A4S CFO LEADERSHIP NETWORK

Essential Guide to **Debt Finance**

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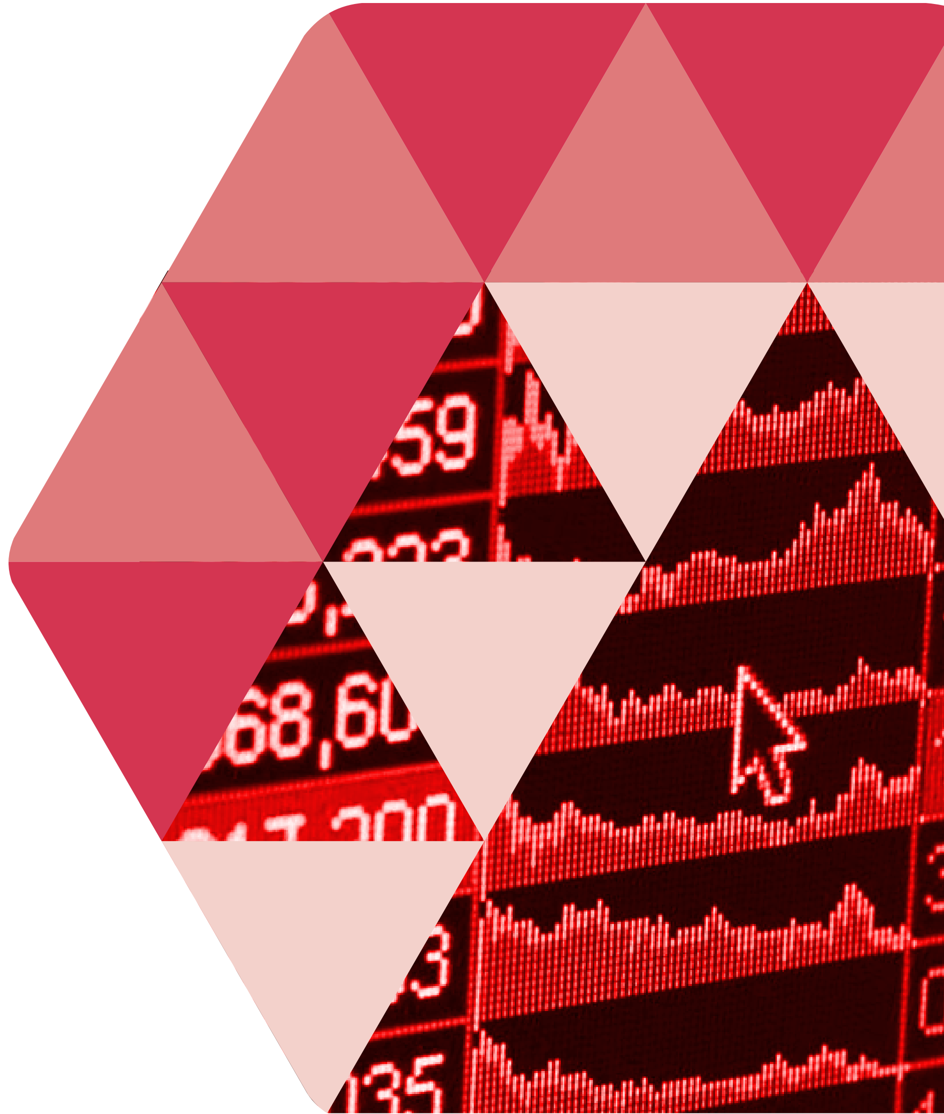
A4S CFO LEADERSHIP NETWORK

ESSENTIAL GUIDE TO **DEBT FINANCE**

Embedding environmental, social and governance considerations into treasury team activities



THE PRINCE OF WALES'S CHARITABLE FUND

NAVIGATING THIS GUIDE

WHAT IS COVERED

This guide aims to help organizations align their treasury and sustainability objectives in order to create and maintain value.

The guide:

- Can support organizations to engage with, and influence, debt providers and their lending decisions.
- Can help to enhance business performance and improve environmental and social outcomes.
- Has been developed through extensive interviews with lenders and debt investors to take into account how sustainable business models are currently considered in debt finance decisions, and how the market is expected to shift in the future.
- Has been developed for treasury teams, but will also be of interest to debt investors and lenders, and other stakeholders seeking to promote a sustainable future, i.e. includes suggested actions and recommendations for addressing challenges.

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INTRODUCTION

- Why did we develop this guide?
- What is sustainable finance?
- Who are the key market actors?
- How is the debt finance landscape changing?

BUSINESS CASE

Why is considering sustainability important for corporate treasury?

- What we're hearing from market participants
- Recognized drivers and benefits
- How lending decisions are affected
- Building momentum for change

THE DEBT PROVIDER PERSPECTIVE

What did we learn from our interviews with debt providers?

- ESG is integral to risk assessment
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- Reputational risk is a key consideration
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IMPLICATIONS FOR TREASURY TEAMS

What are current practices, expected trends, and how can treasury teams adapt?

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- Summary of recommended actions for treasurers

PRACTICAL EXAMPLES

Examples from the CFO Leadership Network and beyond.

- Banks
- Asset managers
- Credit rating agencies
- Corporates

THE PROJECT TEAM

We would like to thank all the project team members, CFOs from the A4S CFO Leadership Network and interviewees who contributed to the A4S Essential Guide to Debt Finance. We would also like to thank those who participated in roundtable the discussions in London and Sydney.

A4S CFO LEADERSHIP NETWORK PROJECT TEAM

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A4S CFO LEADERSHIP NETWORK

INTRODUCTION FROM THE A4S CFO LEADERSHIP NETWORK

I am delighted to introduce the A4S Essential Guide to Debt Finance – providing practical advice for corporate treasurers wishing to integrate ESG factors into their debt financing.

As one of the UK's largest environmental infrastructure businesses providing water, recycling and energy services, Pennon's sustainable business approach is an integral part of our success. Indeed, we believe it is now increasingly difficult for any company, regardless of sector, to ignore the impact of sustainability-related macro trends on their business. All companies must now consider the impact on their bottom line and future viability of issues such as water scarcity, natural resource constraints, climate change and labour conditions in the supply chain. For debt providers, it is no different. Financial institutions must also consider how these issues affect the ability of their portfolio to repay debt, and how that will affect their own measures of success.

At Pennon, we believe that integrating sustainability considerations into our strategy enables us to mitigate risk, generate growth opportunities and reduce costs. We have this in mind when seeking finance, and are increasingly finding that our debt providers are similarly interested in the sustainability of our performance. Much of our capital expenditure is long term in nature and we must consider its viability over 20 years and beyond. It is therefore in our funders' best interests to make sure they are aware of the factors that have gone into our strategic decision-making process.

For the debt market as a whole, it is vital for lenders and investors to price the risks they are taking fully into their financing decisions. This is not yet the case in relation to environmental, social and governance (ESG) risks for the majority of debt financing in the mainstream market. A4S research shows that the reasons for this include:

- A lack of understanding of ESG risks
- Limited transparency from corporates
- Insufficient acknowledgement of the scale and pace of change required to transform our economy into a sustainable one within the necessary time frames – timescales driven by factors such as climate change

While there has been a shift in understanding in the last few years, evidenced by: the increase in green bond issuance; steps towards ESG integration by credit rating agencies; and examples of credit with rates linked to sustainability performance; much more must be done to influence the mainstream debt market if we are to direct sufficient flows of finance to sustainable outcomes.

We have therefore developed this guide to help organizations contribute to the necessary change by aligning their treasury and sustainability objectives to improve environmental and social outcomes, and in doing so bring value to their organization.

To develop the guide, the project team interviewed lenders and bond holders to understand fully the debt providers' perspectives on long-term sustainability factors and how they influence lending decisions. A4S also hosted roundtables for senior representatives from banks, bond investors and other capital market representatives to validate the findings and discuss actions that can be taken. This stakeholder input resulted in the following guidance. We hope you find it of value.

SUSAN DAVY, CHIEF FINANCIAL OFFICER, PENNON GROUP

"Much more must be done to influence the mainstream debt market if we are to direct sufficient flows of finance to sustainable outcomes."

WHY DID WE DEVELOP THIS GUIDE?

THE DRIVERS TO ACT

Companies and their finance providers have strategic, financial and moral incentives to work towards a sustainable economy. Pressure to respond to issues such as climate change is growing as a result of shifting social norms as well as a recognition of the financial implications resulting from a failure to act. At the same time, capital markets participants are increasingly focusing on the creation of positive value, not only for their own organization, but also for society as a whole, rather than the management of risks alone.

Within the debt markets, the response to these trends is evidenced by: the integration of environmental, social and governance (ESG) risks and opportunities into all lending and investment decisions; and the creation of products targeted specifically at delivering environmental or social outcomes, such as green bonds.

In creating this guide for treasury teams, members of the A4S CFO Leadership Network saw a clear need to ensure that they and their teams understood, and were taking advantage of, these trends towards sustainable markets, as well as playing a leadership role in accelerating the transition.

This guide considers some of the actions taken to respond to social and environmental risk and opportunity by the debt markets to date. It includes practical guidance on how treasury and finance teams can play their part.

WHAT IS SUSTAINABLE FINANCE AND WHAT DOES THIS MEAN FOR RAISING DEBT?

Within this guide, we have defined sustainable finance as covering both the integration of ESG considerations into 'mainstream' investment and lending decisions, as well as products with specific environmental or social aims.

Lenders, regulators and investors are increasingly incorporating ESG factors into decision making. They see environmental and social, as well as economic, issues as integral to risk and returns, from both a financial and reputational perspective, as lenders' reputations are now intrinsically linked to those of the borrowers and their use of proceeds. Lenders and debt investors are seeking to engage with borrowers on these issues, and understand how they are responding. Providers of finance are increasingly seeing the link between sustainability performance and credit risks in their portfolios.

From the borrower's perspective, benefits received by those developing sustainable business models include increased engagement and a better relationship with lenders, and many have reported lower cost of debt as a result.

WHAT IS THE ROLE OF TREASURY TEAMS?

The rise of sustainable finance presents some interesting opportunities for treasury teams.

Historically, sustainability has not been seen as relevant to the activities of treasury teams. Over the last few years, however, many treasurers have started to explore their role in financing their organization's transition to a sustainable business model. The opportunity for treasury teams is in understanding how treasury activities can support the organization's strategic sustainability goals, particularly in light of the growing interest of debt providers in the sustainability 'utility' of their assets, as well as the financial returns.

KEY RECOMMENDATIONS

This guide has been informed by a series of interviews with debt investors and lenders facilitated by members of the A4S CFO Leadership Network. Key recommendations include:

- **Building knowledge and capacity within the treasury function.** Treasury teams need to build awareness of sustainable finance trends, and will need to be joined up with other business functions to enable them to understand and promote their organization's sustainability credentials.
- **Being proactive and leading the dialogue rather than waiting for questions from debt providers.** There will be an increased focus on sustainability factors from nearly all key market stakeholders: regulators, listing authorities and credit rating agencies, as well as debt investors and lenders.
- **Developing a sustainable finance framework, including issuing green bonds and integrating ESG into all loans and credit facilities.** Treasury teams can take advantage of growing market interest in sustainable finance products, in their strategic planning and financing activities.
- **Ensuring sustainability is demonstrated through all communications with debt providers.** Organizations with a sustainable business model are expected to become more attractive to debt providers. Clear demonstration in relevant communications is necessary to attract the right lending partners and assist in negotiations.

WHAT IS SUSTAINABLE FINANCE?

Sustainable finance is the integration of sustainability considerations into investment and lending decisions. This includes examples where debt is issued, used and repaid with specific environmental and societal impacts in mind, but it also covers steps to respond to material environmental and social issues and integrate into all lending, financing and investment decisions.

There are increasing moves within the debt markets for sustainability to be factored into debt providers' decision-making. Nonetheless, if we are to achieve a sustainable economy responding to issues such as climate change within the timeframes that are required, then sustainable finance must become the norm – and quickly. To change the market, there needs to be a collaborative effort by all actors.

WHAT DO WE MEAN BY 'SUSTAINABILITY'?

A sustainable business is one that delivers financial returns in the short and long term in a way that generates positive value for society and operates within environmental constraints. Within the investment arena, sustainability issues are ordinarily referred to as 'ESG': environmental, social and governance.

WHY IS THE INTEGRATION OF ESG INTO FINANCE IMPORTANT?

Sustainable finance seeks to allocate capital to organizations, assets and activities that consider and manage economic, social and environmental, as well as financial, outcomes. This integrated approach builds a healthier operating environment in the long term, and a more resilient organization. Sustainable capital markets would correctly value and price in environmental and social externalities. Investors and lenders would have access to information about ESG risks and be able to price the risks they are taking correctly, in order to make informed credit decisions.

IS THIS TO DO WITH GREEN BONDS?

Partly. Green bonds are a distinct form of sustainable finance, though just a segment of the whole. Green bonds are on the rise: in 2018 USD167.3 billion of green bonds were issued[1], compared with just US$41.8 billion in 2015[2]. Even so, this is still **only 0.17% of the USD$90 trillion global bond market.**[3] This highlights the misalignment between business-as-usual debt (and broader finance decisions) and the pathway to a sustainable, low-carbon economy. Though also still a very small part of the whole market, there is a growing market in social and sustainable bonds. For a real shift to occur in the debt markets, the majority of debt would need to take these factors into consideration, and be managed accordingly, regardless of whether bonds were labelled specifically as sustainable finance products. This mainstreaming across all forms of debt finance is what this guide is about.

HOW CAN I UNDERSTAND MORE ABOUT THE NEED FOR A SUSTAINABLE ECONOMY?

The **UN's Sustainable Development Goals** (SDGs), agreed in 2015, provide a useful frame of reference increasingly used by investors, as well as companies and governments, to align decision making and action towards sustainable outcomes. Considerable finance is required to achieve these goals, estimated to total US$90 trillion in the next 15 years.[4] In 2018, A4S, in partnership with Aviva Investors, published '**Financing Our Future**'. This report sets out actions to create a sustainable global financial system, with recommendations for all parts of the investment chain. Further details on recommended actions for each actor can be found in the report.

"With better information and risk management as the foundations, a virtuous circle is being built with better understanding of tomorrow's risks, better pricing for investors, better decisions by policymakers and a smooth transition to a low carbon economy."

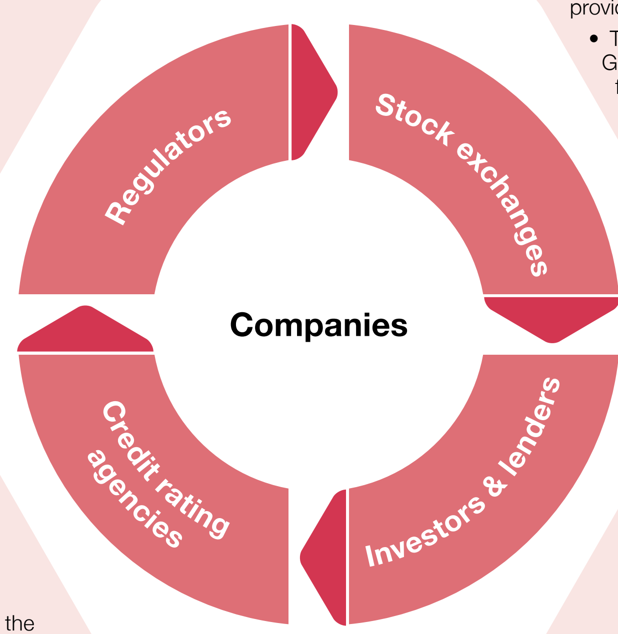
MARK CARNEY, GOVERNOR, BANK OF ENGLAND[5]

Suggested reading:
Financing Our Future

WHO ARE THE KEY MARKET ACTORS?

This guide focuses on the opportunity for corporate treasurers to drive and respond to change through practical actions. For context, it is useful to reflect on the other actors in the debt markets and some of the steps they are already taking to respond to ESG risk and opportunity.

- Without regulatory change, many actors feel that any change towards sustainability will be piecemeal and insufficient.
- Securities regulators and governments are increasing adopting mandatory ESG reporting requirements to provide the disclosures required to enable informed decision making by the market. Regulators have also focused on the adoption of stewardship codes with reference to long-term outcomes and ESG risks.
- Regulators are increasingly focused on addressing systemic ESG risks, working internationally to coordinate approaches and share knowledge, for example through the formation of the Network for Greening the Financial System.
- The European Commission established the High Level Expert Group (HLEG) to recommend steps to incorporate sustainability into policy frameworks.[6] One of the proposals made by the HLEG relates to adoption of a 'green supporting factor'. If adopted, this would incentivize banks to increase financing towards sustainable products.
- The UK's Prudential Regulatory Authority has issued a Supervisory Statement to enhance banks' and insurers' approaches to managing the financial risks from climate change, including setting out the expectation of board level responsibility.[7]



- Stock exchanges and their regulators play a unique role in delivering the standardized ESG data that investors require. Their listing and issuance requirements and guidance ensure that companies file data that is material, meaningful and comparable with their peers.
- Many stock exchanges have, or are in the process of introducing, ESG reporting standards and listing requirements.[8] Over 60+ stock exchanges are committed to the UN Sustainable Stock Exchange campaign which aims for all stock exchanges to provide listed companies with guidance on sustainability reporting.
- The International Organization of Securities Regulators (IOSCO) Growth and Emerging Market Committee has formed a sustainable finance taskforce and set out 11 recommendations for its members to consider when issuing regulations or guidance regarding sustainable financial instruments. This includes proposals to require disclosure on material ESG risks.[9]

- Credit rating agencies play an essential and influential role in determining the cost of debt.
- Some of the work undertaken by credit rating agencies has centred on providing separate ratings on ESG factors, however, steps have also been taken to incorporate ESG risks into mainstream ratings.
- Typically, there is a focus on quantitative analysis to price risks in the short term (3–5 years), while including qualitative analysis covering the full term of the debt (which could be 20–30 years).
- See the case study on Fitch's ESG Relevance scores.

- While many asset owners and managers commit to responsible investment, this is not always fully embedded in investment mandates.[10]
- Longer-term contracts between asset owners and asset managers would reduce the pressure on short-term performance and encourage broader consideration of sustainable growth.
- Many financial institutions have adopted the Equator Principles as a risk-management framework, which has led to greater consistency in social and environmental risk management in project finance.

Explore more in debt provider perspectives

A4S CFO LEADERSHIP NETWORK

HOW IS THE DEBT FINANCE LANDSCAPE CHANGING?

ESG risk considerations are increasingly recognized by debt providers. Treasury teams that understand these pressures, and the opportunities presented by sustainable finance, will have access to a wider pool of funders and will be able to align their debt raising approach with the sustainability objectives of their business.

Previously	Direction of travel
Sustainability did not sit within the domain of treasury functions, but was only the responsibility of a sustainability or corporate responsibility team.	• As organizations increasingly integrate sustainability into strategy, business models, financial planning, risk management and disclosure, this is becoming an increasing part of the treasury role. • Treasurers are involved in shaping the strategic and sustainable direction of their organization's financing.
Companies may have issued green bonds, but were not mainstreaming sustainability into debt finance.	• Sustainability is sought through the alignment of the organization's overall financing strategy with broad sustainable outcomes.
Sustainability was generally considered on a project-specific basis.	• Sustainability considerations are being mainstreamed and integrated. There are opportunities for treasurers to collaborate with others to promote this.
Debt providers and fixed income investors were solely concerned with the magnitude and reliability of financial returns.	• Debt providers are starting to recognize that ESG risks can cause credit impairment and reputational concerns, and have a growing interest in increasing the sustainability 'utility' of their assets, alongside financial return.

What we are seeing from credit ratings agencies:

- Spotlight on credit rating agencies
- Fitch Ratings has an integrated scoring system that shows how ESG factors affect individual credit-rating decisions

What we are seeing from banks:

- Barclays has introduced a Green Product Framework
- Lloyds is providing discounted finance to those investing in a low-carbon future

What we are seeing from regulators:

- The EU is examining how to integrate sustainability considerations into its financial policy framework in order to mobilize finance for sustainable growth

Implications for treasury teams

HOW IS THE DEBT FINANCE LANDSCAPE CHANGING?

Spotlight on: credit rating agencies

Credit rating agencies (CRAs) play a central role in determining the cost of debt. The emerging integration of ESG into ratings processes is therefore a major influence on corporate behaviour and on investment allocation.

ROLE OF CREDIT RATING AGENCIES

Investors rely on the information provided by CRAs to inform their investment decisions on bonds and other forms of credit. Whether and how CRAs build ESG factors into their assessments can therefore affect how attractive a bond or other type of debt is to a lender, and therefore the cost of credit for a company.

CRAs have both been developing ESG ratings as well as integrating ESG risk into the core credit rating. This reflects increasing market recognition that sustainability issues have the potential to have a significant impact on default risk, and so there is a growing demand for material sustainability risks to be incorporated into credit ratings.

The integration of ESG into investment decisions is not just a matter of downside risk – it is also about capturing growth opportunities. The benefits identified in a meta study of ESG in investment grade corporate bonds include:

- Additional returns and alpha through the capitalization of an ESG factor premium
- Lower portfolio volatility
- Higher credit ratings
- Lower credit spreads[11]

One area of focus by CRAs has been on climate risk, including participation in the Financial Stability Board's Taskforce on Climate-related Financial Disclosures. With their unique access to issuers' senior management teams, the role of CRAs is pivotal in influencing increased and better disclosure of ESG risk.

CURRENT ACTIVITIES

Increasingly, studies provide evidence that ESG factors can affect borrowers' cash flows and the risk that a borrower will default on their debt obligation. CRAs are increasingly integrating ESG into their ratings. For example:

- Fitch Ratings recently launched a new integrated scoring system. The ESG Relevance Scores, which were produced by Fitch's analytical teams, display both the relevance and materiality of ESG elements to a rating decision.

See Fitch Ratings' ESG Relevance scores

- In 2012, S&P Global Ratings introduced references to the 'management of environmental and social risks' and the oversight of these risks by a company's board of directors in the Management and Governance section of its credit rating methodology. S&P says it can point to 106 examples over the last two years in which environmental and climate concerns, both event-driven and those occurring over a longer period, resulted in a change of rating, outlook or CreditWatch action.[12]
- Moody's Investors Services clarified its approach in 2019 and has published a range of reports analysing the impact of ESG risks on credit. As part of this analysis, they have assessed the credit exposure of 84 sectors, representing $74.6 trillion in rated debt, to environmental risks, highlighting the most and least exposed sectors.[13]

BUSINESS CASE

WHY IS CONSIDERING SUSTAINABILITY IMPORTANT FOR CORPORATE TREASURY?

WHAT WE ARE HEARING FROM MARKET PARTICIPANTS

Treasury management is about handling the banking requirements and the funding for the organization, and managing financial risk.

Sceptics say, 'Sustainability considerations are not part of this.'

Investors say:	"Our interest in sustainability is increasing, not only in equities but also in debt. We are asking more questions, and are digging deeper into an organization's sustainability performance prior to investing."
Regulators say:	"Climate change and other ESG factors present financial risks. Responding to these risks forms part of investors' fiduciary responsibilities."
Lenders say:	"We are considering sustainability factors in our lending decisions. Sustainability risks can cause credit impairment, for example in the cancellation of projects which breach environmental or social regulations, and as a result, fail to get financing. The suitability and sustainability of a borrower is increasingly perceived as being a reputational risk for us."
CFO Leadership Network members say:	"A thriving economy can only exist in a thriving society and environment. Considering sustainability is therefore closely aligned with long-term economic health. To be responsible and successful in the long term, this alignment needs to be reflected within our relationships with our banks and investors."

Suggested reading:
- Financing a Sustainable European Economy: Final Report 2018 by the High Level Expert Group on Sustainable Finance

SPOTLIGHT ON: FIDUCIARY DUTY

There has been considerable focus on seeking to clarify the fiduciary responsibilities of pension fund trustees in relation to ESG risks. In the UK, the Department for Work and Pensions (DWP) is strengthening regulations in this area. These regulations will include the requirement for pension funds preparing Statement of Investment Principles to set out:

- how they take account of financially material considerations, including (but not limited to) those arising from environmental, social and governance considerations, including climate change; and,
- their policies in relation to the stewardship of investments, including engagement with investee firms and the exercise of the voting rights associated with the investment.

In relation to the default arrangement, trustees will be required to prepare or update their default strategy to set out how they take account of financially material considerations, including those arising from environmental, social and governance risks, including climate change.[14]

The European Commission has undertaken public consultations on institutional investors and asset managers' duties regarding sustainability, which has included reviewing the need for clarification of fiduciary duty.[6]

As institutional investors increasingly incorporate sustainability into fiduciary duties and investment policies, asset managers will need to respond by increasing ESG analysis and integration into fixed income investments.

RECOGNIZED DRIVERS AND BENEFITS

Members of the A4S CFO Leadership Network have experienced at first hand how considering sustainability factors can lead to benefits for borrowers. There is growing evidence suggesting a link between ESG performance and the cost of capital.

$274 billion raised in equity from IPOs & further offers[17]

versus

$2.4 trillion in new corporate bonds + $3.4 trillion in new corporate loans[17]

GROWING EVIDENCE OF THE LINK BETWEEN ESG PERFORMANCE AND THE COST OF CAPITAL

ENVIRONMENTAL

Firms with high environmental impacts and poor environmental management have a higher cost of debt, lower bond ratings and lower issuer ratings. The cost of debt could be up to 64 basis points higher.[15]

SOCIAL

Firms with stronger employee relations have a statistically and economically significant lower cost of debt financing.[15]

GOVERNANCE

Organizations with strong corporate oversight have outperformed their less well-governed competitors by an average of over 30 basis points per month since the beginning of 2009.[16]

Reference for wider benefits and useful suggested reading:
- **Corporate bonds: Spotlight on ESG risks – UNPRI**

RECOGNIZED DRIVERS AND BENEFITS

Examples of benefits our members have experienced:

- Access to a wider pool of debt providers
- Enhanced dialogue and better relationships with debt providers
- Greater recognition of the company's commitment to long term thinking
- Alignment of the company's values wtih those of its lenders and investors
- Lower borrowing rates

HOW LENDING DECISIONS ARE AFFECTED

Banks and investors are increasingly considering organizations' sustainability performance in their lending decisions. Where an organization has taken steps to be sustainable, there are benefits for both the debt provider and the organization itself. Key factors include confidence in the ability of the company to meet its objectives and to repay the debt in full.

Lending decisions can affect how the organization achieves its objectives, while leading to long-term economic, social and environmental sustainability

IF YOU WERE A LENDER WHICH ORGANIZATION WOULD YOU LEND TO?

Organization with poor sustainability performance		Organization with evidence of good sustainability performance
↑	Financial default risk	↓
↓	Financial and extra-financial 'return'	↑
↓	Investor/client satisfaction	↑
↑	Reputational risk	↓
↓	Access to finance	↑
↑	Cost of finance	↓
↓	Investor confidence	↑
↓	Resilience	↑
↓	Employee engagement	↑
↓	External stakeholder perception	↑

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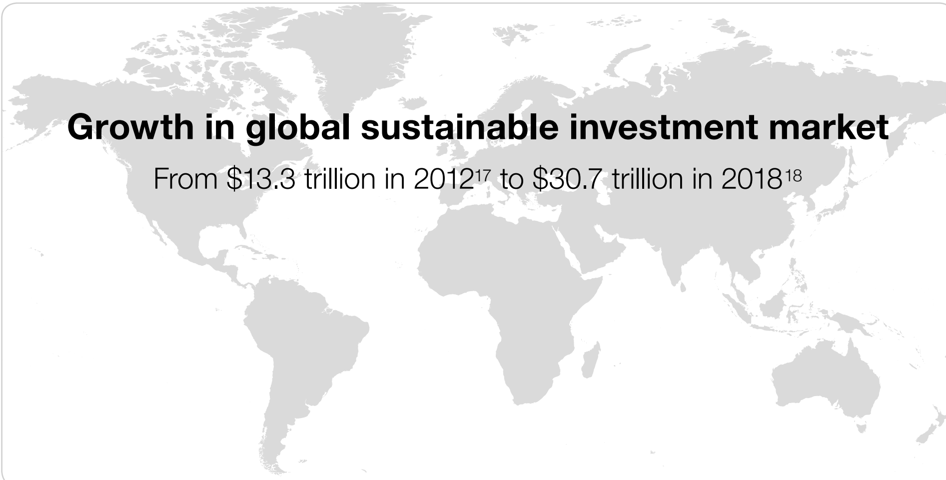
BUILDING MOMENTUM FOR CHANGE

Increased focus on sustainability is driving growth in the sustainable investment market and starting to bring changes to the mainstream investment market. This is not only shown by the perspectives of those in the industry. The data speaks for itself: there has been a 131% growth in the global sustainable investment market between 2012 and 2018.[17,18]

Academic and practitioner research suggests that good management of ESG factors correlates strongly with credit strength.[15]



Suggested reading:
- PRI Fixed Income Investor Guide (2014)
- Final Report: Recommendations of the Task Force on Climate-related Financial Disclosures (June 2017)
- TCFD Implementation: Top Tips for Finance Teams

WHAT WOULD THE DEBT MARKETS LOOK LIKE IF ESG WERE INTEGRATED THROUGHOUT?

Imagine if lending and capital markets were fully compatible with international and national goals for a sustainable economy, society and environment. Activities that do not align with these goals either would not be financed or would only be financed at a higher cost of capital and with the condition that negative impacts were reduced over a defined period, with any remainder offset or otherwise compensated for.

A market with ESG integrated throughout is efficient in providing sustainability information: prices accurately reflect available information about long-term sustainability, and capital is directed to sustainable uses. The debt would correctly value and price in environmental and social externalities, which would be transparently disclosed. This would enable investors and lenders to make informed credit decisions and correctly price the risks they are taking.

This world seems to be achievable. It is not asking for the acceptance of higher risk (in fact, lower risk). But to happen it does need additional capability within debt providers for evaluating the alignment between an organization’s use of proceeds and achieving sustainability objectives. It needs collaboration from all parties across the investment chain to promote market reform and take proactive practical steps towards achieving change. This evaluation is dependent on transparency, in both the use of proceeds and the company’s own sustainability.

Initiatives such as the Financial Stability Board’s Task Force on Climate-related Financial Disclosures and the EU High-Level Expert Group on Sustainable Finance seek to improve data availability and quality. These initiatives are enablers of change.

“Where the business model is not sustainable because the market is changing, an organization will be expected to pay a higher premium to obtain debt.”

CREDIT ANALYST, INVESTMENT MANAGEMENT COMPANY

BUILDING MOMENTUM FOR CHANGE

Green, social and sustainability bonds

WHAT ARE GREEN, SOCIAL AND SUSTAINABILITY BONDS?

Green, social and sustainability bonds are types of listed fixed income security where the proceeds are intended to be used for environmental and/or social projects. This is a developing market and there are a range of emerging frameworks to define what types of project can and can't be included.

Alongside growing integration of ESG factors into all forms of debt, significant opportunities exist to tap into the rapidly growing market for products with explicit environmental or social aims.

FRAMEWORKS

As the market has adapted to ESG considerations, different sets of principles have been developed to set standards and common criteria for sustainable finance products. These include:

- **Green Bond Principles** – discussed further on the next page
- **Social Bond Principles** – for bonds that raise funds for new and existing projects with positive social outcomes
- **Sustainability Bond Guidelines** – for bonds where the proceeds will be exclusively applied to a combination of both green and social projects
- **LMA Green Loan Principles** – based on the Green Bond Principles, which seek to clarify the instances in which a loan may be categorized as 'green'
- **LMA Sustainability Linked Loan Principles** – any types of loan instrument and/or contingent facility (such as bonding lines, guarantee lines or letters of credit) which incentivizes the borrower's achievement of ambitious, predetermined sustainability performance objectives

Please note this is not a comprehensive list and more principles are likely to be developed over time.

BUILDING MOMENTUM FOR CHANGE

Spotlight on: green bonds

WHAT IS A GREEN BOND?

A green bond is functionally a debt instrument, like any other bond. It offers a fixed return, and a promise that the proceeds will be used to finance or re-finance, in part or fully, new or existing sustainable projects. The issuer has to ensure that the proceeds are invested in green projects, such as renewable energy, energy efficiency, projects leading to reduced carbon emissions, etc. It is considered a 'win-win' situation for both the bond issuer and the investor, as they can contribute toward a sustainable future on one hand, and showcase themselves as responsible organizations/institutions on the other.

The first green bond was issued by the European Investment Bank (EIB) in 2007. At that time, the size of the issuance was relatively small. Now, the market is gaining momentum with the number of green bonds issued in 2018 demonstrating a 78% growth since 2016.

In 2018, if social and sustainability-related bond issuance is added to the total green bond figure, this means that US$202.5 billion of ESG-focused bonds were issued.

WHY ISSUE A GREEN BOND?

PRACTICAL EXAMPLE

Anglian Water became the first European utility company to issue a sterling green bond

love every drop anglianwater

See full case study for further information

PRACTICAL EXAMPLE

SSE launched a green bond with a coupon of 0.875%, the lowest coupon that it has achieved for a senior bond

sse

See full case study for further information

CFO LEADERSHIP NETWORK

Essential Guide to **Debt Finance**

BUILDING MOMENTUM FOR CHANGE

Spotlight on: green bonds

HOW DO WE PREPARE TO ISSUE A GREEN BOND?

Several members of the CFO Leadership Network have issued green bonds using the Green Bond Principles. The Green Bond Principles are voluntary guidelines that provide issuers with guidance on key components involved in launching a credible green bond. They recommend that the issuer should:

- Define criteria for a green project
- Define processes for evaluation and selection of the green project
- Have systems to trace the green bond proceeds
- Report, at least annually, on the use of the proceeds

The following A4S CFO Leadership Network member organizations from Europe and Canada have already issued one or more green bond:

- Anglian Water
- Brookfield Asset Management
- City of Vancouver
- Manulife (Singapore and Canada)
- SSE
- Stora Enso
- Unilever

TOP TIPS FROM THE CFO LEADERSHIP NETWORK

The treasury team should:

- Engage with the sustainability function, and the rest of the organization, as appropriate, to understand the material sustainability risks and opportunities for the organization.
- Include sustainability as part of the treasury team's continuous professional development training and new member induction.
- Collaborate with investor relations teams, spend time talking to investors and banks about ESG across all areas of the business.
- Appoint an external partner to validate the organization's green bond framework, increasing investor confidence in use of proceeds.

"It is important that SSE's funding is consistent with our commitment to sustainability, as well as help to maintain a strong balance sheet and strong market rating and is secured at very attractive pricing."

GREGOR ALEXANDER, FINANCE DIRECTOR, SSE

CFO LEADERSHIP NETWORK

THE DEBT PROVIDER PERSPECTIVE

WHAT DID WE LEARN FROM OUR INTERVIEWS WITH DEBT PROVIDERS?

ESG IS INTEGRAL TO RISK ASSESSMENT

Debt providers are incorporating ESG considerations into their credit risk assessments, recognizing that poor sustainability credentials can be indicative of problems in broader management quality.

WHAT DEBT INVESTORS AND LENDERS HAVE TOLD US

"We integrate climate change considerations and take into account sustainable business models in investment processes by flowing this into our credit assessment. These risks cannot be ignored."
Fund Manager, investment management company

"If an organization has good cashflows, but we do not consider it to have a sustainable business model, we will be cautious as the risk profile is asymmetrical, and when things go wrong they do so significantly."
Credit Analyst, investment management company

"If we see an organization take sustainability seriously, for example one with a sustainability director, we know that they are looking long term and that may well feature in our assessment of its credit quality."
Director, corporate and investment bank

WHY?

- Long-term sustainability factors have the potential to affect future viability and cash flows. As a result they influence lending and investing decisions and are increasingly incorporated into screening strategies.
- Assessing sustainability is now also part of some lenders' Know Your Customer (KYC)* procedures.
- There is a growing recognition that poor management of sustainability factors fails to mitigate important risks, and is a proxy for problems with broader management quality implications.
- Integrating sustainability factors in research and analysis allows better understanding of the risks and opportunities the borrower presents.
- Enhanced risk management is a key driver for consideration of sustainability in appraisal of credit risk. Traditionally, this was more common for project finance or designated green bonds but, helped by the awareness these products have created, this is starting to become a trend in general-purpose lending and mainstream bond investing as part of the evaluation of ability to repay.

*Know Your Customer, or KYC, is the process by which a business verifies the identity of its clients and assesses potential risks of illegal intentions for the business relationship. The term is also used to refer to the bank regulations and anti-money laundering regulations that govern these activities. Banks, insurers and export creditors are also increasingly demanding that customers provide detailed anticorruption due diligence information.

TRANSPARENCY AND CONSISTENT INFORMATION IS ESSENTIAL

Debt providers need consistent and high quality data across their portfolios to allow for better-informed decision making.

WHAT DEBT INVESTORS AND LENDERS HAVE TOLD US

"Differential pricing is only possible if reliable data is available. We need consistent data, KPIs and third party validation over such data to lead to differential pricing and better deployment of capital."
Managing Director, commercial banking, large banking group

"There are too many reports and information requests for organizations which are actually not improving the quality of disclosures – also, very long sustainability reports can be difficult to digest. What's important are KPIs and targets and a clear understanding of how the organization is performing against them."
Fund Manager, global asset manager

WHY?

- More debt providers are realizing that data on the financial implications of sustainability factors is not just a 'nice to have' but that comparable, transparent and consistent metrics are necessary as part of mainstream lending and investing decisions.
- Such data enables a better assessment of default risk and potentially differentiated pricing.
- Lenders and investors dislike surprises so a lack of transparency increases risk and borrowers may be penalized.
- Organizations should adhere to consistent sustainability metrics in their external reporting, making clear links to financial performance, as they could otherwise be perceived as having something to hide.
- Currently, the quality of disclosures varies significantly between markets, and without a regulatory or coordinated market-wide response, gaps are likely and present a significant challenge to debt providers and borrowers alike.
- It is not just qualitative or non-financial quantitative disclosures that are needed, but also related financial disclosures.

CFO LEADERSHIP NETWORK

ENGAGEMENT AND STRONG RELATIONSHIPS FACILITATE CHANGE

Debt providers recognize that they have a role to play in influencing corporates to develop sustainable business models.

WHAT DEBT INVESTORS AND LENDERS HAVE TOLD US

"Even if an organization is somewhat behind the curve but it's being proactive in engaging with us on what they're doing, and trying to achieve in the sustainability space, then we will view them positively."
Fund Manager, global asset manager

"In corporate lending we only start relationships with those we intend to have a long-term relationship with."
Director – Corporate Banking, major international bank

"We engage to drive change, divesting won't."
Fund Manager, global asset manager

WHY?

- Although not yet to the extent of equity investors, fixed income investors also want to engage with organizations on sustainability issues, and proactive organizations are viewed more positively than peers who only respond reactively.
- Where organizations face challenges from long-term trends (e.g. responses to climate change), debt providers will tend to maintain relationships if they see that the organization is managing the issue well. Open dialogue is important.
- Engaging with organizations on the topic of sustainability enables debt providers to give further advice and support, strengthening the relationship while reducing risk.
- Organizations and debt providers alike are increasingly looking to have relationships with those with similar principles and responsibility.

REPUTATIONAL RISK IS A KEY CONSIDERATION

Banks recognize that they are increasingly exposed to reputational risk through the lending decisions that they make.

WHAT DEBT INVESTORS AND LENDERS HAVE TOLD US

"Reputational and sustainability risks are becoming equal to credit risk and not secondary; these risks are becoming embedded in the subconscious of lenders."
Managing Director – acquisition finance, major international bank

"Traditionally, we have integrated sustainability factors to avoid bad reputation but we are now doing it to seek positive reputation and attract new business, and position ourselves for the future. Likewise, our clients have to embrace the culture of embedding sustainability, to not only avoid problems but to actually create good."
Managing Director – corporate banking, large banking group

WHY?

- Reputation related to performance on sustainability factors is a key influencer of business value and stakeholder satisfaction. It also affects employee satisfaction, attraction and retention.[19] Investors are increasingly asking 'should we?' rather than 'could we?'.
- If the borrower's reputation suffers:
  1. Default risk increases
  2. The debt provider's own reputation can be damaged by association
- An organization's reputation on sustainability matters will be monitored from press coverage and included in both KYC procedures and risk assessments.
- Some lenders now have a reputational risk committee.
- Credit rating agencies also consider reputation as part of their risk-rating process.

ESG IMPACTS DECISION MAKING

The methods of incorporating material non-financial factors, such as sustainability issues, into the debt finance decision processes within lenders and investors vary depending on the lending or investment strategy. Some examples are shown at a high level below.

Globally, in 2018 there were US$30.7 trillion of assets managed under responsible investment strategies, a 34% increase in two years.[18] Debt providers are increasingly unwilling to sacrifice long-term returns from sustainable organizations for the sake of short-term profitability. Although exclusion lists are limited to a handful of sectors such as defence and controversial weapons, sensitive sectors may be subject to enhanced sustainability standards and due diligence. The common perception among the debt provider community is that there needs to be a transition period for some sectors, such as coal power.

NEW BORROWER

Know Your Customer

Assessment of the borrower profile in relation to sustainability is part of the KYC process in particular areas that influence credit and reputational risk, such as exposure to climate risk, track record on fines, boycotts, incidents, etc.

NEW TRANSACTION

Application/issue of bond prospectus

Assessment of intended use of funds should include a **consistency check** between the use of proceeds and the borrower's broader sustainability and good-practice standards.

Credit analysis

Sustainability factors are assessed and may be included in internal and external **credit ratings**.

Where relevant, sustainability criteria will be considered for their **impact on financial metrics**, such as future cash flows and the borrower's ability to repay.

Review and decision

There is further consideration of the **reputational risk** of the transaction and its impact on the **cumulative risk** of the portfolio.

Documentation

Lending

Covenants on sustainability-related performance levels (e.g. on specific indicators) are increasingly being included and there is an expectation of regular reporting/ transparency.

Investment

For bonds, a review of **regular reporting** on use of proceeds includes impacts achieved, and third-party validation may be conducted.

Negative screening: identifies specific, sensitive activities (e.g. manufacturing of arms, high-carbon fuel production) and prohibits or restricts financing

Positive screening: looks for the best-in-class organizations on the basis of predefined factors

A4S CFO LEADERSHIP NETWORK

IMPLICATIONS FOR TREASURY TEAMS

WHAT ARE THE CURRENT PRACTICES, EXPECTED TRENDS, AND HOW CAN TREASURY TEAMS ADAPT?

IMPLICATIONS FOR TREASURY TEAMS

Sustainability issues are increasingly influencing organizations' strategies, business models and financial planning. If companies do not take action – if they haven't done so already – it is likely that these challenges will reduce both their financial performance and cashflows. The role of treasury teams is therefore closely linked to the risks and opportunities of sustainability in organizations. It is essential to build a common understanding of sustainability within the organization and the opportunity to integrate it into debt-raising decisions.

From interviews with debt providers and the A4S CFO Leadership Network, we have identified the treasury activities most affected by sustainability considerations.

We believe there are opportunities for treasury teams not only to anticipate changes but to lead the market in responding to the challenges and opportunities presented. They can also play a role in encouraging the mainstream debt market to fund sustainable outcomes.

By responding effectively, benefits may be realized in improved access to capital, pricing, reputation and stakeholder engagement, and in attracting new investors.

AFFECTED TREASURY ACTIVITIES RELATING TO DEBT FINANCE

Identifying the need for finance, type of finance and the parties to work with	Determining pricing, covenant and term-sheet criteria	Managing relationships and continuous engagement	Cash management, debt monitoring and reporting

Guidance for treasury teams is explored in more detail across the four key treasury team activities related to obtaining and managing debt finance. Our approach draws upon the debt provider perspective and covers current practice, expected disruption and guidance.

IDENTIFYING THE NEED FOR FINANCE, TYPE OF FINANCE AND THE PARTIES TO WORK WITH

What's happening now?

- Debt providers consider borrower sustainability credentials before transactions.
- Increasingly, treasury teams are considering the sustainability credentials of their advisors and banking partners in their selection process, seeking alignment with their own principles.
- Green bonds have become an effective way of financing green projects. The growth in this market has raised understanding and expectations on use of proceeds and reporting across fixed income teams.
- We are starting to see new types of bond linked to sustainable outcomes beyond 'green'.
- We are starting to see a few examples of price differentials on certain products, e.g. green loans and revolving credit facilities linked to sustainability targets.
- We are also starting to see sustainable finance frameworks to help companies raise debt to support the financing and/or refinancing of assets and expenditures of a sustainable nature.

What do we expect in the near future?

- Sustainable organizations will become more attractive to debt providers. Lenders will have baseline ESG requirements for access to debt.
- Conversely, organizations that have a business model not seen to align with a sustainable future may pay a premium for debt or be excluded by a growing number of providers.
- Banks and investors will face more risks – both credit and reputational – where they choose to fund unsustainable companies and projects.
- Know Your Customer checks, which include an analysis of an organization's sustainability commitments and track record, will increasingly influence credit decisions.
- We will see an increase in lender sustainability policies with minimum standards that their borrowers are required to meet, or achieve over time.
- ESG considerations will be into the mainstream.
- There will be increasing instances of price differentiation for green/sustainable loans and bonds.

Actions you can take now

- Gain an understanding of the different types of financial markets, lenders and products that incorporate ESG principles, as potential sources of funding:
  - Establish a sustainable finance framework.
  - Set goals for including ESG in debt financing.
- Consider sustainability criteria for mainstream corporate and asset-level finance; activities aligned with the SDGs may meet the requirements for Green or Social Bond Principles.
- Assess whether your lenders are signatories to initiatives such as the TCFD, UNEP FI, the PRI, the Equator Principles, and the IIGCC, and review any public sustainability disclosures. Select lenders who are advanced on these issues.
- Liaise with those in your organization who are responsible for driving and monitoring relevant performance measures and assess alignment with lender requirements, opening more access to funds.
- Ensure sustainability is demonstrated as part of roadshow presentations, reporting and other communications, so that these can be used to attract the right lending partners and assist in negotiations.

"A good company doing the right things will have a lower cost of debt in future."

DIRECTOR, BRITISH MULTINATIONAL BANK

See how you're doing on the next page

IDENTIFYING THE NEED FOR FINANCE, TYPE OF FINANCE AND THE PARTIES TO WORK WITH

The maturity map is designed to enable you to benchmark your current approach, and understand how it can be enhanced. The map captures the different dimensions of identifying the need for finance, the type of finance and the parties to work with.

Maturity map

Do you understand how the integration of ESG into your processes for identifying the need for finance, the type of finance and the parties to work with supports the success of your organization? Do you have the information you need to make informed decisions in these areas?

Treasury team activities	Limited consideration of sustainability in activity	Moderate consideration of sustainability in activity	Advanced consideration of sustainability in activity
Decision making on finance needs	• Sustainability factors are not considered in decisions relating to finance and associated party identification.	• Sustainability factors are sometimes considered in decisions relating to finance and associated party identification, particularly for specific projects.	• Sustainability factors are regularly considered in decisions relating to finance and associated party identification, for both specific projects and the business more broadly. A sustainable finance framework is in place.
Lender selection	• Lenders' sustainability credentials are not requested nor analysed.	• Lenders' sustainability credentials may be requested and analysed if an issue is brought to light.	• Lenders' sustainability credentials are analysed on a continuing basis and specific criteria are used on selection, e.g. their performance on key sustainability indicators and participation in initiatives such as the Task Force on Climate-related Financial Disclosures.
Labelling	• Green, social and sustainable bonds and loans are not considered as viable financing options.	• Green, social or sustainable bonds and loans are issued, but green credentials are not integrated into mainstream borrowing.	• Green, social and/or sustainability credentials and covenants, as relevant, are integrated into all project and corporate-level debt agreements.
Organization-wide approach	• Other teams within the organization are not aligned to provide performance monitoring in line with lender requirements.	• Other teams within the organization are, in some instances, aligned to provide a response to lenders' monitoring requirements.	• Other teams within the organization are aligned to provide a response to lenders' monitoring requirements and integrated with treasury team planning.
	Beginner	Intermediate	Leader

DETERMINING PRICING, COVENANT AND TERM SHEET CRITERIA

What's happening now?

- Project or asset risks are being factored into fair value analysis and are starting to influence price, tenor, allocation and level of lending and investment decisions.
- There is increasing evidence that price premiums are applied to organizations (and markets) perceived to be less sustainable. Where banks have a sustainability rating embedded into their broader risk ratings, this will indirectly influence price. As a result, should an organization be perceived as less resilient to long-term sustainability factors, and so less sustainable, debt may be harder to obtain and come at a premium.
- It is not just a question of price, but also of access to finance. If an organization's sustainability performance does not meet a lender's policy requirements, and there is no commitment to do so over time, then a lender may decline to provide credit or do so only on stricter terms, tighter covenants or short tenors.
- Generally, sustainability factors are not yet included in ratings, covenants or term sheets, unless they directly affect performance criteria, but this is starting to change.

What do we expect in the near future?

- Discounts will become increasingly applied in the next two to five years for organizations that show commitment and a track record on sustainability.
- Green bonds and green loans may get a pricing advantage with premiums paid by investors/lenders with dedicated green mandates.
- Where sustainability criteria are not met, pricing penalties are rising in mainstream debt. Pressure from lenders is growing for covenants or term sheets to be linked to sustainability indicators. Covenants may require regular monitoring of sustainability performance and more stringent financial covenants are expected to allow for potential sustainability impacts on cashflows or asset impairments.
- Lenders will set further sustainability criteria, particularly in sensitive or high-carbon industries such as thermal coal mining or fossil-fuel-based engine manufacturers, as a condition of access to capital, and increasingly will stop lending to these sectors.
- Lenders will expect greater disclosure of sustainability risks and how they affect business models and financial plans.

Actions you can take now

- Work with colleagues across the business to articulate and report clearly on business and financial risks that involve ESG factors, as these may influence the pricing and covenant criteria.
- Be prepared for covenants or term sheets that increasingly incorporate requirements on performance against sustainability indicators.
- Take a long-term view of the metrics to be included in covenants and consider working with sector peers for consistent performance metrics.
- Be prepared for requests for greater disclosure of sustainability risks and how they affect business models and finances. This will not only be the case for sensitive or high-carbon sectors, but across all sectors needing to show consideration of broader sustainability issues, including the 'S' and 'G' ones.
- Proactively negotiate with financial auditors to ensure adequate understanding of ESG by the debt covenant audit team.

See how you're doing on the next page

DETERMINING PRICING, COVENANT AND TERM SHEET CRITERIA

The maturity map is designed to enable you to benchmark your current approach, and understand how it can be enhanced. The map captures the different dimensions within pricing, covenants and term sheet criteria.

Maturity map

Do you understand how the decisions you make when negotiating pricing, covenants and term sheet criteria support the success of your organization? Do you have the information you need to make informed decisions in these areas?

Treasury team activities	Limited consideration of sustainability in treasury team activity	Moderate consideration of sustainability in treasury team activity	Advanced consideration of sustainability in treasury team activity
Performance	• Treasury focuses on financial factors when negotiating terms.	• Treasury sees the benefit of good sustainability credentials and consults with relevant colleagues to understand the organization's sustainability performance.	• Treasury supports a sustainable business strategy and transparent reporting of performance against strategic objectives. • Its staff collaborate with those who have responsibility for driving and monitoring performance, both to help plan the funding of their activities and to improve performance and monitor compliance against related covenants and reporting requirements.
Terms	• Consideration of sustainability factors in current or future covenants or term sheets would be challenging to the organization.	• Consideration of sustainability factors in current or future covenants or term sheets could be responded to, but processes and documentation would need to change.	• There is consideration of sustainability factors in current or future covenants or term sheets, which is facilitated by the organization's long-term view. • Treasurers work with sector peers to develop consistent performance metrics.
	Beginner	Intermediate	Leader

MAINTAINING RELATIONSHIPS AND CONTINUOUS ENGAGEMENT

What's happening now?	What do we expect in the near future?	Actions you can take now
• Relationships between organization management (including treasury) and lenders/debt investors can be key to financing decisions. Transparency and engagement on the management of sustainability and long-term factors are key to building trust in that relationship. • Engagement on sustainability is very low in day-to-day lending/short-term funding (although there are some examples of ESG incorporated into commercial papers and revolving credit facilities). • Level of engagement on sustainability varies by sector; it is currently relatively high for utilities, energy, transport, fashion, real estate and natural resources, where there is clear evidence of climate, environmental or social risks or impact. • Relationships with credit rating agencies are also important for understanding their current and planned evaluation of risk from sustainability factors.	• There will be an increased focus on sustainability factors by nearly all key market stakeholders: regulators, listing authorities and credit rating agencies, as well as investors. • ESG considerations will permeate a corporate's relationship with its bank(s), integrating with all debt agreements. • There will be deeper dialogue between organizations and debt providers on long-term planning and sustainability (and greater expectations from debt providers that organizations are open to this deeper dialogue).	• Build an open dialogue with debt providers on sustainability to help build trust and lower perceived and actual risk. Engage with debt providers on the pricing approach. • Be proactive and lead the dialogue rather than waiting for questions from debt providers, to help raise awareness and understanding. Start the communication process early. • Remain informed on sustainability issues and invest in training for treasury teams to empower them to have deeper dialogue with debt providers. • Have sustainability and sustainability performance on the agenda for discussion with credit rating agencies. Help credit rating agencies and the investor community understand your sustainability policies and actions and educate them on the social and environmental factors you are addressing.

See how you're doing on the next page

"Climate impact is already considered in risk assessment at the same level as bribery and money laundering – though not criminal activity, climate issues have a significant reputational impact."

MANAGING DIRECTOR, MAJOR INTERNATIONAL BANK

MAINTAINING RELATIONSHIPS AND CONTINUOUS ENGAGEMENT

Maturity map

Do you understand how managing relationships and continuous engagement with your debt providers supports the success of your organization? Do you have the information you need to make informed decisions in these areas?

The maturity map is designed to enable you to benchmark your current approach, and understand how it can be enhanced. The map captures the different dimensions within managing relationship and on-going engagement with your debt providers.

Treasury team activities	Limited consideration of sustainability in treasury team activity and business strategy	Moderate consideration of sustainability in treasury team activity and business strategy	Advanced consideration of sustainability in treasury team activity and business strategy
Engagement	• There is very little or no engagement with debt providers on sustainability issues.	• There is some engagement with debt providers on sustainability issues.	• There are high levels of engagement with debt providers on sustainability issues. • Treasury actively builds an open dialogue with debt providers on sustainability issues to help build trust and lower perceived risk.
Lead discussion	• Sustainability factors are not discussed with debt capital market participants, either to understand existing trends or to explore opportunities for the company to respond and access sustainable finance.	• Sometimes, sustainability factors are raised by the organization, but mainly by external stakeholders.	• Sustainability factors are proactively raised by the organization as part of their interaction with the debt capital markets. • Treasury consistently has sustainability on the agenda for discussion with broader stakeholders, such as rating agencies, treasury peers and regulators.
Capacity building	• No sustainability training is provided for treasurers.	• Limited sustainability training is provided for treasurers. • There is occasional dialogue between treasury and sustainability functions.	• Sustainability training is provided for treasurers to empower them to lead discussions both internally and externally. • There is regular dialogue and collaboration between treasury and sustainability functions. • The organization encourages professional education bodies for treasurers to integrate sustainability considerations into treasury-focused education and qualifications.
	Beginner	Intermediate	Leader

MANAGING CASH, MONITORING DEBT AND REPORTING TO DEBT PROVIDERS

What's happening now?

- There is increasing pressure for companies to report the financial implications of sustainability factors and trends.
- Many organizations' long-term view and forecasts only extend three to five years, even when looking to obtain finance for longer periods. Many sustainability issues will have an impact in the medium to long term, but lenders, investors and treasurers are incentivized to focus on the shorter term.
- There is limited consistency, comparability and transparency of metrics used to monitor corporate sustainability. Efforts are under way to converge measurement and reporting frameworks, seeking, in particular, to develop consistent sector-level KPIs.
- There is growing recognition and demand for the impact of sustainability factors to be considered in relation to pricing, costs and margins, and as a result, cash flows. For example, the TCFD has made explicit reference to cash flow impacts from climate change.

What do we expect in the near future?

- Reporting the financial implications of sustainability factors and trends will become the norm, driven through either regulation or 'soft' regulation.
- Transparency will be a differentiator for access to and cost of capital: low transparency equates to financial risk in the eyes of debt providers, leading to difficulties in obtaining credit (or, at least, cheap credit).
- ESG reporting frameworks will be more closely aligned with each other and to investor needs, with greater clarity over industry-specific KPIs.
- Companies will be expected to reflect ESG considerations in their own investment and cash-management decisions.

Actions you can take now

- Work with finance, investor relations, sustainability practitioners and others within the organization to monitor compliance against covenants and meet reporting demands by:
  1. Building a longer-term story that shows business longevity and resilience.
  2. Focusing on material issues, and reporting outcomes and impacts, including on cashflows.
  3. Including a balanced story of positive and negative performance and impact across sustainability factors.
  4. Reporting opportunities and risks to your business lines, products, services and geographies.
  5. Considering disclosure of the impacts of sustainability factors on key financial metrics.
  6. Considering independent assurance, at least over key indicators.
- Collaborate with industry peers to standardize reporting of sustainability factors and key metrics.
- Bring principles of transparency and purpose, as seen in green bonds/loans, into all debt and cash-management activities.
- Communicate the financial benefit of the actions above through your debt and investor roadshows and to wider stakeholders.

Suggested reading:

- TCFD Final Recommendations Report
- Guidance on integrating ESG into investor roadshows and other communications can be found in the A4S Essential Guide to Enhancing Investor Engagement

See how you're doing on the next page

MANAGING CASH, MONITORING DEBT AND REPORTING TO DEBT PROVIDERS

The maturity map is designed to enable you to benchmark your current approach, and understand how it can be enhanced. The map captures the different dimensions of monitoring and reporting.

Maturity map

Do you understand how the integration of ESG into your cash management, debt monitoring and reporting processes supports your organization's ability to access finance? Do you have the information you need to communicate effectively to the markets?

Treasury team activities	Limited consideration of sustainability in treasury team activity and business strategy	Moderate consideration of sustainability in treasury team activity and business strategy	Advanced consideration of sustainability in treasury team activity and business strategy
KPIs	• The organization's sustainability performance indicators are primarily owned and managed by the sustainability team and are not incorporated into treasury activities. • KPIs are not used consistently within the organization and may not focus on material impacts.	• KPIs are used consistently across the organization and focus on material impacts. • The organization uses a broad set of indicators, aligned with sector peers, as relevant.	• A set of indicators are used that are commonly agreed within the sector and that show a balanced picture of performance. • These indicators include the management of financial risks such as climate change.
Monitoring and reporting	• Monitoring and reporting on sustainability are based on qualitative information.	• Monitoring and reporting on sustainability are based on quantitative and qualitative information.	• Monitoring and reporting on sustainability are based on quantitative and financial information, embedded into the organization's processes and linked to core business metrics.
Transparency	• Some sustainability data is publicly reported.	• Sustainability reports are published and highlight material issues. • Independent verification is provided on some of the data.	• Sustainability indicators are linked to value drivers and reported on within all key capital markets presentations. The information is supported by an unqualified independent assurance report. • The principles of transparency and purpose are incorporated into all debt raising.
Horizon	• The long-term view is three years or fewer.	• The long-term view is between three and ten years.	• The long-term view extends for the life of the debt, with a minimum of ten years.
Cash management	• Cash management decisions are based exclusively on interest rates and liquidity.	• ESG factors are sometimes considered in cash management decisions.	• ESG considerations are fully integrated into investment and cash management decisions.
	Beginner	Intermediate	Leader

SUMMARY OF RECOMMENDED ACTIONS FOR TREASURERS

Treasury teams are pivotal to an organization's strategy, funding and success. Organizations across all sectors are increasingly recognizing the need to consider sustainability factors in risk assessments and integrate them into operations to meet the associated demands from various stakeholders, including debt investors and lenders. Below we summarize some key actions that treasurers can take to support their organization.

1. Seek to understand the sustainability factors affecting your organization and remain updated on emerging sustainability issues, including how financial markets, products and debt lenders and investors are adapting and innovating.
2. Collaborate with colleagues across different divisions to identify the relevant and material sustainability risks and factors affecting the organization, so that these can be managed and reported effectively. The actions taken can be used to attract and negotiate with the right debt providers.
3. Work with debt providers who share your organization's principles on sustainability and have a demonstrable track record on such issues – this can be evidenced from initiatives in which they have participated and public disclosures of their sustainability commitments.
4. Be proactive in engaging with debt providers and credit rating agencies on sustainability issues – initiate the dialogue and be on the front foot – demonstrate the organization's attention to sustainability factors and related risks.
5. Focus on the material factors in your reporting, ensuring transparency on both the risks and opportunities related to the adoption of a sustainable business model and sustainable value creation.
6. Work with peers and industry bodies to integrate sustainability considerations into education and qualifications for treasurers.
7. Bring principles of transparency and purpose seen in green bonds/loans into all debt and cash management activities.

Considering sustainability in an organization's debt finance activities will mean greater opportunities for, and access to, funding, with potentially lower costs, while supporting an overall strategic objective of being a long-term, sustainable organization fit for the future.

PRACTICAL EXAMPLES

EXAMPLES FROM THE CFO LEADERSHIP NETWORK AND BEYOND

PRACTICAL EXAMPLES

ESG considerations are being integrated into debt financing by all key actors in the debt market: banks, asset managers, credit rating agencies and corporates. The market is, as yet, immature but is gaining increasing momentum. A range of examples from CFO Leadership Network organizations and beyond are provided on the following pages. The case studies have been presented to show the different approaches being used.

BANKS

Green product frameworks

Barclays has introduced a green product framework which sets out borrower activities that qualify for a growing set of green products.

Performance-linked products

Lloyds developed a product that provides commercial real estate debt at advantageous rates to reward and incentivize better sustainability performance.

Sustainability bonds

HSBC launched a bond to finance projects that support the achievement of the UN Sustainable Development Goals.

ASSET MANAGERS

Green bond funds

Storebrand developed a green bond fund which invests in companies and projects that have a clear positive impact on the environment and society.

Gender equality bonds

QBE issued a gender equality bond aimed at financing investments in organizations that are leaders in fostering workplace gender equality.

CREDIT RATING AGENCIES

Credit scoring systems

Fitch Ratings launched an integrated scoring system that shows how ESG factors influence individual credit rating decisions.

CORPORATES

Sustainable financing frameworks

Pennon pioneered a sustainable financing framework which links financial impact to sustainability impacts.

Yorkshire Water developed a sustainable finance framework to align its financing with their long-term corporate strategy and sustainability objectives.

Credit facilities

Olam secured a sustainability-linked credit facility where the company pays lower interest rates if it hits more than 50 environmental, social and governance targets.

Royal DSM secured a revolving credit facility which links the interest rate to its greenhouse gas (GHG) emission reduction.

Solvay secured a revolving credit facility which links the interest rate to its greenhouse gas (GHG) emission reduction.

Green loans

Sainsbury's agreed the first corporate 'green' loan for investing in carbon reduction and sustainability projects.

Green bonds

Anglian Water became the first European utility company to issue a sterling green bond.

SSE launched a green bond with a coupon of 0.875%, the lowest coupon that it had achieved for a senior bond.

Sustainability bonds

Starbucks issued two sustainability bonds in order to fund programmes for coffee supply chain management.

Green lease

Pennon, as part of its sustainable financing framework, has signed the UK's first green finance leases.

ESG commercial paper and certificate of deposit programmes

Rabobank launched their 'ESG Leader' Commercial Paper and Certificate of Deposit Programme.

BANKS
GREEN PRODUCT FRAMEWORKS

Barclays

Barclays is a British consumer and wholesale bank, headquartered in London, with a history spanning more than 325 years. It is committed to playing a leading role in the transition towards a sustainable environment and low carbon global economy.

Increasingly, regulatory, reputational and commercial drivers are forcing businesses to engage with the significant risks and opportunities presented by the impact of climate change. 'Going green' can help an organization reduce costs, encourage innovation and differentiate itself from competitors.

To ensure that its clients have access to finance that places green principles at its core, Barclays has developed its market-leading Green Product Framework in conjunction with Sustainalytics, a leading global provider of environmental, social and corporate governance research and ratings.

This framework identifies projects and activities that have a positive environmental impact, such as: energy efficiency, renewable energy, green transport, waste management, greenhouse gas emission reduction and sustainable food, agriculture and forestry. These projects are eligible for Barclays' green financing options, including: green asset finance, innovation finance, green loans, green trade loans and green deposits.

Find out more

How Unipart is benefiting from a green asset finance facility

"What we're increasingly hearing from our clients is a shift in mindset, with sustainability becoming more central to their overall investment strategy. We share that view at Barclays and know that unless sustainability is at the heart of how companies conduct their operations, they could fall behind. As a major UK bank, we're proud to have devised a range of products targeted exclusively at funding green corporate banking investment activity, that will help promote growth now and contribute towards a better, greener, future for all."

ANGELA OTTAWAY, MANAGING DIRECTOR, GLOBAL LENDING GROUP PRODUCT MANAGEMENT, GOVERNANCE & TRANSFORMATION, BARCLAYS CORPORATE BANKING

BANKS
PERFORMANCE-LINKED PRODUCTS

Lloyds Banking Group

Lloyds Banking Group is a British retail and commercial bank.

Our approach to sustainability supports the aims of the UK Government's Clean Growth Strategy, showing our commitment to supporting the UK to successfully engage with the opportunities and challenges created by climate change. We are therefore working towards our overall aim of becoming a leader in supporting the UK to successfully transition to a more sustainable, low-carbon economy.

Funding from Lloyds Commercial Bank already supports a broad range of investments in sustainable business – from small improvements in environmental impact, right through to large-scale renewable energy infrastructure. Examples include our Clean Growth Finance Initiative – which aims to be the most inclusive proposition in the market. The Initiative constitutes £2bn of new funding to help UK businesses invest in a more sustainable future and increase productivity. It aims to deliver the most inclusive UK green funding in the market by providing the incentive of discounted lending to help businesses invest in reducing their environmental impact as well as boosting productivity more generally.

The funding supports Commercial Banking clients across multiple 'green lending' purposes which include:

- Reducing emissions
- Energy efficiency
- Low carbon transport
- Improved water efficiency
- The reduction of waste and recycling

Furthermore, our Corporate Real Estate clients can access discounted Green Loans to improve estate energy efficiency and in the renewable energy sector we launched a new target to help provide power for five million homes by 2020, through our support for renewable energy projects, such as offshore wind farms.

£2bn
new funding for Clean Growth Finance Initiative

"Many of our clients are already pioneering energy efficiency in the real estate sector. However, there's much more that can be done and, as a major provider of funding to the sector, we believe we can have a positive impact supporting our clients as they work to create a greener built environment. We hope, through taking leading action, other lenders will join us and work together to maximize impact on this issue of generational importance."

JOHN FEENEY, GLOBAL HEAD OF COMMERCIAL REAL ESTATE, LLOYDS BANK

BANKS
SUSTAINABILITY BONDS

HSBC

HSBC Holdings is one of the largest banking and financial services organizations in the world.

Following its pledge to provide US$100 billion in sustainable financing and investment by 2025, HSBC has launched the world's first bond in direct support of the UN's Sustainable Development Goals (SDGs). The bond is aimed at financing projects that advance SDGs 3, 4, 6, 7, 9, 11, and 13.

US$ 1 billion funds raised through the bond are being used to finance projects that benefit communities and the environment, for example, building hospitals, schools, small-scale renewable power plants and public rail systems. Examples of eligibility criteria and KPIs are presented here.

For the full framework

Use of proceeds	Eligibility criteria	Key performance indicators
SDG 3: Good health and well-being	• Activities that strengthen the capacity of all countries, in particular developing countries, for provision of free or subsidized healthcare, and early warning, risk reduction and management of health crises	• Number of hospitals and other healthcare facilities built/upgraded • Number of health checks provided • Number of residents benefiting from health care that is otherwise not accessible
SDG 4: Quality education	• Activities that expand access to primary, secondary, adult and vocational education • Activities that target women and minority inclusion in education • Activities that improve educational infrastructure	• Number of educational institutions funded – location and type • Number of students supported • Number of years of education provided beyond what are otherwise accessible
SDG 6: Clean water and sanitation	• Activities that expand public access to safe and affordable drinking water • Activities that provide access to adequate sanitation facilities • Activities that improve water quality • Activities that increase water-use efficiency through water recycling, treatment and reuse (including treatment of waste water)	• Number of tonnes of clean water provided • Number of units of water hygiene equipment provided • Number of water infrastructure projects built, e.g. dams, reservoirs
SDG 7: Affordable and clean energy	• Generation of energy from renewable sources • Construction / maintenance / expansion of associated distribution networks • Manufacture of components of renewable energy technology • Development of products or technology, and their implementation, which reduces energy consumption of underlying asset, technology, product or system(s) • Improved efficiency in the delivery of bulk energy services • Manufacture of components that enable energy efficiency	• kW of clean energy provided • Number of tonnes of CO_2 avoided • Number of household/residents benefiting from affordable and clean energy which is otherwise not accessible • Number of solar farms or wind farms • Location and type of solar or wind farms

ASSET MANAGERS
GREEN BOND FUNDS

Storebrand

Storebrand is a financial services company in Norway which manages NOK729 billion (€75 billion) for two million Norwegians and Swedes, primarily pension funds. This makes us Norway's largest private asset manager. Sustainability is an integral part of Storebrand's core business, and has been core in our investment strategy since 1995. 100% of our investments are screened for sustainability. This means we evaluate economic, social, governance and environmental aspects before we make any investment decisions. We have embedded this approach across our investment portfolio, through exclusions, dialogue with companies (impact), and channelling more investments to companies that score high on sustainability criteria and are part of the green shift. On dialogue and impact we are exerting influence through direct company engagement, proposing resolutions and exercising our voting rights at the company's Annual General Meeting, using proxy voting and expressing our views publicly. In doing so, we often work alongside other investors for more leverage.

This case study highlights one specific area of our work in relation to green bonds.

WHAT?

Our subsidiary in Sweden, SPP, has a green bond fund which has over SEK4.8 billion (€450 million) in assets under management. The investments vary from renewable energy, waste management to water treatment and water supply, and it has been outperforming all of its traditional bond funds competitors. All in all, we have SEK11 billion (€1 billion) invested in green bonds across our different funds.

Storebrand / SPP has also been one of the driving forces behind the first blue bond ever issued in Scandinavia, to clean up the Baltic Sea. This was partly inspired by HRH The Prince of Wales's seminar “Financing of improving ocean health and natural resources”.

WHY?

For Storebrand, sustainability is about risk, return and our own long term focus as well as our customers' security. As a supplier of savings for pensions, it is essential that we have the ability to think long term and generate returns for the customer that do not ruin the world in which the customer will draw his or her pension.

HOW?

The fund is structured like a traditional bond fund, with the objective of offering easy entry to green investments and fit into traditional investment portfolios. Investments are made in green bonds that have been externally reviewed and that are linked to businesses and projects deemed to have a positive impact on the environment and society. Investments cover sectors including renewable energy, waste management, and water treatment and drinking water supply.

storebrand

More on Storebrand's sustainability guidelines

ASSET MANAGERS
GENDER EQUALITY BONDS

QBE

QBE Insurance Group is Australia's largest global insurer. It provides insurance services mainly to Australia, America, Europe and Asia Pacific.

As part of QBE's overall focus on ESG risk, it has developed a sustainable framework to help drive performance and manage risks across the areas of sustainability that are most important to the business and its stakeholders. One key area on which QBE focuses is gender equality, with QBE being a signatory to the United Nations Women's Empowerment Principles. Therefore, in 2017 QBE issued a US$400 million gender equality bond aimed at financing and/or refinancing investments in organizations that are leaders in fostering workplace gender equality.

More information

QBE

The QBE gender bond issue was oversubscribed by more than 20 times, drawing applications for US$8.25 billion.

CREDIT RATING AGENCIES
CREDIT SCORING SYSTEMS

Fitch Ratings

Fitch Ratings is one of the 'big three' credit rating agencies (CRAs). Fitch recently launched a new integrated scoring system that shows how ESG factors infuence individual credit rating decisions.

WHAT?

The new ESG Relevance Scores, which are being produced by Fitch's analytical teams, transparently display both the relevance and materiality of ESG elements to Fitch's rating decisions. They are sector based and entity specific. Using a standardized approach, Fitch is introducing ESG Relevance Scores across all its asset classes. It has already published over 35,000 scores for non-financial corporates, banks, insurance companies, non-bank financial institutions and sovereigns, and will shortly publish scores for public finance, global infrastructure and structured finance.

These ESG scores are currently freely available and are being applied to all rated companies. In future they will become an integral part of Fitch's research reports, which are published on rated entities.

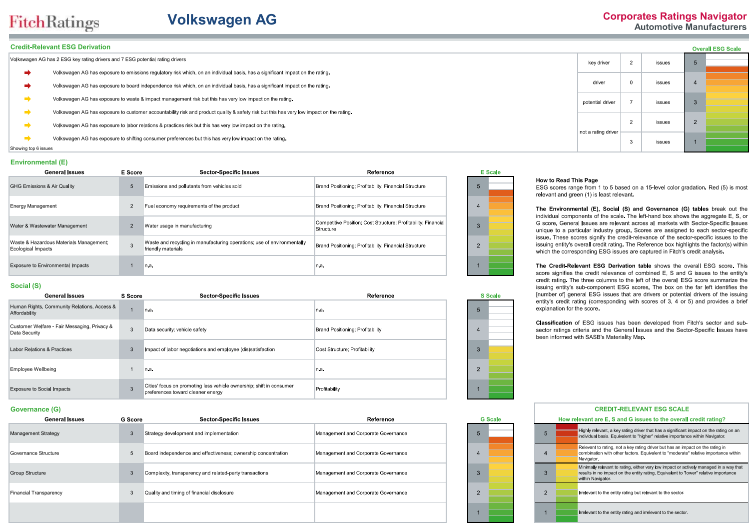
WHY?

The relevance scores were developed in response to the growing need from investors for information on ESG factors within portfolios. The focus is on fundamental credit analysis and so the ESG Relevance Scores are aimed at addressing ESG specifically within that credit context.

The scores will enable investors to agree or disagree with the way in which Fitch has treated ESG at both an entity and a sector level, assist them in making their own judgements about credit rating impact, and enable them to discuss fully all aspects of the credit with the analytical teams.

HOW?

Fitch engaged with investors and other market participants, to understand what they wanted to see from CRAs, before devising the new relevance scores. The scores draw out from existing ratings criteria those ESG risk elements that influence the credit rating decision. The credit-relevant sector-specific E, S and G factors are displayed in industry-specific templates and then scored by the ratings analysts. The scores focus purely on displaying how the E, S and G risks have influenced the credit rating decision, rather than making value judgements on whether an entity engages in good or bad ESG practices.



ESG Relevance scores

CORPORATES
SUSTAINABLE FINANCING FRAMEWORKS

Pennon Group

Pennon Group is an environmental utility infrastructure company at the top end of the FTSE 250; it owns South West Water Limited and Viridor Limited.

WHAT?

Pennon Group became the first business to pioneer a sustainable financing framework linking financial impact to sustainability impacts. The framework is designed to enable the Group to issue sustainable finance throughout the business and is in alignment with the Green Bond Principles, Social Bond Principles and the Green Loan Principles. Under the framework, Pennon Group can issue securities and enter into financing relationships to support investment.

Investments made by Pennon are targeted at improving a broad spectrum of outcomes resulting in activities that demonstrate environmental and socially sustainable outcomes.

Pennon

WHY?

As Pennon Group is one of the UK's largest environmental infrastructure businesses, providing water, recycling and energy services, sustainability is an integral part of the company's strategy. In order to create shareholder value, the Group endeavours to maximize the efficiency of its use of resources, reduce waste, increase levels of recycling, fully exploit opportunities for low-carbon energy generation, and divert waste streams away from landfill. It is crucial that the way that it raises finance aligns with this strategy.

Over £500m raised since May 2018 aligned to International Capital Markets Association (ICMA) Principles

The Social Bond Principles

The Green Bond Principles

Green Loan Principles
Supporting environmentally sustainable economic activity

CORPORATES
SUSTAINABLE FINANCING FRAMEWORKS

Pennon Group

HOW?

The framework is an accredited approach facilitating the following instruments:

- Committed bank facilities
- Long funding finance leases
- Green, social and sustainable bonds

Interest rates vary depending on Pennon's Environmental, Social and Governance (ESG) performance and South West Water's sustainability KPIs. This framework is designed to give the Group the ability to finance projects that drive improvements in sustainability. The eligible portfolio will finance, in whole or in part, primarily projects in the following categories:

- Pollution prevention and control
- Sustainable water and wastewater management
- Climate change adaptation

Pennon

"As a group of businesses which provide essential services to lives, businesses and the environment, Pennon is acutely aware of the importance of integrating sustainability into all aspects of strategic decision-making. As part of this we developed our Sustainable Financing Framework – a UK first of its kind – which supports the financing of water, wastewater and waste management investments, resulting in activities that deliver environmentally and socially sustainable outcomes. In today's world, businesses must not underestimate the importance or the growing opportunities presented by sustainable finance and it is vital that finance teams adjust their mindsets and cultures accordingly, if they haven't already done so."

SUSAN DAVY, CHIEF FINANCIAL OFFICER, PENNON GROUP

CORPORATES
SUSTAINABLE FINANCING FRAMEWORKS

Yorkshire Water

Yorkshire Water is a water supply and treatment utility company servicing the north of England.

WHAT?

In order to help us achieve our ambitious sustainability targets, Yorkshire Water has created a sustainable finance framework. This framework is line with internationally recognized principles and guidelines, and is subject to external review and independent second party opinion. We have adopted an innovative 'whole business' approach that is focused on outcomes delivered from investments and expenditure financed under the new framework. Nearly all our future financing, across a range of debt instruments and facilities, will be covered by the new framework.

We have successfully raised £450m of sustainable finance since launching the framework in January, which includes the first sterling denominated sustainability bond listed at the London Stock Exchange.

WHY?

We have set ambitious targets in our regulatory business plans for 2020-2025 to improve our operational performance, which will have long-term environmental and social benefits. However, our strategic vision for 'taking responsibility for the water environment for good' goes beyond regulatory requirements and commits to long-term sustainability.

Our **Six Capitals** approach was launched in 2017 to embed sustainable accounting across our business decision-making and to quantify the impacts on natural, social and human capital alongside usual financial capital reporting. The objective is to align Yorkshire Water's financing with our long-term corporate strategy and sustainability objectives as a more resilient business is developed for the future.

HOW?

Firstly we had to determine which approach best reflected our strategic approach to sustainability. We considered the long duration of our debt portfolio to build a robust framework to meet Yorkshire Water's requirements and the growing prominence of ESG considerations in the financial markets. To do this we researched recognized global principles and their application, through consultation with existing issuers. The framework goes beyond base requirements and sits alongside our strategy and reporting documents. We are committed to prominently highlighting sustainability in future engagement with existing and potential debt investors. We also plan to migrate the majority of our debt portfolio to sustainable finance as it matures or new financing is raised.

Link to the framework

YorkshireWater

CORPORATES
CREDIT FACILITIES

Olam

WHAT?

Olam International is a leading food and agri-business supplying food, ingredients, feed and fibre to over 19,800 customers worldwide. its value chain spans over 60 countries and includes farming, processing and distribution operations, as well as a sourcing network of an estimated 4.8 million farmers.

Olam recently secured Asia's first sustainability-linked club loan facility of US$500m, which links the interest rate on the loan to achieving clear sustainability targets.

WHY?

As an agri-business, Olam is acutely aware that the world needs increased agriculture production for a growing population without over-extending the earth's capacity to provide. There is a clear business benefit to having a sustainable business model.

This financing is aligned with Olam's strategy of putting sustainability at the heart of its business. It also demonstrates how sustainable companies can become more successful, 'doing good' and 'doing well' at the same time.

HOW?

Under the facility, Olam is committed to meeting improvement targets for a comprehensive range of environmental, social and governance (ESG) metrics, which will be independently assessed. The metrics are tested on an annual basis and if the pre-set improvement targets are achieved, the interest rate on the facility will subsequently be reduced

Olam has appointed 15 banks to provide the facility in equal parts, with ING as the sustainability coordinator.

$500m credit facility

Lower interest rates tied to sustainability targets

Three year term

"We are proud to be the first company in Asia and the agri-sector to secure a sustainability-linked medium-term club loan that links interest rate on the loan to achieving clear sustainability targets."

SUNNY VERGHESE, CO-FOUNDER AND GROUP CHIEF EXECUTIVE OFFICER

CORPORATES
CREDIT FACILITIES

Royal DSM

Royal DSM is a global science-based company active in nutrition, health and sustainable living. A commitment to sustainability is one of its core values, a key business responsibility and an important business growth driver.

WHAT?

To underline Royal DSM's commitment to tackling climate change, it has launched a new €1 billion revolving credit facility which links the interest rate to greenhouse gas (GHG) emission reduction.

WHY?

Understanding and being responsive to sustainability issues is a key driver of Royal DSM's success. The company sees this as a key competency throughout the organization, including the treasury function. Linking the revolving credit facility to sustainability performance helps to keep Royal DSM's commitment to sustainability at the centre of its treasury activities. Integrating sustainability and financing is helping to realize Royal DSM's sustainable 'Strategy 2021: Growth & Value – Purpose led, Performance driven'.

HOW?

Royal DSM worked with a syndicate of 15 long-term banking partners to develop the facility, which links the interest rate to corporate performance in reducing GHG emissions, by using three key performance indicators:

- GHG efficiency improvement
- Energy Efficiency Index (EEI) improvement
- Increasing the percentage of electricity sourced from renewable resources

The €1 billion revolving credit facility underpins Royal DSM's strong liquidity profile, and is intended for general business purposes. The Facility has a maturity of five years, which may be extended by a further two years.

€1bn revolving credit facility

Five year term

Interest linked to GHG reductions

"Royal DSM is deeply committed to providing products and solutions that help to combat climate change. Therefore, I am pleased that our long-term banking partners have supported us in getting this innovative financing arrangement in place, underscoring the importance of sustainability in everything we do and that includes corporate finance."

GERALDINE MATCHETT, CFO AND MEMBER OF THE DSM MANAGING BOARD

CORPORATES
CREDIT FACILITIES

Solvay

Solvay is an advanced materials and specialty chemicals company which is committed to developing chemistry that addresses key societal challenges.

WHAT?

In January 2019 Solvay announced it had agreed a revolving credit facility (RCF) linked to its ambitious greenhouse gas (GHG) reduction targets. The corresponding interest margin incentive is significant enough to support further low-carbon projects in the company.

Solvay has been reporting its annual GHG emissions for a number of years. Its GHG reduction targets and performance against them are made public, and subject to independent reasonable assurance. Solvay's performance against these targets will now link to the RCF's interest rate. The company will pay interest quarterly throughout the year. If it hits the interim GHG target at the end of each year, it will receive a credit, but there will be an equal and opposite penalty for missing the target.

The lead bank for this facility is BNP Paribas, with eight other banks forming the syndicate.

WHY?

Sustainability is an integral part of Solvay's core values and the treasury team were striving to contribute actively to supporting these values. The team therefore researched the different instruments available, ensuring avoidance of 'green washing'. Solvay wanted an approach that was:

- Coherent with the company's sustainable value performance evaluation
- Simple, and part of its existing reporting framework
- Clearly defined, robust and transparent
- Future proofed

The options considered included:

A green bond: this was rejected because there would have been an additional layer of reporting required to demonstrate the use of proceeds. Also, Solvay wanted to avoid restricting the use of the proceeds to specific projects.

HOW?

A credit facility linked to ESG indices: being linked to an ESG global index would not be the most pertinent option, as it could limit control over the performance metrics used and the extent to which they might or might not align with core sustainability objectives.

Ultimately, Solvay chose an RCF linked to its sustainability targets and business priorities. Following discussions internally and with the bank, the facility was linked to a single metric: performance against Solvay's GHG emissions-reduction target. This was because this was well understood, robust and clearly defined, and had a clear track record. As a performance metric it also has an element of future proofing, adaptable in case of changes in business scope.

The bank agreed it was reliable because Solvay had clearly defined its measurement approach over a number of years, the metric is subject to reasonable assurance and is published annually within the Integrated Annual Report.

SOLVAY

"As a treasury team, we wanted to find a way to contribute to Solvay's sustainability values and actively support its ambitious value creation targets."

MARIA ALCON HIDALGO, SOLVAY CORPORATE FINANCE, TREASURY AND INSURANCE HEAD

CORPORATES
GREEN LOANS

Sainsbury's

Sainsbury's is the second-largest chain of supermarkets in the United Kingdom, and understands that the company's success depends on society's success. It supports the UN Sustainable Development Goals and wants to play its part in tackling climate change, injustice and inequality, and ending poverty.

WHAT?

In 2014 Sainsbury's became an early adopter of non-traditional fund procurement by agreeing a £200 million corporate 'green' loan to invest in carbon reduction and sustainability projects. While green bonds are now increasingly issued by institutions to support environmental and sustainable initiatives, this was the first time that a commercial loan had been structured to do the same.

'Project Graphite' is an integral part of Sainsbury's 20x20 Plan, which included plans to invest in:

- On-site renewable energy projects related to photovoltaics
- Biomass boilers
- Ground-source heat pumps
- LED lighting and other energy-efficient initiatives

The project was run by a cross-functional team involving engineering, finance, facilities management, project managers, procurement and planners.

Sainsbury's

WHY?

Sainsbury's saw an opportunity to align its environmental commitments and performance with its loan procurement. The company wanted to signal to the markets its long-term strategy and to work with partners Lloyds Bank and Rabobank on developing the first commercial loan structured around Green Bond Principles.

> *"This £200 million green loan demonstrates our commitment and leadership in carbon reduction and sustainability, and shows the value we attach to environmental improvements."*
>
> **JOHN ROGERS, CHIEF EXECUTIVE OFFICER OF SAINSBURY'S ARGOS (SPEAKING IN HIS FORMER ROLE AS SAINSBURY'S CFO)[15]**

HOW?

An external provider performed a benchmark assessment on the company's environmental policies and performance to illustrate the alignment with the overall objectives of the green loan and to outline its commitment to continuous environmental performance.

The proceeds were managed by the group treasury as part of its liquidity operations. Funding was assigned to eligible assets, i.e. projects and capital expenditures that met the eligibility criteria, over a two to three year time horizon.

The key activities undertaken with the proceeds during the financial year 2017/18 were:

- Energy Efficiency and LED lighting replacement in 49 stores
- Energy Efficiency and LED lighting in 12 stores during a refit, three new supermarkets and 22 new convenience stores
- Combined heat and power plants in one existing supermarket and two new supermarkets
- Refrigeration system gas replaced by natural refrigerant (carbon dioxide) in 29 stores

CORPORATES
GREEN BONDS

Anglian Water

Anglian Water provides water and water recycling services to around six million people in the East of England. Operating in one of the driest, yet fastest-growing and economically important regions of the UK, Anglian Water recognizes that water is vital to the success and long-term future of the planet, the region and the company.

WHAT?

Anglian Water has always raised its debt through UK registered companies, and this debt is listed on the London Stock Exchange. In 2017 the company became the first European utility company to issue a sterling green bond. The £250 million, eight-year bond will mature in August 2025 with a return to investors of 1.625%. The order book peaked at £800m at one point, with nearly 80 investors participating. Since the successful launch of that debt transaction, Anglian Water has raised a further £580m of green bonds to UK and US investors. Anglian Water now proposes to raise the majority of its finance in accordance with the **Green Bond Framework**.

WHY?

Increasingly, environmental and social risk management is influencing the debt markets and investors are attracted to companies that take a sustainable approach to managing their businesses. Green finance has enabled Anglian Water to access funds from a wider group of investors than previously.

£250m initial bond value

Eight year term

£800m peak order book value

1.652% return to investors

£580m in additional bonds

HOW?

The sustainability focus at the heart of the business means that all capital expenditure meets the requirements of the underlying **Green Bond Principles**, although for reporting and monitoring purposes some of its largest and stand-out schemes were chosen to be financed through the bonds. These include:

- Innovative water abstraction projects
- Drought and flood resilience schemes
- Progressive water-recycling and water-resource management projects

Anglian Water has now spent £792 million on the projects funded by the green bonds. With the first bond, it is on track to reduce greenhouse gases by 85,410 tCO_2e. More information can be found in the company's Green Bond impact report **here**.

CORPORATES
GREEN BONDS

Top tips from Anglian Water

1. Spend plenty of time talking to investors about what you do, across the full ESG agenda.
2. Work with experienced banks to develop your green bond framework. Ultimately, it is a marketing document about your organization and needs to demonstrate your sustainability credentials.
3. Don't try to develop internal processes just to issue a green bond. Investors are looking for confidence that sustainability is at the heart of the organization, from the Board down to employees, and rushing to communicate a new, untested process may not be successful.
4. Engage with the right second-opinion provider for your business. As Anglian Water had PAS2080 accreditation across its capital programme, the second opinion provider understood the company's way of working as it was accredited to review that too, and so was already familiar with what Anglian Water had to demonstrate.
5. Don't ignore the numerous ESG questionnaires that come through – it is, increasingly, harder to change bad and ill-informed opinions than it is to spend time getting across the right message.

love every drop
anglianwater

"Sustainability is simply how we do business, all day, every day. We were able to issue this green bond because of our continuous drive to generate value for our customers while delivering environmental savings, all of which is made possible by investor confidence in our strong financial structure, governance and reporting."

JANE PILCHER, GROUP TREASURER, ANGLIAN WATER GROUP

CORPORATES
GREEN BONDS

SSE

SSE is a FTSE 100 UK listed energy company focusing on the energy markets in the UK and Ireland. Its strategy is to create value for shareholders and society by developing, owning and operating energy and related infrastructure and services in a sustainable way.

WHAT?

In 2017 SSE launched an eight-year €600m euro green bond with a coupon of 0.875%, which is the lowest coupon that the company had achieved for a senior bond of any kind.

Following the success of this bond and the low coupon rate, SSE decided to issue another green bond in 2018. This was a nine-year €650m euro bond with a coupon of 1.375%. This issuance made SSE the largest issuer of green bonds from the UK corporate sector and additionally the only UK corporate to offer multiple benchmark-sized tranches in the euro market.

WHY?

To execute SSE's strategy, meet business objectives and manage risk over the long term, the company must ensure that it operates sustainably and responsibly. As an energy provider and UK listed company, its economic, social and environmental impacts are significant and SSE believes it should demonstrate a responsible approach by actively managing those impacts in order to secure long-term commercial success.

At the heart of the strategy is a commitment to contributing substantively to the transition to a low-carbon electricity system. The issuance of two green bonds demonstrates this commitment and supports SSE's continued investment in renewable energy. SSE also believed that investors' interest would be piqued by a different type of bond, and that a lower coupon rate could be achieved through linkage with sustainability activities. This resulted in an estimated saving of between two and three base points on the green bonds issued compared with standard bonds, though SSE acknowledges that this can be difficult to verify.

HOW?

To manage the process, SSE developed a **Green Bond Framework** aligned with ICMA's Green Bond Principles. These are:

1. Use of proceeds
The proceeds from the issuance go towards renewable energy production (onshore and offshore wind farms) or renewable energy transmission.

2. The process for project evaluation and selection
The exercise of project evaluation and selection is carried out by an internal committee led by SSE's Finance Director.

3. Management of proceeds
The proceeds from the bond issuance will be directly allocated to the refinancing of the projects at settlement and, in the event that the whole proceeds cannot be allocated to refinancing of existing projects at settlement.

4. Reporting
Allocation of proceeds of the 2017 green bond and the environmental impact of the projects were reported in SSE's 2018 Sustainability Report.

5. External review
An independent verification report has been produced on the Green Bond Framework and underlying assets. In addition,an independent assurance report has been sourced on the allocation of proceeds and environmental impact reporting. Both can be found on SSE's website.

"In line with our innovative approach to financing investment and as a major investor in the UK and Ireland's renewable energy infrastructure, we are pleased that this second green bond continues to show SSE's focus on sustainability and responsibility principles. This funding is consistent with our commitment to maintain a strong balance sheet and strong market rating, and has been secured at very attractive pricing."

GREGOR ALEXANDER, FINANCE DIRECTOR, SSE

A4S
CFO LEADERSHIP
NETWORK

CORPORATES
SUSTAINABILITY BONDS

Starbucks' sustainability bonds

Starbucks Corporation is an American coffee company and coffeehouse chain. Since early 2019, the company has operated in over 30,000 locations worldwide.

Because of its influence in the coffee supply chain, Starbucks wants to build a future with farmers, protecting coffee suppliers against child labour, wage and health and safety violations, as well as working to combat the environmental risks of coffee farms, such as water inefficiency, soil degradation and deforestation. There is also pressure from consumers, with a growing preference for sustainably sourced coffee and desire for transparency, which all contribute to the decision to align the company's debt with the achievement of sustainable outcomes in line with the company's strategic goals.

Starbucks has issued two sustainability bonds to fund programmes around coffee supply-chain management: a ¥85 billion bond and a US$500 million bond. The Yen bond was offered in 0.372% Senior Notes, with a 7-year tenor. The US dollar bond has a 10-year tenor and coupon of 2.45%. Proceeds from the bonds are used to fund eligible sustainability projects, which include:

- Coffee purchases from suppliers verified by a third party as complying with Starbucks' ethical sourcing verification programme of Coffee and Farmer Equity (CAFE) practices
- The development and operation of farmer-support centres in coffee-growing regions
- New and financed loans made through Starbucks' Global Farmer Fund

¥85 billion

2 bonds

US $500 million

Sustainability bond framework

Yen use of proceeds report

US dollar use of proceeds report

"We had support from management, who took the view that sustainability is integral to our business model and not viewed as a separate "cost". They felt that funding these sustainability efforts should be a central part of our overall funding, and a sustainability bond was great way to do this… The bond acted as a lightning rod for a lot of separate social responsibility efforts at the company and helped align financing and these efforts for the first time."

DREW WOLFF, VICE PRESIDENT TREASURER, STARBUCKS

CORPORATES
GREEN FINANCE LEASES

Pennon Group

Pennon Group is an environmental utility infrastructure company at the top end of the FTSE 250; it owns South West Water Limited and Viridor Limited.

WHAT?

Pennon Group became the first business to pioneer a **Sustainable Financing Framework** which links financial impact to sustainability impacts.

As part of the framework, Pennon has announced that South West Water has signed the UK's first green finance leases. The £60m green finance leases were completed with lenders, in accordance with the Green Loan Principles (GLPs) set out in March 2018, to help finance the cutting-edge Mayflower Water treatment works in Devon. Mayflower, under the GLPs, is an eligible green asset as the treatment works will be the first in the UK to use innovative 'ceramic membrane' filtration using fewer chemicals and less energy than traditional processes for treating raw water. Clean treated water will be supplied to over 250,000 customers in and around Plymouth. Mayflower will cost around £60m in total and entered commissioning in 2018.

WHY?

Our objective is to deliver sustainable shareholder value by providing high-quality environmental infrastructure and customer services. Our strategy is to lead in the UK's water and waste sectors, invest for sustainable growth and drive value through efficiency.

Investments made by Pennon are targeted at improving a broad spectrum of outcomes. The Sustainable Financing Framework supports the financing of our water, wastewater and waste management investments across the Group resulting in activities that demonstrate our environmentally and socially sustainable outcomes. The Framework provides the ability for the Group to issue sustainable finance throughout the business, and supports finance raising through long funding finance leases, as well as through committed bank facilities, private placements, and green, social and sustainable bonds.

HOW?

The GLPs set out the categories for eligible green projects. South West Water's business covers a number of these categories and has to meet the challenges of managing the region's expectations for natural resources as well as providing sustainable water and waste-water management for the region.

Maintaining UK bathing waters to EU regulated standards through the company's waste-water infrastructure, and projects such as South West Water's Upstream thinking programme to maintain and improve bathing water quality, has seen significant investment in these assets which the company now looks to green financing to support. In return, the company can report on the benefits provided through the investment, including lower energy consumption, reduction in chemicals used or energy production.

Pennon

CORPORATES
COMMERCIAL PAPER & CERTIFICATE OF DEPOSIT PROGRAMMES

Rabobank

Rabobank is a Dutch multinational banking and financial services company headquartered in Utrecht, Netherlands. It is a leader in food and agriculture financing and sustainability-oriented banking.

WHAT?

Rabobank is the first issuer to launch an 'ESG Leader' commercial paper and certificate of deposit programme (the 'ESG Leader Programme'). The Programme offers short-term investments in Rabobank that may be labelled as 'ESG investments'. Rabobank's ESG Leader classification is based on an independent assessment of its ESG performance by Sustainalytics.

The first launch amounted to EUR 1.2 billion. The size of the programme is EUR 5 billion maximum. The bank may issue ESG Leader commercial paper as long as it maintains its ESG Leader status, as assessed by Sustainalytics.

WHY?

In capital markets, where investments have a longer time horizon, bonds are deemed sustainable when they comply with market standards such as the Green Bond Principles. A prime characteristic of the sustainable bond market is the focus on a sustainable use of proceeds. This approach, however, is not fit for commercial paper and certificates of deposit, owing to their short-term nature: loans are redeemed by the issuer within a year and deposits are also returned to the depositor within a year. Portfolio management and reporting efforts would overburden these instruments. Loans might already have been redeemed or deposits returned to the depositor by the time the reports were available.

HOW?

Sustainalytics provides research and ratings on the ESG performance of 11,000 companies and then ranks these companies against their industry peers. Companies that rank among the top 5% of their industry peers are classified as ESG Leaders within Sustainalytics' coverage universe. Rabobank has a top five position in its industry. The ESG Leader Programme therefore provides investors with more diversified investment opportunities and contributes to capital being channelled to more sustainably operating companies.

"We noticed that money markets did not yet offer products to responsible investors, which limits investors seeking both diversification of their investments and higher positive impacts of their investments. Our new programme opens the opportunities to do so for investors."

ROBERT RUISCH, HEAD OF COMMERCIAL PAPER AND CERTIFICATES OF DEPOSIT TRADING DESK, RABOBANK

"We sought other ways to qualify these money market instruments in a robust way that provides trust to the investors that their money is invested with a company that is recognized as a leader for its environmental, social and governance performance, through independent, rigorous and systematic research by Sustainalytics."

OLAF BRUGMAN, HEAD OF SUSTAINABLE MARKETS DESK, RABOBANK

A4S CFO LEADERSHIP NETWORK

Essential Guide to **Debt Finance**

FURTHER READING

- Navigating the SDGs: A Business Guide
- Financing Our Future
- Final Report: Recommendations of the Task Force on Climate-related Financial Disclosures (June 2017)
- Financing a Sustainable European Economy: Final Report 2018 by the HLEG on Sustainable Finance
- PRI Fixed Income Investor Guide (2014)
- Investing in the Common Good: A Sustainable Finance Framework
- Sustainable Investing and Bond Returns
- ESG Integration in Investment Management: Myths and Realities
- The Role of the Corporation in Society: Implications for Investors
- Sustainable Investing: Establishing Long-term Value and Performance
- The Sustainability Bond Guidelines 2017
- The Green Bond Principles 2017
- UNPRI Shifting Perceptions: ESG, Credit Risk and Ratings
- The Elephant in the Room, Aligning Global Bonds Markets with Climate Goals

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THE A4S CFO LEADERSHIP NETWORK

The Prince's Accounting for Sustainability Project (A4S) was established by HRH The Prince of Wales in 2004 to convene senior leaders in the finance, accounting and investor communities to catalyse a fundamental shift towards resilient business models and a sustainable economy.

The A4S CFO Leadership Network was launched at St James's Palace in December 2013. It brings together a group of leading CFOs from large organizations that are seeking to embed management of environmental and social issues into strategy and decision making, and is currently the only network of its kind. The Network has worked on a number of projects including this guidance for treasury teams. The outputs from the other projects are available from the A4S website www.accountingforsustainability.org

Our project team would value feedback on this guide from other organizations working in this area. Please send any comments to: info@a4s.org

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LEAD THE WAY

Developing a strategic response to macro-sustainability trends

- Managing Future Uncertainty
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- Finance Culture
- Incentivizing Action*

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Developing measurement and valuation tools

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- Social and Human Capital Accounting

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