

Financial Inclusion & Sustainability

Issues and Regulatory Solutions

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UNIVERSITÉ DU
LUXEMBOURG

20th Anniversary Lecture – University of Luxembourg 6 February 2024

- Why do we care about sustainability & financial inclusion?
- What is the nexus between sustainability & financial inclusion?
- What are the tools to get to Inclusive Sustainable Finance?
- What can we learn from regulatory experience so far?

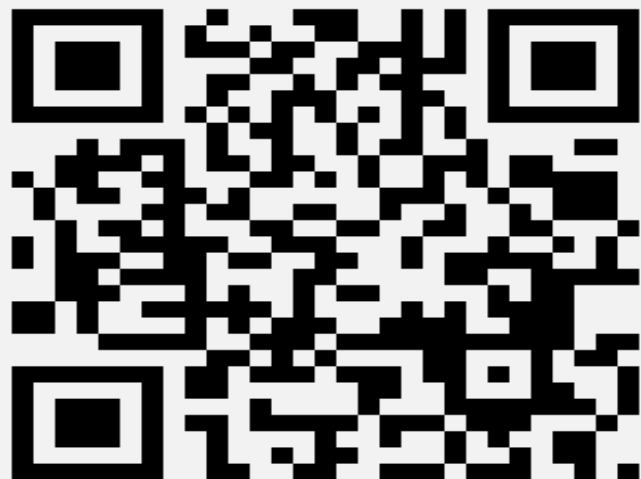
- Installed by way of Memorandum of Understanding in 2014
- Team of up to 15 researchers
- Partners: Appui au développement autonome, Ministry of Foreign and European Affairs
- Research focus on Law and Regulation of Inclusive Finance and Financial Regulation
(Sustainable Finance Regulation, FinTech Regulation and Collective Investment Schemes)
- Flagship events:
 - Certificate in Law and Regulation of Inclusive Finance (8th Cohort 2024)
 - 9th Inclusive & Sustainable Finance Research Conference [with ADA, EIB, MFAE] (21 November 2024)
 - 10th University of Luxembourg FinTech Conference [with LHoFT] (2 Oct 2024)
- Standing cooperation with Alliance for Financial Inclusion, an organization of regulators and central banks of more than 80 emerging and developing economies

Professor in Financial Law, ADA Chair in Financial Law (inclusive finance), Faculty of Law, Economic & Finance, University of Luxembourg

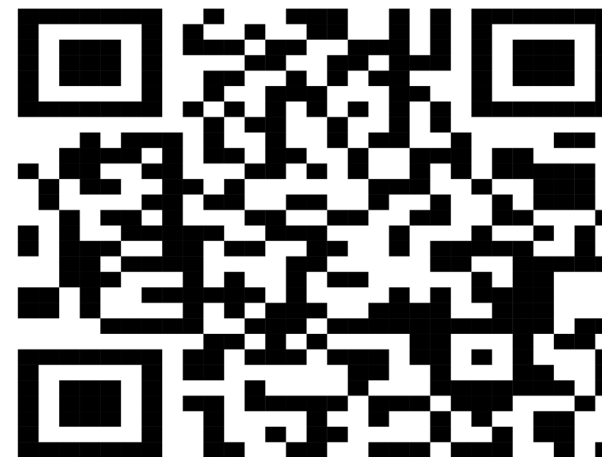
- In Luxembourg since 2015
- Focus on Inclusive & Sustainable Finance, FinTech, Investment Funds and Corporate Governance
- Coordinator of House of Sustainable Governance & Markets, UL
- Co-PI of Luxembourg's National Center of Excellence in Research (NCER) in Financial Technologies
- Adviser to Policy Makers and Regulators worldwide
- Standing cooperations with central banks in EMDEs
- Speeches at United Nations, AFI Global Policy Forum, BIS, FSB, COP27 (Egypt) and COP 28 (Dubai)
- 400+ publications

Start date: September

Collective Investment Schemes
Law & Regulation



Banking & Financial Law



40 Students per year

Languages: English and French
[Study Programme list - University of Luxembourg | Uni.lu](#)

2 Semesters

I. Defining the topics

II. Why do we care?

1. Financial Inclusion as driver of EFGI
2. EFGI as roots of Sustainable Development

III. The Need for Regulation

IV. Lessons learned around the world on « how to regulate »

IV. Towards an Inclusive Sustainable Regulatory System

Take Aways and Conclusion

I.1. Defining the Topics: Financial Inclusion

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Uninhibited Access to

stable, efficient, low-cost, high performing, easy-to-use

Sustainability, Fintech
& Financial Inclusion
www.ssrn.com/abstract=3387359

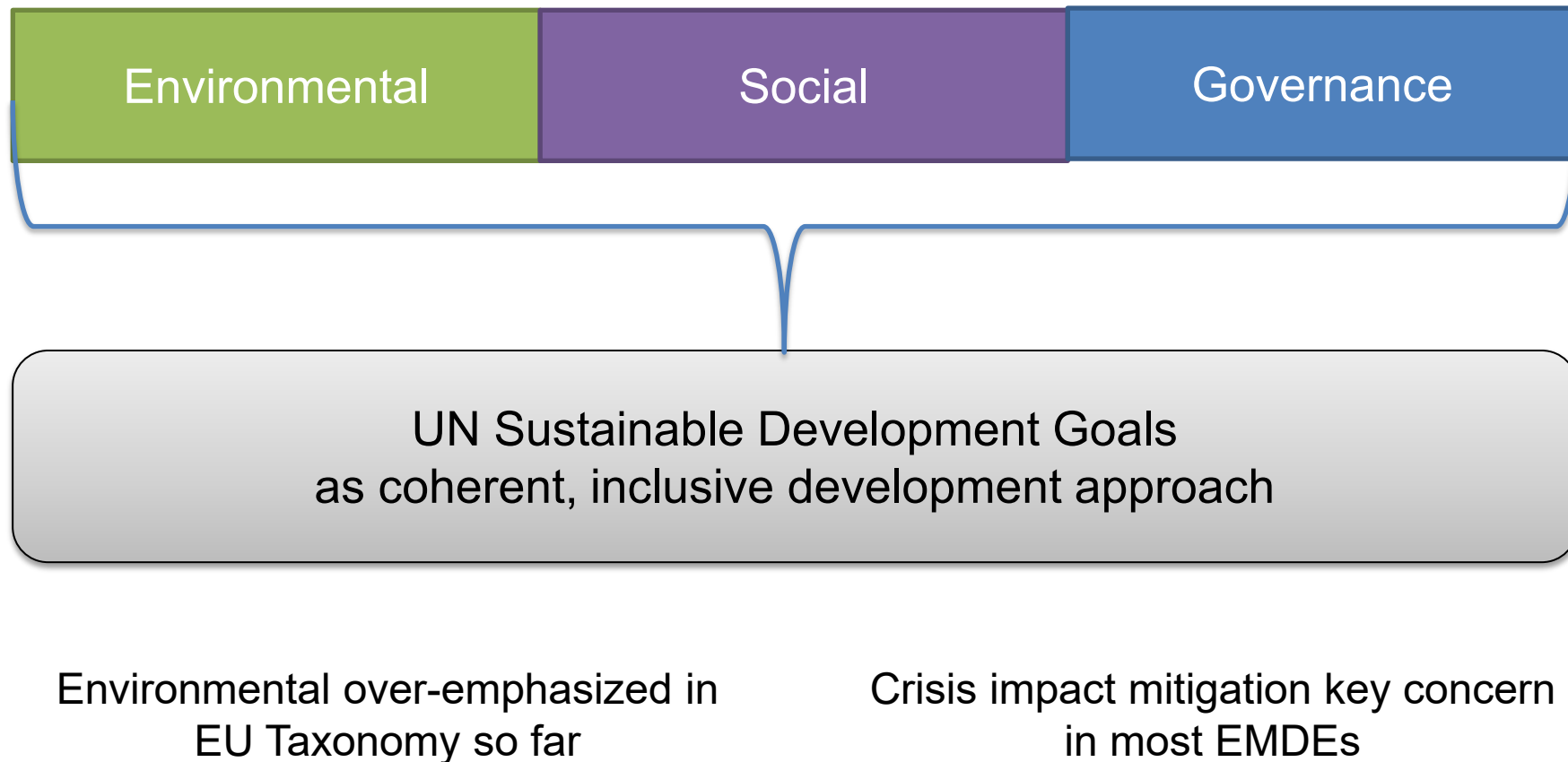


Financial Services

- Payments
- Credit
- Investment & Savings
- Insurance

I.2. Defining the Topics: Sustainability - ESG

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4. Governance (law, regulation, organization)

- Mandatory Regulation: Disclosure, Fiduciary Duties
- Self Regulation
- Organization
- Accountability

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II.1. Three Rationales for Financial Inclusion Approaches

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A. The old view: assistance to the poor (« subsidy story »)

- Helping the vulnerable out of misery

B. Furthering Long-termism (« social effects of financial services »)

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Inclusion

FT4FI Roadmap

www.ssrn.com/abstract=3245287

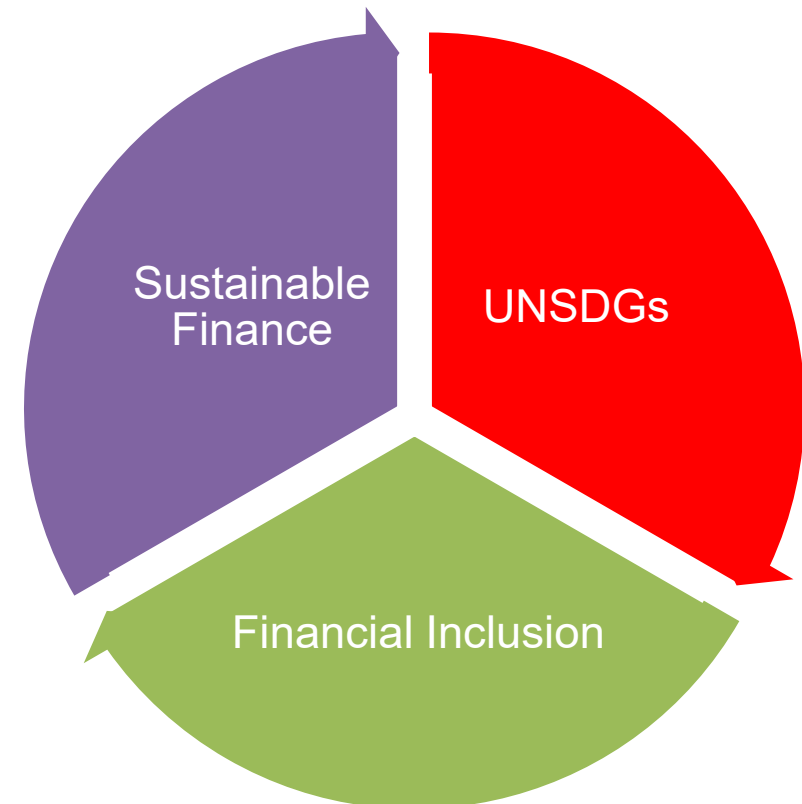


Sustainability, Fintech
& Financial Inclusion

www.ssrn.com/abstract=3387359



Financial inclusion: Precondition for
⇒ long-termism of all business actors
⇒ positive influence on ESG factors



B. Furthering Long-termism (« social effects of financial services »)

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Inclusion

FT4FI Roadmap

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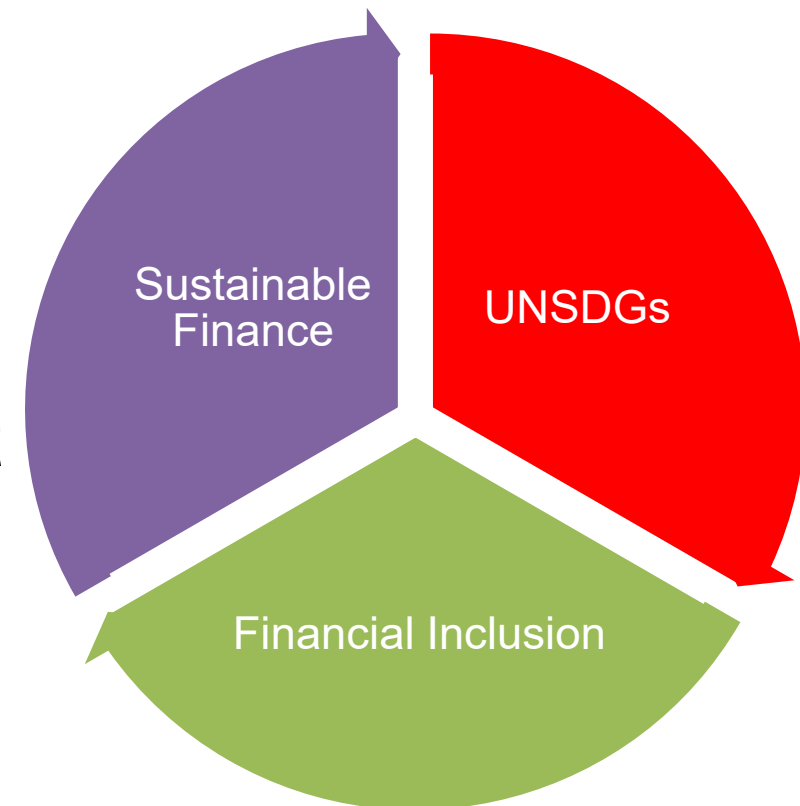
Sustainability, Fintech
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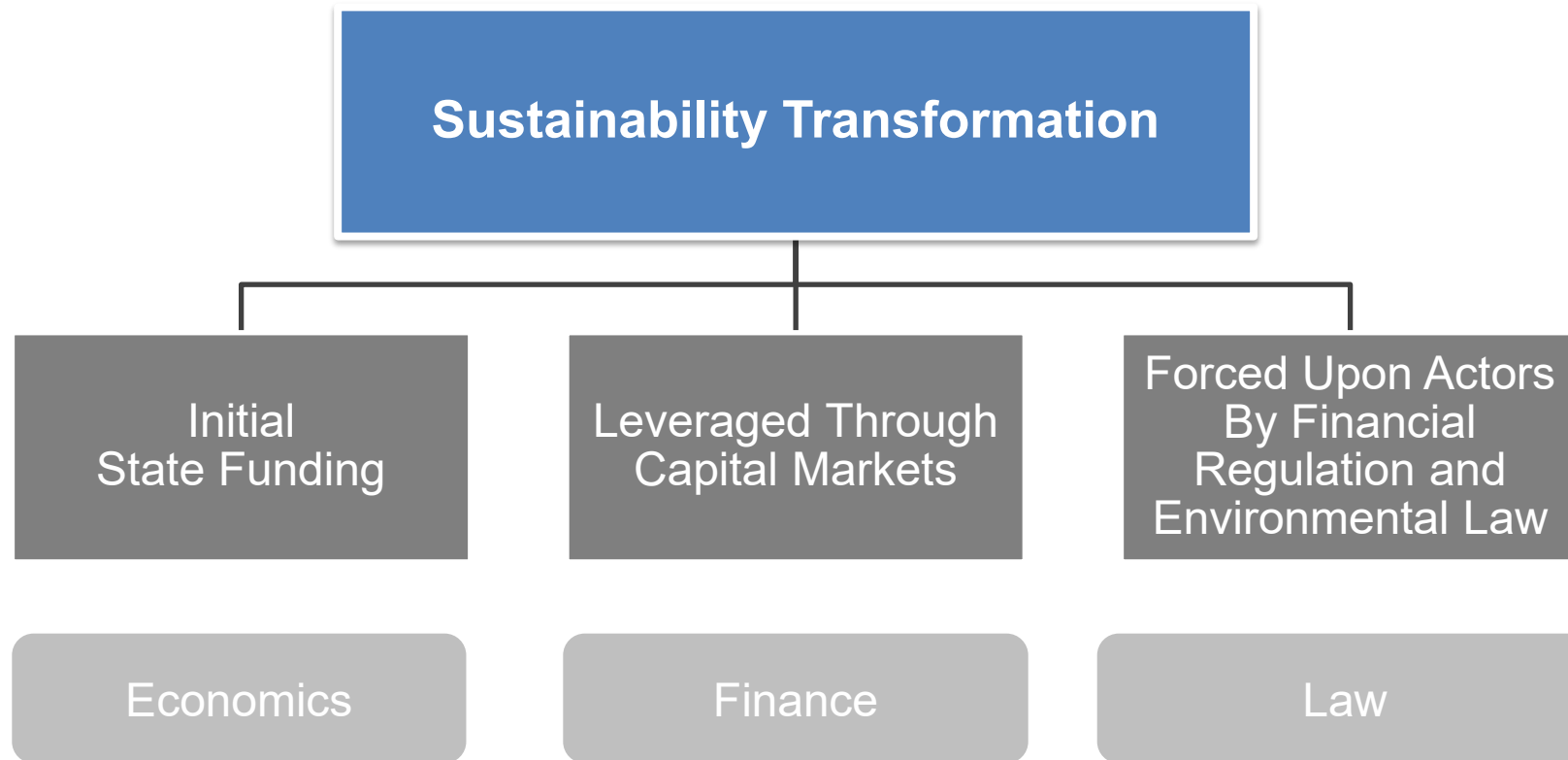
Financial inclusion

- key driver to all UNSDGs
- precondition for effective sustainability crisis management
- requires pro-FinTech policy



C. Activating Schumpeterian Magic (« the Efficiency Story »)

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- The novel view: Financial Inclusion as an infrastructure project for EMDEs
 - Major investments into financial technologies (FinTech) and governance
 - Reduced Transaction Costs
 - Enhanced market efficiency
 - Enhanced financial stability
 - Stronger internal refinancing capacity of EMDEs

Financial Inclusion: driver of ESG + FinTech + Governance + Social Inclusion

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II.2. EFGI as Tools of Sustainable Development

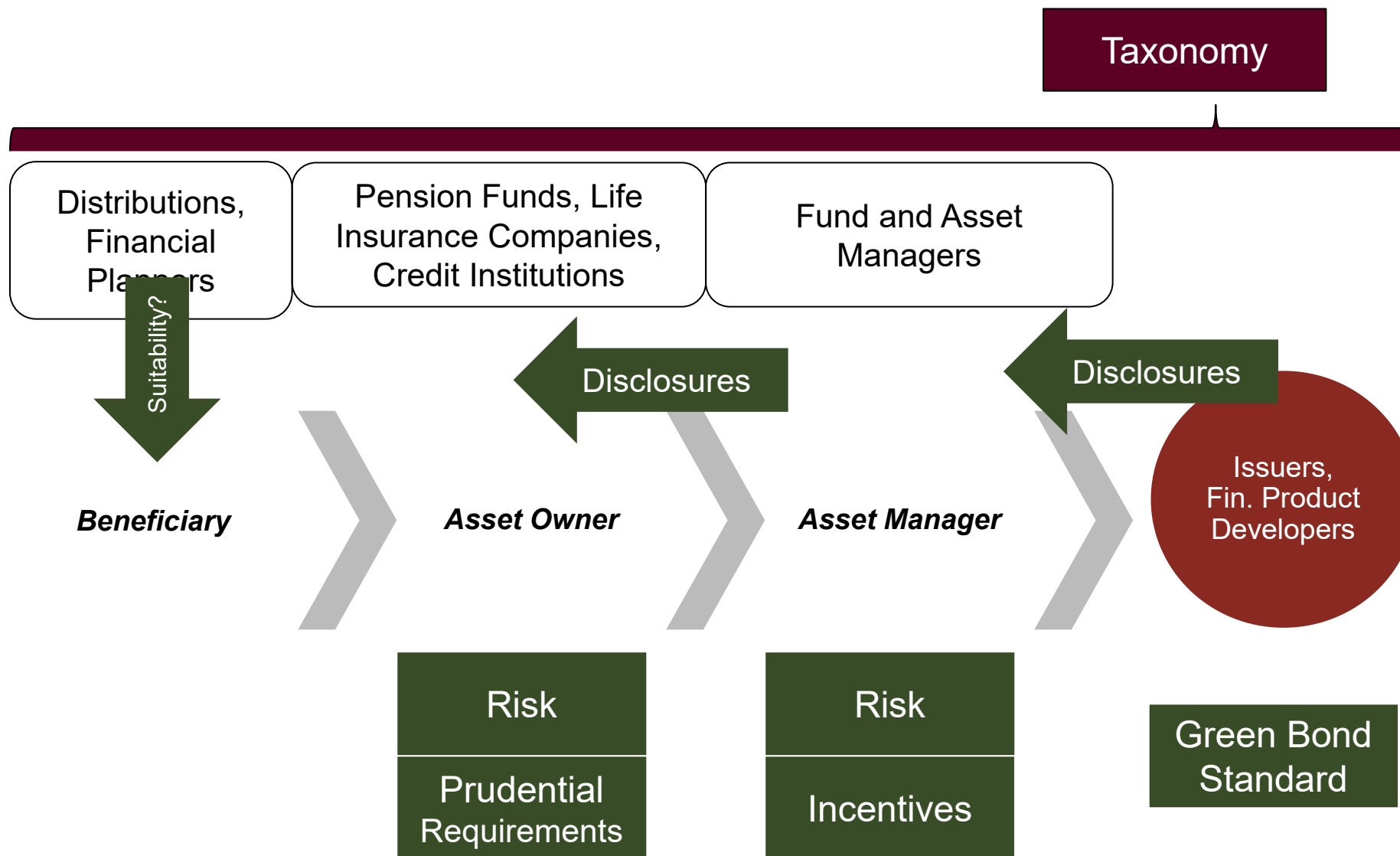
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- ESG + FinTech + Governance + Inclusion: EFGI
- Defining the objectives of Policy Action
- Integration of UN SDGs in corporate investing



II.2. Markets need Information - the Financial Services Value Chain

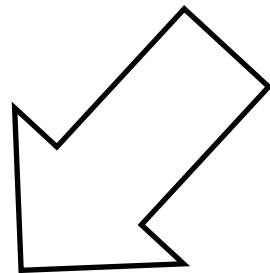
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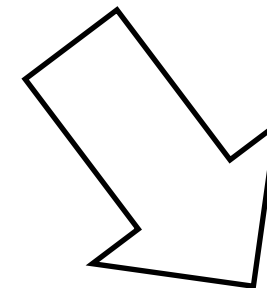
Core Issues of Sustainable Finance

Information asymmetry:
Who delivers truly on the Green promise?

**Oversupply of Capital seeking
Green cash-flows**



Enhanced Agency Conflicts
(Greenwashing, variance of issuer-paid
Sustainability Ratings etc)



Asset Price Bubble

II.2. EFGI as Tools of Sustainable Development

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FinTech

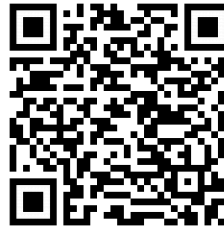
Technology as Solution

- Information processing (RegTech)
- Data verification (DLT)

⇒ Issues:

- data origination?
- openness to innovation?
- Costs?
- Applicability to MSMEs?
- BigTechs & Size effects

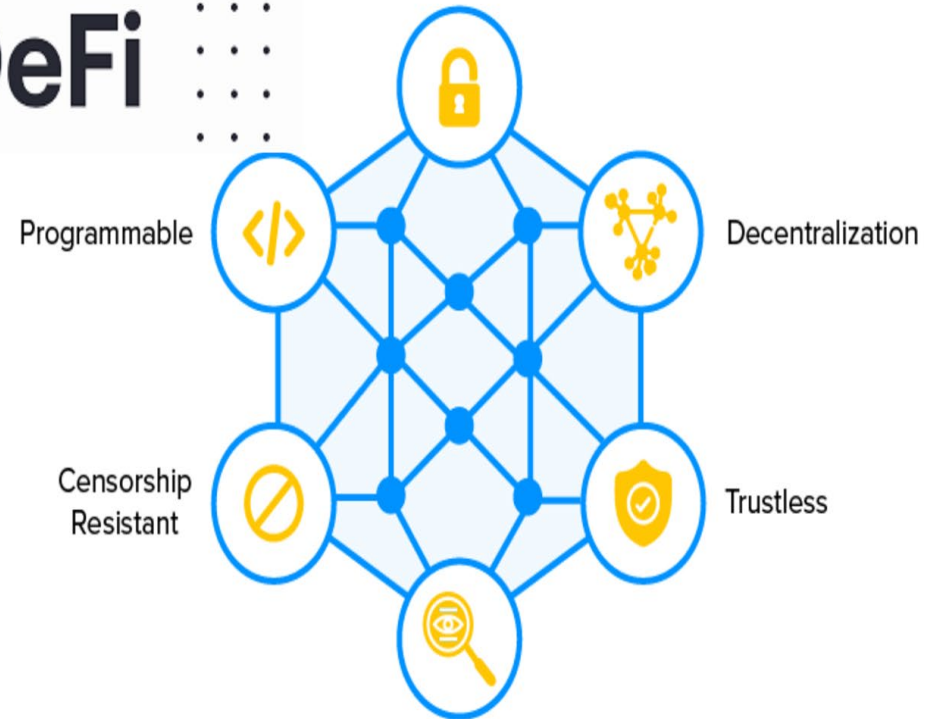
TechFin / Data-driven Finance
www.ssrn.com/abstract=2959925



Distributed Ledgers / Blockchain
www.ssrn.com/abstract=3018214



DeFi



Financial Inclusion: driver of ESG + FinTech + Governance + Social Inclusion

In short: progress (\approx sustainable development) !

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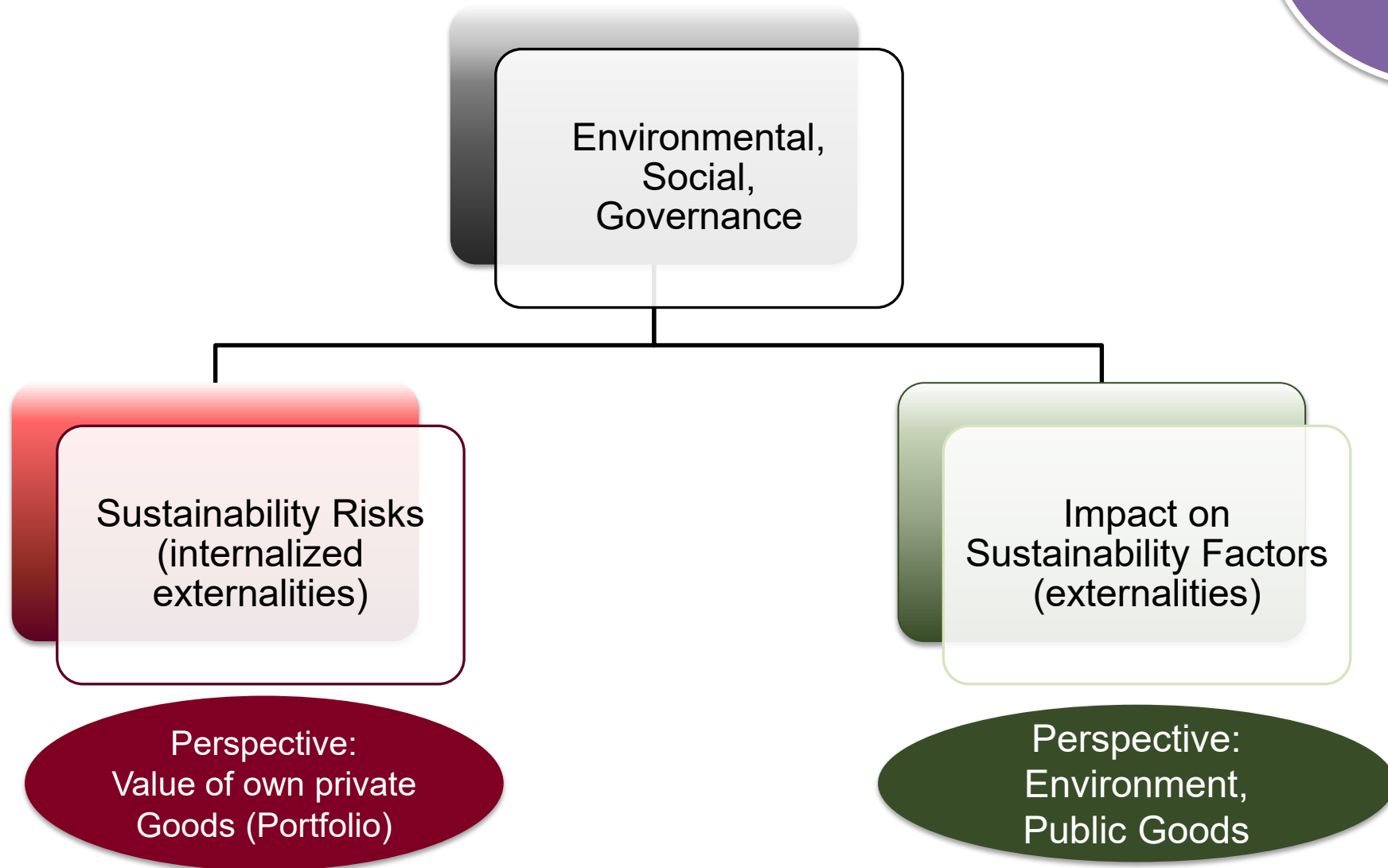
V. Towards an Inclusive Sustainable Regulatory System

Take Aways and Conclusion

Double Materiality

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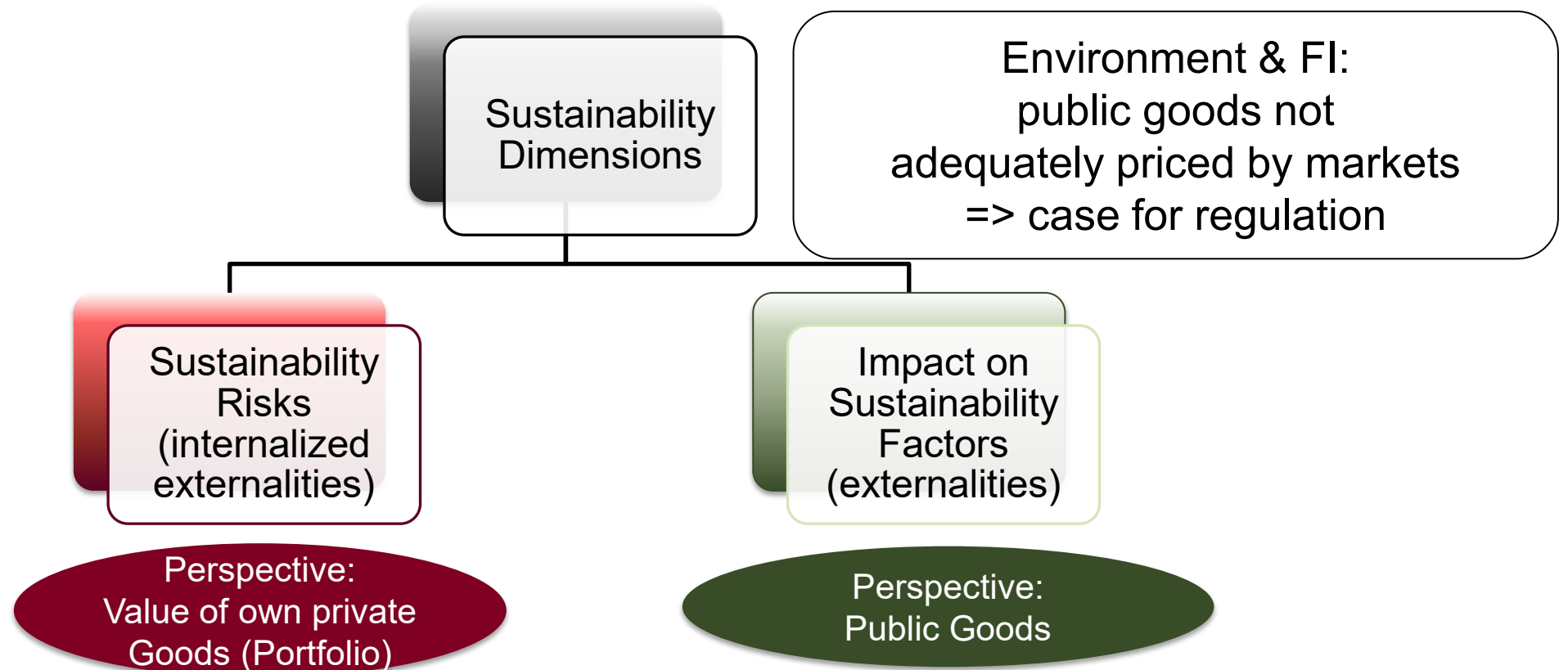
Governance



Double Materiality

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Governance



The Role of Regulation in Sustainable Finance

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Pricing sustainability impacts

Activating private capital

Ensuring fair competition

Reducing transactions costs through classification, disclosure

Protecting investors & clients

Systemic risk prevention and crisis mitigation (Sustainability risk as systemic risk)

1) Pricing sustainability

- Markets poor at pricing sustainability impacts on firms and society
- Regulation as solution?

2) Activating private capital

- Public resources limited, volatile
- Regulation as incentive?

3) Competition

- Incentive to present as Green what is not Green
- Riding on the « Green Asset Bubble »
- « Greenwashing » as unfair competition

4) Terminology & Classification

- Abundance of methodologies
- Need for one « official classification »
- « Greenwashing » as evidence of legal uncertainty / lack of international standard

5) Depositor & Client Protection

- « Greenwashing » as fraud
- Regulating as precondition for enforcement

6) Systemic risk prevention

- Sustainability crises as reality
- SF regulation assists in:
 - a) mitigating crisis impact
 - b) preventing future crisis

IV. Lessons learned around the world on « how to regulate »

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Key areas for ISF Regulation

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Governance

1

- What is sustainable? (classification)

2

- Who acts sustainably? (disclosure)

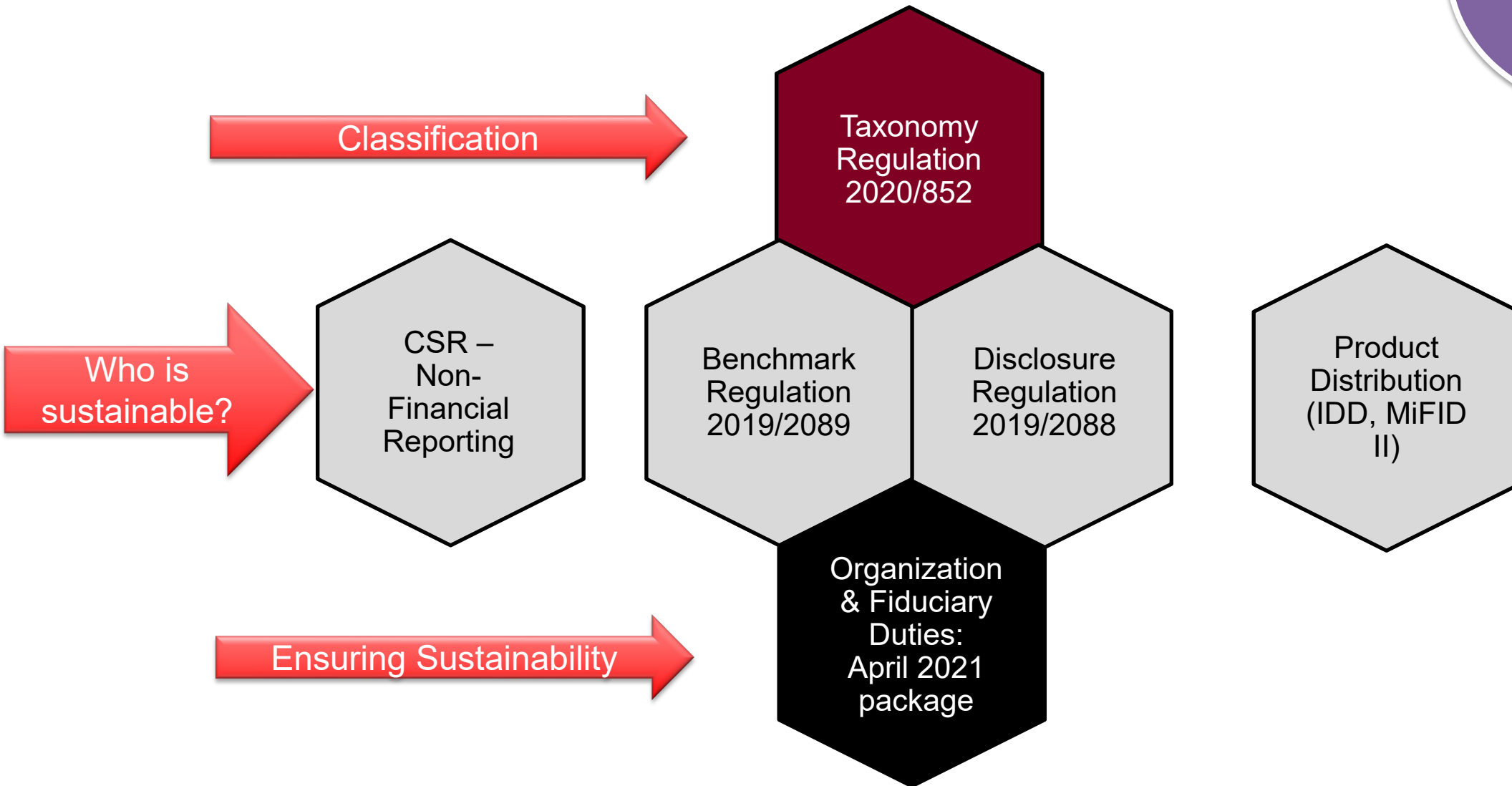
3

- Ensuring sustainable conduct

Example: The EU's Main Legislative Initiatives

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Governance



IV.1. Sustainability Classification

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- Easy in theory, difficult in practice
 - Ambition vs Reality
 - Different approaches
 - Granular ex ante (EU Taxonomy): costly, risk of regulatory failure
 - Broad principles ex ante, detailed upon application (review board)
 - Granular only on national priorities, broad on rest
- => costs of ex ante vs ex post regulation; risk of regulatory errors

IV.1. Example of Classification: Art 3 EU Taxonomy Regulation

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Substantial contribution to one environmental objective (e.g. carbon neutrality, biodiversity etc. - all defined by the Taxonomy Regulation)



Economics

Does not significant harm (DNSH) other environmental objectives



Law

Compliance with Minimum Legal Safeguards (Art. 18 Taxonomy Regulation)

OECD Guidelines for
Multinational Enterprises
(supply chain, liability etc.)

UN Principles for
Business and Human
Rights

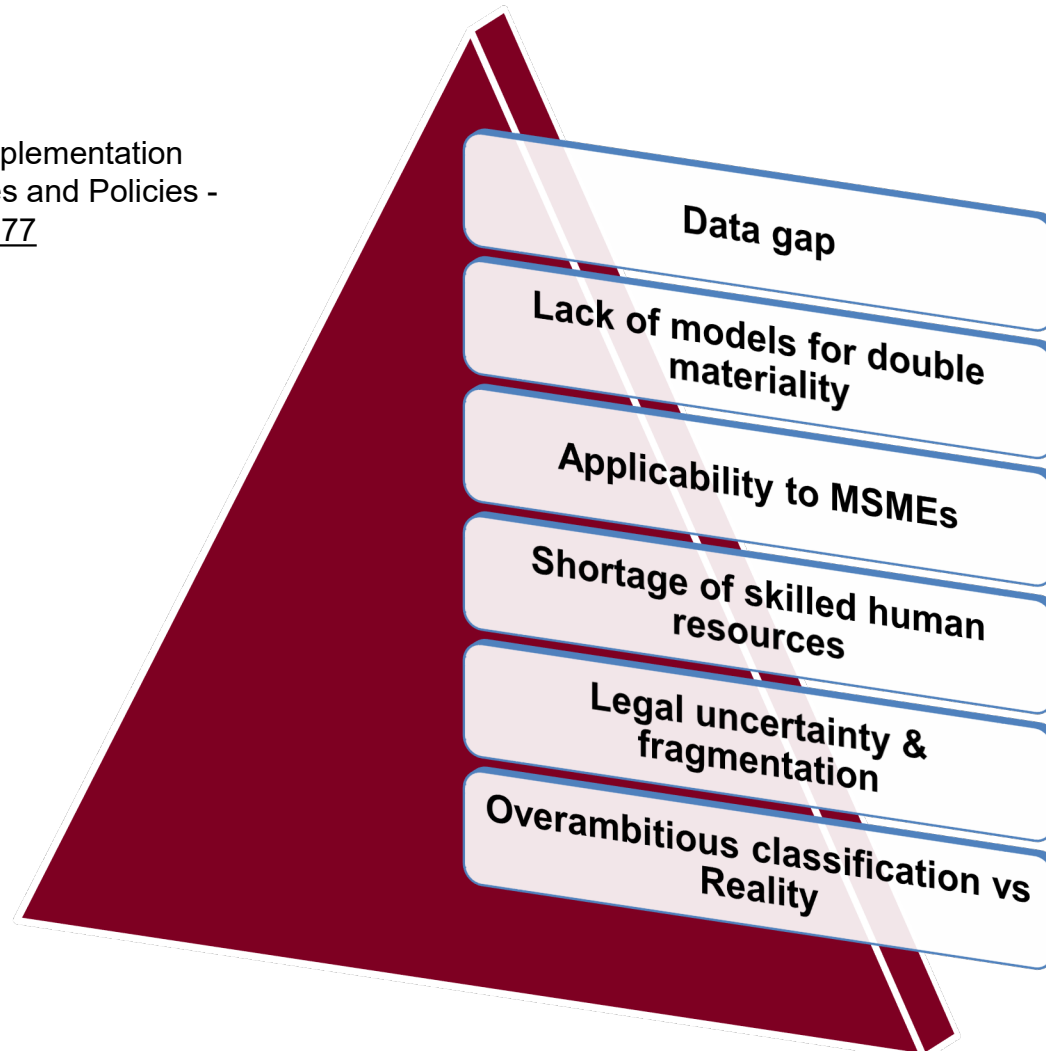
UN&ILO Minimum
Labour Laws, work
safety, Social Insurance

- Disclosure and Audit
- **On-balance sheet intermediaries (banks):**
 - Capital requirements : Sustainability Impacts as (Future) Risk
 - Issue: how to calculate prudential requirements?
- **Off-balance sheet intermediaries (asset & fund managers, PF):**
 - Fiduciary duties (investment and risk management)
 - Issue: how to ensure profitability *and* sustainability?

IV.3. Ubiquitous Challenges of Regulating Inclusive Sustainable Finance

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Roadmap for Inclusive Green Finance Implementation
- Building Blocks to Implement IGF Initiatives and Policies -
www.ssrn.com/abstract=4278277



- I. Defining the topics: EFGI
- II. Sustainable Development as nexus of EFGI
- III. EFGI as Tools of Sustainable Development
- IV. Lessons Learned around the World
- V. Towards an Inclusive Sustainable Regulatory System**

Take Away and Conclusion

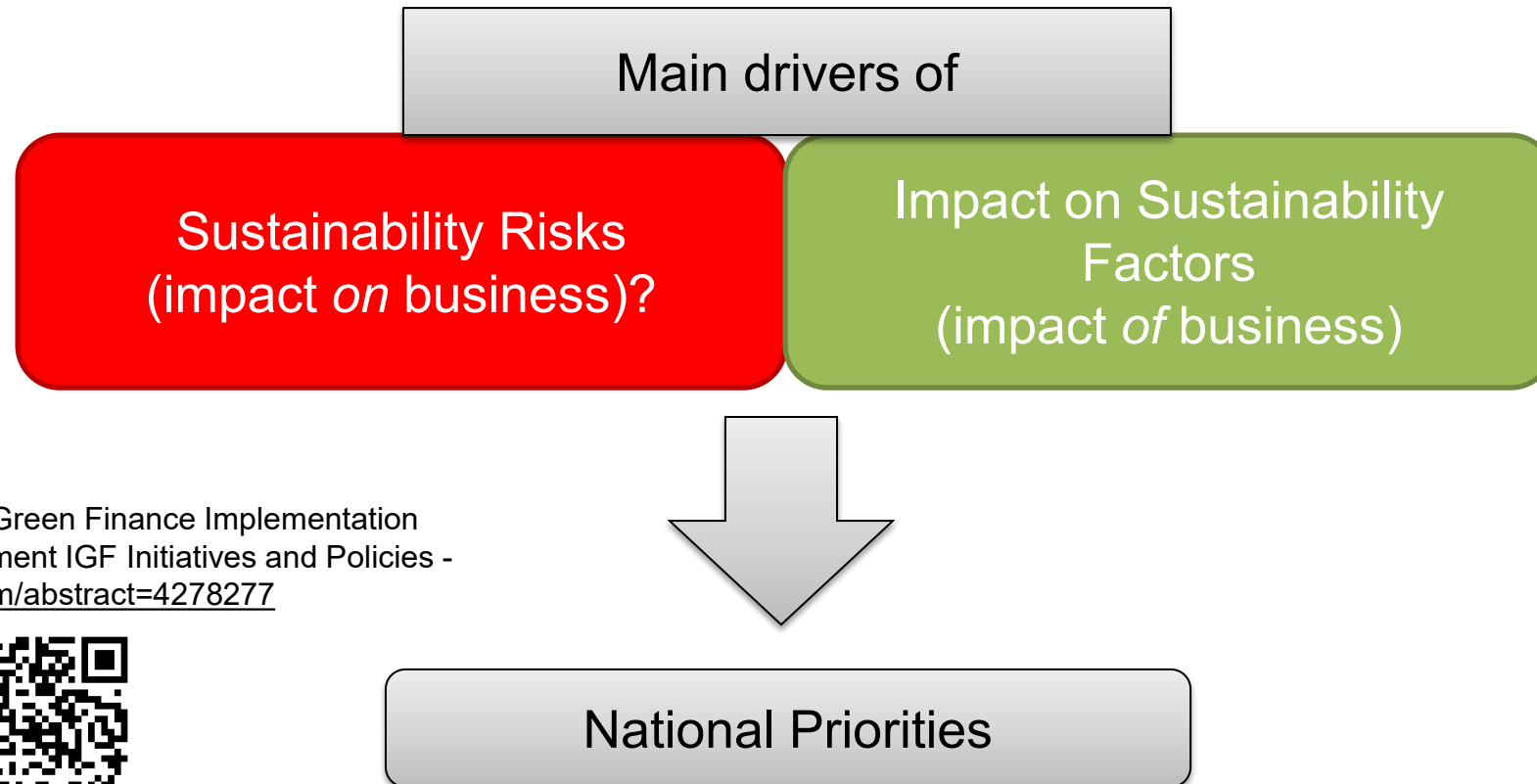
V. Towards an Inclusive Sustainable Regulatory System

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1. Focus (!) on national priorities (!)
2. Sandbox thinking
3. Scorecard Approach to Classification
4. A proportionate approach to MSMEs
5. Ensuring impact ... impact measurement

V.1. Identifying national priorities

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V.2. Sandbox Thinking

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Learn from
regulating
FinTech!

„Sandbox Thinking“

- 1) Regulators & industry to **admit lack of knowledge, data, legal uncertainty, resources, tested models, implementing standards**
- 2) Acknowledge **phase-in period** until gaps are addressed
- 3) Enhanced reliance on **proportionality requirements** on all levels of financial regulation and supervision

Phase-in Period:
focus => gap filling by all
public & private actors

Robust
data-based
assessment

Final Period
focus: full compliance

Towards Sandbox Thinking in EU
Sustainable Finance Law and Regulation
www.ssrn.com/abstract=4147295



Policy approach during phase-in:

- Focus on mutual learning
- Enhanced coordination to avoid cross-border fragmentation
- Leniency and transparency on remaining divergence of standards
- Disclosure on *testing of* models, rather than application of (untested) models
- Acknowledge division of labour in delegation chains (PM vs RM)
- Accept official estimates (eg. Official estimates by ministries, Statec, Cbs etc.)
- Build-up of sustainability data in Single Data Access Point

V.3. Scorecard Approach to Classification

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Traditional classification

- Ex: E-vehicle = sustainable, combustion = not sustainable
- One-dimensional => E OR S OR G

⇒ Binary Effects (winner takes all)

⇒ Underweighting transition

- Car 20l/100 => Car 5l/100: 75% savings
- Car 20l/100 => e-vehicle: costly, lack of infrastructure => too much too fast

⇒ Only gradually precise

- Decision of classification involves compromises on UNSDGS
- Depending on these compromises some UNSDGs suffer (ex: e-vehicles)
- More granular scores desirable for impact investing

Addressing the 'Winner-takes-all' Character
of Sustainability Taxonomies

www.ssrn.com/abstract=4488521



Towards a European Social Taxonomy:
A scorecard Approach

www.ssrn.com/abstract=4218874



V.4. Classification for MSMEs

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- Basel Risk-based Perspective: harmful for MSMEs & sustainability
- Criteria: SMEs' furthering of one UNSDG
 - Data gathering
 - Reporting throughout investment period
- Substitute for DNSH & governance criteria with public data
- **Aggregate approaches based on sectors**
(similar to Basel accord for small client financial risk)

Towards Sandbox Thinking in EU
Sustainable Finance Law and Regulation
www.ssrn.com/abstract=4147295



V.5. Impact Investment requires Impact Measurement

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- So far little evidence that Sustainable Finance prompts change
- Lack of data so far major barrier for sound impact measurement
- Harmonized classification will facilitate measurement, but transparent and sound models in dire need.

Sustainable finance is no means it itself. Active regulation to ensure ongoing measurement, adjusting, model development, innovation to ensure that SF can make the difference!

Regulating SF in the Dark
www.ssrn.com/abstract=3871677



- 1) Markets without regulation unable to achieve sustainability. Regulation crucial from various perspectives.
- 2) E important, but little evidence that focus on «E» truly effective. Financial Inclusion crucial for truly sustainable development. Financial Inclusion to further EFGI; in short: progress.
- 3) SF regulation rests on double materiality classification, disclosure and operating rules for on- and off-balance intermediation. FinTech crucial for information processing and verification. Data origination remains an issue.
- 4) SF approaches suffer from implementation challenges: lack of data & models, lack of skills, expertise & resources, legal fragmentation, high implementation and transaction costs
- 5) Regulators to learn from FinTech and adopt **sandbox thinking**, transparent scorecard classification, aggregate approaches to MSMEs, and ensure ongoing impact assessment & measurement with a clear focus on national priorities.
- 6) Financial Inclusion IS far more important for the planet than it seems.

Thank you!

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Roadmap for Inclusive Green Finance
Implementation - Building Blocks to
Implement IGF Initiatives and Policies
www.ssrn.com/abstract=4278277



EU SF Framework in Light of
International Standards
www.ssrn.com/abstract=3984511



Sustainability, Fintech
& Financial Inclusion
www.ssrn.com/abstract=3387359



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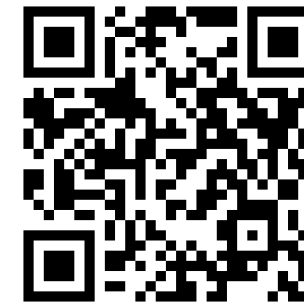
1 Million or 100 Million Casualties? –
COVID-19 vs EMDEs and LDEs
www.ssrn.com/abstract=3597657



Towards Sandbox Thinking in EU
Sustainable Finance Law and Regulation
www.ssrn.com/abstract=4147295



Regulating SF in the Dark
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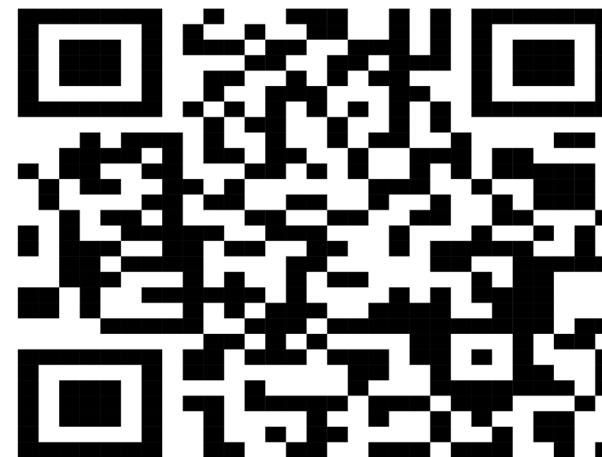
FinTech book

Start date: September

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