ALGER

TRANSCRIPT

A Common Language for “Green” in Europe

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Despite the increased integration of environmental, social and governance—ESG—considerations in the investment process in recent years, we believe the focus from investors, corporations, and governments on these three letters will continue to increase for many years to come. Currently, the emphasis is on the “E” as countries around the world work to combat climate change and protect the planet. Governments are also participating by setting ambitious targets to become carbon neutral.

Europe leads the rest of the world in the ESG initiative with the European Green Deal, which was presented at the end of 2019. The EU Green Deal includes policy measures and a roadmap to aid in the transformation of the European Union into a sustainable economy for the future. A key component of the Deal is for the continent to achieve carbon neutrality by 2050, with an intermediate target of a 55% reduction in greenhouse gas emissions by 2030 as compared to the 1990 levels. To achieve this target, companies will need to transform their activities to fit into a new green economy. This in turn leads to two crucial questions. How do we define what is green? And how do we fund the additional annual 350 billion euros required for this transformation over the next decade?

To help answer the first question, the European Union introduced the European Taxonomy, which is a unified classification scheme to assist investors and corporations in aligning with the transition to a low carbon economy. The objective of the EU Taxonomy is to create a common language by legally defining what is environmentally sustainable or green. This applies to different sectors based on criteria that substantially contribute to the environmental objectives. By clearly defining what is green, the EU Taxonomy will incentivize and encourage companies to launch new projects, or upgrade existing ones, to meet these criteria. This tool is essential to the implementation of the EU Green Deal and meeting the climate objectives.

To address the second question, the EU introduced the Sustainable Finance Action Plan. The key components of the plan aim to channel finance towards climate goals through a mix of public and private investments and to enhance transparency through improved disclosure requirements for corporations and investors. Public investments will come from the Green Deal Investment Plan and the European Recovery Fund. The financial sector will play a key role in private investments and help re-direct investments towards more sustainable businesses as well as help to finance growth in a sustainable manner over the long term. To facilitate this, corporate disclosures will require companies to report how their financial metrics align with environmental objectives. At the same time, asset managers will be required to disclose what percentage of assets in their portfolios are Taxonomy-compliant. We expect the disclosure rules will result in asset managers marketing ESG strategies that are more aligned with the EU climate objectives.

By defining what is sustainable and increasing transparency through disclosures, the EU has set the foundation to aid in mobilizing capital towards meeting climate goals. We believe this is likely to have a significant impact on the way investors around the world allocate capital. We also believe that ultimately, this will lead to high demand for companies and assets that are aligned with the environmental objectives of the EU Green Deal and push up relative valuations and prices of these assets.

There is a global movement for climate change and Europe has taken center stage with the development and implementation of the EU Taxonomy. The rest of the world is closely watching, as there is a strong chance the taxonomy will become the blueprint for the global standard of ESG investing in coming years.

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