Dear Caspar,

The European Commission presented its action plan for financing sustainable growth in March 2018. A major element of the plan is to encourage financial institutions to finance the transition to a climate-neutral economy.

The EU has drafted a taxonomy regulation to help investors identify investments that contribute to this goal. The taxonomy is a classification framework that seeks to define the environmental impact of economic activities. In essence, it ensures consistency in determining what can be classified as a sustainable activity.

However, various parties have criticised the proposed taxonomy. For example, green bond issuers are critical of the fact that only a very small fraction, less than 1%, of all real estate qualifies as sustainable.

"The taxonomy will make the market for sustainable investments more transparent, reliable and stronger."

Parties at the other end of the spectrum argue that the taxonomy's definition of what is sustainable is actually not strict enough. For instance, the taxonomy classifies wood and ethanol as sustainable energy sources, even though their combustion releases CO_2 and other pollutants.

Of course, there are hooks and eyes to discover with every standard that is introduced. It is therefore important to determine where the balance lies in stimulating innovation in companies and the adoption of the taxonomy by the masses.

Crucial to this is the question to what extent companies that play an important role in the energy transition are encouraged to implement sustainability in their activities. For example, to what extent do energy companies suffer or benefit from being classified as sustainable or not?

In addition, it is important that there is transparency about the way in which the taxonomy develops. By periodically tightening the limits for sustainable economic activities, as has already been announced, companies are encouraged to continue to innovate and operate more and more sustainably.

For the time being, taxonomy therefore appears to be making an important contribution in theory to the realization of the objectives of the European Green Deal. The taxonomy will make the market for sustainable investments more transparent, reliable and stronger.

The taxonomy's scope is also wide-ranging, given that non-European parties that cooperate with EU investors may also have to satisfy the requirements of the regulation.

But what is your view of these developments, as a portfolio manager? Will they help you to decide what a sustainable investment is and why this is also relevant from a financial point of view?

Regards,

Ruud Hadders
Responsible Investment Officer – ACTIAM

Hi Ruud,

Given the debate about the differences in data providers' ESG scores, the desire to establish a uniform sustainability framework is indeed a step in the right direction. In theory, uniformity will make it easier to compare apples with apples.

Specifically, there are differences between companies that provide ESG data (each company has its own considerations and frameworks) and whilst that is obviously a company's unique selling point, the data differences are considerable. So, as an investor you're still highly dependent on the wisdom of a particular data provider and the choices it makes. The taxonomy determines what is and, specifically, what is not sustainable. At first sight, that makes it easier for investors: it rules out any debate about whether a company is sustainable or not, irrespective of which data provider is used.

The introduction of the taxonomy also makes the role of data far more important. Fund managers will have to specify which funds are sustainable and, more specifically, why. This means that, for every company I include in my portfolio, I will actually have to demonstrate with data that is sustainable. And even then data providers will have a role to play. This is because the taxonomy will initially apply to funds and then to European companies meaning that there will be an enormous surge in demand for ESG data. The fact is that companies in the United States, for example, do not have to release the data needed to assess their operations against the taxonomy. Data providers will therefore collect the data on each of the companies concerned and repackage it for investors.

"Companies that appreciate that sustainability is one of the drivers of their share price will advertise themselves more and try to ensure that all their processes and products are in line with the taxonomy."

However, the greatest pitfall is not the fact that the EU has drafted a taxonomy, but rather that several countries like China, Japan, Canada and Indonesia and organisations are doing so. If you invest worldwide, then it gets somewhat complex. Furthermore, companies that report their ESG performance can use various frameworks (such as the standards set by the Sustainability Accounting Standards Board, or those determined by the Carbon Disclosure Project).The chosen standard leads to a difference in (amount of) data.

Fortunately, there are moves being made towards establishing uniformity among the frameworksThe Dutch Authority for the Financial Markets (AFM) and its French counterpart the AMF (Autorité des marches financiers) have, for example, also put forward a number of proposals to achieve uniformity and transparency with regard to ESG data, specifying quality and the prevention of greenwashing as cornerstones of the proposed regulation. We of course applaud this development.

There are still a number of shortcomings in the taxonomies, but they are, however, generating interesting developments in business operations and capital flows. Companies that appreciate that sustainability is one of the drivers of their share price will advertise themselves more and try to ensure that all their processes and products are in line with the taxonomy's sustainability criteria. If sustainable funds are no longer able to invest in a security because it is not in line with the taxonomy even though it was previously regarded as sustainable, its price will fall. It is likely that the introduction of the taxonomy will initially lead to some price fluctuations.

Therefore, the European taxonomy is a step in the right direction. The next step will however be even more important: global uniformity on sustainability criteria, enabling American and European apples to be compared with each other in practice. If this goal is ultimately secured, then it will be much easier to decide whether a fund has a high ESG score or not. Therefore, any distinction will not come from the differences in assessment methods, but rather from the actual sustainable investment beliefs / ESG values adopted.

Regards,

Caspar Snijders
Portfolio Manager Equities – ACTIAM

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For equity investments, our objective is an optimal financial and sustainable return via passive and active solutions. Our equity team has a long-standing history in sustainable investments and realizes a solid performance, both financially and socially. All our equity funds receive no less than four stars in the Morningstar rating (source: Morningstar, September 2020). The ACTIAM Global Equity Impact product also receives four Morningstar globes in the field of sustainability! It is not without reason that we were awarded Winner Lipper Group Awards "Equity Large" in 2019.

Find out what our equity team can do for you or go directly to our funds.

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