OCTOBER 2020

THE EUROPEAN GREEN DEAL
IMPLICATIONS FOR INVESTORS

A PLEDGE TO MAKE THE EUROPEAN UNION (EU) CARBON NEUTRAL BY 2050 LIES AT THE HEART OF THE EUROPEAN COMMISSION'S EUROPEAN GREEN DEAL. IN THIS PAPER WE EXPLORE THE SCOPE OF THE PLAN AND ASSESS IMPLICATIONS FOR INVESTORS.

RECONCILING THE ECONOMY WITH THE PLANET

Making the EU carbon neutral by 2050

When European Commission president Ursula von der Leyen announced Europe's Green Deal towards the end of 2019, she described the plan as seeking to "reconcile the economy with the planet" and championed it as the principle mandate of her tenure. The plan is heavily focused on achieving the bloc's long-term climate objectives and includes spending and financing programmes across areas spanning biodiversity, food and agriculture, low-carbon power generation and electric vehicles.

Central among the goals is a pledge to make the European Union (EU) carbon neutral by 2050. In effect, this means EU carbon emissions will be offset by at least similar levels of carbon removal. By 2030, the European Commission seeks to reduce emissions by 55% This is a significant development.

Reaffirming Paris Agreement commitments

With the EU being one of the largest carbon emitters, this marks a clear advancement of global decarbonisation goals and represents a considerable improvement on prior pledges. Ultimately it is hoped the future growth path of the EU will be one that is sustainable, resource efficient and competitive, and in the process, one where economic growth is decoupled from resource reliance.

The Green Deal also strengthens the EU's Paris Agreement commitments, the main goal of which is to keep rises in global temperatures 'well below' two degrees above pre-industrial levels.

COVID-19 and Next Generation EU

The emergence of the COVID-19 pandemic in early 2020 redoubled the EU's commitment to the Green Deal. As economic damage from shutdowns mounted, European governments agreed to a major €1.85 trillion recovery package. This is made up of a €750bn economic stimulus plan, named "Next Generation EU", and a €1.1 trillion seven-year budget programme. One third of the stimulus plan will be directed to climate action investments, integrating much of what was proposed in the 2019 Green Deal.

Green finance is expected to play a leading role in the funding of Next Generation EU stimulus plan, with 30% coming from green bond issuance.

GREEN OPPORTUNITIES FOR INVESTORS

An economy-wide stimulus plan

Achieving the Commission's targets will require action across all levels of the European economy including:

- Investing in environmentally friendly technologies
- Supporting industry innovation
- Rolling out cleaner public and private transport forms
- Decarbonisation of power generation
- Improving building energy efficiency
- Working with international partners to improve global environmental standards

The sheer scope and scale of the Green Deal will thus provide considerable opportunity for investment across all sectors of the economy. Indeed, stimulus efforts are much more likely to succeed if the much more sizeable funds in the hands of private investors are leveraged.

How can investors position to take advantage of the Green Deal?

Through investing in companies directly impacted by the Green Deal

There are several ways investors can position to benefit from the Green Deal. First, investors can re-orient their portfolios towards more sustainable technologies and those businesses directly affected by the Green Deal. Opportunities could potentially abound across sectors as diverse as energy, agriculture, construction, materials, food and industrials.

The process of investing will have been made easier with the recent adoption by the European Parliament of the Taxonomy Regulation. This will result in an EU-wide framework to "provide clarity and transparency on environmental sustainability to investors, financial institutions, companies and issuers thereby enabling informed decision making in order to foster investments in environmentally sustainable activities."[1]

Investors may seek to focus on companies in these sectors that are actively seeking to reduce their carbon footprint or are devising solutions that contribute towards helping the EU achieve its goal of net-neutral carbon emissions by 2050. In turn, investors may benefit by not only allocating capital to such companies and investments but also by actively avoiding companies set to be left behind by the Green Deal.

The shift to renewables

With almost three quarters of the Europe's greenhouse gas emissions caused by energy production according to the European Commission[2], the shift towards renewables could present considerable opportunities for investors. Wind and solar power are expected to see some of the fastest rates of growth over the coming decade as the marginal costs continue to decline.

For example, the global offshore wind market grew nearly 30% annually between 2010 and 2018 and is likely to continue growing at a rate of almost 13% over the coming two decades according to the International Energy Agency[3]. The cost of renewables has fallen, and they have become competitive, if not cheaper, to operate than fossil fuel generation. Hydrogen as a form of clean energy is also a specific target of the Green Deal, with substantial investments measuring in the hundreds of billions of euros over the coming decades.

The impact bond market continues to grow and mature

Impact bonds are issuances where proceeds raised are dedicated solely to projects that will meet environmental or social criteria. The three most common types are:

- **Green bonds:** the proceeds are exclusively applied to eligible green projects.
- **Social bonds:** the proceeds are exclusively applied to eligible social projects.
- **Sustainable bonds:** the proceeds are exclusively applied to an intentional combination of both green and social projects.

The EU is a global leader in green finance and the largest issuer of green bonds worldwide. The EU's intention to finance 30% of Next Generation EU's €750bn financing needs with green bond issuance should ensure that this remains the case.

In a further boost for impact bonds and green finance, the European Central Bank (ECB) has announced that it will now accept sustainability-linked bonds (SLBs) as collateral and as eligible for its asset purchase programme, provided that the SLBs comply with specific criteria. The programme-specific criteria, which previously excluded SLBs due to their linking of coupons to an issuer's sustainability profile and thus rendering the coupon structure "a priori uncertain", will now be extended to incorporate sustainability performance targets.[4]

As the impact bond market continues to grow and mature, investors should find an expanding universe of investment opportunities across a range of fixed income investments.

CONCLUSION

The European Commission's pledge to make the EU carbon neutral by 2050 as part of its Green Deal marks a clear advancement of global decarbonisation goals and a significant improvement on prior pledges. For investors, the sheer scale of the investment required to achieve these goals look set to provide considerable opportunity across all sectors of the economy.

[1] EU Technical Expert Group on Sustainability. Spotlight on taxonomy 2020.

[2] European Commission. A Clean Planet for All. 28 November 2018.

[3] IEA Offshore Wind Outlook 2019.

[4] See announcement here:
https://www.ecb.europa.eu/pub/pdf/other/EN_ECB_2020_45_f_sign~6a8d473bbe..pdf?627f0f21a7d1e0cda138204feb43c2e5

CONTRIBUTORS

Joshua Kendall
Head of Responsible Investment, Research and Stewardship

Derek Traynor, CFA
Senior Investment Content Specialist

IMPORTANT INFORMATION

ASSOCIATED INVESTMENT RISKS

Fixed income

- Where the portfolio holds over 35% of its net asset value in securities of one governmental issuer, the value of the portfolio may be profoundly affected if one or more of these issuers fails to meet its obligations or suffers a ratings downgrade.
- A credit default swap (CDS) provides a measure of protection against defaults of debt issuers but there is no assurance their use will be effective or will have the desired result.
- The issuer of a debt security may not pay income or repay capital to the bondholder when due.
- Derivatives may be used to generate returns as well as to reduce costs and/or the overall risk of the portfolio. Using derivatives can involve a higher level of risk. A small movement in the price of an underlying investment may result in a disproportionately large movement in the price of the derivative investment.
- Investments in emerging markets can be less liquid and riskier than more developed markets and difficulties in accounting, dealing, settlement and custody may arise.
- Investments in bonds are affected by interest rates and inflation trends which may affect the value of the portfolio.
- Where high yield instruments are held, their low credit rating indicates a greater risk of default, which would affect the value of the portfolio.
- The investment manager may invest in instruments which can be difficult to sell when markets are stressed.
- Where leverage is used as part of the management of the portfolio through the use of swaps and other derivative instruments, this can increase the overall volatility. While leverage presents opportunities for increasing total returns, it has the effect of potentially increasing losses as well. Any event that adversely affects the value of an investment would be magnified to the extent that leverage is employed by the portfolio. Any losses would therefore be greater than if leverage were not employed.
- Investment in any strategy involves a risk of loss which may partly be due to exchange rate fluctuations
- Any projections or forecasts contained herein are based upon certain assumptions considered reasonable. Projections are speculative in nature and some or all of the assumptions underlying the projections may not materialize or vary significantly from the actual results. Accordingly, the projections are only an estimate.

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Institutional Business Development
businessdevelopment@insightinvestment.com
+44 20 7321 1552

European Business Development
europe@insightinvestment.com
+49 69 12014 2650
+44 20 7321 1928

Consultant Relationship Management
consultantrelations@insightinvestment.com
+44 20 7321 1023

@InsightInvestIM
company/insight-investment
www.insightinvestment.com