

THE HUB MARKET INSIGHTS

NEWS AND VIEWS FOR INSTITUTIONAL INVESTORS

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Green finance, a way to transform the economy towards a more sustainable model.

Key takeaways:

- Green finance is a tool we can use to combat climate change and transform the economy. Such transformation will demand colossal investments.
- The European Commission has launched its action plan to channel the capital held by institutional investors and the savings of private citizens towards a sustainable economy.
- French institutional investors are already bound by Article 173 of France's Energy Transition Law and ahead of the rest of Europe when it comes to integrating ESG criteria into their investment processes. But much remains to be done, particularly in the field of reporting.
- Stronger promotion of clearer green labels could help retail investors better understand ESG risks and invest their money in more sustainable products

According to Philippe Zaouati, CEO at Mirova and Chair of Finance for Tomorrow, we need to redirect capital massively to fund the environmental transition and finance a sustainable economic model. Institutional investments and household savings are still not sufficiently focused on green assets.

Philippe Zaouati, can finance really play a role in combating climate change?

Today, we find ourselves in a fairly unusual situation. Our companies are grappling with a number of profound and extremely fast transitions. Climate change, which can be seen as one aspect of a general environmental transformation, is the most visible and perhaps the most threatening of these. If we are to respond effectively, our economies need to be transformed. They must allow the emergence of new economic models, new infrastructure and new sectors. This also implies we will have to support those sectors and regions where activity will decline.

Transforming the economy will require colossal financing, both in developed countries and even more so in emerging economies. The bulk of this investment



Philippe Zaouati,
CEO at Mirova,
Chair at Finance
for Tomorrow

capital is available. I am thinking of institutional investors looking for long-term investments. I am thinking too of household savings, particularly in Europe, too much of which is currently invested short term. Traditionally, the role of finance has been to match investment needs with financing needs. This has now become not just a business but a responsibility. I think that finance can, and must, channel this capital to where it is needed to transform our economies and combat climate change. If this is to happen, financial players will have to offer investors clear, comprehensible products, suited to their investment profiles, particularly as regards risk. These products must also perform, something that is now possible thanks to innovation and the development of the new economy. In the end, it comes down to investing in the solutions of tomorrow.



France has pioneered the regulation of green finance by asking institutional investors to factor ESG criteria into their investment decisions. Europe has also taken up the issue. The European Commission has launched its action plan on sustainable finance. What are its key principles?

The Commission published an action plan for the financing of sustainable growth on 6 March, drawn up following publication in January of the report by the High Level Expert Group on sustainable finance to which I contributed.

The action plan has three main planks.

The first is to redirect capital flows toward a more sustainable economy.

Having started by recognising that the problem is not the availability of capital but our collective capacity to channel it into sustainable models, the Commission sought to propose solutions to identify and direct flows. The first of these is the development of a taxonomy of “sustainable” assets, which will make it possible to create standards and labels for sustainable finance products that would encourage investment in sustainable projects, particularly infrastructure. The sustainability issue also needs to be incorporated into investment advice and the way firms address saver preferences. Finally, the last solution we put forward, was to develop benchmarks to guide investments, particularly on climate issues.

The second plank of the action plan is to **systematically integrate sustainability issues into the management of financial risks**. The Commission will even be looking at incorporating sustainability

issues into prudential requirements for banks and insurers.

Finally, the third plank is to **promote transparency and a long-term vision within the financial sector**, by bolstering the publication of information and accounting rules on sustainability and by encouraging more sustainable and long-term corporate governance.

Part of this action plan was implemented in May as a legislative proposal, currently before the European Council and Parliament. It includes measures to create a European taxonomy for sustainable assets by 2022, to integrate ESG criteria into the duties of investors and their reporting obligations and to define methodologies for climate benchmarks. At the same time an expert group, including a Mirova employee, is working to define the practicalities of how these proposals would work on the ground.

The Commission must not only be applauded but actively supported for its pro-active approach and putting up proposals that are both ambitious and reasonable.

French institutional investors are obliged by regulations to report on how they reflect ESG criteria in their investments. How do you see Article 173?

France is ahead of other countries when it comes to reporting. Article 173, whose results are being closely followed across Europe - with differing degrees of enthusiasm - requires institutional investors to report on how they incorporate ESG factors into their investment strategies. The direction of travel is clearly set. Something France can be proud of.

But there is still plenty more to do: not all institutional investors are yet meeting their reporting requirements in a satisfactory manner, as Novethic’s recent studies show¹. Also, reporting methodologies are not harmonised, making it hard to compare investors with each other or even to easily decide if such investments are compatible with a low-carbon economy. The transparency obligation has not been designed to encourage the reorientation of capital flows toward a low-carbon economy compatible with the Paris Agreement and, in fact, is not fit for this purpose as it stands. We also find that less than 2% of assets managed by the top 100 investors subject to Article 173 are invested in what might be called “green” finance.

Finally, the information that is published is not easily understandable for savers.

What about individual savers: how can they be encouraged into greener savings?

Green finance needs retail investors. As we, more or less, win the battle with institutional investors it becomes ever more crucial to get citizens, and their savings, on board. For this to happen, the first and most important step is to talk to them. We should be asking them about ESG risks in the same way they are asked about what financial risks they are willing to accept. Do they, for instance, want to be sure they are not investing in companies with bad practices? Or, do they want to help to finance assets that contribute directly to building a sustainable economy?

We also need to safeguard savers as consumers, by making sure the labelling of products is neither misleading nor confusing. Here, the key issues are the

1. “173 nuances de reporting”, Novethic, November 2017

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labels we have, how they can be improved and how they can be more widely applied to products that claim to have sustainable features. Finally, we cannot recruit savers to the cause if the green finance product range is not promoted by a real push on the part of distributors to offer labelled products and flag up this sustainable range to savers. Insurers have made a number of commitments but their ambitious words need to be better translated into action: green investment products have substantial market depth, despite what you sometimes read. The sustainable offer must be further developed, more strongly promoted and

also flagged up and explained in a totally transparent way to citizens so they can understand where their savings are going when they invest in a “solidarity” product, a “responsible” product or a “green” product. These are - with their Finansol, ISR or TEEC labels - three complementary but very different approaches.

Now that ESG is moving into the mainstream, how can an investor tell the good managers from the bad and see through the greenwash?

ESG criteria have become a normal part of investment and this is excellent news

which we should celebrate. Few would have predicted this a few years ago. Still more encouraging is that, in large part, the demand for such products has come from investors and citizens. I think institutional investors will work with those portfolio managers who share their vision – which may be more or less demanding. As for individuals, the points we set out above will be essential to give them access to high-quality products with full transparency.

Written on 20 September, 2018.

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