ATFS Bulletin July 2021 – The Rising Importance of ESG

Environmental, Social & Governance (ESG) Standards builds on CSR and Sustainability by providing quantifiable indicators to manage the various ESG issues, (for example monitoring an organisation's carbon footprint) and providing a tangible measure of accountability. In recent years, organisations across a range of sectors have adopted ESG principles through the significant growth of sustainable finance loans. From 2016 to 2020 the market saw a 272% increase in ESG linked debt finance. There is a general recognition that ESG is now an integral part of how large corporations conduct their business.

Beyond Education

Global legislative ESG reporting requirements are growing as governments seek to meet targets set in the Paris Climate Agreement. In the EU, the revised Non-Financial Reporting Directive requires large entities and groups to disclose information on their development, performance and position and the impact of their activity, relating to ESG and other matters. In the USA, the SEC has proposed extended measures to enhance financial disclosures to include ESG. In addition, the UK Government and the G20 is pushing all UK premium listed companies to adopt the principles of the Task Force on Climate Related Financial Disclosures by reporting on their climate related risks by 2022, with full adoption and mandatory reporting expected for all by 2025. Organisations that do not report, must explain why not. This can be seen as an indicator of what will eventually impact organisations across all sectors.

With movements like this, outside of the education sector we have seen radical steps in recent years with large corporations such as BP writing down assets by £14bn in an attempt to clean up their act. They recognise the value of crude oil and gas will fall as demand drops during the transition to net zero. This is one of their steps to becoming a more diversified, resilient and lower carbon company.

The Landscape for the Education Sector

Like insurance firms, investors more now than ever are looking at risk more holistically, including an organisation's exposure to environmental, social and governance risks and what is being done to mitigate them. Investors are looking to not only protect their exposure to high-risk investments but boost their environmental credentials by investing in organisations which demonstrate best practice with ESG and risk management.

Within the Education Sector we are beginning to see an increase in the issuance of green finance products and sustainability linked loans and bonds. The funding journey to net zero will be a mixed approach for most institutions, without reliance on a single source. For Educational Institutions looking to diversify their net zero funding strategy, what will accessing debt finance mean for finance, risk & governance teams over the next 10 years?

It is likely in the future that those without a robust ESG strategy will struggle to access funds and at competitive rates; this may even become a non-negotiable item. We expect to see more and more lenders utilising an Institution's ESG rating to support their decision-making process, becoming part of the credit/due diligence process.

Beyond accessing competitive borrowing rates there is a vast competitive advantage to be capitalised on, for example, attracting the best talent. With younger generations of staff, ESG factors are more than just a consideration; they are a way of life and a key component of their belief system. Organisations that show a commitment to ESG factors will be better positioned to recruit new talent, who in turn bring fresh ideas and innovation.

For those wanting to lead, what can be done to “get your house in order”, to achieve excellence. Leadership teams may want to start considering the following questions:

- Do you have an ESG strategy and has it been externally certified?
- Do you have dedicated resource to drive the implementation of your ESG strategy?
- Who is responsible for updating your ESG strategy at regular intervals?
- Who is responsible for setting and sign-off KPI’s?
- Has a governance structure been set up to help manage ESG related decision making and risk & issues mitigation?
- Is there a robust risk management process in place to support ESG related matters?
- Do you have processes in place to capture the data required for ESG reporting?
- Do you have the technology in place to help facilitate data capture?
- Do you have resource in place to provide quality assurance support on the data captured?
- Have your staff been trained from top down so everyone understands their role in achieving the ESG KPIs?
- Does your borrowing strategy link to your ESG strategy in terms of long-term borrowing?

Future of Sustainability Linked Loans

The flexibility offered by the SLL’s being classed as a ‘general purpose loans’, open to organisations from all sectors, has led to a significant acceleration in the adoption of SLLs since their inception in 2017.

As the market matures it can be expected that the product will evolve further in terms of standardisation of performance targets. The popularity and scalability of SLLs is also likely to lead to development of new products in the sustainable finance industry. There are already specific ESG products available for investments, as well as a rapidly growing sub-sector of Banking through ethical/sustainability focused lenders.

With the sustainability agenda firmly established in the finance world, both borrowers and lenders can work together to influence its continuing development for both mutual and global benefit.

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