Have the prospects of global and EU ESG policies changed with the Covid crisis?

Ambroise Fayolle

Vice President, European Investment Bank (EIB)

Covid recovery and green transition are no zero-sum game

Economic recovery from the COVID-19 slump should not be seen as a zero-sum game. The urgent need to bring life back to our economies should not come at the expense of our climate and environmental ambitions – those two objectives should reinforce each other.

After all, climate investment always carries with it additional benefits. Automated, electric cars, for example, cut greenhouse gas emissions, but they also reduce accidents from driver error, decrease noise pollution and improve air quality. We should direct our massive stimulus packages towards investments that reorient our economies toward climate and environmental action, at the same time as they boost jobs and growth.

We must ensure that stimulus packages keep the world on track to meet the Paris Agreement targets. We must protect the environment, help the most vulnerable countries around the world and ensure that business has a sustainable future everywhere. Failure to do so will have severe long-term consequences for our societies.

The European Investment Bank Group's role as the EU climate bank is to stimulate a green recovery. We have long lead the way for climate action. Last year, we stepped up our climate ambitions by committing to:

- end the financing of unabated fossil fuel-based energy generation
- align all financing activities with the Paris Agreement by the end of 2020
- dedicate at least 50% of our annual financing to climate action and environmental sustainability by 2025
- catalyse €1 trillion of climate action and environmental sustainability investment in the next decade.

We know we can do this. Only a few months ago, the amounts necessary to finance climate change seemed so great that many doubted the money could ever be found. Yet the COVID-19 stimulus packages are larger still. And the result will be jobs. According to a report backed by the Global Commission on the Economy and Climate[1], a partnership of seven developed and developing countries, low-carbon growth could offer economic benefits of $26 trillion by 2030.

The European Investment Bank has a strong foundation in green and sustainable financing. Since we pioneered the world's first Climate Awareness Bond, we have issued close to €29 billion of green bonds. In 2018, we issued our first sustainability bond to support projects that back social and environmental investment. Coronavirus has not slowed us down. Even since the lockdowns started in March, we have issued well over €4 billion of these thematic bonds, exceeding the entire volume of 2019.

Just as we were already central to this shift towards green financing, we have also recognised that it is good for jobs. We are sure the green transition can contribute to economic recovery from COVID-19 by creating more jobs, building new and fast-growing industries and promoting greater competitiveness. Again, even before COVID-19 struck, we were on this path. The EIB Group is an important partner in the Just Transition Mechanism to support those who may be adversely affected by a structural shift away from carbon-intensive activities. That commitment remains strong. And when the EU bank makes a commitment, it has significant impact. Since 2012, we have provided about €170 billion of finance to support over €600 billion of investment in projects that reduce greenhouse gas emissions and help companies—from the smallest start-ups to international conglomerates—adapt to the impacts of climate change.

Ours is a global commitment, not just to climate action, but also to innovative strategies that open up new markets to environmental investment. Two years ago, we committed $100 million to the Green Bond Cornerstone Fund, which is expected to significantly increase the growth of green bonds in emerging markets. Last year, we invested €60 million in the Amundi European Green Credit Continuum Fund, which aims to broaden the credit spectrum of green bonds and loans beyond its previous focus on large investment grade issuers. COVID-19 has shown us what is truly important in our lives, as each of us has to make some sacrifices to protect those most vulnerable to the disease. Let us carry that solidarity with us as we confront the great challenge of climate change. ●

1. https://newclimateeconomy.report

Sirpa Pietikäinen

MEP, Committee on Economic and Monetary Affairs, European Parliament

Sustainable finance is the answer for Covid-19 recovery

260 billion euros are needed annually in the EU by the end of this decade in order to reach climate and energy targets. A common misconception is that this will require drastic additional investments. On the contrary, tools, resources and money already exists. Total assets under management in Europe in 2019 were estimated at 23 trillion euros. The global assets under management are around 90 trillion dollars.

Corona recovery measures in the EU and Member States reached 3 trillion euros within just a few months, even before the planned Recovery Package and Commission's proposal for Recovery Instrument, Next Generation EU. In this perspective, the annual 260 billion seems rather achievable. Moreover, sustainable transition makes financial and economic sense.

The Global Commission on the Economy and Climate estimated that climate action stands a chance to deliver over 26 trillion dollars in economic benefits. The return on investment in carbon neutral and circular technologies and infrastructure is estimated to be multifold, over 7 trillion dollars by 2030.

It is becoming clear that sustainability risks have a financial impact on assets. By 2100, expected financial losses could amount to over 4 trillion dollars in present value terms, according to a study conducted by Economist Intelligence Unit in 2015. A 6°C scenario could put 13.8 trillion dollars at risk, threatening 15 percent of global assets under management, and therefore posing a risk to the financial system as a whole. Recent studies hint that the systemic risk might put in risk a third of the financial markets.

In order to integrate sustainability risks and impact within investment decisions, or for authorities to decide on large-scale projects or public procurement tenders, there is a need for a robust toolbox to assess risks and to measure impact. All public money spent should follow the EU taxonomy classification in order to create effective coherence between public and private resources. Zero-euro should be used supporting fossil economy and environmentally harmful activities. This means the full respect of Do Know Significant Harm principle and gearing at least 50 % of investments to climate and environment transition.

The newly adopted EU Taxonomy is a revolutionary step towards correcting the way financial sector and the real economy can price in environmental externalities. The sign-off of the landmark regulation in June puts the EU in the forefront of global sustainable finance agenda, both in public and private sectors. Greening the financial sector is becoming an urgency in order to make investment decisions that affect generations to come.

We need comparable sustainability data based on robust standards built on harmonized sustainability indicators that measure key aspects of sustainability of an economic activity, using a common methodology. Relevance of each indicator varies from one industry and sector to another, the core environmental calculation system should consist of measuring key aspects of production, consumption and resource efficiency: use of resources, water consumption, direct and indirect land use, emissions including CO_2 emissions, production and treatment of waste, and the impact of an activity on biodiversity.

> *EU Recovery Plan and the next Sustainable Finance Strategy are the opportunity to speed up the necessary transition into a sustainable economy.*

The next step in Sustainable Finance strategy should be the development of integrated reporting and accounting standards that equip different stakeholders, from corporates planning investments in the real economy to financial intermediaries making investment decisions or managing assets on behalf of asset owners, to end investors, public authorities and the civil society, with tools to make informed decisions regarding where money is spent.

It is our duty to ensure that these recovery trillions are spent sustainably in the long term. No euro should be spent on unsustainable economic activity or businesses. Otherwise we will be leaving to future generations both public and climate debt. For this we need the tools for assessing the environmental impact of an investment and public spending more than was thinkable when the EU taxonomy was proposed. EU Recovery Plan and the next Sustainable Finance Strategy are the opportunity to speed up the necessary transition into a sustainable economy. Covid-19 and the recovery financing can be a virtue in the vice. Circular economy and sustainable finance – a match made in heaven. ●

Verena Ross

Executive Director, European Securities and Markets Authority (ESMA)

Enhancing sustainable finance through better disclosures

Sustainable finance remains a strong priority for ESMA as also highlighted in our recent Strategy on Sustainable Finance[1]. Under the political direction of travel set by the co-legislators, ESMA and national securities regulators look at this important issue with their mandates to prevent threats to financial stability and ensure investor protection in mind. This mandate is very relevant for the adjustment of financial markets to the risks arising from climate change and the associated transition to a more sustainable financial system.

In parallel, financial markets are at a point of change, as investor preferences shift towards financial products that incorporate Environmental, Social and Governance (ESG) factors. This trend has become clear in European equity and bond markets. Since the beginning of 2019, ESG equity funds domiciled in the EU attracted net inflows of €54 billion, compared to outflows of €128 billion for other equity funds.[2] The growth of the European private-sector green bond market also far outpaced that of the broader corporate bond market, but the supply of such bonds still falls short of current investor demand.

At this critical juncture, transparency is key. The EU Disclosure Regulation sets out relevant requirements for a broad range of financial market participants, financial advisers and financial products, often supplementing existing sectoral rules for these actors and products. The aim of this regulation is to strengthen protection for end-investors and improve disclosures to them.

ESMA is working with EBA and EIOPA to create Technical Standards under this Regulation on which it has recently launched a public consultation that closed on 1st September. In the Consultation Paper[3], the proposed requirements can be broadly divided into two themes:

- Principal adverse impact reporting at entity level: these are disclosures of principal adverse impacts of investment decisions on sustainability factors – including detailed indicators for environmental and social impacts; and

- Pre-contractual, website and periodic product disclosure: applicable to products with either environmental or social characteristics ("light green") or with sustainable investment objectives ("dark green").

In addition, the recently published EU Taxonomy Regulation has added many new empowerments in the Disclosure Regulation, including on the "do not significantly harm" principle and on product-related taxonomy disclosures.

However, investment firms are only a part of the ESG disclosure spectrum. As ESG investing becomes more popular, we need to ensure that market participants are provided with relevant and reliable disclosure also by non-financial companies, to enable comparisons across different companies and sectors. It is also important to ensure that disclosure requirements are consistent across the whole investment chain, covering both investment firms and the companies they invest in.

ESMA has consistently called for better corporate ESG disclosures, most recently in our response[4] to the European Commission's consultation on reviewing the Non-Financial Reporting Directive (NFRD). There are currently multiple disclosure frameworks, and ESMA considers that a consolidation is required, which should also take full account of the need for connectivity between non-financial and financial reporting. The medium-term goal should be a single set of international standards, as this will be most helpful for companies as well as investors given the global nature of both financial markets and sustainability challenges. In the short term, ESMA acknowledges that standardisation is needed at European level to meet the immediate investor demand for more useful company disclosures. ESMA therefore welcomes the European Commission's initiative to start looking at European standards for company disclosure and encourages the Commission, in parallel, to continue pursuing the international track to pave the way for one global disclosure standard for companies. ESMA stands ready to assist these European efforts by undertaking any standard-setting work in this important field. ●

1. https://www.esma.europa.eu/press-news/esma-news/esma-sets-out-its-strategy-sustainable-finance
2. Morningstar data and ESMA calculations
3. https://www.esma.europa.eu/sites/default/files/jc_2020_16_-_joint_consultation_paper_on_esg_disclosures.pdf
4. https://www.esma.europa.eu/sites/default/files/library/esma32-334-245_response_to_ec_consultation_on_revision_of_nfrd.pdf

John Berrigan

Director-General, DG for Financial Stability, Financial Services and Capital Markets Union, European Commission

Sustainable finance is the key to a sustainable future

The EU Action Plan on Financing Sustainable Growth is a priority of the Commission's Capital Markets Union (CMU) Action Plan, and one of the key steps in implementing the Paris Agreement and the EU's Agenda for sustainable development. The sustainable finance strategy will also play a key role in the recovery from the economic fallout of the COVID-19 outbreak. We must bounce back from this pandemic and use the opportunity to redesign parts of our economies. Our sustainable finance work is integral to the EU Green Deal and Next Generation EU. Our sustainable finance taxonomy is what will guide investments under Next Generation EU into an environmentally sustainable recovery.

The sustainable economy transition requires significant investment across all sectors. Reaching the EU's current 2030 climate and environmental policy goals would already require additional investments of approximately €470 billion a year by 2030. Private investment is key. The EU budget and Member State public spending can provide some of this massive investment, but not all. Only the private sector can provide the scale. This is why we need laws to unlock that private investment and for the financial sector to channel it effectively. The Commission will lead the global work in this area and help sustainability-conscious investors choose suitable projects and companies.

We have already made great progress on our key: the Taxonomy Regulation establishes the first legislative framework that defines what environmentally sustainable economic activity is. Two new categories of EU climate benchmarks were created and ESG disclosure requirements for benchmarks proposed. The Disclosure Regulation was adopted in spring 2019. It requires financial market participants and advisers to provide sustainability disclosures to end-investors. This list is not exhaustive. We are picking up successes as we move forward step by step.

The EU is leading the way in this field. Given the challenges and the enormous investment needed worldwide, global financial markets have a greater role to play. This is why, in October 2019, the EU, together with Argentina, Canada, Chile, China, India, Kenya, and Morocco launched the International Platform on Sustainable Finance. In 2020, Indonesia, New Zealand, Norway, Singapore, and Switzerland joined the group. It is heartening that the Platform continues to grow. It now unites 45% of the world's GDP and 50% of the world's population. Not a bad start.

To speed up efforts to reform the financial system, and to ensure that sustainability remains a permanent feature of EU policies, the Commission is setting up a new platform on sustainable finance that will begin its work in 2020. As a central forum for discussion, the platform will bring together private sector experts, market participants and public bodies.

> *Our work on sustainable finance is an integral part of the EU Green Deal and Next Generation EU.*

By the end of 2020, we will present a renewed strategy on sustainable finance that shifts focus to the real economy and corporates, as well as to public authorities and citizens - to give everyone the necessary tools to transition from brown to green. We will amend the Non-financial reporting directive to improve companies' climate and environmental data disclosure to better inform investors about the sustainability of their investments. We will strengthen companies' disclosure of sustainability-related information, the Eco-label for sustainable financial products, and incorporate sustainability in prudential requirements and the provision of financial advice. Citizens and retail investors can play a major role to finance the transition with the right tools. We will provide those tools.

The digitalisation of the EU financial system offers excellent opportunities in this sense. Financial incentives and new forms of private-public cooperation will be imagined and implemented. Climate and environmental risk management will be improved by integrating them into the EU prudential framework and assessing the suitability of the existing capital requirements for green and brown assets. It also means examining how the financial system can help increase resilience to climate and environmental risks, in particular when it comes to physical risks and damage arising from natural catastrophes.

We have come a long way, and we are moving ahead confidently. Sustainable finance is the key to a sustainable future, and we are wasting no time in building exactly that for generations of Europeans to come, as well as for those of the rest of the world. ●

Daniel Hanna

Global Head, Sustainable Finance, Standard Chartered

From sustainable finance to finance being sustainable

Covid-19 has had profound health, human, economic and financial impacts. It has also accelerated the focus on sustainable finance and the desire for a green recovery. Up to 90% of high net worth investors are now interested in sustainable investing, according to the results of our recent Sustainable Investing Review (https://av.sc.com/corp-en/content/docs/Sustainable-Investing-Review-2020.pdf), with 42% considering investing up to 15% of their funds in sustainable investments over the next three years. In March, during the height of concerns regarding the pandemic, we saw a record inflow from corporate clients into our UN Sustainable Development Goal money market deposit product. This trend is not unique to Standard Chartered's clients. Over 90% of sustainable indexes outperformed traditional indexes during the pandemic-led market downturn in Q1 2020 and many of those indexes continued to outperform during the rebound that followed. Exchange-traded funds focused on companies with above-average grades for ESG practices attracted more than USD10 billion in the first four months of 2020, more than all of 2019 combined.

The public sector has also given greater focus to sustainable objectives due to the pandemic. Globally, the Covid recovery package stands at over USD10 trillion. We believe it is vital that public money serves environmental as well as social and economic outcomes. The European Commission has taken encouraging and ambitious steps to integrate environmental principles into its recovery package. Helpfully, we are also seeing some emerging markets, the fastest growing source of new carbon emissions, adopt a similar focus on ESG. Malaysia announced a stimulus plan that includes USD2.9 billion for rooftop solar panels and LED street lighting.

The Philippines Central Bank approved a Sustainable Finance Framework to support the renewable energy transition in the wake of the pandemic. The African Union Commission and the International Renewable Energy Agency will collaborate to advance renewable energy to bolster the continent's response to the pandemic.

Progress is being made. But much more is needed. Our Opportunity2030 report (https://av.sc.com/corp-en/content/docs/Standard-Chartered-Opportunity-2030.pdf) highlighted the USD10 trillion private sector investment required for just 3 of the UN's Sustainable Development Goals – clean water and sanitation (SDG 6), clean energy (SDG 7) and sustainable infrastructure (SDG 9) – across 15 countries in Asia and Africa. While real economy investment is required, the finance sector needs to do more to mainstream ESG-led decision making to support a sustainable recovery and a low carbon transition. Our Sustainable Investing Review found that the most significant barriers to further sustainable investment are lack of information and standards.

More effort is required to increase, improve and harmonise data and disclosures from all sectors of the economy, in particular from emerging markets which are the most at risk from climate change but also represent the biggest sustainable investment opportunities. Information is improving thanks to initiatives such as the Task Force on Climate-related Financial Disclosures. However, the quality and consistency of broader sustainability data is often poor, non-comparable and inconsistently disclosed. In addition, sustainability metrics, models and methodologies need to be harmonised and made more transparent in order to inform investment outcomes and drive capital allocation to where it is needed most.

The Covid pandemic presents a unique opportunity to shape a green recovery and the future of finance.

Finally, we need to ensure international alignment to harness the power of global markets, financial innovation and to facilitate cross-border investment flows, specifically into emerging markets. These efforts need to be underpinned by the global adoption of definitions of sustainable economic activities, to give confidence to investors and to prevent "sustainability-washing". The latter has taken on a new level of importance as the market considers developing Covid-recovery instruments. The EU taxonomy marks a step forward and we hope to see regulatory convergence between markets. More work is needed, however, to develop science-based transition pathways covering all sectors and regions. These are not new challenges. What is new is that the Covid pandemic presents a unique opportunity to shape a green recovery and the future of finance.

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.

> *New ESG policies represent indispensable guidance for international finance.*

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. ●

Ann Prendergast

Managing Director, Head of State Street Global Advisors Ireland (SSGA)

ESG: a matter of value, not values

As a result of the Covid-19 pandemic, the world has dramatically changed: it is clear that industry must take a more holistic approach to ESG, as we remain engulfed by a pandemic, the effects of which will continue to pose profound social, political and economic challenges around the globe for years to come. Some argue that the COVID-19 crisis will be a catalyst for climate action, given that the speed with which events unraveled during the pandemic could bear similar resemblance to the effects of climate change. The question is then how fast we will see the repricing of assets and changes in the economy as a result of this action.

The crisis also underscores the importance of social issues, intensifying social and economic inequities where certain demographics are more vulnerable to the virus and economic shutdown. COVID-19 has escalated ESG issues, making them demonstrably integral to corporate resiliency. As fiduciaries of our clients' assets, State Street has a duty to act in their best interests and, increasingly, this includes consideration of ESG factors relevant to the performance of investee companies. Addressing material ESG issues is essential to a company's long-term performance – a matter of value, not values.

From an investor perspective, it is important to distinguish between "values-driven investing", i.e. strategies aligned with an investor's own ESG preferences that prioritise environmental or social impact over returns, and "value-driven" investing, which incorporates material ESG factors alongside other traditional financial metrics while still seeking to maximise returns (known as ESG integration). There is a growing body of research demonstrating the value of ESG integration in investment strategies: stronger cash flows, lower borrowing costs and higher valuations are common features of companies focused on managing material sustainability risks.

ESG issues have been growing in significance for some time, as structural shifts in economies and business models driven by technology are elevating the value companies derive from intangible assets, such as brand value and employee engagement. Traditional financial accounting is becoming less complete for investment decision-making, as knowledge-based companies leverage technology and talent as major sources of competitive advantage rather than the tangible assets of old-style manufacturing. It is hard to argue that investors should ignore companies' governance or their exposure to non-linear risks, such as climate change.

Now Covid-19 reinforces our view that social characteristics are a proxy for resilience. Our research illustrates that the stocks of companies with strong ESG characteristics – such as good employee safety practices, effective supply chains and agile operations able to repurpose products to meet new market needs – suffered lower declines during the March equity sell-off than the shares of competitors with comparatively weaker ESG characteristics. This indicates that ESG integration can be an effective means for promoting a long-term investment focus on value creation.

> *COVID-19 reinforces our view that social characteristics are a proxy for resilience.*

The public and private sector responses to the crisis serve as a timely reminder of how policymakers and financial market participants can collaborate to address critical challenges. With ESG, and sustainability more broadly, firmly at the heart of the EU's economic recovery, grey areas between material and non-material ESG issues must be resolved, to further facilitate the development of better metrics, methodologies and reporting standards. This cannot be fully achieved without greater international coordination, including leveraging the work of the Sustainability Accounting Standards Board and the global Task Force on Climate-related Financial Disclosures. Researchers are already making progress on ways to help investors better measure the financial impact of intangible ESG value drivers, such as human capital development. Improving the quality, consistency and comparability of ESG information is in everyone's interest and will clarify the relationship to financial materiality.

In an uncertain world in which ESG matters more, not less, to strong corporate resilience and sustainable performance, promoting material ESG considerations in investment decision-making is good for the long-term interests of all our clients.