MARKETING COMMUNICATION

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Investing in sustainability

The US and Europe:

paving the way towards energy transition

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The Mirova Europe Environmental Equity and Mirova Climate Solutions Equity strategies are exposed to the following risks: capital loss, equity securities, small, mid and large cap companies, foreign exchange, ESG investments, geographical concentration, portfolio concentration, global investments, emerging markets, changes in laws and/or tax regimes, financial derivatives, counterparty risk and sustainability risks.

The winds of change are blowing:

Mirova sees opportunity on both sides of the Atlantic

The European Union and the United States are committed to ambitious climate policies aimed at achieving carbon neutrality in their respective territories by 2050. To this end, each bloc has defined its own regulations, which include specific milestones along their respective decarbonisation trajectories.
While the giants that are China and India will undoubtedly play a key role in the global fight against climate change, it is in the West that legislation in this area is currently the most advanced. Passed in the summer of 2022, the Inflation Reduction Act (IRA)[1] is the most ambitious clean energy support programme ever launched in the United States. In response, the European Union (EU) is proposing legislation complementary to its existing plans, namely: 'Fit for 55'[2] and the EU Green Deal.[3]

Will these regulations suffice for either the US or Europe to achieve carbon neutrality by 2050? To what extent will they act as a catalyst in the fight against global warming? How will they make it easier to finance the deployment of renewable energy? What investment opportunities may result from their implementation, particularly along value chains in the fields of solar wind and hydrogen? What impact will these policies have on the stability of supply chains and the competitiveness of European companies?
In this dedicated article, Jean-Pierre Dmirdjian, Senior ESG and Impact Analyst for Energy & Environment, and Christine Tricaud, Portfolio Manager, explore these topics, about which investors are most curious.

Jean-Pierre Dmirdjian

Senior ESG and Impact Analyst-Energy and Environment

Christine Tricaud

Portfolio Manager

1. IRA: The Inflation Reduction Act of 2022 is a US law that aims to curb inflation by reducing the deficit, lowering prescription drug prices and investing in domestic energy production while promoting clean energy. It was passed by the 117th U.S. Congress and signed into law by President Biden on 16 August 2022.
2. Fit for 55 is the most ambitious European legislative package on environmental transition to date, both in terms of its time horizon and sectoral implications. The Fit for 55 plan's measures aim to reduce territorial greenhouse gas emissions by 55% by 2030 versus 1990 levels. Source: European Commission.
3. Set of European laws to combat climate change. Source: European Commission

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At a glance

1

The public policies articulated on both sides of the Atlantic are especially focused on increasing local production capabilities in the area of low-carbon energy and related technologies, thus promoting investment in these sectors and energy sovereignty.

2

Mirova's analysis shows that the greenhouse gas (GHG) emissions reduction target set by the United States for 2030 is more ambitious than Europe's. However, the Inflation Reduction Act (IRA) alone will probably not suffice to meet US commitments.

3

In Europe, the announced targets for installed wind power capacity appear unlikely to be met, however, technological advances could rebalance the equation, enabling the EU to meet its interim milestone for greenhouse gas reductions.

4

Designed to support the growth of companies involved in the development of low-carbon energy production sources, the Mirova Europe Environmental Equity and Mirova Climate Solutions Equity strategies should benefit from the investment opportunities these new packages yield.

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How do the respective plans for decarbonising the US and European economies stack up?

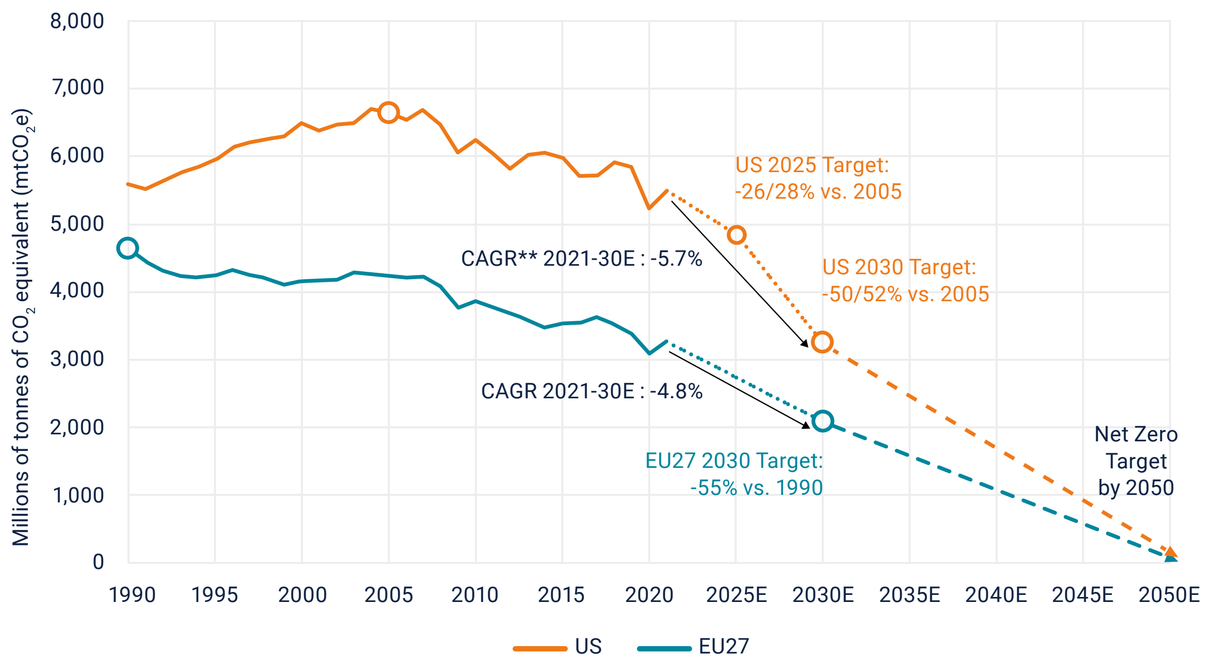
President Biden opened a new chapter in the fight against climate change by recommitting the United States to the Paris Agreement on the day after his inauguration. In the country's first Nationally Determined Contribution (NDC), the US adopted the target of reducing net GHG emissions by 50-52% in 2030 versus 2005 levels. The US administration has also committed to a goal of net-zero emissions by 2050[4] at the latest.

Meanwhile, the European Union (EU) has, since July 2021, undertaken to reduce its GHG emissions by at least 55% by 2030 compared to 1990 under the 'Fit for 55' programme, and has also set itself the target of achieving neutral GHG emissions by 2050.

On the basis of these targets, GHG reduction over the decade look set to be greater for the US than for the EU.

This is only logical, given that the United States currently has significantly higher emissions in absolute terms – by around 70%[5] – than the EU, and the country will therefore need to reduce its emissions more quickly to remain on a Net Zero 2050[6] trajectory, as the following graph illustrates.

COMPARISON OF HISTORICAL NET GREENHOUSE GAS EMISSIONS* AND TARGETS FOR THE UNITED STATES AND THE EUROPEAN UNION, 1990-2050



* Net greenhouse gas emissions, including LULUCF (Land Use, Land Use Change and Forestry) Source: Mirova, UNFCCC, European Commission, White House

** CAGR : Compounded Annual Growth Rate

4. Source: Source: The White House, FACT SHEET: President Biden Sets 2030 Greenhouse Gas Pollution Reduction Target Aimed at Creating Good-Paying Union Jobs and Securing U.S. Leadership on Clean Energy Technologies
5. Source : Mirova, UNFCCC, European Commission, White House
6. Source : European Commission

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The Inflation Reduction Act (IRA): a major turning point in decarbonising the US economy

By proposing historic measures for reducing CO2 emissions, the Inflation Reduction Act (IRA) marks a real turning point for the decarbonisation of the US economy. The IRA aims to encourage the production of green technology in North America, making it possible for the US to take the lead in the global fight against climate change. According to some estimates, the IRA will enable the United States to cut its greenhouse gas emissions by around 42% by 2030 versus 2005.[7]

A STRONG PUSH FOR TRANSITION

The IRA aims to:

- combat inflation and make clean energy less expensive.
- promote investment in domestic energy production and local industry.
- reduce the country's carbon emissions.

The law thus attests the clear determination to drive a massive economic shift towards energy and environmental transition, with the potential to jumpstart innovation through considerable investment in green solutions and clean electricity.

TAX INCENTIVES AS A KEY STRATEGIC MECHANISM

The United States has relied on tax incentives to promote renewable energy in the form of grants and loan guarantees since 1992. The IRA is no exception, providing tax credits, subsidies and loans to households and businesses in the United States. According to the current administration's estimates, new spending on energy and fighting climate change will total some 369 billion dollars over the next 10 years.[8]

- **Encouraging the production of renewable energy:** the IRA plans to foster the development of new renewable electricity production and storage units by reducing their cost through existing tax breaks, namely Production Tax Credits[9] and Investment Tax Credits.[10]

- **Promoting the use of renewable energy**: a determination to nurture a thriving clean energy industry is also reflected in those subsidies the IRA provides for private individuals, to facilitate the purchase of electric or hydrogen-powered vehicles, or to install solar panels or heat pumps, provided that the equipment purchased is manufactured in the United States and that a certain percentage of the components and raw materials used are also sourced from the US or from countries with which the country has a trade agreement.

- **Encouraging local industrial production of clean technologies:** The introduction of tax incentives for the production of solar panels, wind turbines and energy storage batteries are likewise intended to galvanise local production as a way of securing the United States' supply chains and energy sovereignty by reducing dependence on China.

The IRA provides investors with visibility over the next decade and highlights opportunities across the renewable energy value chain, with support to accelerate the deployment of renewable energy parks, facilitate local production and the development of industrial applications in the field of clean energy.

ChristineTricaud,
Portfolio Manager

7. Source : Analysis undertaken as part of the REPEAT project at Princeton University.
8. Source : US Department of Labor
9. Created by the 1992 Energy Policy Act, the PTC is a ten-year, inflation-adjusted US federal income tax credit for each unit of electricity generated by certain types of renewable or zero-carbon energy projects.
10. The ITC is a tax credit created under the Energy Policy Act 2005. It is a one-off credit based on a percentage of the investment in the construction of new facilities producing renewable energy.

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In response to the IRA, the European Union is stepping up its regulatory drive to support energy transition

Given the current climate emergency, the IRA constitutes a strong positive signal from the world's leading economic power – and the country with the second largest carbon emissions in 2022.[11] However, its announcement was seen as a blow to the European Union's economy, raising fears that Europe's competitiveness in clean technologies could be undermined. In the spring of 2023, both in response to the US legislation and in order to strengthen its energy sovereignty, the European Commission proposed additional measures to complement the 'Fit for 55'[12] and the EU Green Deal[13] packages.

ELECTRICITY GENERATION: REFORMING THE ELECTRICITY MARKET

The EU's Electricity Market Design Reform aims to 'develop renewable energies, better protect consumers and strengthen industrial competitiveness.'[14] Perceived as an adjustment rather than a radical reorientation, these measures aim to protect consumers by providing greater price stability on the electricity market and make renewable energy more affordable by facilitating agreements between energy farm owners and offtakers. In Europe, development of new renewable energy capacity relies on centralised auctions, which offer the visibility of long-term contracts for developers. Comparing this system with the American mechanisms described above captures the historical differences between these approaches to promoting clean energy: tax incentives on the one hand, and long-term contracts on the other.

Discussions regarding energy market reforms are ongoing the European institutions, but could lead to an agreement by the end of 2023.

INDUSTRIAL PRODUCTION: ACCELERATING THE DEVELOPMENT OF LOW-CARBON TECHNOLOGIES

The Net Zero Industry Act (NZIA)[15] seeks to provide a framework for strengthening Europe's low-carbon technology manufacturing ecosystem, with an emphasis on the following objectives:

- Intensifying the production of decarbonisation technologies that are key for Europe's economies,
- Supporting projects for developing such technologies by facilitating innovation and investment,
- Simplifying the regulatory framework for manufacturing these technologies to increase the competitiveness of EU players in this industrial sector.

A wide range of sectors are affected by these regulatory developments, including solar photovoltaics and thermal solar power; onshore wind and offshore renewables; battery/storage solutions; heat pumps and geothermal energy; electrolysers and fuel cells; biogas/biomass; carbon capture and storage, and last but not least, grid technologies, including electric vehicles and high-speed charging.

Recent changes to rules regarding state aid already allow EU member states to subsidise their local green technology industries, such as batteries for electric vehicles or solar panels.

11. Source : European Commission
12. 'Fit for 55' is the most ambitious European legislative package on environmental transition, both in terms of time horizon and sectoral implications. The Fit for 55 measures aim to reduce territorial greenhouse gas emissions by 55 emissions by 2030 compared to 1990 levels. Source : European Commission
13. Set of European laws to combat climate change. . Source : European Commission
14. Source: European Commission
15. NZIA: The Net Zero Industry Act is part of the Green Deal Industrial Plan presented by the European Commission. This text aims to support the location in the European Union of strategic value chains for decarbonisation.

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STRENGTHENING THE COMPETITIVENESS AND SOVEREIGNTY OF SUPPLY CHAINS

EU member states have established a set of measures aimed at guaranteeing access to 'a secure, diversified, affordable and sustainable supply of critical raw materials.'[16] Among these is the Critical Raw Materials Act, which complements aspects of the EU Green Deal. In particular, the regulation aims to limit the risk of shortages, by reducing the EU's dependence on third-party countries and sets national supply targets for the end of the decade.

Improving circularity (recycling, reuse, substitution) and diversifying supply are also key objectives identified by the Commission. The list of so-called 'critical' raw materials – drawn up on the basis of their economic importance and the challenges facing their supply chains – includes more than 30 materials, including cobalt, copper, lithium, manganese, nickel, rare earths for magnets, silicon and more.

Adoption by the European Council of the NZIA (Net Zero Industry Act) and the Critical Raw Materials Act is expected in 2023-2024. The question of how to finance these measures remains a key issue, even though some funds are already available, such as the European Innovation Fund and the European Recovery Plan.

Taking two distinct approaches, the regulations adopted by the United States and the European Union are helping to accelerate the energy transition of their respective economies. However, these advances on both sides of the Atlantic must not obscure a need for greater cooperation at the international level, particularly with China and India, in view to achieving global neutrality of net GHG emissions by 2050.

Jean-Pierre Dmirdjian,
Senior ESG and Impact Analyst-
Energy and Environment

16. Source : European Commission

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What opportunities for investors amidst the shifting regulatory environment on both sides of the Atlantic?

In both the United States and Europe, regulations designed to promote low-carbon industrial and energy solutions are helping to give institutional and private investors easier access to long-term opportunities. Government money alone is not enough to finance the transition of our economies to a model that is sustainable and fair, thus the financial sector as a whole has a crucial role to play, for example by offering investors investment solutions that are consistent with decarbonisation requirements.

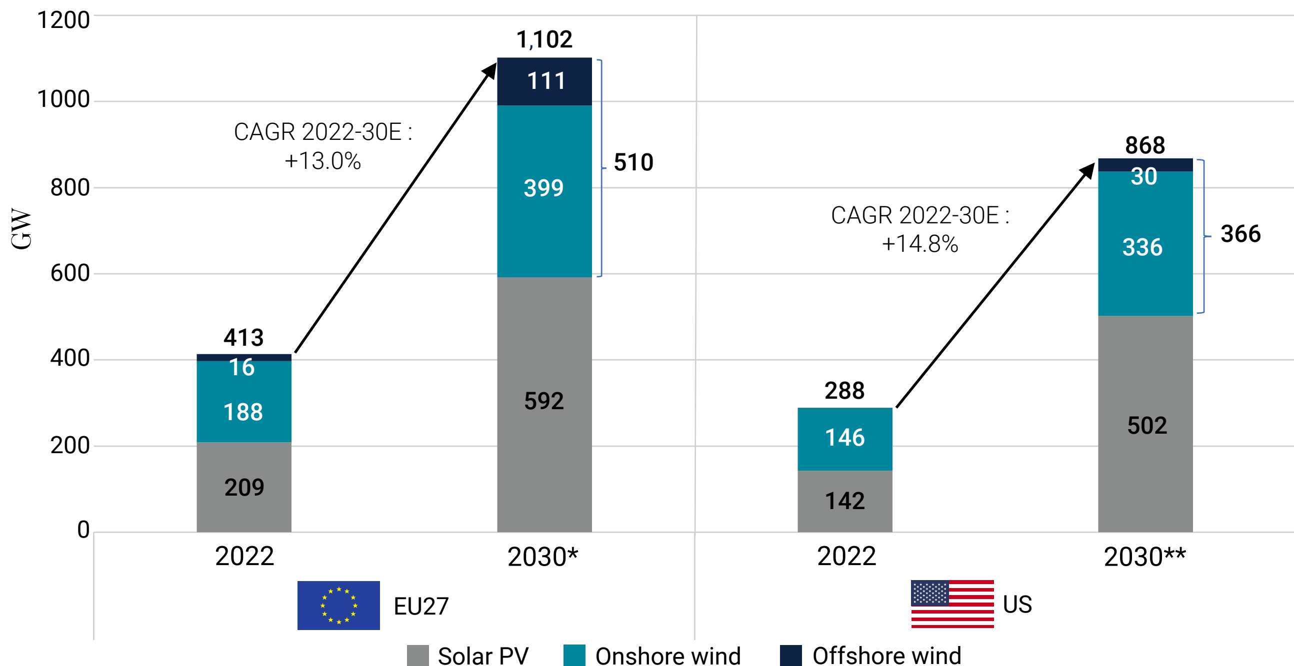
FOCUS | WIND AND SOLAR ENERGY: AN EVER BRIGHTER FUTURE ON BOTH SHORES OF THE ATLANTIC

Renewable energy technologies are key to reducing emissions from electricity generation. With the IRA, the US is shifting up in the deployment of wind and solar generation capacity, with double-digit growth expected through 2030.

While Europe's REPowerEU plan[17] sets explicit targets for installed capacity by 2030 for wind (510 GW) and solar (592 GW),[18] the United States has not set any such national targets, either through the IRA or the Bipartisan Infrastructure Law (BIL).

However, experts are predicting significant increases in wind and solar generation capacity in the US. According to estimates from the National Renewable Energy Laboratory (NREL) assessing the impact of the IRA and BIL policies on the US energy system, a combined installed capacity for wind and solar close to 870 GW in 2030 seems credible. These figures reflect robust average annual growth rates of +13.0% per year between 2022 and 2030 for the EU27, and +14.8% per year for the US.[19]

INSTALLED SOLAR PHOTOVOLTAIC AND WIND ENERGY CAPACITY IN THE EU27 AND IN THE UNITED STATES



* Based on REPowerEU objectives; ** Based on the NREL median scenario.
Source: Interpretation and estimates by Mirova, based on SolarPower Europe, WindEurope, the European Commission, SEIA, US DOE and NREL.

17. On 18 May 2022, the European Commission published the REPowerEU package, aimed at speeding up the transformation of the European energy model: it proposed emergency measures concerning energy prices and gas storage, as well as medium- to long-term measures for boosting energy efficiency and increasing reliance on renewable energy.

18. Source : European Commission

19. Source : National Renewable Energy Laboratory (NREL), 'Evaluating Impacts of the Inflation Reduction Act and Bipartisan Infrastructure Law on the U.S. Power System'

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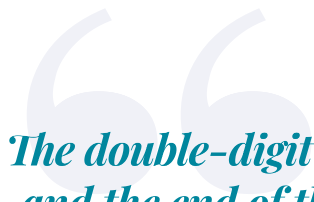
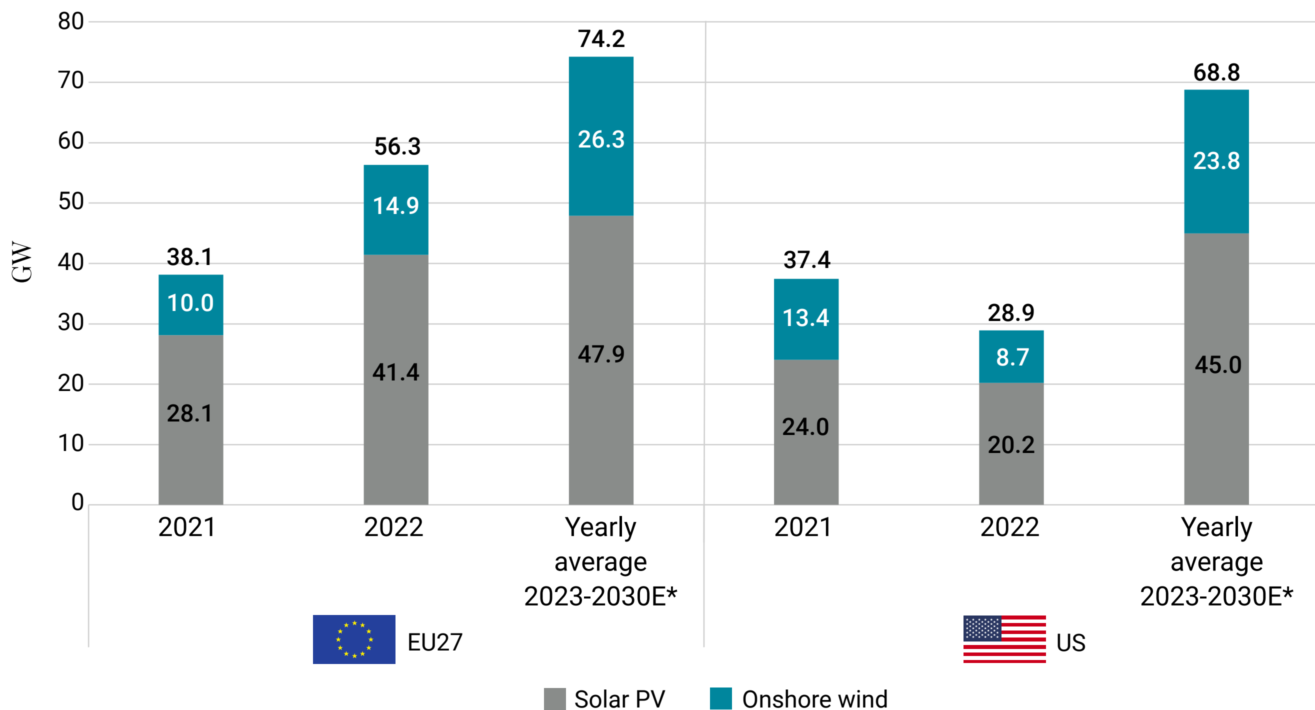


The double-digit average annual growth rates expected between now and the end of the decade for installed solar photovoltaic and wind power capacity in both the EU and the US reflect a significant need for investment across the entire value chain for these renewable energy sources.

Jean-Pierre Dmirdjian,
Senior ESG and Impact Analyst-
Energy and Environment

Are the EU's 2030 capacity targets realistic? While the dynamic growth in solar PV installations over the past year bodes well for the future (see graph below), it is increasingly clear that current estimates for wind power installations will fall short of the 510 GW target announced by the European Commission for 2030. Even if we assume that member states meet their ambitious targets for offshore wind, a substantial gap will persist between the additions deemed feasible and the necessary capacity for onshore wind: over the next five years, the WindEurope industry lobby group[20] predicts onshore wind capacity additions in the EU27 of 15.3 GW per year on average[21] , well below what is needed to meet the REPowerEU wind capacity target for 2030. That said, WindEurope suggests that installed wind capacity of only 440 GW (vs. 510 GW may actually be sufficient for the EU27 to deliver on its commitment of 42.5% renewables in the bloc's energy mix, thanks to better load factors for newly installed turbines (more powerful and efficient) compared to the average of turbines in the existing wind fleet.

ANNUAL ADDITIONS TO SOLAR PHOTOVOLTAIC AND ONSHORE WIND ENERGY CAPACITY IN THE EU27 AND IN THE UNITED STATES



* Net installations (commissioning minus dismantling) of solar photovoltaic and wind power capacity required to meet the REPowerEU targets for the EU27 and the NREL median scenario for the United States in 2030.
Source : Interpretation and estimates by Mirova, based on SolarPower Europe, WindEurope, the European Commission, SEIA, US DOE and NREL.

20. WindEurope is a European association based in Brussels, which promotes the use of wind energy in Europe.
21. https://windeurope.org/about-wind/

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EVERYTHING YOU NEED TO KNOW ABOUT THE MIROVA EUROPE ENVIRONMENTAL EQUITY STRATEGY

• A global understanding with simultaneous treatment of the 3 main, interconnected environmental issues:

- Climate change
- Loss of biodiversity
- Resource scarcity

• Identification of the most effective solutions and of the sectors generating the most impact, which should and could lead to critical technological changes:

- Renewable energy and energy efficiency
- Resource preservation and recycling
- Green building
- Low-carbon mobility
- Changing production methods: developing alternative and bio-based solutions, ending intensive farming, reducing consumption, etc

• Investment in the most relevant players along the same value chain:

The Mirova Europe Environmental Equity strategy identifies the most relevant players in an industrial sector according to Mirova: manufacturers, equipment suppliers, energy companies, etc., in order to target companies whose solutions are at the cutting edge of the transition.

• Every effort to align with a maximum global warming scenario of 2°C[22]

• Conviction-based management, led by a team of experts specialising in environmental issues since 2007[23]

The specific risks associated with investing in the strategy relate to capital loss, equity securities, small-, mid- and large-cap companies, exchange rate risks, ESG investments, geographical concentration, portfolio concentration and sustainability risk.

EVERYTHING YOU NEED TO KNOW ABOUT THE MIROVA CLIMATE SOLUTIONS EQUITY STRATEGY

• A global understanding with simultaneous treatment of the 3 main, interconnected environmental issues:

- Climate stability
- Resource security
- Healthy ecosystems

• 3 regions for investments targeting leaders in green and innovative technologies:

- North America: distributed solar power and storage, fuel cells, industrial eco-efficiency
- Europe: onshore and offshore wind turbines, electrolysers,[24] bioplastics[25] and recycling
- Asia: battery-powered electric vehicles (BEVs), fuel-cell vehicles (FCVs), batteries/fuel cells, hydrogen

• 6 themes that contribute to the global environmental and energy transition:

- Sustainable waste and water management: sustainable management of water resources, waste treatment and recycling, biogas, circular economy, etc.
- Sustainable agriculture: organic and sustainable farming, sustainable forest management
- Green building: insulation, renewable-energy construction technologies
- Industrial energy efficiency: low-consumption electric engines, process optimisation
- Renewable energies: solar, hydro, geothermal, wind and storage
- Clean transport: electric vehicles, hydrogen-powered buses and rail/sea/road transport

• A portfolio of 40 to 60 companies that present structural growth and competitive advantage:[26]

- Preference for exposure to disruptive innovations
- Companies assessed on the competitiveness of technology or services offered, the quality and sustainability of management, their business model, balance sheet and growth potential

The specific risks of investing in the strategy are related to capital loss, equity securities, global investments, emerging markets, ESG-focused investments, small-, mid- and large-cap companies, exchange rate risk, portfolio concentration, changes in regulations and/or tax regimes, derivative financial instruments, counterparty risk and sustainability risk.

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22. Consistent with action plans put in place to comply with the Paris Agreement, i.e. the increase in average global temperature between 1850 and 2100 that must not be exceeded. Non-binding internal limits mentioned in the fund's legal documents. Mirova may change these limits at any time without notice. The carbon impact of investments is calculated using a proprietary methodology that may incorporate biases.
23. 2007 saw the launch of Natixis Impact Life Quality, a French strategy with an identical investment policy, this was merged with the Mirova Europe Environmental Equity strategy in 2013.
24. Alkaline electrolysers and proton exchange membrane (PEM) electrolysers are positioned as mature solutions for producing green hydrogen for manufacturers seeking to reduce carbon emissions.
25. Plastics made from plant or animal biomass.
26. Source : Mirova at 31/07/2023

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Will climate targets be met?

IN EUROPE, BINDING TARGETS APPEAR TO BE BEARING FRUIT

In Europe, according to analysis by Climate Action Tracker (CAT), the adoption of 'Fit For 55', reinforced by REPowerEU is expected to reduce the bloc's emissions by around 60% below 1990 levels by 2030, thereby exceeding the EU's target of 'at least 55%'.

According to CAT, the policies and actions Europe has undertaken are consistent with the Paris Agreement, which aims to limit the increase in the Earth's average temperature to well below 2°C. CAT points out, however, that other levers, such as halting investment in additional import capacity of liquified natural gas (LNG), or updating its National Determined Contribution (NDC) could further underpin Europe's fight against climate change

IN THE UNITED STATES, THE IRA ALONE WILL NOT SUFFICE TO MEET CLIMATE COMMITMENTS

In the United States, models designed by the National Renewable Energy Laboratory (NREL) indicate that the IRA and BIL have the potential to prompt a radical transformation of the country's electricity sector. With low-carbon electricity likely to account for more than 80% of total generation by 2030,[27] and GHG emissions falling by more than 80% versus 2005 levels, the United States would be well on its way to achieving carbon neutrality in the electricity generation sector by 2035.[28] Although not legally binding, these decarbonisation targets are a cornerstone of the current US administration's policy for the electricity sector.

With regard to the US economy as a whole, analysis conducted as part of the REPEAT project at Princeton University indicates that, on their own, the IRA and BIL legislation would lead to a reduction in emissions of around 42% versus 2005 levels by 2030. Therefore, further government policies and actions will be needed if the US is to meet its commitment under the Paris Agreement to reduce emissions by 50-52%.

27. Source: National Renewable Energy Laboratory (NREL), 'Evaluating Impacts of the Inflation Reduction Act and Bipartisan Infrastructure Law on the U.S. Power System
28. White House Fact Sheet, 'President Biden Signs Executive Order Catalyzing America's Clean Energy Economy Through Federal Sustainability', December 8, 2021.

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Two distinct approaches, but a shared focus on decarbonisation that offers a source of opportunities for investors

While differences in their approach may lead to trade frictions between these two powers, the regulations respectively adopted by Europe and the United States do provide support for their energy transition plans. The targets announced on both sides for reducing greenhouse gas emissions are paired with massive support for transition technologies and strengthening of supply-chain sovereignty. This move towards low-carbon solutions creates opportunities for investors, enabling them to position themselves on long-term trends that help to reduce greenhouse gas emissions.

A FAVOURABLE CONTEXT FOR MIROVA'S STRATEGIES

The climate trajectory of our portfolios is held below the 2°C limit, as stipulated in the Paris Agreement,[29] and 100% of the funds managed by Mirova are classified as Article 9 under the SFDR[30] regulation, making our investment solutions especially geared to meeting the world's environmental and social challenges and ensuing regulatory changes:

The approach of our climate-themed equity strategies is consistent with the European and American decarbonisation plans, proposing investments geared towards companies that provide solutions, particularly in the fields of low-carbon energy production, energy efficiency and carbon capture.

The Mirova Europe Environmental Equity[31] strategy is aligned with European regulatory initiatives aimed at promoting a sustainable economy, in particular through its investments supporting innovative decarbonisation technologies.

In addition, European decarbonisation programmes are helping to foster the penetration of low-emission technologies in portfolio companies.

The Mirova Climate Solutions Equity[32] strategy provides global exposure to the entire value chain of energy transition technologies, such as those offered by certain Asian battery manufacturers, US solar equipment manufacturers and European renewable energy producers.

On the bond side, which has been on the up and up following successive increases in key interest rates – on both sides of the Atlantic – Mirova has a diversified offering that enables investors to adapt to various market conditions and access the full economic spectrum while supporting environmental and social development.

Any investment involves risks, including the risk of loss of capital, durability and liquidity' in the disclaimer after the last paragraph on the bondholder.

While there is still a long way to go, the challenge of decarbonisation must be met and the contributions of institutional and private investors are critical for the transition to succeed. We are convinced that positioning ourselves now in support of a sustainable economy can enable investors to reconcile financial returns and positive impact.

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29. In all its investments, Mirova aims to offer portfolios consistent with a climate trajectory of less than 2°C as stipulated in the 2015 Paris agreements, and systematically displays the carbon impact of its investments (excluding Solidarity and Natural Capital management), calculated using a proprietary methodology that may include biases.

30. With the exception of certain dedicated funds and funds delegated by management companies outside Groupe BPCE. The Sustainable Finance Disclosure Reporting (SFDR) Regulation aims to provide greater transparency in terms of environmental and social responsibility within the financial markets, notably through the provision of sustainability information on financial products (integration of risks and negative impacts in terms of sustainability). Products classified under Article 9 of the SFDR possess a sustainable investment objective, as compared with products classified under Article 6 (no sustainability objective) or Article 8 (environmental and social characteristics). For more information, use this link.

31. The specific risks associated with investing in the strategy relate to: capital loss, equity securities, small, mid and large cap companies, exchange rates, ESG investments, geographical concentration, portfolio concentration, sustainability risk.

32. The specific risks of investing in this strategy are related to: capital loss, equity securities, global investments, emerging markets, ESG focused investments, small, mid and large cap companies, exchange rates, portfolio concentration, changes in laws and/or tax regimes, derivative financial instruments, counterparty risk, sustainability risk.

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