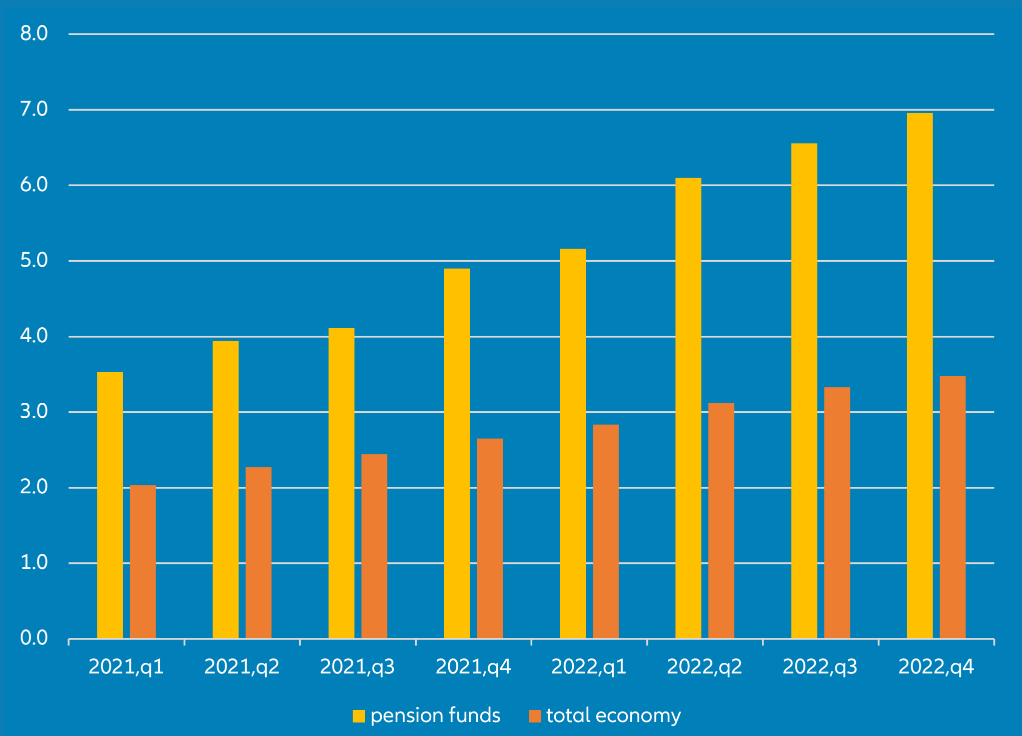
Box 3: Sustainable finance and pension funds: it's a match!

Sustainable finance is booming: From individual savers to large institutions, investors are dedicating an ever-increasing share of their portfolios towards ESG (environment, social, governance) financial products to support the transition to the low-carbon economy. Over the next five years, according to PwC, ESG-oriented funds are set to grow much faster than the market as a whole (+12.9% vs +4.3%) and ESG Assets under Management (AuM) under this scenario are set to reach USD34trn by 2026. Europe is set to remain a driving force in global green finance: It already accounts for more than half of the total ESG AuM, as of 2021, helped by regulatory efforts to promote sustainable finance through common standards, and thus more transparency and comparability of ESG products. The green bond market is a good example: 42% of the total green bond market is denominated in EUR , the result of the EU's standard-setting taxonomy regulation for green bonds. Despite its skyrocketing growth, the ESG boom has raised some important questions about conflicts of interest – for example jobs (S-related) versus emissions (E-related) – and measurability i.e. data availability. While the former simply addresses the inherent challenges of the green transition itself and the need to manage a "just transition", the latter is a genuine concern – but one that becomes less and less relevant over time as regulatory action is aimed at increasing requirements for ever more disclosures of sustainability information.

At the end of the day, for asset managers and pension funds in particular, financial metrics are what count the most: Pension obligations have to be fulfilled by earning decent returns. But the decisive question is what these key figures will look like in 10 or 20 years. To answer this, ESG criteria play an important role because non-financial factors often become financially material in the long run, reflecting the preservation of natural and social foundations as the basis for successful economic activity. No wonder then that pension funds, the quintessential long-term investors, are embracing sustainable finance. This is also reflected in the figures. The ECB has started to publish statistics on sustainable finance (experimental indicators on sustainable finance). Even though these data do not go back very far and only cover bonds, the development in the last two years is impressive: The share of green investments in fixed income has doubled in this period and is now already at 7%. Since pension funds are generally invested for the long term and portfolios change only slowly, this is a rapid development. This share is also twice as high among pension funds as among investors as a whole (see Figure 14).

Strong pension funds represent a win-win situation: They not only stabilize the pension system, but also actively contribute to the green transformation by being at the forefront of the sustainable finance revolution. This is increasingly reflected in their investment policies, in which more and more pension funds are committing to the 1.5°C target of the Paris Climate Agreement. In addition, associations such as the Net Zero Asset Owner Alliance are driving the development further by jointly defining criteria and processes for an investment strategy aligned in this way.

Figure 14: Share of green investments in debt securities holdings in %, pension funds and total economy



Sources: ECB and Allianz Research.