ESSENTIAL GUIDE TO DEBT FINANCE

EXECUTIVE SUMMARY

Embedding environmental, social and governance considerations into treasury team activities

INTRODUCTION

The *A4S Essential Guide to Debt Finance* aims to help organizations align their treasury and sustainability objectives in order to create and maintain value. It considers some of the actions taken to respond to social and environmental risks and opportunities by the debt markets to date and includes practical guidance on how treasury and finance teams can play their part. The guide:

- Can support organizations to engage with, and influence, debt providers and their lending decisions.
- 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, ie includes suggested actions and recommendations for addressing challenges.
- Can help to enhance business performance and improve environmental and social outcomes.

To develop the guide, interviews with lenders and bond holders were held to understand 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.

Download the full guide here

A4S CFO LEADERSHIP NETWORK

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THE ROLE OF TREASURY TEAMS

Pressure to respond to issues such as climate change is growing. 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.

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.

The guide has been informed by interviews with debt investors and lenders. From these, the guide includes the following recommendations:

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 AND HOW IS IT CHANGING DEBT?

Sustainable finance is the integration of sustainability considerations into investment and lending decisions. This includes instances 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.

The guide shows where 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 recognizing 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.

"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, FORMER GOVERNOR
BANK OF ENGLAND

THE DEBT PROVIDER PERSPECTIVE

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.

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.

ENGAGEMENT AND STRONG RELATIONSHIPS FACILITATE CHANGE

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

WHY?

- Engaging with organizations on the topic of sustainability enables debt providers to give further advice and support, strengthening the relationship while reducing risk.

TRANSPARENCY AND CONSISTENT INFORMATION IS ESSENTIAL

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

WHY?

- Such data enables a better assessment of default risk and potentially differentiated pricing.

REPUTATIONAL RISK IS A KEY CONSIDERATION

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

WHY?

- Reputation related to performance on sustainability factors is a key influencer of business value and stakeholder satisfaction.

IMPLICATIONS FOR TREASURY TEAMS

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

Identifying the need for finance, type of finance and the parties to work with

Determining pricing, covenant and term-sheet criteria

Maintaining relationships and continuous engagement

Cash management, debt monitoring and reporting

Guidance for treasury teams, across these four key activities, is explored in more detail in the guide. The approach draws upon the debt provider perspective and covers current practice, expected disruption and actions to take.

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. The guide summarizes 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.
2. Collaborate with colleagues across different divisions to identify the relevant and material sustainability risks and factors affecting the organization.
3. Work with debt providers who share your organization's principles on sustainability and have a demonstrable track record on such issues.
4. Be proactive in engaging with debt providers and credit rating agencies on sustainability issues and 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.

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. The guide includes a range of examples to show the different approaches being used.

BANKS

Green product frameworks

Barclays 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.

MATURITY MAP

The maturity map is designed to enable you to assess what you are currently doing and how you can advance to a leading position. It has been developed as a way to capture the different dimensions of debt finance. How integrated is sustainability throughout your business? Do you understand how to communicate and engage with your debt providers on sustainability factors? How do you integrate sustainability into Treasury team activities?

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	Full consideration of sustainability in treasury team activity and business strategy
Identifying the need for finance, type of finance and the parties to work with	• Sustainability factors are not considered when identifying finance and lenders. • Green or sustainability bonds are not considered as viable financing options.	• Sustainability factors are sometimes considered when identifying finance and lenders e.g. for specific projects, or if an issue is brought to light. • Green or sustainability bonds are used as viable financing options.	• Sustainability factors are regularly considered when identifying finance in all mainstream decisions. Lenders' sustainability credentials are analysed regularly. • Green credentials and covenants are integrated into all debt agreements.
Determining pricing, covenant and term sheet criteria	• Treasury do not consider the organization's sustainability performance when planning funding. • The organization would find it challenging to add sustainability factors into ongoing or future covenants or term sheets.	• Treasury understands the benefit of strong sustainability performance, and liaises with those responsible for that performance. • Sustainability factors could be considered in ongoing or future covenants or term sheets, but processes and documentation would need to change.	• Treasury supports improvement of sustainability performance and transparency, working with sector peers for consistent metrics. • Treasury works with relevant teams to plan funding of activities, to improve performance, and monitor compliance. • Sustainability factors are considered in all ongoing or future covenants or term sheets.
Maintaining relationships and continuous engagement	• There is no or very limited engagement with debt providers on sustainability issues. • Treasury have little sustainability knowledge. • There is no dialogue between treasury and sustainability teams.	• There is some engagement with debt providers on sustainability issues. • Treasury have some knowledge of relevant sustainability factors. • There is occasional dialogue between treasury and sustainability teams.	• There are high levels of engagement with debt providers on sustainability issues. Treasury actively build an open dialogue to help build trust and lower perceived risk. • Sustainability training is provided for treasurers and they encourage professional education bodies to make this available more broadly. • There is regular dialogue and collaboration between treasury and sustainability teams.
Managing cash, monitoring debt and reporting to debt providers	• The organization uses only a few sustainability indicators. • Monitoring and reporting on sustainability are based on qualitative information. • Some sustainability reporting is published. • Time horizon is at most 3 years.	• The organization uses a broad set of indicators commonly used in its industry, focused on material impacts and dependencies. • Monitoring and reporting on sustainability are based on quantitative and qualitative information. • Sustainability reports are published highlighting performance on material issues. • Time horizon is up to 10 years.	• Commonly agreed industry KPIs are used, focused on material impacts and dependencies. These include management of financial risks such as climate change. • Monitoring and reporting on sustainability is based on robustly controlled quantitative information and considers financial impact. • Performance on material sustainability issues is reported in an annual integrated report and independently assured. • Time horizon extends to beyond 10 years.
	Beginner	Intermediate	Leader

THE A4S ESSENTIAL GUIDE SERIES

Organizations today must navigate an increasingly complex, interconnected, and constantly evolving world. Sustainability factors affecting society, the environment, and the wider economy are generating bigger opportunities and risks.

Our CFO Leadership Network has produced a set of Essential Guides to help organizations embed social and environmental considerations into their strategy, culture and processes. They are developed by finance teams for finance teams, but will also be of interest to others seeking to understand current approaches to integrating sustainability into financial practices and decision making.

LEAD THE WAY

Developing a strategic response to macro sustainability trends

- Managing Future Uncertainty
- Engaging the Board and Executive Management*
- Finance Culture
- Incentivizing Action*

TRANSFORM YOUR DECISIONS

Integrating material sustainability factors into decision making

- Strategic Planning, Budgeting and Forecasting
- Management Information
- Capex

MEASURE WHAT MATTERS

Developing measurement and valuation tools

- Natural and Social Capital Accounting
- Social and Human Capital Accounting
- Valuations and Climate Change

ACCESS FINANCE

Engaging with finance providers on the drivers of sustainable value

- Enhancing Investor Engagement
- Debt Finance
- Implementing the TCFD Recommendations
- Implementing a Sustainable Finance Framework

** Coming soon*

GET IN TOUCH OR FIND OUT MORE

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