Sustainable finance, pandemic & climate transition

Dr Stephen Minas
Energy Community Eternal Summer School
25/02/21
Webinar overview

• Challenge of financial transition
• Paris Agreement
• EU and other key players
• Market standards
• Pandemic impact
• State of play, early 2021
• Implications for Contracting Parties
Global finance stock

- Low-carbon investment in assets under management: $203 bn
- Total assets under management: $71 tn
- Green bonds and climate-aligned bonds outstanding (2017): $895 bn
- Global debt securities outstanding (2017): $91.92 tn

(UNFCCC Standing Committee on Finance)

- Potential stranded assets in 2050: $20 tn
- Potential real estate assets at risk in 2070: $35 tn
Global finance flows

- Investment in fossil fuel: $742 bn
- Investment in renewable energy: $295 bn
- Green or climate-aligned bond issuance: $154 bn
- Fossil fuel subsidies (2015): $373 bn
- Renewable energy subsidies (2015): $150 bn
- Climate finance flows: $681 bn
- Losses from natural catastrophes (2017): $339 bn
- Energy investment needs (2018): $1.7 tn/yr

(UNFCCC Standing Committee on Finance)
Paris Agreement

• Article 2.1: This Agreement, in enhancing the implementation of the Convention, including its objective, aims to strengthen the global response to the threat of climate change, in the context of sustainable development and efforts to eradicate poverty, including by:

• (a) Holding the increase in the global average temperature to well below 2°C above pre-industrial levels and to pursue efforts to limit the temperature increase to 1.5 °C above pre-industrial levels, recognizing that this would significantly reduce the risks and impacts of climate change;

• (b) Increasing the ability to adapt to the adverse impacts of climate change and foster climate resilience and low greenhouse gas emissions development, in a manner that does not threaten food production;

• (c) Making finance flows consistent with a pathway towards low greenhouse gas emissions and climate-resilient development.
European Green Deal & Sustainable Finance Framework

- Revised 2030 targets
- 2050 target
- Sustainable finance framework
- European Green Deal
  - EGD Investment Plan
  - Just Transition Mechanism
- Economic & Investment Plan for the Western Balkans
- Green Agenda for the Western Balkans
Taxonomy for sustainable activities

- **Taxonomy Regulation (2020):**
- **Environmental objectives:**
  - Climate mitigation, adaptation, etc.
- ‘criteria for determining whether an economic activity qualifies as environmentally sustainable for the purposes of establishing the degree to which an investment is environmentally sustainable’ - Whether activity:
  - ‘contributes substantially’ to environmental objectives
  - ‘does not significantly harm’ environmental objectives
  - Meets minimum social safeguards & technical screening criteria
- “**Member States and the Union** shall apply the criteria ... to determine whether an economic activity qualifies as environmentally sustainable for the purposes of any measure setting out requirements for financial market participants or issuers in respect of financial products or corporate bonds that are made available as environmentally sustainable.”

- **Applies to transparency pre-contractual disclosures & periodic reporting re:**
  - ‘environmentally sustainable investments’
  - ‘financial products that promote environmental characteristics’
- **Transparency of undertakings in non-financial statements.**
- ‘Substantial contribution to mitigation’ includes:
  - RES, EE, energy infrastructure decarbonization, etc
- **Delegated Act on climate objectives:**
  - Draft released Nov 2020
  - CION currently finalising
- **Mitigation & adaptation criteria to apply from Jan 2022**
E.g. Electricity generation using solar photovoltaic technology

- **Description of the activity:**
  - Construction or operation of electricity generation facilities that produce electricity using solar photovoltaic (PV) technology.

- **Substantial contribution to climate change mitigation:**
  - The activity generates electricity using solar PV technology.

- **Do no significant harm:**
  - The activity assesses availability of and, where feasible, uses equipment and components of high durability and recyclability and that are easy to dismantle and refurbish.
  - EIA completed according to EU Directive or, in 3rd countries, equivalent national rules.
  - Etc
  - (DRAFT delegated act, annex)
Sustainability-related disclosure

• Regulation on sustainability-related disclosures in the financial services sector (Nov 2019):
  • Financial market participants & financial advisers ‘shall’ publish info on ‘policies on the integration of sustainability risks’ in investment decision-making or investment/insurance advice.

• Provides for:
  • Transparency of adverse sustainability impacts of investment decisions
  • Pre-contractual disclosure of how sustainability risks integrated into investment decisions
  • ‘Where a financial product promotes ... environmental or social characteristics’, info on how product meets these characteristics
  • Etc

• Applies from 10/03/21
EU climate benchmarks

- Benchmarks:
  - S&P 500, MSCI indices, EURIBOR etc
- Proliferation of low-carbon indices
- Climate benchmarks regulation (Nov 2019):
  - Aim: Provide consistency, combat ‘greenwashing’

- 2 new benchmarks:
  - “EU Climate Transition Benchmark”: underlying assets are selected, weighted or excluded in such a manner that the resulting benchmark portfolio is on a decarbonisation trajectory
  - “EU Paris-aligned Benchmark”: underlying assets are selected, weighted or excluded in such a manner that the resulting benchmark portfolio’s carbon emissions are aligned with the objectives of the Paris Agreement

- Sovereign debt currently excluded from benchmarks:
  - “currently not enough data to assess the carbon footprint resulting from decisions made by sovereign entities.”
EU Green Bond Standard

• **TEG recommendations (June 2019):**
  • Create a voluntary EU Green Bond Standard.
  • The EU-GBS should comprise four core components: (1) alignment of Green Projects with the EU Taxonomy, (2) Green Bond Framework, (3) reporting and (4) verification by accredited verifiers.

• **EGD Investment Plan (Jan 2020):**
  • CION will establish an EU Green Bond Standard.
Publication of Green Bond Framework:

1. Issuer’s green bond strategy and alignment with the EU Taxonomy
2. Description of types of Green Project categories to be financed
3. Description of methodology and process regarding allocation and impact reporting

Before or at issuance

Documents 1 & 3 verified by approved external verifiers

Approval of external verifiers

Annual allocation reports:

1. Confirmation of alignment with EU GBS
2. Breakdown of allocated amounts per project or portfolio
3. Geographical distribution of Projects

Final allocation report

From gradual to full allocation

IMPACT REPORT
Impact reporting at least once at full allocation, or annually
China: Establishing a “Green Financial System”

• Guidelines:
  • Vigorously Develop Green Lending (Policy framework, green credit policy system, promote banking ‘self-regulation’ and securitization of green loans, ‘introduce lenders' environmental legal liability’, etc)
  • Enhance the Role of the Securities Market in Supporting Green Investment (unify green bond definitions, use local government guarantees to reduce financing costs of green bonds, support IPOs of ‘qualified green enterprises’, etc)

• Launch Green Development Funds and Mobilize Social Capital through PPPs
• Develop Green Insurance
• Improve Environmental Rights Trading Market and Develop Related Financing Instruments
• Support Local Government Initiatives to Develop Green Finance
• Promote International Cooperation in Green Finance
• Prevent Financial Risks and Strengthen Implementation
Towards a ‘green’ Belt & Road Initiative?

- 2020: 1st year with more BRI renewable financing than fossil fuel financing
- ‘Green BRI’ projects
- Impact of China’s 2060 carbon neutrality goal?

Downhill
China’s overseas energy financing drops to the lowest since 2008

<table>
<thead>
<tr>
<th>COUNTRY</th>
<th>AMOUNT</th>
<th>DESCRIPTION</th>
</tr>
</thead>
<tbody>
<tr>
<td>Nigeria</td>
<td>$2.5 billion</td>
<td>Gas pipeline project</td>
</tr>
<tr>
<td>Ivory Coast</td>
<td>$286 million</td>
<td>Gribo-Popoli hydropower project</td>
</tr>
<tr>
<td>Rwanda</td>
<td>$214 million</td>
<td>Nyabarongo II hydropower project</td>
</tr>
<tr>
<td>Lesotho</td>
<td>$70 million</td>
<td>Solar PV power plant</td>
</tr>
<tr>
<td>Bangladesh</td>
<td>$970 million</td>
<td>Power grid strengthening project</td>
</tr>
<tr>
<td>Pakistan</td>
<td>$260 million</td>
<td>Thar 330MW coal-fired power project</td>
</tr>
<tr>
<td>Serbia</td>
<td>$214 million</td>
<td>New Belgrade district heating system</td>
</tr>
<tr>
<td>Cambodia</td>
<td>$80 million</td>
<td>Rural power grid extension project</td>
</tr>
</tbody>
</table>

(Bloomberg)
Transnational developments

• Greater disclosure
• More standards
• Competition on net zero
• All asset classes
• Greater scrutiny on ‘greenwashing’
Pandemic impact

**Figure 2**
Announced COVID-19 response fiscal stimulus package

Note: Dark blue represents G20 countries and light blue represents countries outside of the G20. Updated on 1 February 2021.
The impact of pandemic stimulus measures

(Vivid Economics)

Figure 3  
Sum of global fiscal stimulus policies of countries considered in our analysis

US$4.6 trillion

Environmentally relevant stimulus

US$10.3 trillion

Non-environmentally relevant stimulus
Figure 1 | Greenness of Stimulus Index

Source: Vivid Economics using a variety of sources, consult Annex II for the entire list of sources
Note: Updated on 1 February 2021
Pandemic impact: EU response

Grant allocation key

- **2021-2022 (70%)**
  - unemployment 2015-2019
  - inverse GDP per capita
  - population share

- **2023 (30%)**
  - drop in real GDP over 2020
  - overall drop in real GDP 2020-2021
  - inverse GDP per capita
  - population share

Support the green transition
at least 37% of resources contribute climate action and environmental sustainability
Financial transition: State of play, early 2021

Sustainable debt

Surpassing $700 billion
Global sustainable debt issuance

Green on Top
2020 bond performance

Source: Bloomberg, NEF
Note: nominal dollars

- Year-to-date returns of all types of global bonds
- Year-to-date returns of global green bonds

Source: Bloomberg
Sustainable fund volumes surge on record inflows

Assets under management ($bn)

Europe | US | Asia | Global

Active | Passive

Net flows ($bn)

Europe | US | Asia | Global

Active | Passive

Source: Morningstar
© FT
Increasing number of funds rebranding to ESG

Number of funds by type: 
- Active
- Active repurposed
- Passive
- Passive repurposed

Source: Morningstar
© FT
Carbon pricing

Emissions covered by carbon pricing initiatives
Share of annual global greenhouse gas emissions (%)

61 carbon pricing or emissions trading schemes have been implemented

Luring Big-Money Investors
EU carbon prices soar on Green Deal

Source: Bloomberg
2021:
- ‘Launch’ of China’s national carbon market.
- CION proposal for EU ETS reform.
- UK ETS ‘established’, not yet trading.
Carbon border adjustment

- 2020: CION announced work on Carbon Border Adjustment Mechanism (CBAM)
- European Parliament due to vote on CBAM resolution in March 2021
- CION CBAM proposals planned for 2021 Q2
- ‘Carbon adjustment’ levy (Biden 2020 campaign pledge)

(Bloomberg)
Implications for Contracting Parties

- Transition of finance flows is accelerating
- Pressure on fossil fuel financing from both markets & official sector
- No reliable fossil fuel lender of last resort
- Growing market support for clean energy & other sustainable economic activities
- EnC *acquis* implementation
- 2030 targets and NECPs
Thank you!