements.

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