Natalie Westerbarkey

Head of EU Public Policy, Fidelity International

Covid crisis accelerates shift towards sustainable capitalism and new economic order

The global COVID-19 pandemic crisis has clearly accelerated the shift to incorporate environmental, social and governance (ESG) criteria into investment processes by asset managers. Data from Fidelity's proprietary ESG rating tool launched in 2019 shows that corporates with robust ESG ratings have suffered less financial loss on average and outperformed those with poorer ones. The correlation of ESG factors with financial performance is also increasingly evident in data published by international providers.

As a result, sustainable capitalism is on the rise and investors have a growing financial interest in embedding ESG factors into their portfolios, as the maximisation of shareholder returns at any cost no longer leads to the desired financial output. Such insight is not new; corporates with robust governance have traditionally been considered better long-term investment targets. The same applies for corporates with a strong track record on social issues, such as labour and human rights, and on mitigating their environmental impact. Ignoring these areas, we know, can result in corporate failure which ultimately destroys financial returns.

The newer aspects are the increasing investor awareness of the global interrelation between the E, S and G factors and a greater understanding of just how swift and decisive the impact of these factors on financial returns can be.

The adoption of new EU and global ESG policy frameworks provide greater clarity for investors, corporates and consumers on a common approach of what exactly constitutes sustainable finance. Hence, new ESG policies represent indispensable guidance for international finance. International finance, however, encompasses both private and public sector investments. Therefore, it is crucial that public sector actors also apply ESG standards when investing in corporates, especially where companies benefit from the large Covid-19 recovery packages provided by the EU and member states. Otherwise, it would create an unlevel ESG-playing field between private and public sector players resulting in weaker corporate and economic resilience to future shocks.

Citizens should be given the opportunity to benefit financially from this shift towards more sustainable sectors and participate in the economic recovery. This can be achieved in form of retail equitization programmes, for example, through the existing European Investment Bank's EFSI projects - the European Fund for Strategic Investment. Investor education and public awareness are key components for this initiative to succeed. The financial sector as an intermediary has an important role to play too. Fidelity recommends promoting such projects and their investment opportunity as part of the CMU, the EU's Capital Markets Union initiative. One major goal of this framework is shifting finance of start-ups, small-medium size enterprises (SMEs) and large corporates from bank to non-bank funding. However, investor capital needs to be channelled from deposits into equitization opportunities in a way that enables broad participation in future economic growth, while also ensuring investors understand the potential risks.

Given its strong governance and EU-budget guarantee, the EIB EFSI could be one such channel. The EU's European Investment Project Portal and Advisory Hub could also be used to focus on financing projects that contribute to the European Green Deal, as the High-Level Forum report proposed in June 2020. Most importantly, any equitization opportunities need to be easy to understand, relatively low risk and visible to institutional and retail investors - especially those concerned about low and negative interest rates, who are seeking an improvement on their existing returns.

Time is of the essence. Setting up a European centralised information repository of EU listed companies - including transparency on their ESG data - should be a priority to make these investment projects accessible to investors quickly. This could build on the historic momentum of the EU Recovery Fund deal agreed by EU leaders in June, which aims to be operational from 1 January 2021.

Taken together, these initiatives will help economies, companies and investors chart a more sustainable course out of the Covid-19 crisis towards a new economic order, using the UN's Social Development Goals as blueprint for the 2020s decade. In this new era, only those corporates with a robust sustainable agenda across E, S and G will be able to attract significant investor capital and deliver long-term financial outperformance. ●