SUSTAINABLE FINANCE: GOING GREEN’S CRUCIAL INGREDIENT

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The scale of the energy transition required in Europe and the wider world is huge, as is the financial bill attached to the shift. Companies are already starting to align their business models around green policies but is there appetite for change?
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Gentiloni’s SDG-oversight will be ‘key’

By Sam Morgan | EURACTIV.com

Italy’s former finance minister Domenico Siniscalco insists that sustainable finance is going from strength to strength and that it will hold the key to effectively combating climate change. He also believes that Italy’s new Commissioner, Paolo Gentiloni, will play a crucial role.

Domenico Siniscalco served as Italy’s finance minister between 2004 and 2005. An economist by profession, he also was a lead author on the Intergovernmental Panel on Climate Change’s 2001 report and is now vice-chairman of Morgan Stanley.

He spoke with EURACTIV’s Sam Morgan.

Public awareness of climate change has made a quantum leap since you started working on the subject in 1989. Do you think that the way business is conducted has made a similarly large step?

I believe that after many years where climate change was treated top-down by governments and movements, with few results, the landscape for business is now changing dramatically in a market direction. It’s been propelled by three major fundamental changes, the first of which is a change in preferences. Young people in particular, as well as people in business care now, when it comes to environmental liabilities. You can see and touch this change everywhere you go because if reform is not owned by the general public, it will never happen.

The second point is technology. We’re witnessing a wave of tech that is revolving around electrification and renewables in power production. Firms involved in that are trading much better than traditional utilities. Once you have a growing percentage of clean electricity then you must electrify whatever you can. It’s already happening. In transport, it’s shifting rapidly towards electricity and, surprisingly, in a good way, China is ahead of everyone else. There’ll be a minor share of heavy industry still relying on fossil fuels but all other productions can shift towards electricity. In Italy, a manufacturing champion with a lot of SMEs, this is going to be particularly successful.

The third leg of this big change is finance. There are today $31 trillion in sustainable assets, which has grown by 34% over the last three years. It’s amazing how things have changed. We have the ingredients for a fundamental shift.

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How big a catalyst has the Paris Agreement been in all this?

I see decarbonisation and climate action as a trend, where there are milestones. Kyoto is one, Paris is another. None of them is decisive, as it's a continuous process of change in technology, finance and preferences. Nothing against Paris, it was good but don't give it too much credit because it's a long path. Climate action After trial and error, it's finally taking on a life of its own.

You were a lead author of the IPCC report in 2001, which got the Nobel Peace Prize in 2007. Last year's edition has been hailed as a landmark report in terms of spelling out the impact of global warming. Do you have a feeling of 'told you so', given you were involved nearly twenty years before?

The great thing about the IPCC is that it helps disseminate and simplify information from numerous sources. When Greta Thunberg says listen to science, the science is the IPCC. Year after year, these reports change. The great merit of it is that the IPCC has pushed back and marginalised climate science denial and negationism, while focusing on costs, benefits and impacts. The most recent reports are interesting because they are thematic, deep dives that are very important. But don't take them at face value, because science is changing. It is a way of taking stock of research and conveying it. Numbers will change and it's healthy when they do because research continuously evolves.

The EIB has updated its energy lending policy to largely phase out fossil fuels and increase climate investments. How big a signal is that?

That's crucial. Whenever you have a big project, you fund it through a pyramid of instruments. Those segments need to be totally consistent with one another, so if you want EIB funding, you must be sustainability compliant, Sustainable Development Goals-compliant. It will drag the whole process of financing in that direction. Italy's new Commissioner Paolo Gentiloni's duties in this area will be equally important. Business responds to incentives, so if the demand, EIB, policymakers all go in a certain direction then it will move forward. That said, energy transition must involve all energy sources.

Is the fact that Gentiloni will oversee the SDGs a significant step for this new Commission?

It's important because if I go back to my days as an adviser to the Italian government and European Commission, then when I was finance minister, it's pretty obvious that the environment needs to be routed in other policies. The very fact that Paolo is running that portfolio with SDGs is key. I know Paolo very well for being a smart compassionate guy around this topic, we've been working on it together throughout the 90s and early 2000s. I can't think of anyone better to push this agenda forward.

Should the Commission have a Commissioner dedicated solely to the SDGs though?

I do not agree with that. The issue should not be treated separately from economic development, we need to integrate, we need to understand that climate change and, more generally, environmental policy is one dimension of human development. Treated separately, it will always be treated as a “luxury”. Climate and energy are the real dimension of growth.

Diving deeper into the detail. Recent forays into issuing bonds linked to the SDGs have been made. Is that kind of instrument the future of finance?

An Enel SDG bond arranged by Morgan Stanley has attracted a lot of interest in Italy. It is structured like a conditional bond, you are paid a certain rate, if, for example, the firm fails to achieve its renewables target, investors will get paid a higher rate. It's extremely innovative.

London's Thames Tideway sewer project is partly financed by green bonds. If more large-scale infrastructure projects like this are financed in a similar way, is that how sustainable finance really takes hold?

Best practices are very important. An avalanche effect with ESG-SDG bonds can improve the landscape dramatically. They incentivise the companies who issue them to comply with their own objectives. The danger we have to watch out for is greenwashing, this pretending to have an environmental approach. We need someone external, a third party to check whether it is legitimate. Sometimes that is made redundant because the results are tangible, like a bigger share of renewable power in the energy mix.

Can those independent checks be carried out by the EU?

It makes sense. But I also believe in private sector ratings.

Where is the next big milestone in climate policy, in your opinion?

In my understanding, the political process is like those rivers that go above and below ground. It's hard to predict how and how fast it will proceed. It's a bit naive to believe that tragedies like the one we had in Venice recently will change sentiments. I don't forecast the speed of the process but the direction of change is very very clear.
Greener business models are starting to gain in popularity as environmental legislation starts to bite and company heads decide their balance sheets will look healthier in the long-run if they embrace change. A shift from just financing individual green projects towards revamping business blueprints is also starting to take off.

As UN climate talks in Madrid kick off, EU leaders gear up to discuss a broad decarbonisation strategy and the new European Commission prepares to unveil its Green Deal, questions still linger over how green policies will actually be implemented.

In the world of business, the impact of climate measures like renewable power targets, the emissions trading scheme and a push for more sustainable finance is starting to be felt.

The rising price per tonne of carbon and a raft of clean energy goals for 2030 has pushed power companies across Europe to start ditching fossil fuels.

Carbon-intensive fuels have started to make less economic sense for business leaders as the price of renewables like solar and wind starts to fall in tandem with a strengthened Emissions Trading System (ETS).

That has prompted insurers to keep coal in particular at arm’s length. A new report by the Unfriend Coal campaign estimates that firms with combined assets of $8.9 trillion have begun pulling out coal investments.

Demand is the crucial factor and a similar situation is evolving in the transport sector, where battery prices are beginning to come into the same price range as the internal combustion engine.

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According to a new report by Bloomberg New Energy Finance, battery prices per kilowatt hour have fallen 87% since 2010 and average prices should reach $100 per kw/h by 2023. The report cites increased electric vehicle demand and tech developments as main factors.

"According to our forecasts, by 2030, the battery market will be worth $116 billion annually, and this doesn’t include investment in the supply chain,” said BNEF’s James Frith about the profitability of the sector.

GREEN MONEY

Italy’s former finance minister Domenico Siniscalco told EURACTIV in an interview that $31 trillion is currently held in sustainable assets globally, marking a 34% increase over the last three years.

Siniscalco said “it is amazing how things have changed” and added that “we have all the ingredients needed for a fundamental shift” in terms of energy transition and new green policies.

The energy transition in Europe is set to hit national governments with a collective bill of over half a trillion euros every year up to 2050, if the EU is to keep to its Paris Agreement obligations.

United Nations estimates put the annual financial shortfall at around $4 trillion for global efforts.

But the landmark climate accord is not the only UN-level instrument shaping the way administrations make policy or companies go about their business. The Sustainable Development Goals are also on the agenda.

Ursula von der Leyen’s new Commission is set to devote more time and energy to the SDGs than its predecessor, the Juncker Commission, and key appointments already reflect that new focus.

Each of von der Leyen’s 26 Commissioners have been tasked with making sure the cross-cutting goals are achieved in their respective policy areas, while economy chief Paolo Gentiloni will coordinate the effort.

Siniscalco, a contemporary of Italy’s new Commissioner Gentiloni, told EURACTIV that “I can’t think of anyone better to push this agenda forward”, adding that the decision to task all members of the college with the SDGs, rather than have a dedicated Commissioner, was the right call.

“The issue should not be treated separately from economic development, we need to integrate, we need to understand that climate change and, more generally, environmental policy is one dimension of human development. Treated separately, it will always be treated as a ‘luxury,” he added.

The SDGs have already found their way into the world of business too. Italian energy firm Enel recently issued a bond linked to the goals on renewable energy and carbon emissions reduction (SDGs 7 and 13).

In what has been lauded as an innovative financial instrument, Enel tagged the rate paid out by the bond to two key performance indicators: one on reaching 55% renewables penetration by 2021 and another on reducing its carbon intensity.

If the company misses those targets, investors will be paid a bigger return. Financial analysts told EURACTIV that the bond has attracted a lot of interest but that more firms will have to offer such financial products if they are to start having a truly disruptive effect.

The bond is in fact the first time a sustainability-linked KPI will cause fixed income rates to increase rather than decrease. That is part of the reason why the $1.5 billion bond was oversubscribed threefold.

Linking the way business decisions are made to sustainability also marks a progression beyond simply financing on a project-by-project basis, which has been the main modus operandi of companies, particularly energy firms, to date.

IDENTIFYING GREENWASHING

One issue that still holds back widespread sustainable investing is the lack of solid criteria to determine what is and what is not a green investment though. There are no truly universal standards at present that can be used.

Money managers insist that common benchmarks are needed to really open the taps. At EU-level at least, the prospect looks more promising, as negotiators continue to hammer out the so-called sustainable taxonomy system.

The new law is meant to provide a blueprint drawing on science-based criteria but talks continue as member states and MEPs are divided over what should be classed as ‘green’. Nuclear energy, in particular, is proving to be a stumbling block.

A finalised taxonomy would likely go hand-in-hand with the European Investment Bank’s (EIB) recently updated energy lending policy, which aims to scrub the lender’s loan books of fossil fuel projects by the end of 2021.

The EU bank’s course correction has been hailed as a powerful signal by business and NGOs alike, in particular its offer of higher co-financing limits for energy efficiency and renewable energy projects.

Financial experts are now largely in agreement that there is not a lack of money for green projects, there is just a lack of links between those cash flows and the right projects. But a line between the dots is starting to be drawn.

That, coupled with the willingness of progressive company leaders to go back to the drawing board and redraw their business strategies, gives truth to Siniscalco’s assertion that “a fundamental shift” is on the horizon.
THE URGENT NEED TO ACT FAST AND NOW

• It is becoming increasingly evident that actions to limit global warming to 1.5°C are no longer a choice. As stated by the IPCC Special Report, we are running out of time and, in order to avoid the devastating impacts of climate change, GHG emissions need to be reduced by 45% by 2030 and our economy must be fully decarbonized by 2050.
• Companies and governments must be ready to lead the change by setting challenging targets, also aimed at influencing customer behaviour. Companies are expected to serve as an example of worldwide best practices and they need to be aware that it is in their own interest to adopt sustainable corporate strategies in order to be able to manage the risks and opportunities linked to the carbon transition. Sustainability means, indeed, Value Creation.
• To accelerate the transition, three strands of action will need to be progressed: (1) making clean and affordable electricity the mainstream energy technology of choice; (2) boosting sustainable and digital infrastructure development whilst ensuring maximum resilience; (3) making electricity the energy vector of the future, thus transforming mobility and lifestyles, digitalizing real estate and cities.

ENEL’S MISSION AND ACTIONS ON THE UNITED NATION’S SUSTAINABLE DEVELOPMENT GOALS (“SDGS”)

• The UN has identified the Sustainable Development Goals (SDGs) as a universal call for action for governments and companies, to be tackled by 2030.
• Enel is the leading global energy transition private player, both industrially (1st for Renewables installed capacity, Energy Distribution customers served and retail customers base) and financially speaking (2nd utility globally in terms of market capitalisation and 1st in terms of EBITDA and net income).
• Enel’s strategy and Business Plan have a direct impact on 4 SDGs which account for around 95% of capital spending through 2022, when Enel is expected to generate 20.1 billion euros of EBITDA:
  • Around 14 bn will be devoted to SDG 7 on Affordable and Clean Energy to support the
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decarbonisation process driven by our Global Power Generation line and accelerated by our retail unit.
- Around 12 bn are linked with SDG 9 on Industry, Innovation and infrastructure and will be deployed in reinforcing the resiliency and improving the digitalisation, efficiencies and quality of our networks.
- Around 1 bn will be invested in SDG 11 on Sustainable Cities and Communities, mainly to new electrification oriented services.

Through these, we aim at acting on SDG 13 on Climate Action, thus achieving the targets we have set for 2020 and 2030 in term of CO2 emissions, both certified by Science Based Target Initiative (SBTi)

SUSTAINABILITY IS VALUE FRAMEWORK

Sustainability and value creation are not mutually exclusive – If you plan and act for Sustainability, you generate value by means of superior financial performance through higher cash generation, more predictable results and lower risk… Such a framework is the strategy that every company should follow to address the challenges we face and generate more value. At the same time, Investors should weigh Environmental, Social and Governance factors in their investment decisions, while Credit Rating Agencies need to incorporate sustainability in a transparent way when assessing the credit profile of companies, resulting in a lower cost of debt for the best performing ones.

Value drivers of a sustainable company – Enel is committed to a strategy based on meeting the objectives of the Paris Agreement (COP21) whilst creating sustainable value over the long term. Over the last five years (2015-2019), the Group has increased profitability with the dividend per share (DPS) expected for 2019 reaching 0.33€ from 0.16€ in 2015, an increase of more than 100%, while achieving objectives related to decarbonization, digitalization, and customer service. The Group’s 2020-2022 Strategic and Business Plan continues on this pathway, based on a long-term view and the achievement of a series of objectives aiming to reach an implicit DPS of 0.42€ by 2022. Our market capitalization has passed from 35€Bn in 2014, to 70€Bn today.

- An overview of sustainable finance so far – Sustainable finance today is mainly driven by financial products that embed an ESG component in the structuring. Green, Social and Sustainability Bonds have specific requirements in terms of «use of proceeds», that have to be invested in sustainable activities and require a specific level of reporting.
- Enel’s leading role in the Green Bond space – Since 2017, Enel has issued 3 Green Bonds for a total amount of 3.50€Bn outstanding: 1.25€Bn in 2017, 1.25€Bn in 2018 and 1.00€Bn in 2019.

Enel has committed to investors to allocate its Green Bonds to sustainable activities only. Over the last 3 years, Enel has experienced a constantly growing demand for its Green Bonds by investors.

- Stilla (green) drop in the (fixed-income) ocean – It is fair to say that Green Bonds (and use-of-proceeds bonds more in general) represent useful tools for those companies that have a segregated sustainable business that they would like to develop. For those companies like Enel, instead, where the strategy and business model are clearly sustainable, we strongly believe that innovative general corporate purpose financing products which create financial incentives for the company to fulfil its sustainable business model are the best way to progress the evolution of sustainable capital markets.

A new “general purpose” to accelerate sustainable finance – Enel’s SDG Linked Bonds Programme

From the experience of green bonds, we therefore elaborated a new “general purpose” approach with our new SDG Linked Bond Programme, complementary to the “use of proceeds” model of the Green Bonds, that aims at accelerating capital flows towards sustainable investments, leveraging on:

- The guarantee of a fully sustainable strategy – a clear link to the sustainability strategy of the issuer has been set (55% renewable installed capacity by 2021 and direct GHG emissions by 2030 equal to or less than 125g of CO2 per kWh), representative of almost 100% of Enel investments linked to the UN SDGs.
- The translation of sustainability into economic and financial value – a clear evidence of the value of sustainability has been achieved with both our SDG Linked transactions, with an upfront discount of around 15 basis points with respect to a comparable bond without sustainability features.
- The transparency of the sustainability performance of the Company – to ensure the transparency of the results, the achievement of the target will be certified by a specific assurance report, in the context of the comprehensive reporting on the sustainability performance of the Issuer.