Investing in the Low-Carbon Economy

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Private capital has never been given such an important role in tackling climate change and decarbonising the economy. As Philippe Le Houérou, CEO of International Finance Corporation (IFC), says, the private sector "holds the key," noting that it "has the innovation, the financing and the tools."

Financing Decarbonisation

Amundi, Europe's largest asset manager[1], creates innovative solutions to bring new large-scale funding dedicated to financing the low-carbon economy.

"We started looking at our carbon strategy on the equity side, trying to optimize our portfolios' performance in relation to the benchmark while reducing carbon risk," says Alban De Faÿ, Credit Portfolio Manager and Head of SRI Fixed Income processes at Amundi. "It's one way to integrate climate-change risks into equity investments."

Four years ago, Amundi partnered with Swedish pension fund AP4, index provider MSCI and France's Fonds de Réserve pour les Retraites (FRR), to develop a range of low-carbon indexes and subsequent passive investing strategies for a new market of investors seeking to manage and mitigate their carbon risk exposure. The MSCI Global Low Carbon Leaders Indexes consist of companies with significantly lower carbon exposure than the broad market average.

Many emissions-intensive sectors already provide good-quality data, but other sectors are in their infancy.

"Low-carbon indexes are a good way to learn about these topics and help equity investors reduce their risk," says De Faÿ. "We really need to improve the quality of the data and standardise this kind of risk, and building new indexes is a good way to improve the amount and quality of data available."

Expanding the Green Bond Market

Amundi is also at the forefront of efforts to expand the green bond market, and launched its first open-ended green bond fund in 2015, and its first 100 percent green bond fund in 2016, which aims at measuring the positive environmental impact of the funds it lends.

"In fixed income, it's quite different from our approach in equities," says De Faÿ. "Our main focus is how we can finance low-carbon projects and help issuers to accelerate their move towards low-carbon economy. We want to offer investors solutions to innovate and finance more green projects.

The two green bond funds maintain different strategies to fit the requirements of investors looking to finance the low-carbon transition. The first fund aims at financing key players involved in the energy transition. Its strategy leverages green bonds as a financing mechanism with high transparency and enlarges this universe to other issuers which embrace the transition towards sustainable energy.

" In addition to green bonds, we also fund 'pure play' companies that have more than 50 percent of their turnover dedicated to low-carbon activities— like for instance a company which is a leader in energy efficiency and smart grid applications," explains De Faÿ. "There is a big gap between the energy we produce and what is available to use because of transmission losses, so they can make a real difference".

"In addition, there are a lot of sectors facing big challenges in relation to their carbon footprint, where they really need innovative investors to help issuers transform to low-carbon. It's about both risks and opportunities," says De Faÿ. The fund also finances issuers identified as leaders due to their proactive approach in terms of climate change mitigation.

Amundi's second green bond fund uses an impact-investing strategy. It only invests in green bonds where the issuer provides evidence on key environmental indicators, such as CO2 emissions avoided. This allows investors to finance sectors that might be deemed environmentally risky, as these sectors prove they are making improvements.

In equities, investors want to reduce their exposure to carbon risks, and may seek to avoid high-emissions sectors such as utilities. However, for fixed income investors wanting to invest sustainably, such companies may be attractive as green bonds are an efficient tool to help electricity generators innovate and move away rapidly from high-carbon power plants.

Challenges Remain

The next challenge is to create a single, standardised definition of what is and isn't "green." For example, in China, clean-coal projects can be considered as green, but in Europe, they won't. De Faÿ believes that the EU's Sustainable Finance Action Plan, which includes a sustainability taxonomy, will be "a big help."

Similarly, levels of transparency still vary from issuer to issuer. In the utilities sector, the information tends to be comprehensive because it is the sector's own assets that generate data; in banking, metrics can be more opaque because the sector is reliant on more third-party information.

More diversity is needed in the types of issuers and the yields they offer. The green bond market has, to date, been chiefly made up of issuance from the multilateral development banks, which offer great security to investors, but low yields.

"Many investors are looking for a higher yield, and green bonds can't offer that yet," acknowledges De Faÿ. "The market needs more corporate issuers providing higher yields to meet the needs of all type of investors. If we can develop a high-yield market, it will drive more low-carbon investment."

The Climate Bonds Initiative

The Climate Bonds Initiative states that banks need to issue more green bonds and green loans, and increase their underwriting support for the sector. This would also help the market to finance more than just large-scale renewable energy facilities and portfolios of green loans for banks. Amundi has the capabilities to cooperate with banks on these issues, to extend the green market to all fixed income market segments due to the expertise of dedicated teams specialised in these specific segment like loans, smaller bonds and private placements.

"It would be nice to imagine that one day we will have green market on all types of solutions, such as asset-backed securities [ABS] and collateralised loan obligations [CLOs]," says De Faÿ. "If we do this, we will have a market that answers all the different types of financing needs for companies and the needs of investors around risk and return. It is starting to happen, but at the moment, we are not able to deploy all of these fixed income weapons."

In the spring of 2018, Amundi launched a green strategy in partnership with the World Bank to support demand for green bonds (through a €1.5 billion fund investing in emerging-market green bonds). This strategy is the world's largest emerging market-focused green bond fund, and aims to increase the capacity of emerging-market banks to fund climate-smart investments.

It is expected to deploy $2 billion into emerging-market green bonds over its lifetime, as its proceeds will fully invested over seven years in green bonds.

The market for sustainable finance products remains small. Interest from investors is strong and growing, and as more products become available that meet the requirements of a wide range of investors, sustainable finance is set to go from strength to strength, bringing new momentum to the low-carbon transition.

FOOTNOTE

1 Source: IPE "Top 400 asset managers" published in June 2018 and based on AUM as of end December 2017.