PRIVATE FINANCE AND THE GREEN RECOVERY

SURVEY AND ROUNDTABLE FINDINGS

29 July 2021
ABOUT THIS PAPER

Throughout 2020, the PRI ran a survey and organised a roundtable to explore investors’ perception of the EU Recovery Package. This paper summarises the key findings. It aims to contribute to the successful implementation of the recovery package and suggests ways to maximise the contribution of private finance. This paper builds on PRI’s work on Investor priorities on the EU Green Deal and the Covid-19 Sustainable and Inclusive Recovery, which presents a series of recommendations for investor policy engagement on sustainable recovery packages.

BACKGROUND

The COVID-19 pandemic has had a profound impact on lives, livelihoods and economies. It has exposed the fragility of our economic systems and the environmental systems on which they depend. European investors have been at the forefront of those calling for a recovery that is sustainable and equitable.

The European Green Deal, announced in December 2019, sets a roadmap for the European economy to transition to a more sustainable and equitable basis. The Green Deal establishes goals of climate neutrality, greater climate resilience and wider environmental protection, as well as detailed strategies for decarbonising critical sectors such as buildings, transport, industry, food, and forestry.

In December 2020, the European Commission adopted its Recovery Plan for Europe. The EUR 1,850 billion plan is comprised of a reinforced long-term EU budget and Next Generation EU, a temporary budget increase partly funded through European Commission borrowing. Crucially, the Recovery Plan will align with the EU Green Deal commitments and channel public investments and support towards the key sectors identified under the Green Deal. At a time of unprecedented public investment, the Commission reaffirmed the need for better collaboration between private and public finance in the recovery proposal – a key theme of research released by the PRI in April 2020. With an estimated EUR 260 billion annual investment gap necessary to achieve the EU’s climate goals by 2030¹, private finance must play a key role in accelerating a green and sustainable recovery.

In this context, the PRI engaged investors to understand how the Green Deal and the Recovery Package can maximise the contribution of private finance. The roundtable discussion and survey focussed on the key elements of the proposed recovery package and the critical sectors for the Green Recovery.

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¹ European Commission impact assessment for InvestEU SWD (2018)
KEY FINDINGS

1. Investors welcome the alignment of the EU recovery package with the high-level commitments in the EU Green Deal. In the run up to COP 26, the EU should use its leadership to push for alignment between Covid-19 recovery packages and long-term climate goals in other countries internationally.

2. Member States, being responsible for most of the planning and implementation of the recovery funds, will play an essential role. Monitoring and conditionality of national plans will be critical.

3. Clear, robust transition pathways to net-zero are required at each member state level. A coordinated sectoral and financing strategy with a net zero roadmap, tailored to Member States would present a huge opportunity for the EU to take a leading role in the run up to COP 26. National roadmaps should align and feed into a global net zero strategy with clear science-based sectoral pathways, in accordance with the goals of the Paris agreement.

4. Certain sectors, such as renewable energies, are identified as presenting significant opportunities for investors, but care must be taken to avoid crowding out private finance in the deployment of recovery packages. Along with other stakeholders, investors should be consulted and included in the Recovery and Resilience Facility process to maximise the crowding-in of private investment and to ensure greater transparency, a stronger public acceptance of projects and better-quality projects.
ANALYSIS

INVESTORS STRONGLY WELCOME THE ALIGNMENT OF THE EU RECOVERY WITH THE GREEN DEAL

The EU’s long-term budget, coupled with the temporary recovery instrument Next Generation EU (NGEU), will be the EU’s largest ever stimulus package, totalling over EUR 1.8 trillion. The choices taken in spending and investment will have a profound effect on the sustainability profile of the European economy, and the opportunities available for private investors.

Participants gave their strong approval of the Commission’s proposals to put the European Green Deal at the centre of the recovery package. The pandemic has caused very urgent short-term needs for certain sectors (aviation, tourism, etc.) and governments have generally reacted quickly to support these. Nonetheless, participants noted that climate change has the potential to cause far greater damage over the medium to long-term.

The EU’s COVID recovery package has also had a positive ripple effect in the rest of the world. Investors highlighted that EU developments are already significantly impacting on non-EU capital markets. Other governments have since followed with similarly ambitious recovery packages – most notably the US’ American Rescue Plan Act and particularly the American Jobs Act announced earlier this year, which will have major structural effects on climate policy.

IMPLEMENTATION BY MEMBER STATES IS CRITICAL

The survey and roundtable were conducted in 2020, before Member States had published their national recovery plans under the framework of the EU’s Recovery and Resilience Facility. While investor participants were supportive of the European Commission’s aim to align the recovery package to net-zero, they were less confident that EU Member States would remain aligned to these high-level goals in their national implementation. For example, participants noted that some – but not all – Member States have introduced conditional bailouts on high emitting industries such as aviation and reconciling these decisions in a coordinated way with a net-zero framework remains a challenge.

Nonetheless, participants also noted that the national plans will present a significant opportunity for Member States to develop best practices, including more consistent implementation of the “Do No Significant Harm” requirements set out by the Commission in the EU Recovery Package.

Participants also highlighted monitoring and conditionality of EU funding as critical, in particular how Member States’ plans and distribution of funding would be monitored, given the substantial potential impacts on the economy. The complexity of the EU package was noted as a particular challenge for observers. While the majority of NGEU funding will be distributed via the Resilience and Recovery Facility, the remainder is spread across several instruments such as the Just Transition Fund and Horizon Europe. These instruments are negotiated, approved, developed, and distributed differently, on different principles and with separate monitoring and compliance arrangements.

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2 For example, the French Government set conditions for Air France which included requirements to halve CO2 emissions per passenger kilometre by 2030, strict reduction targets for domestic flights and restrictions on flights which directly compete with a rail journey of 2.5 hours or less.
**NET-ZERO ALIGNED TRANSITION PATHWAYS**

Investors agreed that the investment opportunities created must be aligned with EU sustainability goals and global limits/thresholds. They must also support industries – particularly those sectors which are able and willing to transition – and ensure that the transition is just and provides adequate support to emissions-intensive regions.

The Paris Agreement, European Green Deal and climate neutrality goals provide targets, but investors argued for a firm policy framework containing transition pathways for specific sectors/industries to provide policy certainty. Such pathways would build confidence amongst investors and should be aligned to a global net-zero framework based on the best available science.

Sectoral roadmaps should leverage on existing work, such as the University of Technology Sydney (UTS) **sectoral net zero pathways** (commissioned by the **UN-convened Asset Owner Alliance**), or the net zero scenarios developed by the **Network for Greening the Financial System (NGFS)** and **M2020**. The PRI has also developed a roadmap of policies which are necessary to deliver a net zero EU economy by 2050: **Delivering Net Zero Emissions in the European Union report**.

Participants wanted the EU and Member States to deliver tailored sectoral roadmaps – reflecting the national context, and looking at what burdens each sector faces, the technology required for each and how each will transition. A coordinated sectoral and financing strategy with a net zero roadmap, tailored to Member States would present a huge opportunity for the EU to take a leading role in the run up to COP 26.

Such pathways must emphasise investment opportunities, not only risks. This could be supported by framing pathways in terms of investment needs, rather than the more negative framing of emissions reductions over time which may lead investors to view them as divestment-focused pathways.

Participants agreed that financing from the recovery funds should support businesses to create transition plans which would enable the development of comprehensive capital raising plans. The EU Taxonomy – and specifically disclosures on capital expenditure (capex) alignment with the environmental performance thresholds set by the taxonomy - can be used as a common tool for governments and investors to monitor and support companies’ transition plans.

**CROWING IN OR CROWDING OUT? GREATER COORDINATION BETWEEN PUBLIC AND PRIVATE FINANCE AND POLICY IS NEEDED**

Public spending and investment will be extremely influential in the achievement of the EU’s climate goals – both in terms of the actual projects and activities undertaken, and the signals sent to the market.

Participants noted the challenges of identifying investment opportunities which make a positive contribution while matching the risk/return requirements of the investor. Increasing the availability of investment opportunities is critical for investors to move beyond divestment from poor performing sectors and increase real-world positive impact.

While private investment, and particularly institutional investment, can make a substantial contribution, not all technologies or objectives are already suitable for institutional investors. The public sector will be better placed to finance or support emerging or high-risk activities. These
significant sums of public money, if not directed appropriately, could result in crowding out of private investment.

Participants supported a clear assessment of financing needs within National Recovery and Resilience Plans, recovery instruments and EU-wide strategies, such as the Renovation Wave (domestic energy efficiency). This should seek to understand the investment needs and matching these to the appropriate financing routes and sources of financing for elements of the sustainability transition.

Participants noted that certain technologies are already bankable and attract ample liquidity – examples included sustainable energy infrastructure, such as Solar PV, offshore and onshore wind. Certain sectors and technologies still rely heavily on public support and are not considered appropriate for institutional investors yet. Examples given included the development of hydrogen as an energy source and carbon capture and storage. Others may be suited to specialised investors.

In distributing recovery funding, participants suggested that priority support should be given to less proven technologies in the form of grants, equity or guarantees.

In the survey participants were asked to identify additional measures that would allow private investors to better contribute to the green recovery. Respondents said most welcomed measures would be greater ESG integration (18%), improved disclosure rules (16%) and greater public support (13%). For European only respondents, the top actions were improved disclosure and greater public support (see Annex 1, Question 24 for more detail).
The EU and Member States could support these markets by:

- Providing greater clarity and coherence in the guiding regulations and frameworks for sectors, such as energy efficiency and infrastructure. Harmonization of key frameworks, such as Energy Performance Certificates, would build investor confidence.

- Supporting the development of project pipelines, particularly for new infrastructure.

- Holding high environmental and social standards in public procurement, which can both stimulate demand for sustainable solutions and send a signal to the market.

- Targeting support to enhance the creditworthiness of off-takers (for example, buyers agreeing to purchase energy derived from a renewable project) by offering guarantees where the off-taker is not creditworthy, or offtake contracts are not sufficiently long-term.

- Ensuring the additionality of any new financing initiatives. As mentioned above, the public sector will be better placed to finance or support emerging or high-risk activities. Along with other stakeholders, investors should be consulted and included in the Recovery and Resilience Facility process to maximise the additionality of private investment.

OUTLOOK

The EU Recovery Package – due to its size, scale and timing – is a once-in-a-lifetime opportunity for the EU and its Member States to finance the transformation to a more sustainable and equitable economy, as set out in EU Green Deal.

At the time of writing, the European Commission is assessing national recovery plans submitted as part of the Recovery and Resilience Facility process. Ensuring that Member States’ plans adhere to the principles set out by the European Commission, particularly those relating to a minimum of 37% of expenditure for climate investments and reforms, will be essential. The success of the Just Transition Fund will also be crucial in ensuring that workers and communities are supported in sectors that require deep transformation.

The PRI will continue to engage investors to explore the opportunities presented by the national recovery plans and the EU Green Deal, and advocate for the political instruments necessary to accelerate the implementation of sustainable finance and the transition to net zero by 2050 in Europe.
ANNEXES

PRIORITY SECTORS FOR PRIVATE INVESTMENTS

The initial survey took place early in the pandemic and reflects some of the short-term impacts of the pandemic on company valuations, for example due to a shift towards home working and teleconferencing at the expense of business travel. European and Global investors identified healthcare, energy and information and communication technology (ICT) as the sectors presenting the greatest opportunities for private investment to contribute to a sustainable, equitable recovery (see Annex I, Question 23 for more detail).

In the roundtable, which took place slightly later in the pandemic, participants viewed this question through the lens of the long-term recovery of the European economy. The discussion focussed on sectors with substantial job-creation benefits, and those where targeted deployment of public support could foster the development of emerging sustainability solutions. In the short-term, green spending was felt to be most likely to be accepted where it also creates jobs and improves the skills of workers.

Substantial discussion was given to infrastructure (encompassing energy, transport and ICT), recognising that it is central to the sustainability transition and has a significant multiplier effect. Investors also noted that some Member States may begin to sell infrastructure assets as their budgets come under increasing pressure, presenting opportunities to investors with a long-term view and good management of ESG risks.

Sustainable energy infrastructure and energy efficiency were noted as having high environmental benefits and job creation potential relative to fossil fuels, as well as automotive industries if conditionality is deployed appropriately (i.e. if bailouts, investment and spending encourage the transition to zero emissions vehicles). The majority of surveyed investors believe that COVID-19 has led to structural changes in the energy sector which present opportunities for policy reform (see Annex 1, Question 11).

Finally, participants noted that climate is important but a full range of environmental, social and governance issues must be considered. In the survey, the vast majority of investors said COVID-19 had brought social issues onto their radar, particularly occupational health and safety, social safety nets (e.g. access to health care, unemployment protection, furloughs, income support through social assistance) and worker protection (i.e. emergency paid leave, sick benefits and pay leave, family leave and care policies, layoffs, changes in work schedules) (see Annex 2, Question 1 for more detail).

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3 In the survey, infrastructure was not identified as a priority in its own right, likely because over the short-term investors did not expect the pandemic to substantially influence asset valuations.
ANALYSIS OF COVID RECOVERY SURVEY

The total number of PRI signatories (asset owners and investment managers) that participated in this survey was 64. Of which there were 4 from Asia, 27 from Europe, 12 from Latin America, 15 from North America and 6 from Oceania (none were from Africa).

**Question 1a - Has Covid-19 brought social issues that were not already within your priorities on the radar?**

![Graph showing the number of responses for different regions regarding new social priorities.](image)

**Question 1b - If yes, which ones? (tick all that apply)**

![Bar chart showing new social priorities for all respondents (global) and European respondents.](image)
Question 4 - How has the COVID-19 crisis changed the way you engage on social issues? (tick all that apply)

How has the COVID-19 crisis changed the way you engage on social issues?

- Greater investor collaboration to tackle the barriers
- Engagement with policy makers
- Engagement through AGMs and proxy voting

How COVID-19 has changed social issues engagement in Europe?

Percentage distribution across answers:

- Global
- Asia
- Europe
- Latin America
- North America
- Oceania

Number of responses:

- Greater investor collaboration to tackle the barriers
- Engagement with policy makers
- Engagement through AGMs and proxy voting
Question 9 - Has the COVID-19 pandemic affected the incorporation of an accelerated energy transition (post-COVID-19) into your investment decisions and stewardship?

Has Covid 19 affected incorporation of a rapid energy transition into investment decisions?

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Question 10 - Do you see the COVID-19 recovery phase as an opportunity for governments to step up ambitions towards net zero by 2050 and Paris alignment?

Is the COVID-19 recovery phase an opportunity for governments to step up ambitions towards net zero by 2050 and Paris alignment?

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**Question 11 -** Do you believe COVID-19 has accelerated the structural changes that the energy sector is going through? Will this change present opportunities for policy reform (e.g. fossil fuel subsidies) and renewable energy?

**Question 23 -** Where do you see the most substantial opportunities for private investors to contribute to a sustainable, equitable post-COVID economic recovery? (tick all that apply). If ‘other’ please describe. Please explain.

The graphs for question 23 and 24 show:

- The priority sectors for these opportunities in different regions as a percentage of all answers (Note, this was done as if each tick box was an individual answer rather than each participant)
- The percentage of all investors who selected/mentioned each option
- The priority areas specifically in Europe.

Note, ‘Infrastructure’ was not a tick box option, but a few survey participants mentioned it in the ‘other section’ and one said they took ‘real estate’ to mean ‘infrastructure’. Other non-tick box sectors mentioned were Agribusiness, Education and Tourism.
Question 24 - What additional measures could be taken to support private investors to contribute?

This was an open-ended question, but key themes were present throughout. Responses were grouped into the following categories. The graph below presents responses for European respondents only. For global respondents, the most welcomed measures were greater ESG integration (18%), improved disclosure rules (16%) and greater public support (13%) – See report page 6.
ABOUT THE PRI

The Principles for Responsible Investment (PRI) is the world’s leading initiative on responsible investment. The PRI is now a not-for-profit company with over 4,000 signatories (pension funds, insurers, investment managers and service providers) to the PRI’s six principles with approximately US $100 trillion in assets under management.

The PRI supports its international network of signatories in implementing the Principles. As long-term investors acting in the best interests of their beneficiaries and clients, our signatories work to understand the contribution that environmental, social and governance (ESG) factors make to investment performance, the role that investment plays in broader financial markets and the impact that those investments have on the environment and society as a whole.

The PRI works to achieve this sustainable global financial system by encouraging adoption of the Principles and collaboration on their implementation; by fostering good governance, integrity and accountability; and by addressing obstacles to a sustainable financial system that lie within market practices, structures and regulation.

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