Mobilising Investors for a Just Transition in Europe

Summary of the Discussion at the Paris Roundtable[1]

KEY CONCLUSIONS

1. **The just transition is ever more central to EU efforts to build a sustainable economy:** The polycrisis of 2022 has reinforced the central importance of the just transition for building a sustainable, secure and inclusive economy in the EU and worldwide. Placing workers, communities and consumers at the heart of the phase out of fossil fuels and scale up of resource efficiency and renewable energy is a strategic imperative at a time of war, energy and climate shocks, inflation and supply chain disruption as well as deepening fuel poverty. Financial decision-makers increasingly recognise that an accelerated and just transition to net zero is essential in 2023. This means achieving a fair distribution of the costs and benefits in the transformation and also delivering good jobs with decent work in key sectors such as building renovation, clean energy expansion, net zero industry sustainable transport and nature-based solutions.
2. **Just transition needs to be mainstreamed in sustainable finance policy and practice:** As a result, the environmental and social dimensions of transition are critically interdependent for the financial sector. The EU has led the way with its just transition financing mechanisms for carbon-exposed regions, supported by the work of development banks such as the EIB and the EBRD. The next challenge is to incorporate the just transition as a cross-cutting priority within the EU sustainable finance policy framework. This means showing how business and financial institutions can be held accountable and be incentivised to support the just transition through structures such as the Sustainable Finance Disclosure Regulation (SFDR), the Corporate Sustainability Reporting Directive (CSRD) and Corporate Sustainability Due Diligence Directive (CSDDD).
3. **Investors are starting to take action to support the just transition, but pace of action limited:** Just transition is being incorporated into investor climate strategies and the new generation of net zero plans. Shareholders are increasingly holding companies to account for net zero and the social dimensions of climate through initiatives such as the Investors for a Just Transition coalition. And a small number of asset managers are reallocating capital to the just transition through new fund offerings (to date focused on fixed income. Overall, the pace of action is promising but insufficient. A crucial next step is developing shared metrics of 'what good looks like'.
4. **Welcome to the real world – connecting finance with place-based realities:** Getting a common agreement on what just transition for finance means is essential within the EU and globally. But there is also a risk of this becoming too top-down, insufficiently recognising the specificities of different sectors and regions. The roundtable focused on the needs and opportunities facing Poland, where the task of making the just transition come to life has to be achieved with a relatively underdeveloped capital market. This means that just transition becomes a core pillar of sustainable finance policy, making a fundamental link between investing in climate solutions and generating good quality employment which is respected in the community.
5. **Next Steps:** Since the Roundtable, COP27 and other developments have further underscored the urgent need for a just transition achieved through high standards and social dialogue. To mobilise investors for just transition in the EU, two key areas need further exploration: first, how can the just transition be enabled by the EU's sustainable finance architecture, notably in terms of disclosure and due diligence?; second, how can investor just transition efforts result in real capital allocation to the places and people that need it most across the EU? We plan to host a 2nd Roundtable to address these twin challenges.

[1] This note was prepared by Brendan Curran, Nick Robins and Adithya Subramoni based on discussions with c30 finance, policy & stakeholder experts at a roundtable hosted by Candriam on 25 October 2022.

SESSION HIGHLIGHTS

The roundtable was hosted by the London School of Economics in association with Candriam and Finance for Tomorrow to identify how private investors in the EU can best support a just transition across four sessions. What follows is a summary of session discussions.

Session 1 – Financing a Just Transition in the EU: Policy and public finance

Role of public and private finance in delivering good jobs: It is vital to ensure that good jobs do not leave Europe as a result of the challenges posed by the transition and energy crisis. There is an opportunity to create place-specific good jobs through the transition that builds efficiency into the European workforce. The next few years are critical as the Just Transition Mechanism (JTM) and associated funding supports these transitions across the countries within the EU. It will be necessary that each transition has its foundations in strong labour standards and decent work. Despite significant public finance being made available through the JTM, there remains a crucial role for private finance. They can invest in companies that do not violate union rights, invest in companies that have a credible transition plan inclusive of social dialogue with workers and other stakeholders, and pass due-diligence checks on labour rights and human rights.

Adjusting existing EU regulation to consider the Just Transition: The EU is not starting from scratch on the social for transition frameworks, but the challenge now is to reverse engineer Just Transition into existing legal frameworks and transition plans. For instance, potential next steps could be to use the policy dialogue lever to include how the workforce (instead of revenue) are exposed to unsustainable activity in the taxonomy. There is scope here for private finance actors to proceed through their advocacy roles to include Just Transition in directives like CSRD (already adopted), CSDDD and SFDR which is up for review in 2024. However, there was discussion within this session as to whether more granularity is what was required from the EU Green Taxonomy to deliver meaningful stewardship from investors on the just transition.

Finance is only a means to an end: Finance alone cannot provide the reallocation of capital necessary to drive the transition. First, policy and public finance have an important role in shaping the environment for finance to be effective. They need to take an active role beyond risk-sharing and derisking and move towards improving regulatory and supervisory frameworks. In some countries, for example Romania, there is a crowding out effect because of fiscal imbalances. Public policy must improve underlying conditions to develop capital markets to counter this. Second, the quality of finance is key. At present, there is a skew by 95% towards debt instruments which is unsuitable to achieve the high-level climate and social ambitions. Considering maturity and tenure needed for transition projects, equity needs to be more prevalent. Finally, finance needs to reflect and respond to conditions of real economy because doing otherwise presents greenwashing risks.

Real economy reporting challenges: Companies have limited experience in reporting under evolving sustainability frameworks and sizing metrics which poses a challenge to both them and investors who need access to data in a standardised manner. Companies need to have tools to build capacities and to understand best practice. Therefore, there is a need to create a one-stop shop including tool kits and manuals that cater to all company sizes. This needs to be rolled out in dialogue with policymakers and investors to ascertain expectations for KPIs that include the Environmental and the Social.

Session 2 – Financing the Just Transition: Institutional Investors

Emerging examples of Just Transition financial instruments in the EU: Ostrum's global sustainable transition bond fund is an example of emerging Just Transition financial instruments in the EU. It qualifies under the Article 9 funds of the SFDR and has included Just Transition at three level; project level, methodology and JT indicator at issuer level. However, based on their experience some challenges in this domain are disclosures as to what constitutes as sustainable investments.

Complexities of sustainable investment ambitions: Although there is a high ambition for investors to achieve long-term climate and social goals, there is limited links to short-term financial drivers. The SFDR sets up a start-off point for sustainability in the EU, but it challenges the fiduciary duty of investors who also invest in market that extends beyond the EU. Hence, bringing in clarity on social for sustainable investing is vital. There is a need for policy and private finance to work hand in hand to address these issues together and build in incentives in the system that match with short-term financial drivers.

Leveraging engagement through collaborative initiatives: Collaborative initiatives like the Investors for a Just Transition coalition group demonstrate successful first steps in collecting best practices, proof of concepts to engage with SMEs, investors, and corporates (that are selected by the coalition). This builds a platform for identifying best practices to promote just transition through collaborative knowledge sharing with handpicked corporates in the buildings and construction sector. This develops a knowledge platform for successful engagement case studies with industry pioneers that can be useful to lead dialogue with laggards after.

Session 3 – On the ground realities and place-based investment in Poland

Poland faces twin challenges - climate change and financial market development: Post-soviet countries do not have as developed capital markets. However, there is an opportunity is to build a capital market that aligns with environmental and social investment risk and opportunity. The Polish economy is trying to move away from a 'reliance on grants' mentality with many regional corporates and policymakers having limited knowledge about financial instruments available to raise capital. Therefore, there is also a role here to improve awareness of financial instruments and access to instruments with sustainable criteria. The planned first steps here are to encourage small companies and local municipalities to issue their own cost-efficient bond issuances.

Adapting the economy to climate change a very real political challenge to Poland: 90% of coal companies are state-owned in Poland. The engagement strategy for Poland's transition hinges not on how smart investor engagement is with communities, but rather what the expectations of institutional investors would be in advancing a strong capital market that can support the transition in Poland. The climate transition in Poland is expected to cost around 250 billion euros where public investment can cover around 200 billion, hence, the 50m shortfall will need to come from private finance.

Leveraging the role of Poland's banking system: Although the capital market being underdeveloped remains a key issue in Poland, there exist alternative forms of raising capital. The Polish retail banking sector is quite strong in terms of data availability and connectivity to customers.

This was evidenced by its performance through the 2007 financial crisis where the banking system should resilience in comparison to other EU states. The primary reason for this is that the banking sector has a developed digital retail capability and previously social credits have also been distributed via banks. There is significant scope for replicating transition-friendly schemes through these strong links to retail customers. Where capital markets are underdeveloped, the capital market unions have a role to advance, but in Poland's case there is a considerable reach to be leveraged through the banking sector as well.

Addressing employment realities and breaking stereotypes regarding renewable energy jobs: Transitioning the workforce from carbon-intensive sectors to renewable energy jobs comes with two significant challenges. First, there is a fall in pay for those moving from high-paying coal-based jobs and second there is a sense of loss in ones' professional prestige when moving from coal mining to renewable jobs like solar panel installation. These factors have hindered the translation of 1 to 1 job conversions while transitioning to a green industry base. Fighting this stereotype is essential to building acceptance for the renewable skill force. It is vital to address this through measures like reservation pay for people in companies changing from paying job to a stable but less paid job, skills force mapping etc.

Session 4: Focusing on financial mechanisms

Bringing Just Transition into the real economy: There remains a role for policy to incentivize private finance and build an enabling environment. There is also increasing demand from investors to move from pure green to resilience, adaptation, and just transition-focused issuance. For instance, green and resilience issuance is expected to hit $5 trillion in 2025. Moving forward, ESMA regulation on Article 9 funds will require disclosure on social factors of investment and disclosures on the percentage of social investment under Article 9, but there is still scope to further regulatory push on SFDR. The potential next step would be to engage with relevant decisionmakers to ensure the just transition is included as a required standard and a fundamental norm with the ICMA and introducing a green bond plus issuance where a just transition dimension can be added retrospectively on the clause.

Human resource availability, the real bottleneck: A significant issue is in managing the human resources for the transition in terms of retraining and recruitment. Transitioning job is not an easy process normally and there will need to be significant support for training and re-skilling programmes where workers are open to that process. The support of DFIs like EBRD will be critical as they can take a market making role through their technical assistance support and concessional financing. As part of the EBRD's Just Transition Initiative, they worked on Tauron's decarbonization bond issuance and supplied transition finance conditional on including reskilling and retraining of workers.

Social taxonomy needs to be ambitious: If there is to be a social taxonomy, it must increase the expectations for social considerations in financial activities. At present sectors like utility and transport already fall under the EU taxonomy as there is some social in the wider green of their work. However, the objective is to rewire the economy to ensure all economic activities are socially aligned.

Using the taxonomy as a metric: Although there exist issues with comparisons on what is standard for sustainability-linked loans and products, a potential option here for investors is to measure taxonomy alignment. Since it is a measurable component, investors can engage with the objective of increasing taxonomy alignment.

Next Steps

Since the Roundtable, COP27 and other developments have further underscored the urgent need for a just transition through social dialogue. To mobilise investors for just transition in the EU, two key areas need further exploration:

1. How can the just transition be enabled by the EU's sustainable finance architecture?

To be both efficient and effective the pursuit of the just transition will need to take place within the deepening EU sustainable finance policy architecture. In many ways, the just transition is an iconic bridge issue between the environmental and social pillars of sustainable finance.

To take just one example, since the roundtable, The Council of the EU adopted the EU Corporate Sustainability Reporting Directive (CSRD) which will mean many more companies will be required to provide sustainability disclosures and introduces more detailed reporting requirements on the environment, human rights and social standards as well as sustainability related risk. CSRD disclosures will be based on a common framework of European Sustainability Reporting Standards (ESRS) developed by the European Financial Reporting Group (EFRAG). The first draft of the ESRS was submitted by the EFRAG in November. This included general disclosures (including on governance, strategy and impact, risk and opportunity management) as well as specific social disclosures covering an organisations own workforce, workers in the value chain, affected communities and customers and end users. It is expected that the Commission will adopt the final standards by delegated acts in June 2023. EFRAG will now work on the second set of draft ESRS which are sector specific covering the Global Reporting Initiative (GRI) sectors. These reporting standards should produce more data to support investor action for a just transition.

What is perhaps needed now is a **'just transition playbook'** that shows how the requirements in the CSRD, the SFDR, the CSDDDR and others can best ensure that business and finance are connecting the environmental and social pillars of the just transition. This process could also identify where specific just transition efforts might be needed, and could connect with early discussions within the International Sustainability Standards Board (ISSB) to move beyond pure climate reporting to encompass the just transition.

2. How can investor just transition efforts result in real capital allocation to the places and people that need it most?

Beyond the need for clear regulatory frameworks that support the just transition, additional efforts are required to make sure that capital is actually being reallocated to the places and people in the EU that need it most. Since the Roundtable, the LSE has published our Making Transition Plans Just Report as well as our Just Financing Tool (launched at COP27 in partnership with the UN International Labour Organization).

The sustainable bond and loan market is one of arena where financial innovation on environmental and social investment is actively taking place, with issuance starting to point towards explicit just transition financing. We would like to explore further how we can encourage greater fixed income development of just transition funding, including sovereign, municipal, development bank and corporate issuances.

Next workshop in 2023: Given the strong feedback from the October roundtable, we propose to host a 2nd roundtable, potentially in Brussels in the first half of 2023. This would focus on going deeper into the two challenges set out above. We would welcome feedback on these themes as well as support to work with us on this.

Participants

First Name	Last Name	Organisation
Naïm	Abou-Jaoudé	Candriam
Wim	Van Hyfte	Candriam
Pauline	Descheemaeker	Candriam
Nick	Robins	LSE
Brendan	Curran	LSE
Adithya	Subramoni	LSE
Pauline	Becquey	Finance for Tomorrow
Marguerite	Culot	Finance for Tomorrow
Serge	Giacomotto	EU Commission
Nathalie	Beauvir-Rodes	Ostrum Asset Management
Mireille	Martini	Climate Bonds Initiative
Carine	de Boissezon	EDF
Anna	Vasylyeva	EBRD
Pietro	Calice	World Bank
Samantha	Smith	Just Transition Centre
Katarzyna	Szwarc	Polish Ministry of Finance
Michał	Hetmański	Instrat Foundation
Mike	Brown	Climate Bonds Initiative
Elise	Attal	Principles for Resonsible Investment
Lorena	Sorrentino	CSR Europe
Johannes	Schroeten	E3G
Simonetta	Spavieri	Royal London Asset Management

Ekaterina	Chubarova	ILO
Rae	Lindsay	Clifford Chance
Vonda	Brunsting	Harvard University
Patrick	Haustant	Amundi
Mathieu	Firmian	AXA IM