Outside the box: Investing in a better tomorrow

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Two years ago, I took my family to Australia to show our young kids the natural beauty and biodiversity of our planet. To our sadness, we found pristine beaches threatened by plastic from around the world, and sick endangered ocean creatures, the victims of human actions. It was a personal wake-up call.

Like the rest of the world, Europe is facing a range of environmental and social challenges. How we choose to tackle these will become a defining feature of our time. Many efforts are ongoing and capital markets need to contribute their share. This also applies to the ESM.

In 2018, the ESM made Environment, Social, and Governance (ESG) efforts one of our top agenda items, and as the most capitalised International Financial Institution (IFI) in the world, with paid-in capital of €80.5 billion, we have a strong role to play.

So what have we done? Our investors, shareholders and broader public are increasingly asking us about our Green and Social initiatives. At investor roadshows or student presentations, this is a top concern. Climate Change was placed top risk at the World Economic Forum in 2020. While the coronavirus shapes markets at the moment, in the long term, ESG themes will drive markets.

We just made a strong commitment by signing up to the United Nations-backed Principles for Responsible Investment ("PRI").

As an institution with a public mandate and an important issuer in capital markets, the ESM assigns high importance to integrating ESG into our operations, most notably in our investment activities. In signing the UN-PRI, we commit to push and promote more sustainable investment practices and a more durable global economy.

ESM commits to the Six Principles of the UN-PRI

1. We will incorporate ESG issues into investment analysis and decision-making processes.
2. We will be active owners and incorporate ESG issues into our ownership policies and practices.

3. We will seek appropriate disclosure on ESG issues by the entities in which we invest.
4. We will promote acceptance and implementation of the Principles within the investment industry.
5. We will work together to enhance our effectiveness in implementing the Principles.
6. We will each report on our activities and progress towards implementing the Principles.

Source: United Nations Principles for Responsible Investment[1]

It is not an isolated decision. We joined a group of reputable investors, because we believe we can only push for a change if investment funds, large or small, are mobilised in a responsible manner. Since 2006, nearly 3,000 investors in more than 50 countries have signed the PRI. These investors are responsible for assets under management worth a combined $90 trillion. That's near-equivalent to the current World Gross Domestic Product, as estimated by the World Bank.[2]

What makes our commitment to responsible investing even more significant is that we have chosen to apply UN-PRI to all our invested capital.

The ESM manages capital it has received from the 19 Member states of the euro area and invests it in bonds issued by governments, public agencies and supranationals, who, to a high degree, already have ESG-friendly policies. That is already a good step into ESG.

The ESM's large paid-in capital ensures the high credit-worthiness of the ESM. In turn, we are able to both borrow from capital markets and lend at favourable rates to distressed Member States when they lose capital market access, as happened to several countries during the European sovereign debt crisis.

So we are already contributing to social cohesion in the euro area with our lending actions. Without ESM lending to countries that have lost market access, there would be extreme social hardship. These countries would be forced to reduce public expenditures overnight to the level of revenues. With the ESM providing financial assistance, the required fiscal adjustment can be spread over three years. This minimises social hardship.

That is another good step into ESG as we ensure financial stability in the euro area with our bonds, that can be seen as "Stability bonds", just like "Green bonds" contribute to positive environmental actions.

But the steps to ESG are gathering pace and we have decided to increase our commitment. The ESM spent more than a year preparing for this important moment, the

signature of the UN-PRI. From now on, we will increasingly apply the UN-PRI to our investments. This is a long-term commitment.

Transparent Green

One of the principles of the UN-PRI that we have signed up to is the duty to report annually our progress on the principles we adopted.

This is a very important underpinning for the process. The report will be made public and will show where we are and the progress we have made.

But as I outlined, the ESM is no novice to ESG. What we now witness with the PRI is the culmination of actions, in some cases over many years, to become more engaged with ESG. For example, since 2014, the ESM has been a buyer of Green Bonds with the intention of supporting the development of sustainable investments.

A well as our choice of investments in recent years and the purpose of our "Stability Bonds", the ESM has worked to improve our in-house ESG efforts as an institution too.

The ESM is committed to finding sustainable solutions to single-use plastics, which have a detrimental impact on ecosystems and public health. The ESM signed the Zero Single-Use Plastic Manifesto, an initiative of Luxembourg's leading sustainability network, Inspiring More Sustainability. By signing this manifesto, the ESM pledges to eliminate single-use plastics throughout the institution by the end of 2020.

Finally, as an important step towards integrating ESG best practices in its operations, the ESM started in 2019 to examine and report the carbon footprint arising from its internal operations. You can get a snapshot of where we are in this report. In subsequent years, you will be able to learn about our progress as we continue on our ESG journey.

You can find more about our ESG-related initiatives from the ESG home page.

I opened this blog with the stark realities of what my family witnessed in Australia. That was in 2018. The need for change has become even more apparent today. Significant parts of the areas we visited were destroyed or damaged by the recent bush fires. Tracking news on Instagram from the communities and national parks we visited, showed how vulnerable our planet is. I had to tell my kids, that some of the beauty we saw in 2018 is not there anymore. We have a shared responsibility to achieve a better world. From ESM "Stability bonds" to responsible investments, and from banning single use plastic to managing our carbon footprint, we are doing our bit to protect our planet.

[1] UN-PRI (2020) Signatories' commitment
[2] World Bank Group (2019) GDP (current US$)