

# THE EU LONG-TERM SUSTAINABILITY STRATEGY

## 1. Is there sufficient clarity and consistency between EU strategies and member states?

### 1.1. Predictability and clarity of EU policies to favour a much bigger pipeline of bankable investment opportunities

A policy-maker stated that currently there is no other subject that is more interesting from the political viewpoint and in terms of public opinion. Sustainability has never been so high, and young people demonstrate in streets across the world. According to the latest Eurobarometer 95% of EU citizens say the environment is their top priority, and 66% say that the EU should do more. At the last Davos World Economic Forum, the top three risks for the business community were linked to climate change, the environment and sustainability, far ahead of cyber, economic crises or protectionism. Sustainability is on the table, and for the first time, sustainability and climate are topics for the next European elections.

The Paris Agreement, the Sustainable Development Goals agenda, the circular-economy strategy and the long-term strategy on climate and energy are all setting the way forward with ambitious targets that require a significant financial contribution. The state of public budgets and finances is well-known, and everybody is looking at the financial sector to make this happen. A policy-maker added that \$180 billion per year is the figure which has been estimated in order to achieve the Paris Agreement, but if the investment needed in water, biodiversity, the circular economy and clean air is integrated then this figure is around \$320 billion. The EU will not succeed in the fight against climate change if it neglects the protection of biodiversity, investment in the circular economy, water and air quality, and nature. All of it has to form part of an overall strategy, and climate change cannot be dissociated from the rest. Sustainability is a much wider concept and all the elements need to be embraced.

The European Commission is working on the green-bond standards, on the EU Ecolabel for financial products, and on integrating sustainability in ratings and in prudential requirements. Exploration is needed on whether there is sufficient clarity and consistency between the EU and member states' sustainability strategies to provide investment predictability, particularly in order to avoid the risk of stranded assets. If the answer to that question is yes, then discussion is needed on why it is not being translated into a much bigger pipeline of bankable investment opportunities than is currently the case. There also needs to be discussion on what needs to happen, the challenges and barriers, opportunities, whether more or less should be done from a regulatory viewpoint, and whether regulation should be avoided or intensified.

### 1.2. Energy union strategy

A policy-maker stated that the long-term sustainability strategy of the EU is not only bankability but also compatibility with the capital markets union. It is one of the areas where in some cases it is closer to the banking system, in some cases it is closer to institutional investors, and in other cases it is both.

The strategy is now at a very good point from an EU point of view. The Energy Union Strategy has been created, which has established very specific targets and governance systems for 2030. There are concrete legislation, targets and policy objectives for 2030. The EU has also established a

degree of direction for where it wants to be by 2050, which is a completely decarbonised Europe. There is a strategy for the next decade. The energy sector has targets on energy efficiency, greenhouse-gas-emission reduction and renewable-energy introduction, but the EU has also a governance system whereby it will monitor what every member state is doing and is committed to doing, and then review the implementation between 2023 and 2027.

Europe is very close to achieving the 2020 targets on energy efficiency and greenhouse gas emissions, and in some cases over-achieving them. They are not linear, so achieving the 2020 target does not necessarily guarantee that Europe will achieve the 2030 targets. There is a good starting point and a good trajectory up to 2030, but the difficulty going forward is important in many areas. If the 2030 targets are achieved and there is no policy change after that then by 2050 greenhouse gas emissions will only reduce by 60%. There is a gap that needs to be addressed between 2030 and 2050.

A policy-maker noted Europe is ambitious, particularly its public. In the last four years the European Commission has made proposals to increase renewable energy by 27%, energy efficiency by 30% and car efficiency by 30%. It was outmanoeuvred by the European Council and European Parliament, which is very rare, as the targets were deemed too low. The Council raised the bar, so Europe is now faced with an increase to 32% on renewables by 2030, 32.5% higher on energy efficiency; and 37.5% for the car sector. That will have an immediate effect on the investments that are going to be required in the coming 10 to 15 years. The \$180 billion figure is the number that the Commission stated when it put its proposals on the table, but it is not what the public sector can do. The EU can provide around \$40 billion, so help from the private sector is needed.

European Commission strategy is bankable but also very holistic. It does not fit with the priorities of every investor. There are parts of the energy strategy that require steady investment. An investor with a profile of investing in utilities will be very attracted to that. The same is true for investors who invest in buildings, mortgages or securitisation structures. There are segment of the market and of the energy transition that are attractive to conservative investors, but there are also other more dynamic investment segments that are linked to innovation, such as hydrogen development and new technologies. This holistic approach does offer an investment opportunity for everybody provided that each investor engages in the segment of the market that fits the needs of its client or shareholders.

A policy-maker believed that it is a dynamic environment in many areas where innovation is needed. The EU needs to remain open to innovation. In this respect, there are certain things that can be done at EU level and certain things that have to be done at member-state level. Not everything can be done in Brussels, and the EU needs to rely on this partnership and ownership at the level below. It is the case for innovation strategies that have to be done regionally. If they do not work then the EU needs to give incentives, but there needs to be an aggregation of things at the lower level and a balance. There is an upfront cost, not all of which has to be passed to consumers or end-users. Those costs have to be smoothed out because the net benefit of this strategy is positive for consumers.

## 1.3. Areas of investment

A policy-maker stated that there are six areas that are important within this package. The first area is the important element of energy efficiency. Huge investment has to be made in the energy efficiency of buildings. 66-75% of investment that is needed over the next decade is in energy efficiency. This is difficult for commercial real estate, because all commercial real-estate investors are already investing in the energy efficiency of buildings as it pays off in terms of running costs. However, it is more difficult for private housing stock because of administration and urban regulations, and the lack of a unified mortgage market in Europe. Initiatives need to be taken on the financial markets side as well as in terms of regulations and administrative procedures in order to ensure that the renovation of buildings picks up speed. By the end of the year member states will be obliged to present building renovation strategies so that member states will have a clear commitment around how many buildings and with what rhythm, incentives and policies they will stimulate building renovation.

The second area is renewable energy. Around 20% of European energy comes from renewables, but by 2050 it is predicted to be at least 80%. Renewable energy will triple from where it is today. The deployment of renewables also has an additional advantage in that it reduces Europe's energy import bill. The third area is mobility, which will change drastically under all scenarios. A large part will be electrified but it will not be the only technology available. The fourth area is that industry has to remain competitive and be sustainable, so there is a huge engagement of industry in this area. The fifth area is the smart network and related infrastructure. The European Commission has almost completed its infrastructure for the cross-border movement of gas but has not yet completed its infrastructure for open borders for electricity within Europe. Investment in electricity networks is needed, both in terms of physical infrastructure and the smartness of that infrastructure. The sixth area is a huge room for involvement in new technologies.

## 1.4. Transparency should help leveraging the role of investors to foster sustainability

An industry representative believed that from an asset manager perspective there are three aspects that are key to making sustainability more bankable. The first element is to create the right investment parameters and taxonomy. The second element is the need to standardise and accelerate meaningful company disclosure. The third element, which is the most important, is the need to incentivise or even generate investor demand.

Asset managers play a key role in developing these three areas because they play a key role in the financial ecosystem. They allocate the capital and are protectors of their clients' money, especially long-term savers and pensioners. Asset managers act as a steward of shareholders' interests through active engagement, representing the interests of their clients in the individual investee companies. It is important that these companies and asset managers invest and operate on a sound and profitable basis, and sustainable factors will become more and more important.

The basis of all investment parameters will be the taxonomy. If the taxonomy is right, then it also creates comparability at the investee-company level. It is important that a flexible taxonomy is developed that is nuanced rather than a classification system that is too restrictive, because there is a need to allow those companies that are not yet green but that have a climate trajectory to be included rather than excluded. If they are not, then too many economic activities would fall outside the investable, sustainable universe. Active

engagement is most important, and asset managers can move companies who are underperforming into environment, social and governance (ESG), as well as raising their financial value.

Active engagement with investee companies is critical to changing behaviour as well as encouraging disclosure. Divestment is not the answer in terms of companies that are not green yet, because it not only limits the universe but will not make a change and will not allow Europe to reach the environmental targets that it has set. Active engagement is needed.

Last year, asset managers representing 11.5 trillion of assets wrote two open letters published in the Financial Times. The first letter asked for the oil and gas sector to take responsibility for all of its emissions, and the second letter went to utility and power companies, encouraging them to accelerate decarbonisation and the transition. The sector welcomes the Technical Expert Group on disclosure reporting, because it aligns the Non-Financial Reporting Directive (NFRD) with the Task Force on Climate-related Financial Disclosures (TCFD). If more companies measure and meaningfully disclose then there is more that asset managers can include in their investment processes.

Investor clients ultimately direct the capital that is managed on their behalf. Identification of sustainability preferences is needed, in addition to raising awareness. There is a strong educational element to that in terms of explaining how these EU policies impact them. More focus is needed on raising awareness of what the specific investment opportunities are. It goes slightly into the marketing area, but it is also simply understanding the policies and making them more visible to the end investors. Asset managers can play a key role because they continuously talk to investors.

An audience member asked why the EU does not package and create retail financial products in terms of sustainability, and believed it is very difficult for a citizen to buy a sustainable financial product. An industry representative explained that asset managers are looking to offer more products in the retail space. More can be done to explain what is green and what is not, and to design and label funds. There is no universally agreed standard for funds; a suggestion is to have a spectrum that would allow for the indication of how green a fund is, which would give the consumer the option.

## 2. Long-term views and perspectives

### 2.1. How urgency can be balanced with a long-term outlook

An industry representative believed that there is no alternative but to act as soon as possible. One important point in the landscape described by a policy-maker is the fact that in the future new energy and energy efficiency will come from decentralised sources. It will not be a single site; energy efficiency needs to be built into every building, everywhere. A long-term strategy and investment vision is needed, which is why it is so difficult.

Sustainability is a 'nightmare' for the industry and for finance because there is a lack of predictability. 20 or 30 years ago, nobody could have predicted the situation Europe is currently in, which is also being accelerated. There is a contradiction between transition and an emergency, where Europe currently is. There is a feeling of inconsistency between some Key Performance Indicators in finance around accountability, prudential ratios and what needs to be done. In this sector there is also lots of political interference.

There is a need to finance small projects for the long-term. Financing small projects is very expensive. For this, the industry needs to have people who are able to leverage with the private sector, and actors who have a key role as enablers. The public finance sector can be part of that.

The sectors where the EU needs to invest are in energy efficiency and renewables. About 75% would have to be invested in energy efficiency, residential buildings and tertiary buildings. Despite the fact that there is a regulatory framework, there are lots of degrees of freedom given to member states around how they are going to implement that. At the highest level there is certainty for private sector investment, but in detail it is now up to member states to state how that is going to be implemented. National Energy and Climate Plans detail how member states are going to implement the proposals by 2030. The proposals themselves might not be detailed enough to be bankable for the banking sector. There is more work to be done; that is where the private sector and investors should clearly signal to member states that they need to be clear about how they want to achieve those targets, because that is not mentioned in the EU legislation.

## 2.2. Improving EU financing mechanisms, and in particular EU and national public funding involvement

An IFI representative stated that the investment needed is \$250 billion per year. It is about 1.5% of GDP of the EU. The EU is running a current-account surplus that is vastly bigger than that, so it has savings that could be financing that. There has been a very dramatic change in the EU energy system from 20 years ago. That change is essentially based on innovation and improvement in existing technologies. It is not just a question now of developing the technology that exists currently, but also of having to take care of innovation for the future. This is higher risk and a big technology challenge, but this is the field where there is significant need for investment.

In the energy sector the vast majority of the system is organised so that the end users of energy pay. It is not useful to dream up subsidy mechanisms that may not be sustainable. The EU should try to target public resources where it can make a difference, and private finance solutions can deal with the rest. A large proportion of needs are in the energy efficiency sector.

The first problem in that sector is information. Most of the owners of those buildings do not realise how much it costs, whether it makes sense, what it really entails or how to organise finance. Creation is needed of a proper way for pure, straight information. Viewed from the perspective of finance, the EU has to deal with a very granular system of loans or financing requirements. Smart aggregation mechanisms are needed to deal with that. Securitisation is not very popular, but it is a tool on which reflection is needed.

The InvestEU mechanism is going to be the workhorse of EIB activity moving forward in that sector. The EIB does not see itself as just financing; its role is to try to catalyse others to participate in financing. The EIB's means are too small to be able to play a big role on its own. Regarding reconciling ex-ante emissions with ex-post benefits, the answer is long-term investors with huge assets that are able to be amortised over a long period. The InvestEU programme is excellent because it enables national promotional banks or institutes (NPBIs) to have direct access for at least 25% of the EU guarantee.

An IFI representative noted that the EIB has launched its review of the energy-lending policy, and encouraged anybody with a keen interest in the energy sector to communicate with it. The easiest way to do so is via the website.

## 2.3. The importance of carbon price signals in addition to optimised financing mechanisms

An industry expert explained that a huge amount of investment is needed to succeed in the energy transition. Many sectors are involved, such as energy, transportation, buildings and industry. Giving a significant price to carbon will lead to a

reduction in activities which are becoming too costly due to its use.

The EU is presently targeting the volume of emissions permits in the framework of an Emissions Trading System (ETS). The recent reduction in its volume has led to an increase in the price of carbon, which increased to €25 per tonne, but has already decreased to €21 per tonne. The price of carbon remains very volatile. What is needed to allow sustainable investment to change gears in the EU is a long-run, predictable carbon-price signal at a speed which is economically and socially acceptable, but which leads to true energy transition. A taskforce for carbon pricing in Europe has been created, made up of firms, think-tanks and academics from all EU countries in order to push this idea at the European level.

A Central Bank official believed the EU has been lucky because Central Banks have greatly helped it in alternative energy. However, it is unlikely that there will be such low energy prices for the next 20 years. A carbon price is needed. Industry players in Austria have stated that the Commission's trading system is a failure, because a reliable long-term price is needed in order to plan in advance. To invest now it is important to know where the carbon price will be in 20 or 30 years, and with the trading system that cannot be achieved. What is needed is a carbon tax which starts at a certain price and increases reliably every year. The income from this carbon tax could be given back to the population. In Austria and most other countries there is a huge tax on wages; if it is given back to lower social-security contributions then there is a change.

A policy-maker believed it is not that easy. Something the EU never expected is the fall in the cost of technology for renewable energy. That has been seen in Europe, with member states setting a particular price on electricity which was foreseeable for many years but was probably the most gold-plated policy ever seen in the EU. It was effective, but consumers are still complaining today. That is the beauty of the ETS, because the price and the price formation take the two aspects into account. It also looks at how cheap the technology is going to be. If the technology is getting cheaper and cheaper, then that high carbon price is not needed.

A policy-maker stated that since the late 1980s the European Commission tried for 10 or 12 years to introduce a carbon tax. It has been impossible to get this through Council and Parliament because of the unanimity. The carbon tax that would be established through an inter-institutional process would not be what would be required in order to get the technologies going. Since then it has tried twice more, but it is not working. However, it is working at national level. There is a carbon tax in Sweden and Norway, which works very strongly because those countries have pushed certain technologies.