

The EU long-term sustainability strategy



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From well-defined investment needs to bankable projects

The EU has set clear and ambitious environmental sustainability policy objectives and targets in line with the UN Sustainable Development Goals ('SDGs'), the 2015 Paris Agreement, and its own environmental priority needs. This includes targets for waste reduction and recycling, for energy efficiency improvements, for renewable energy generation, for water quality protection and improvement, for air quality improvement, etc. These are further supported by programmes and objectives that approach the sustainability challenge from a more systemic viewpoint such as the shift towards a circular economy, sustainable consumption and production, etc.

Achieving our climate and environmental policy objectives is going to require substantial financial investment – both public and private. Recent estimates¹ suggest an additional 180 billion euros per year will be needed between now and 2030 in the EU to meet our climate mitigation and adaptation objectives. For achieving the EU's other environmental objectives, the estimates² include, for example, an additional 54 billion euros per year until 2030 to meet our air pollution objectives and an additional 60 billion euros a year to meet our water quality objectives.

So, for many of our environmental sustainability objectives the priority investment needs are relatively clear and well defined. With the launch in May 2018 of its proposal for a Regulation on the establishment of a framework to facilitate sustainable investment³, the EU Commission aims to develop a comprehensive taxonomy of 'real economy' activities that substantially contribute to the achievement of the EU's environmental and climate change objectives. This will greatly help delineate and improve the identification of sustainability investment needs.

The EU Commission has also suggested, as part of its next Multi-annual Financial Framework (2021-2027) proposal, to substantially increase both the absolute levels, as well as the proportion, of funding that is orientated towards needed climate and environmental infrastructure investments.

But it will require much more than what is available from EU and Member State public purses to close the investment gaps. Private sector finance has a huge role to play. By all accounts, however, the challenge is not private sector funding availability but the pipeline of bankable projects.



>>> So, the investment funds are there, and the investment needs are fairly clear. However, one further important piece of the investment puzzle needs to be addressed; creating the market and structural conditions that make the project investments bankable. Consider the need by a local region or commune to build and operate a sewage treatment plant. If the local authorities are able set up a framework whereby the local citizens pay an annual service fee, this generates an identifiable, predictable revenue stream thus creating an attractive investment opportunity. Or, it may be about finding ways to group a series of smaller investments needs (e.g. energy efficiency improvements in a series of apartment buildings) to create an attractive, bankable project proposition.

In short, addressing the 'missing pipeline' issue is going to require some creative, innovative, and joined up thinking between the different actors involved. We need to get much smarter and much better coordinated in how we internalise the environmental externalities, so they are not simply a cost to be borne from the central pot of taxpayers money or by businesses, but are set up as 'services' which create identifiable markets and revenue streams.

Finally, it is not only about investment projects and fixed income instruments. It is also about directing investment towards companies and activities that are substantially contributing to achieving our environmental and climate mitigation objectives. This requires greater attention and transparency by the financial sector on how it integrates longer-term sustainability/ESG considerations into the set up and marketing of its exchange-traded funds (ETFs), pension funds, and other equity-based financial instruments.

I am confident that it is possible to move in the right direction if we are able to link sustainable finance to the real economy, to deliver bankable projects. ●

1. Restoring EU competitiveness, EIB, 2016.
2. Restoring EU competitiveness, EIB, 2016. Impact assessment for Regulation establishing the Invest EU Programme. SWD(2018) 314.
3. COM (2018) 353 final.



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Big ambitions and investments for net-zero emissions

The European Commission's new long-term strategy on greenhouse gas reduction aims for an ambitious net-zero emissions target by 2050. For those of us who work at the confluence of policy and finance, the question now is: How do we get there from here?

The net-zero target requires an economic transformation. The energy sector's role is central, because it's responsible for over 75% of EU emissions. Multilateral investors like the European Investment Bank have a big contribution to make, which is why we're currently reviewing our energy lending policy. Our financing and advice must be directed at investments that cut emissions and combat climate change. We must create the jobs and growth in the renewable energy and energy efficiency sectors that will ensure the transition leaves behind no part of our societies and no region of the world.

Our impact is already significant. In 2013-17, the energy projects we signed resulted in avoided emissions of about 8 million tonnes of CO₂ annually, equivalent to >>>

>>> emissions from 1.7 million cars driven for one year. In the last five years, the EIB provided over € 50 billion in energy investment to renewable energy, energy efficiency and grid projects. This lending helped make solar and wind power much cheaper. The global impact of EIB renewable energy projects since 2013 will ultimately be 38,000 MW of generation capacity, producing enough clean energy to supply 45 million households.

But it's not enough. The Commission's strategy estimates that, to achieve a carbon neutral economy by 2050, investment in energy systems would have to increase to 2.8% of GDP, from 2% today. This means additional investment of €175 billion to €290 billion a year (excluding transport) from 2030 onwards. That's not the kind of money any one EU member state can find all by itself. Multilateralism will be crucial to delivering on this strategic goal, and the EIB will be a keystone investor in this great challenge.

It isn't only the sheer size of the investment that's a factor here. The long-term nature of these commitments requires a steady hand like the EIB to back them. For grids, annual investment needs are expected to rise by nearly 70% in the post-2030 period. Similarly, power generation is likely to double.

Let's not forget that all policy must take into account the needs of the citizens we serve. That's why the concept of a "just transition" was so much discussed at COP24. The economic and social impacts of the energy transition on regions with high employment in fossil fuel extraction, energy intensive industries and conventional automotive manufacturing are included in the Commission's long-term strategy. Planning for the social implications will be vital for successful decarbonisation in Europe and elsewhere.

In all this, the EIB can be a central catalyst. The bank can address market failures and support other financial entities to identify sustainable activities. We are already working with commercial banks to help them identify climate action windows in our lines of credit. This can be extended to other intermediaries and to other sustainable activities beyond climate action. Another possible avenue should be increased cooperation with national promotional banks in identifying green investment and the assessment and management of negative impacts and risks. Here our extensive advisory and technical assistance can be vital.

There are many pieces to the puzzle, as we develop the plan for financing the path toward net-zero emissions. The EIB's role is to show that decarbonisation is a viable business model. We aim to do exactly that. ●



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Legal, loud and long - Is the EU's climate policy bankable?

The European Union has just agreed the full legislative framework in order to fulfil its obligations under the Paris agreement. Ahead of the Paris COP, the EU pledged to reduce its domestic greenhouse gas emissions by at least 40 % in 2030 compared to 1990. At the beginning of the Juncker Commission, a whole set of legislative proposals was tabled comprising the revision of the EU ETS, new targets for Member States outside the emission trading sectors, new targets for renewable energy and energy efficiency, new standards for emissions from cars, vans and for the first time heavy trucks. In addition, improvements to the enabling framework were

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>>> proposed like for instance the electricity market, the clean vehicle directive, eurovignette. All of these pieces of legislation have been adopted, and in the case of renewables, energy efficiency, standards for cars and vans, the European Parliament and the Council have agreed on even more ambitious targets than those proposed by the Commission. If agreed policies are fully implemented, greenhouse gas emissions could be reduced by around 45% in 2030.

"2030 signals to investors are legal, loud and long, more necessary for a climate-neutral EU by 2050."

- ARTUR RUNGE-METZGER

Moreover, the Commission has tabled the new multiannual financial framework that proposes to significantly ramp up innovation and technology development. In addition, the new Innovation Fund with revenue from the EU ETS will cater for risky "first of a kind projects" in the energy and industrial sectors in Europe as of next year.

This new comprehensive legal framework provides certainty and predictability for investors until 2030 – as often demanded by the private sector, and this will happen almost instantly. For instance:

- i. In the aftermath of the adopted revision of the ETS Directive, carbon prices have risen from € 5 per ton CO₂ to around € 20 per ton CO₂. This will make many investments indeed bankable, and provide an additional market pull for renewable energy technologies.
- ii. Improving the efficiency of cars by 37,5% between 2021 and 2030 will require a significant roll-out of new zero and low emission vehicles and establishing the necessary infrastructure. It is estimated that around 25% of newly sold cars in 2030, either battery electric or hybrid car, will have an electric engine. These represent 5 million new clean cars in 2030 or in total 35 million clean cars on the road by 2030. Clearly, this creates opportunities for investments into new factories and new technologies.
- iii. Improving energy efficiency by 32,5% by 2030 will require a staggering increase in investments into renovation of buildings until then, the majority of it to be mobilised from the private sector. Member States have just delivered their national energy and climate plans until 2030 that provide further detail how this ambitious target can be achieved.

Often one hears that for long-term investors 2030 is already around the corner and predictability until then might be insufficient. Many investments, in particular, in infrastructure are long-lasting with long pay back periods. Therefore, the Commission has looked at the long-term until 2050 proposing that by then Europe should become climate neutral. No doubt, this will be a Herculean task. Not only will it require a significant additional investment over the coming decades in the order of € 170 - 260 billion per year, but also a restructuring of investment from business as usual to "clean" investments. For instance, will we see a penetration of around 80% renewables in Europe's electricity production in parallel with a significant increase in the use of electricity. In addition, hydrogen, biofuels and e-fuels will be new players in the energy system which can also be used for energy storage. In the coming months, the European Parliament, EU Heads of States and Government and national fora in Member States will discuss this long-term strategy.

In parallel, a serious discussion on sustainable finance has emerged in the EU over the past years. The Commission together with Member States and stakeholders is trying to chart a way forward to ensure that investors direct finance to the benefit only sustainable investments. Transparency in the green bond market is one aspect here which can support investors in their choice. Anticipating potential stranded assets, like long-term investment in fossil fuels, can equally help investors to reduce risks of their investment portfolio. ●



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A predictable investment environment for energy transition

The recently agreed legislative package, “Clean Energy for All Europeans” completes the EU’s 2030 energy and climate framework and opens up enormous opportunities for investors in the clean energy transition. From 2020, each Member State will produce detailed National Energy and Climate Plans that will engage them on concrete commitments on energy transition and greenhouse gas emission reduction. Drafts are now being assessed by the Commission who will issue recommendations next June. Plans will be fundamental points of reference to increase predictability for 10 years to business and investment in particular sectors and technologies.

The direction of travel is decarbonisation of Europe by 2050. With the 2030 package and without any further policy change we will only reach 60% reduction in GHG emissions by 2050. So in reality more action will be needed in all fields post 2030. The EU’s legislative framework provides the predictability necessary to mobilise private investments at the necessary scale.

The new Renewables Directive strengthens investment certainty by preventing retroactive changes in support schemes. The new Electricity Market Design Directive strengthens market access for renewables and introduces effective demand response enabling renewables (RES) to become the backbone of our electricity system. It phases in a balancing responsibility and phases out priority dispatch eliminating market distortions. It obliges Member States to de facto increase cross border electricity trade by imposing among others a new min threshold of 70% in capacity allocation. The electricity market rules will also provide the first EU framework for capacity mechanisms taking into account the regional dimension. This ensures they are a last resort measure minimally distortive to regular market functioning, while phasing out carbon intensive generation capacities. Gas generation, including low carbon gas, will also be used as a means to accompany the transition out of coal power generation. This will require investments as outlined in the EU’s gas infrastructure strategy.

As regards the demand-side huge changes will take place on energy efficiency for buildings and on mobility. Buildings account for 40% of total energy consumption and around 75% of the EU buildings are energy inefficient. The Energy Efficiency Directive and the Energy Performance in Buildings Directive require higher renovation rates. Long-term renovation strategies of Member States will provide clarity on the decarbonisation of the building stock through: (a) provisions on “nearly zero-energy buildings”, (b) strengthened energy performance certificates, (c) provisions on the low-emission mobility strategy (e.g. adequate charging infrastructure for electric vehicles), and (d) the smartening of buildings through automation and controls. Finally, ecodesign and energy labelling regimes continue to stimulate consumption of more energy-efficient products. All these measures provide investment opportunities in developing and deploying new technologies and services. Moreover the clarity these measures provide will materially diminish regulatory risk and have a direct, positive impact on project risk assessment and the consequent cost of capital.

The transformation of mobility will be another area where ground breaking developments will take place in the next decade. Electrification of private cars, development of a European battery capacity and hydrogen solutions for cars and other heavier vehicles are only examples of areas where dramatic investment opportunities take place. In an >>>

>>> example of increasing “sector-coupling”, greater (low carbon) gas use, including from electricity, will also enter maritime fuel consumption, together with increases in biofuel in maritime and aviation in the long-term.

Although private investment is expected to finance most of these needs, public finance will continue to play an important leverage role. The Commission has proposed that 25% or EUR 320 billion of the EU budget should contribute to climate action in 2021-2027. Indicatively this will break down to approx. €85bn through structural and cohesion funds, €34 bn of the Horizon Europe budget and 30% or approx. €195 bn of the investment generated under the Invest EU budget will be dedicated to climate change and energy transition.

With detailed plans and strengthened measures, investment in clean energy becomes clearer, safer, and thus cheaper. It is now time to bank on the opportunities provided and so steer the financial system towards becoming integral part of the energy transition. ●



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Pace over perfection - accelerating EU long-term sustainable investments

Progress has been made on the EU sustainable finance agenda and most importantly: the collective awareness of all players - the financial services industry, investee companies and investors - is shifting, as they all increasingly focus on sustainability.

Despite this improved awareness, the absence of universal agreement on taxonomy remains a major impediment to achieve greater levels of sustainable investment in the EU. Major efforts have been made, with close collaboration between regulators, governments and the financial services sector, however more progress is essential.

At present, there is no commonly agreed definition as to when an investment can be considered sustainable. The European Commission’s taxonomy proposal aims to overcome the uncertainty by establishing an EU-wide classification system to identify which conditions need to be fulfilled for an activity to classify as sustainable. The creation of a system that is fit for purpose, is therefore the most critical piece of the puzzle we need to get right.

The secret to success will be striking the right balance between a nuanced, yet not prescriptive system. It should allow for flexibility to accommodate innovations in technology, science, product development and investment strategies. The greater the flexibility, the greater the diversification potential and hence, choice for the end investor.

As we navigate the challenges to creating such a taxonomy, it is important to take the following principles into consideration:

First: timing - pace over perfection. It may take some time to complete the taxonomy, especially to achieve coherence at the international level. Nevertheless, it is important that industry and policy makers progress with implementing the system to the extent that they can, instead of waiting for an optimal global framework to be completed. This >>>

>>> will bring about change quicker. The development of a taxonomy is a reiterative process that will need to be perfected over time.

Second: non-binary classification - engagement over exclusion. The taxonomy aims to identify what sustainable economic activities are. In reality, the lines are not always clear-cut. Hence the taxonomy needs to capture activities that may not yet be considered fully sustainable but could become sustainable in the near future through a clear roadmap. Asset managers have a key role to play in the process through active engagement. If the aim is to make EU long-term sustainable investment strategies more “bankable”, the taxonomy needs to be as wide as possible to catch a genuine breadth of economic sectors and activities. Asset managers - through their investment process and engagement skills - can then incentivise companies towards a more sustainable behaviour. If definitions are designed too narrowly, they may limit the ability of having a thematic or positive impact.

Third: ratings and research - taking a differentiated view. As investee companies are embracing non-financial disclosure practices, a more transparent, detailed and comparable data set is becoming available. This will allow asset managers to translate the data into financial investment metrics. To accelerate the EU’s long-term sustainable strategy, developing appropriate sector and asset class specific rating systems and benchmarks is key to help move each asset class and sector forward at its own pace. For example, classifications may be easier to establish for sovereign green bonds and infrastructure investments. For corporate green bonds or equities, it is more challenging: specific instruments issued could be considered sustainable, however, the overall issuing or parent company may not fulfil the same level of green criteria. In combination with active company engagement by asset managers, corporates can become more sustainable, having overall positive impact.

Lastly, and very importantly, asset owners - both retail and institutional - will be critical for the success of the EU’s long-term sustainability strategy: their preferences ultimately decide how capital is channelled into the economy. With a robust and workable taxonomy, public and private stakeholders will be better able to deliver on identifying their preferences, improving suitability related client communication, investor education and overall enhancing awareness of sustainable finance among asset owners. ●