A partnership for growth

Our Sustainable Finance podcast series

With almost 40% of new debt issuance in Europe now having a form of sustainable label, and with the overall market of sustainable debt doubling in 2021, our **Eversheds Sutherland Sustainable Finance podcast series** was certainly well timed. Providing a fascinating and practical insight into how sustainable finance is evolving across markets, asset classes and geographies, we look forward to learning more.

Significant growth, greater flexibility in the use of proceeds and availability of different products has enabled households, businesses and institutions to link their financing strategies with their specific sustainability goals. Consequently, the forecast trend of a fundamental reshaping of finance and reallocation of capital is expected to continue; indeed many predict sustainable finance will rapidly become mainstream over the next few years.

Whilst geopolitical events of early 2022, and particularly changing energy security and defence strategies, may cause pause for thought, in many ways these events highlight the importance of transition even more - not only for sustainability reasons but to reduce external dependencies. With the above in mind, it seems a good opportunity to reflect on conversations with our respective colleagues and guests so far and consider the key trends and discussion points that have emerged.

Episodes one and two

We opened the series (episode one and episode two) by considering why sustainable credit is good credit and how businesses that can demonstrate sustainability will see value and capital moving their way. As our planet battles a climate crisis, and with government intervention only able to go so far, we learnt that sustainable finance from the private sector is a fundamental tool in the fight against climate change. At the same time, evidence is mounting that sustainable business models offer better performance for all stakeholders including investors, employees, suppliers and consumers. We discussed why businesses need to know the starting point of their sustainability journey, highlighting that external support may be required to help identify appropriate KPIs (key performance indicators) and SPTs (sustainability performance targets).

In response to an increasing regulatory background, lenders and other financial investors are also on their own journey to reduce financed emissions, which is impacting both the pricing and allocation of capital. It is expected that carbon-adjusted performance and ESG vulnerability assessment factors will play a greater role in credit selection, with unsustainable businesses less able to access credit over time.

Episode three

During episode three, we heard that with investor appetite, as well as a pull at the underlying asset level, the leveraged finance private debt market is now regularly including sustainability considerations as part of its decision-making. Wider adoption is expected as sustainability, including social and governance factors, are likely to become key credit factors over the coming years for ESG asset-hungry investors and banks. That said, we also heard

there is evidence of a degree of resistance, as some wait for further regulation and transparency before committing while others have concerns around greenwashing (due to a lack of meaningful data) or over the impact on their returns caused by offering margin reductions.

Episodes four and five

In episodes four and five, we discussed how the public debt capital markets are developing on both sides of the Atlantic from a sustainable finance perspective and the role of ICMA (the International Capital Markets Association) who issued what is considered to be the first set of market-specific sustainable finance principles back in 2014, and who recently updated these to take account of latest developments.

We learned how the market is continuing to innovate, from the green bond market which started in 2007 with banks undertaking large bond issuances where proceeds were earmarked for on-lending to their clients for green purposes, to the current range of 'use of proceeds' products, such as social bonds, sustainability bonds and transition bonds. Additionally, the market for performance or behaviour-based sustainability-linked bonds has also taken off, albeit the challenges of setting KPIs for long durations, typical of bond issuances, was noted compared to much shorter three-five year loan tenors.

Looking at future trends, it was agreed that there is currently more demand for paper than product in the market. However, as regulation tightens and the market matures, investors are expected to become more selective with heightened awareness of the risk of greenwashing, and so extra levels of diligence may be put in place.

Episode six

Episode six provided a practical insight into how a borrower and a lender collaborated to embed LMA (Loan Market Association) principles into a sustainability-linked RCF. We heard how the corporate borrower was keen to embed ESG related commitments across all areas of its business, including its financing arrangements, and how this was highly commended by its external stakeholders.

As a result of the borrower's existing ESG policies and great collaboration with their lender, it was possible to put industry relevant KPIs and ambitious, meaningful SPTs in place which covered both environmental and social targets. The sophistication of the client's approach to sustainability and the extent of existing reporting meant the process was particularly efficient.

Episode seven

We had a unique insight in episode seven in to how a private equity fund considers sustainability in the aftermath of the commitments from COP26. The discussion focused on the importance of all elements of 'E', 'S' and 'G' and how good governance, through a qualified and diverse board structure, can lead to better investment performance. Using the concept of a 'sustainability lens' in decision making was a recurring theme. Once the positive ESG impact of the business has been established, attention is focused on how that can be amplified during the investment period.

A recurring comment was made on the lack of consistency and transparency in terms of regulations, frameworks and disclosure, and the importance of good advice to ensure that fund managers can navigate requirements sufficiently and ensure they are not only compliant but do the right thing.

Episode eight

For episode eight, we changed tack slightly to discuss green consumer finance and how the promises and momentum from COP26 are being embedded into products for, and engagement with, consumers to enable them to achieve their own green ambitions. The conversation covered how the development of green mortgage products is accelerating following the introduction of the Green Home Finance Principles, which guides consumers to purchase efficient properties or access funding to improve energy efficiency.

In terms of developments over the next five to ten years, cross-industry collaboration and innovation is driving progress. One example shared was of a lender, energy supplier and boiler manufacturer working together to ensure consumers are aware of and can get the required efficiency benefits. A note of caution regarding the importance of levelling up, to ensure that all segments of society can participate, was also noted.

Episode nine

Episode nine explored the importance of the sustainability agenda in infrastructure financing. The discussion centred on how some of the newer sustainable projects, such as EV charging and battery storage, are challenging the traditional infrastructure credit mindset of long term predictable cashflows. Thus, the importance of organisations like the UK Infrastructure Bank working alongside private capital and banks to provide innovative solutions will be essential.

Episode ten

Our tenth episode explained how a sustainability coordinator, typically seen on a syndicated transaction or a bond offering, will act as an interface between the lender group and the borrower to help simplify the process by providing best practice and peer sector insight. Such coordinators will also aim to mitigate any challenge of greenwashing/social washing/sustainability washing by reviewing and analysing targets for relevancy and scale of ambition, whilst checking they are neither false or misleading. A fundamental point was reinforced: that it is not the role of the coordinator to advise the borrower on or impose KPIs or SPTs, rather it is providing clients and balances in the overall process.

Episode 11

Throughout episode 11, we provided an overview of the reporting requirements for sustainable finance loan products in light of the updated guidance from the LMA. The desire for external reviews and validation has become increasingly important for lenders and this updated guidance navigates the added clarity the market has developed. The summary of the guidance outlined the different types of reporting available, the qualifications that report providers should have in order to satisfactorily undertake the review and when each type of report should be requested.

Episode 12

In our most recent episode 12, we discussed what external support there is for businesses who are embarking on their sustainability journey. The view was that sustainability should be a strategic priority for all businesses, but that materiality and prioritisation should be defined at the outset, and any intent and narrative should be turned into some form of written plan which is owned and adopted at board level.

The conversation also touched on resistance from some corporates to sustainable finance. The point was made that companies need to think beyond the pricing benefit as the effects will soon encompass access to capital; lenders are under pressure to lend sustainably and as such are setting a higher bar. Companies who have entered sustainable financing arrangements have evidenced they have an ESG strategy, reporting framework and ambitious commitments to a level acceptable to financial institutions, which could improve the perception of such companies from other external stakeholders.

Whilst further developments and innovation are required over the coming years to include more of society in the transition, sustainable finance is becoming ever more popular and we at Eversheds Sutherland look forward to playing an integral role in helping our clients take full advantage of the benefits and contributing to their sustainability journeys.

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