eurelectric
powering people

Enabling sustainable investments via sustainable finance

Eurelectric position paper

January 2019

Eurelectric represents the interests of the electricity industry in Europe. Our work covers all major issues affecting our sector. Our members represent the electricity industry in over 30 European countries.

We cover the entire industry from electricity generation and markets to distribution networks and customer issues. We also have affiliates active on several other continents and business associates from a wide variety of sectors with a direct interest in the electricity industry.

We stand for

The vision of the European power sector is to enable and sustain:

- vibrant competitive European economy, reliably powered by clean, carbon-neutral energy
- smart, energy efficient and truly sustainable society for all citizens of Europe

We are committed to lead a cost-effective energy transition by:

investing in clean power generation and transition-enabling solutions, to reduce emissions and actively pursue efforts to become carbon-neutral well before mid-century, taking into account different starting points and commercial availability of key transition technologies;

transforming the energy system to make it more responsive, resilient and efficient. This includes increased use of renewable energy, digitalisation, demand side response and reinforcement of grids so they can function as platforms and enablers for customers, cities and communities;

accelerating the energy transition in other economic sectors by offering competitive electricity as a transformation tool for transport, heating and industry;

embedding sustainability in all parts of our value chain and take measures to support the transformation of existing assets towards a zero carbon society;

innovating to discover the cutting-edge business models and develop the breakthrough technologies that are indispensable to allow our industry to lead this transition.

Dépôt légal: D/2019/12.105/2

WG Financial Regulation
WG Social Sustainability

Contact:
Ronan HAAS, Advisor Gas to Power and Financial Regulation – rhaas@eurelectric.org
Krzysztof LASKOWSKI, Advisor Climate and Social Sustainability - klaskowski@eurelectric.org

Better finance for better development

KEY MESSAGES

- Eurelectric's members are committed to delivering a carbon-neutral power supply in Europe well before 2050. This commitment, together with the electrification of other sectors of the economy, will make a major contribution to help Europe meet its climate targets.

- Decarbonising the European power sector will require investments of €89bn to €111bn per year until 2045. Efficient market-based investment frameworks and adequate market design are required to provide the right signals to investors. Connecting finance to a more sustainable economy is essential to provide clarity and confidence to investors.

- The approach to sustainable finance should allow to achieve the long-term decarbonisation objective of carbon-neutrality, as defined in the Paris Agreement. Europe needs a financial system that enables a sustainable economic development built on social integration, taking care of the environment and limiting the impact on the endowments of nature.

- The proposed EU taxonomy must enable and accelerate investments and innovation in all transition enabling technologies and related business models. Eurelectric therefore recommends a flexible and technology-neutral system with a view to achieve carbon neutrality rather than an inclusion/exclusion list. The EU taxonomy should take into account the different starting points of Members States and their individual pathways towards carbon-neutral power systems.

- Based on existing practices, Eurelectric supports the development of a uniform EU Green Bonds Standard to mobilise resources for climate change adaptation, renewable energy and other environment-friendly projects.

Introduction

Sustainability is broadly recognised as the model for Europe's future development. In this sense, finance is an essential lever to achieve ambitious collective goals for economic prosperity, social inclusion and environmental regeneration.

The European power sector welcomes and supports the objective of the Commission Action Plan on Sustainable Finance to enable inclusive growth, funding in particular society's long-term needs for innovation and infrastructure, and accelerating the shift to a resource-efficient and low-carbon economy. The creation of a Technical Expert Group (TEG), continuing the work of the previous High Level Expert Group (HLEG), is a key step in the right direction.

Sustainable finance is the way to reconcile a better development with a better finance. In this framework, climate change is indisputably a priority when addressing long-term sustainable development issues. To achieve sustainable finance, we believe that the financial sector needs to adopt a carbon-neutral approach. Finance should indeed work to catalyse long-term innovation and enable immediate deployment of the best available solutions for the decarbonisation, electrification and digitalisation of the economy.

A decarbonised power sector is at the heart of the European fight against climate change. Europe's capacity to meet the ambitions of the Paris Agreement depends heavily on our industry's ability to decarbonise electricity. Eurelectric members are committed to invest in clean electricity generation, the required networks and other transition-enabling technologies, such as storage and demand response, in order to deliver carbon neutral electricity well before 2050 as outlined in the flagship study 'Decarbonisation Pathways'[1]. This includes digitalisation, demand side response and reinforcement of grids so they can function as platforms and enablers for customers, cities and communities. This commitment follows a statement made earlier in 2017, in which the power sector declared that it does not intend to invest in new coal plants after 2020.

Enabling investments in the power sector

The Paris Agreement demonstrates the priority and urgency attributed to mitigating climate change by global leaders, including the EU. The European power sector can be fully carbon neutral ahead of 2050 and contribute to the broader decarbonisation objectives through strong electrification of key economic sectors (buildings, transport and industry). Achieving this long-term goal in a cost-effective manner will necessitate a very significant investment effort. According to the Commission's estimates, over the next decade, Europe will need around €177bn a year in low-carbon investments to meet the 2030 climate and energy targets[2]. For the 2031-2050 period, the European Commission's Long-term Strategy

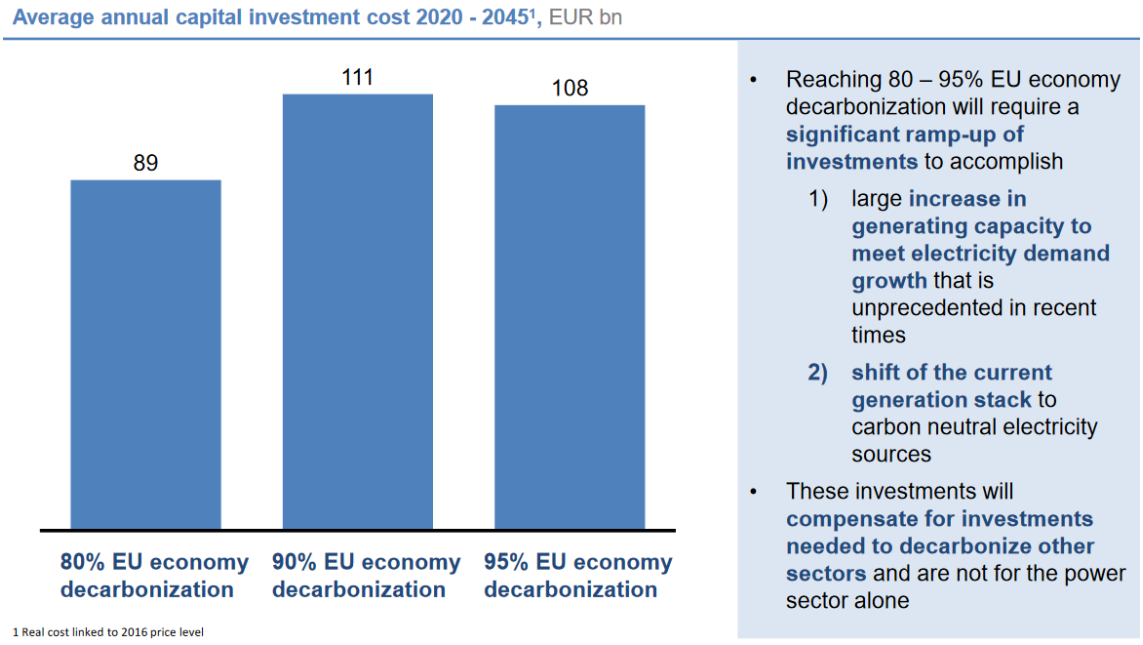
[1] https://www.eurelectric.org/decarbonisation-pathways/

[2] The estimate is an yearly average investment gap for the period 2021 to 2030, based on PRIMES model projections used by the European Commission in the Impact Assessment of the Proposal of the Energy Efficiency Directive (2016), http://eur-lex.europa.eu/legal-content/EN/TXT/?qid=1483696687107&uri=CELEX:52016SC0405.

estimates that the 80% reduction scenarios would require an average annual investment of € 1.33 tn[3].

Investments in carbon neutral energy sources and over €700 bn invested in renewable energy sources by the European power sector between 2004 and 2016 show its clear commitment to decarbonisation. Carbon free generation assets and the required networks are now supplying an increasing amount of Europe's electricity requirements. In 2016, following a clear upward trend, 56% of all electricity & heat generated across the European Union came from carbon-free sources, including 30% from renewables[4].

The results of Eurelectric's Decarbonisation Pathways study shows that the potential for electrification is substantial across energy-using sectors and will underpin deep decarbonisation of the economy. Deep decarbonisation is by implication an electrification journey. Electrification is the most direct, effective and efficient way of reaching the decarbonisation objectives. To achieve 80% to 95% decarbonisation of the EU economy, electrification needs to accelerate and the power sector needs to become carbon neutral. According to Eurelectric's Study, investments needs in carbon neutral generation, demand response and storage are in the range of € 89-111 bn/year over the period of 2020-2045.



Source: Eurelectric Decarbonisation pathways Study

Europe needs a clear framework for long-term and cost-effective investments in innovative transition-enabling and carbon-neutral technologies. Moreover, investment in the required

[3] This figure includes investment in transport sector. Excluding transport vehicles, average annual investment under the 80% reduction scenarios would amount to € 486 billion in 2031-2050
https://ec.europa.eu/clima/sites/clima/files/docs/pages/com_2018_733_analysis_in_support_en_0.pdf
[4] Eurostat, https://ec.europa.eu/eurostat/statistics-explained/index.php/Renewable_energy_statistics#of_electricity_generated_come_from_renewable_sources

networks will contribute to connect them and ensure the security of supply, which all involve a high level of capital intensity.

There are three elements that Eurelectric would like to highlight to enable investment in the power sector via sustainable finance:

- Firstly, sustainable finance should be coherent with other existing tools such as the EU Emissions Trading System (ETS). The European electricity sector has been reiterating its call for overall economic efficiency and environmental effectiveness of the EU ETS taking into account different starting points between the Member States. Thus, sustainable finance should be in line with existing EU policies by providing certainty for investments in carbon-neutral assets and stimulating the industry to actively contribute to the achievement of the long-term targets.

- Secondly, we must strengthen financial stability and pricing in financial markets by improving the assessment and management of long-term material risks and intangible drivers of value creation – including those related to environmental, social and governance (ESG) factors. Additionally, perceived risks of long-term investment commitments should be reduced by ensuring regulatory stability. Retroactive regulatory changes are detrimental to the investment environment.

- Finally, the administrative costs of financial and non-financial reporting obligations of companies should not increase. In particular, reporting obligations should not cover the totality of social and environmental impacts, but only impacts directly related to corporate key figures and adjusted to the technology in question.

Shaping a taxonomy for Europe

Eurelectric supports the idea of creating a level playing field for so-called 'green' financial products as there is an evident need to provide greater clarity to the markets through a more coordinated EU approach. The European taxonomy will contribute to these goals and help to establish a common language for sustainable finance. A well-designed taxonomy should take a forward looking approach to discuss how specific financial instruments can support the enhancement of innovative business models. Given the prominence of such a classification, its impact should be carefully assessed and in line with the other climate regulatory framework of the ETS system, e.g. technologies acknowledged as green in the ETS system must also be recognised in the taxonomy.

The electricity sector offers the best opportunities for a large-scale decarbonisation, including through digital initiatives. This is due to a wide range of low carbon and carbon free generation technologies, electric technologies as well as energy efficiency and enabling infrastructure (e.g. storage, smart grids, electric vehicle charging, etc.). For instance, Bloomberg estimates that the digitalisation of the electricity sector will generate close to 40 bn USD of energy savings, in 2025, with half of this savings created by the use of smart

meters[5]. Therefore, Eurelectric considers that finance should prioritise investments in these technologies.

The power sector believes that a technology-neutral approach to taxonomy should be adopted in order to achieve the carbon neutrality objective. Such an approach should consider as eligible all transition-enabling technologies and innovative business models since they contribute to the European decarbonisation targets. Moreover, this approach should be in line with the European objective of ensuring security of energy supply and competitiveness in a cost-effective and socially responsible manner. Taking into account the diversity of energy mix across the Member States and their individual pathways towards a sustainable power system – and a carbon neutral economy – is also important.

Under the new European framework, whether an economic activity qualifies as environmentally sustainable will depend on four requirements. The activity must contribute substantially to one of the six EU environmental objectives provided in the legislation[6], must be consistent with the other five objectives and must comply with social safeguards, as well as with technical screening criteria.

Eurelectric believes that technical screening criteria mentioned in the Taxonomy Regulation proposal are needed to determine whether or not an activity substantially contributes to one or more environmental objectives. Regarding possible technical screening criteria for the electricity sector, they should recognise as environmentally sustainable all the transition-enabling technologies, transformational ("greening") projects & infrastructures, and the retrofit of existing power plants as long as they significantly improve the environmental performance. This will contribute to the achievement of a decarbonised, fully sustainable and secure European energy future.

Therefore, the impact of a common framework for sustainable finance, and in particular of a common taxonomy, has to be carefully assessed, when it comes to the implications at the EU regions level, where the availability of sustainable assets differs. The transition has to be fair and responsible, both socially and geographically, in the awareness of its socio-economic impacts.

Role and features of a European Green Bond Standard

Sustainable finance requires a joined-up approach to the development of financial services. Among them, Green Bond Standard can be used to mobilise resources for climate change adaptation, renewable energy and other environmentally friendly projects. That is why, Eurelectric is convinced that Green Bonds have an important role to play in the mobilisation of financial resources in order to decarbonise the electricity sector and for climate change adaptation. However, there are significant differences in the green bond market within Europe. This can be problematic, since an investor cannot be sure about the bonds quality.

[5] https://about.bnef.com/blog/digitalization-provide-38b-benefits-energy/

[6] Proposal for a Regulation of the European Parliament and of the Council on the establishment of a framework to facilitate sustainable investment, https://eur-lex.europa.eu/legal-content/EN/TXT/PDF/?uri=CELEX:52018PC0353&from=EN

Today, there are two international regulatory systems that bond issuers can refer to when issuing the security. First, there is the Green Bond Principles (GBP) published in 2014 by the International Capital Market Association (ICMA) and several large investment banks. Second, the Climate Bond Standard (CBS) establishing recommendations for sector-specific standards that climate bonds should meet before they are certified. Both guidelines are voluntary, and there are no monitoring mechanisms in place to enforce them, although both of them recommend an external verification. GBP and CBS provided a common understanding of the green bond market by streamlining practices and providing visibility for investment decisions.

1. Main features of the EU Green Bond Standard

As a member of the European Commission TEG on Sustainable Finance, Eurelectric is specifically engaged in the discussions on the EU Green Bond Standard (GBS). Therefore, we would like to underline the following features. The EU GBS should:

- Incorporate the key components of those two existing standards

European Green Bond Standard building on the GBP and CBS and with the right supporting measures would be instrumental for the GB market to deliver on expectations.

The European Green Bond market is diverse. The EU GBS should therefore be aligned with the principles contained in GBP and CBS international standards. The European Regulation should also go beyond that in order to build key European voluntary principles and put in place monitoring mechanisms to ensure that green bonds are used in accordance with the objectives pursued. Furthermore, it has to be in line with already acknowledged technologies within the ETS system.

- Provide a definition of green and be aligned with an EU sustainability taxonomy

A uniform green bond eligibility and selection criteria would help issuers to determine what type of projects or portfolio could be financed using the proceeds of green bonds and the associated expected environmental benefits.

The easiest way to set up a system of green bond classification is to adopt the categorisation under the GBP and the CBS, which already contain a list of qualified project types. However, there is a lack of global consensus on which projects are green enough to be labeled as such. One way to address this problem is through a comprehensive approach to green bond classification.

The classification should avoid an all-or-nothing approach, allowing certain industries to move at a different pace towards greener solutions. After all, each industry and each country has a different need, thus a universal standard rule may not be plausible for every

actor. This is advantageous because projects in accordance with the stage of development of the country would still promote transitioning to a more sustainable society. With regards to the power sector, each Member State has its own energy mix. This should be taken into account in order to prevent significantly increased costs for some Member States (including those with higher carbon value chains) to modernise and replace capacities as needed in order to meet the power sector commitment to carbon-neutrality well before 2050.

- Couple green bonds with incentive policies

Regarding the concerns around the risk-return profile of green bonds, Eurelectric agrees that this could be addressed through public measures, either by increasing returns through public incentives or by measures reducing the risks associated with a bond. The power sector will support incentives or supporting factors that will help to reduce the financing costs and/or increase the volumes of capital flowing to green projects.

- Send policy signals to reduce the risks associated with the issuance

This includes creating European guidelines with dedicated resources to support the design, rating, credit enhancement, approval and underwriting of corporate bonds products. This might effectively increase the scale of bond financing and reduce the European bond market development costs.

2. Disclosure and reporting

Currently, voluntary standards under the GBP and CBS suggest that issuers release annual reports, meaning that investors who have any uncertainty as to the spending of their bond proceeds must wait a long time before they can obtain disclosure on what projects were financed through their bonds.

Eurelectric agrees on a European Green Bonds reporting regime. A mandatory reporting requirement at EU level would encourage bond issuers (and consequently stimulated the green bonds market) to obtain third party verification prior to labeling a green bond, as well as increased post-issuance public disclosures. The transparent disclosure is necessary to prevents “green washing”.

In respect to the financing and/or refinancing phase, once all bond proceeds have been allocated, the reporting regime should be appropriate, i.e simple and somehow flexible. Indeed, too complex and too rigid reporting rules may lead to energy companies abstaining from issuing green bonds if the administrative requirements seem unnecessarily burdensome.

Companies issuing green bonds should also be required to offer periodic disclosures that state what funds are being used for, and include information such as spending efficiency,

progress and updates on projects, and impact performances. Accordingly, it would be beneficial for the EU to adopt annual reporting requirements for the financing and/or refinancing phase.

Moreover, an appropriate reporting will allow investors to follow how their proceeds are spent, and serve as a way to motivate bond issuers to steer clear of greenwashing their bonds. Appropriate means that some new renewable technologies may give rise to more frequent reporting while annual reporting would be suitable e.g. for a wind farm after the first year of operation.

3. Verification and supervision

On verification and supervision requirements, Eurelectric would like to emphasise the following elements:

- Confirmation of clean technologies

In order to have a workable legislative system, acknowledged environmentally sustainable technologies based on the common taxonomy must be registered. Given the different pathways of European Member States towards decarbonisation & sustainability, it is important to establish a framework, which includes all transition enabling technologies. Eurelectric therefore recommends a flexible system rather than an inclusion/exclusion list. Such a system must allow existing but also new and emerging technologies to be recognised as clean, based on a taxonomy which takes into account different starting points and pathways of Member States, as well as innovation and possible technological breakthrough.

This might require new projects and technologies to deliver a justification, but overreaching administrative burdens should be avoided. The administrative burdens of justification (e.g. more or less frequent reporting) could be adjusted to the technology or project in question. As it is the case in the EU competition law, competitors may be allowed to have joint projects, where some cooperative setups are generally acknowledged (development of new technology) while others need a more substantiated argumentation (e.g. if closer to market related functions).

In short, the European regulation should include clear standards to determine what can be qualified as a green bond based on the common taxonomy. However, flexibility is recommended in order to let new technology and innovative projects to be acknowledged if it can be justified. In this context, it is vital to frequently update the European regulation according to new insights/science/analysis on what can be determined as an environmentally sustainable economic activity. Thus, the regulatory framework should give room for a dynamic setup underpinning the development of new and green technologies.

While still making room for new technologies to develop, the market for green bonds would benefit greatly from a generally recognised standard (technologies) enforced through a global rating agency grading the issuers of green bonds. The impact of such framework could be more pronounced for small and medium issuers whose green bonds could not receive a high rating (superior to a "BBB").

In relation to the existing corporate ratings specific value should be considered under the existing rating methodologies for issuers who have good track record in ESG.

Litigation process should be based on a due diligence standard for the analysis and review of environmental green bonds. The due diligence process would involve verification of whether the issuers complied with relevant green bond regulations, whether the proceeds are used towards environmentally beneficial projects that match any public statements or bond description issued to investors, and also measure the ESG outcome.

- Certification assurance

Verification by independent third parties should be mandatory, so that the legitimacy of the green bonds can be evaluated before they are labeled green. According to the flexible setup proposed above, the verification process should be adjusted to the project in question letting obvious green projects benefit from less scrutiny than projects where the green impact needs more justification.

The GBP and CBS guidance both have third party verification as a step for companies and institutional banks, making it almost impossible to monitor and verify on an ongoing basis. Having a mandatory verification step will allow more transparency in how bonds are used, and give investors more assurance as to the legitimacy of their bonds.

The success of that measure depends on the relevant assurance mechanism obliging issuers to undertake:

- **Pre-issuance review** to ensure that green bonds are aligned with the required project eligibility and selection criteria. The assurance mechanism is the review that should be undertaken by an independent external party.
- **Post-issuance external review** to ensure that the green bonds proceeds are allocated in accordance with the project eligibility and selection criteria stated prior to issuance. The assurance mechanism is similar to the pre-issuance review, that is, the review should be undertaken by an independent external party.

For comparability of reviews done by different external parties, a single review standard should be introduced.

- Labelling a bond as green

Eurelectric agrees that an entity should be mandated to verify if external reviewers are able to conduct the green bond certification in accordance with the European guidelines. The labelling scheme should be based on an independent verification following a robust certification process. The European scheme should be largely inspired by the Requirements to become an Approved Verifier developed by the Climate Bonds Standards.[7]

To be appointed, external reviewers should meet the following criteria[8]:

- Be a legal entity with a registered office in the European Economic Area or Switzerland and required financial resources to conduct the verification.
- Be independent of the entity issuing the bond, its directors, senior management and advisers. In particular, the organisation providing the second opinion must not be a subsidiary or owner, either in full or in part, of the entity issuing the bond.
- Be remunerated in a way that prevents any conflicts of interests arising as a result of the fee structure.
- Be an entity specialising in assessing the framework of the bonds' environmental objectives, with sufficient financial and market specific expertise to perform a comprehensive assessment of the use of proceeds. Such expertise could be demonstrated for example by:
  - Affiliation with relevant and widely recognised industry bodies;
  - Significant and appropriate previous experience in providing second opinions on green bond.

[7] https://www.climatebonds.net/certification/become-a-verifier
[8] http://www.lseg.com/sites/default/files/content/documents/Green%20Bonds%20Listing%20Process%20Outline.pdf (extracted on July 2018).

Eurelectric pursues in all its activities the application of the following sustainable development values:

Economic Development

- Growth, added-value, efficiency

Environmental Leadership

- Commitment, innovation, pro-activeness

Social Responsibility

- Transparency, ethics, accountability

Union of the Electricity Industry - Eurelectric aisbl
Boulevard de l'Impératrice, 66 – bte 2 - 1000 Brussels, Belgium
Tel: + 32 2 515 10 00 - VAT: BE 0462 679 112 • www.eurelectric.org
EU Transparency Register number: 4271427696-87