Environment Analyst's Global Business Summit 2021

Green finance & ESG moves mainstream

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Headline takeaways

- ESG has ushered in a **renaissance period** for environmental professional services
- Environmental consultants need to encourage clients to adopt meaningful ESG policies, which target **impactful outcomes**
- Link between sustainable and financial returns is now well established
- We are in the midst of a global revolution in sustainable debt markets and green finance instruments helping to fuel the push to 'build back better'
- Green bonds, green loans, sustainability-linked loans and bonds are the tools of sustainable debt financing
- COVID-19 has served as an **accelerant to the ESG agenda** globally

Recommendations for consulting firms:

➔ Ensure clients avoid ESG applications (both projects and businesses) that might be seen as greenwashing; **anticipate future sentiment**

➔ **Assess your team's capability** to deliver services in the following growth areas:
  - Educating corporate boards on climate risk / carbon literacy
  - Integrating and implementing new climate risk disclosure requirements
  - Designing practical methodologies to align with net-zero pledges

➔ The **implementation of ESG strategies** is where environmental professional service firms can **add sector leadership**. Start expanding capabilities to gear up for this

Context

“Green finance goes mainstream lining up trillions behind the global energy transition” WSJ (May 22, 2021)

“Environmental, social and governance is becoming one of the investment mainstreams.” FT (May 20, 2019)

Framing the problem: The world faces many challenges, but today we face one for which the solution is multi-layered and intricate - the need to transition towards a global sustainable future. Challenges of this size and magnitude, require solutions backed by innovative and effective funding strategies. And lots of them.

Raison d'etre: The reason for “green finance” is to focus on the development of measures to build back better by funneling financial investments into sustainable development projects, initiatives, environmental technologies, and policies.

ESG & the environmental renaissance: During his summit keynote address, Frank Sweet, global business line chief executive for environment at **AECOM**, said that the rise of ESG had ushered in a renaissance for the sector. “Investments have reached nearly $2tn, tripling in three years. I’m not talking about ESG-rated stocks and investment vehicles, I’m talking about investments that really have an environmental focus. Globally ESG investments continue at a rate of about $3bn per day, or an additional $1tn annually and likely accelerating.”

Role of the environmental consultant

What is the role of the environmental consultant in terms of green finance? How does the industry protect ESG from losing credibility, and ensure that we continue to raise the bar on company performance? “That is a provocative question,” said Frank Sweet. In his opinion, the chief role will be to encourage clients to adopt meaningful ESG solutions. “We have to make sure that they are not just greenwashing their projects and businesses. Our clients need to be able to demonstrate to shareholders that they are creating a positive impact on the environment and society.”

In his presentation, Gabriel Malek, investor influence coordinator at the **Environmental Defense Fund**, built upon Sweet’s statements. He identified three specific opportunities available to consultants and business advisors in this fast growing sector:

- Educating corporate boards on climate
- Improving climate risk disclosure
- Aligning performance incentives with climate metrics.

Malek stated: “Investors want public companies with clear leadership on climate. But not every company is going to want to add new board members, they would rather educate their current board about climate risk. That’s where environmental consultants come in. Regulations are changing rapidly, science is evolving, our understanding of climate is growing, and they need to integrate these insights into the board room.”

“Companies [in the US] will soon be introduced to a new SEC [Securities and Exchange Commission] reporting framework ,” he continued. “They will look to consultants to help them navigate that framework. Lawyers will definitely play a role in these disclosure issues, but consultants will be there to help determine what issues are most material, and how to present that information to investors in a way that is most effective and accurate."

Finally, investors are demanding that companies make net-zero pledges, but how are people throughout those organisations actually integrating those pledges into their day to day work? Companies need the expertise of consultants to understand internal business dynamics, and to help implement new procedures.

Sustainable and financial returns

KPI parity: Sustainable returns and financial returns are approaching parity in terms of investor priorities. Why? The consensus across all of the panellists present at the summit was that sustainable and financial returns go hand in hand. You cannot have one without the other.

Build back better: We are living in a time of increased urgency in terms of global sustainability. Climate finance plays a major role in both repairing the planet overall and specifically in COVID-19 recovery. The refrain "build back better" (in bold and underlined) was heard often and passionately during the summit.

Unlocking the finance: Environmental & sustainability consultants are helping to unlock green finance by providing expert advisory services underpinning access to capital. ESG support can help unlock both debt and equity investment - the customary funding tools utilised in green finance.

ESG centre stage: Investing in the energy transition through green finance and ESG is clearly fashionable and clearly necessary. As is often the case, the conversation is being led by the financial world as ESG is both a business risk and an opportunity. 75% of World Economic Forum conversations this year focused on sustainability/resilience/net zero.

ESG opportunities: Requires innovative thinking. The pervasive sentiment throughout the summit was one of optimism about innovative funding and investing methodologies for projects that provide a chance to create a sustainable post-pandemic future.

Green finance investing

We are in the midst of a global evolution in sustainable debt markets and green finance instruments. Growth in sustainable assets is most pronounced in Europe but rising quickly and commensurately in the Americas and Asia Pacific. An exponentially growing number of institutional and retail investors include ESG considerations as part of their comprehensive investment strategies.

Michael Wilkins, senior research fellow, sustainable finance, **S&P Global Ratings**, described the three main philosophies of ESG that investors take into consideration:

- First, socially responsible investing is the process of eliminating or selecting specific investments based on ESG considerations. Financial performance is the primary objective of this investing strategy.
- Second, ESG integration consists of investors integrating ESG factors to enhance financial analysis and help reduce risk in a portfolio. Financial performance is the primary objective of this investing strategy.
- Finally, in addition to financial returns, investors also look for investments to have a positive environmental or social impact. This philosophy is called impact investing. Sustainable finance and sustainable debt typically fall under the impact investing category.

Green finance funding

Financing a sustainable transition: Innovative solutions are indispensable when it comes to rebuilding a better world. Integral to that goal, the financial sector is developing novel types of green and sustainability debt instruments to serve the market. The sustainable debt market helps to fund environmental and/or social goals leading to the growth of green bonds, green loans, sustainability-linked loans and bonds.

The majority of sustainable debt issuance has been in the form of bonds and loans, and there are two main types of instruments:

Use of proceeds instruments	Sustainability-linked instruments
Use of proceeds instruments are used to finance specific projects with environmental and/or social benefits. Green, social and sustainability bonds/loans fall under this category. The proceeds of Sustainability bonds are exclusively applied to finance or re- green and/or social projects.	Sustainability-linked instruments are those instruments where the repayment terms are dependent upon certain performance indicators at the issuer-level. Sustainability-linked bonds/loans fall under this category Sustainability-linked Instruments link the cost of funding to the achievements of specific predefined sustainability performance targets.

Market drivers

CV-19 accelerant: Summit participants unanimously agreed that COVID-19 has served as an accelerant to ESG. Priorities change during a crisis. Historically, financial regulatory activity has been of the command and control variety which restrict and constrain profit motives and maximisation through mandates, fines or criminal penalties, This type of governance typically results in an adversarial relationship.

Changing regulatory dynamics: The world response to the pandemic has introduced regulatory activity of a more stringent nature, and the hope of summit participants was that this regulatory momentum would carry on to help achieve greater acceptance of sustainability guidelines and laws, ones that look beyond deterring and more towards encouraging corporates, investors, lenders – market participants that adopt sustainable goals.

Green issuance on the rise: Carbon net-zero emissions pledges are projected to spur green issuance in 2021. On 21 April (ahead of the UN Climate Change Conference 26 in November) 43 banks from 23 countries signed a commitment statement as founding members of the **Net Zero Banking Alliance**. Members committed to align lending and investment portfolios with the agreed upon 'Guidelines for climate target setting for banks'.

Yield performance: A major driver of growth discussed at the summit was the fact that infrastructure and renewables issuances have been, and are, outperforming fossil fuels in terms of yields. Broad market ESG indexes are outperforming the competition, causing asset managers to increasingly divest from sectors considered unsustainable.

The market is seeing direct results of pressure from investors, for example, in the ousting of three board members at **ExxonMobil**, as a consequence of its failure to commit to disclosure of Scope 3 emissions. In January, the company eventually included the disclosures as part of its energy and carbon summary, although Exxon tried to downplay the severity of the information, stating: "Scope 3 emissions do not provide meaningful insight into the company's emission-reduction performance."

The investors supporting Exxon's disclosures, as well as those pressuring the company to commit to actionable pledges towards sustainable cleaner fuels, included the California State Teachers' Retirement System, the Church of England, and hedge fund **DE Shaw**.

During his recounting of the Exxon example in his presentation, Adrian Bliss, environment and sustainability account leader with **Mott MacDonald** said: "Nothing focuses the mind of a Fortune 500 company board member as much as the prospect of them losing their jobs."

The sustainability premium: Within certain industries (automobiles, banks, oil and gas), companies with better ESG profiles are performing better all-around than their peers. Summit participants called this "enjoying a sustainability premium".

Many other drivers were noted during the presentations, including:

- President Biden's $2.2tn infrastructure proposal
- EU Action Plan on Financing Sustainable Growth
- EU Taxonomy Regulation, 2020
- The development of sustainability-linked loan and bond principles.

Reporting Frameworks

ESG still evolving: Current reporting frameworks will need an extensive overhaul to encompass a whole new cluster of intangible, qualitative metrics. Summit participants discussed the need for a unified classification system for sustainable activities. The merits of this being increased unanimity between the outputs of ratings and benchmarking platforms, the downsides being the loss of flexibility to choose the systems and approaches which better suit the end-user.

Standardisation inevitable: Tomorrow's market will require standardisation and comparability of ESG data. A lack of standardisation results in higher costs to collect, curate and analyse data to deliver on investors' expectations. Every analyst knows that if you can't measure it you can't model it.

Data accessibility: Investment strategies have already adjusted to accommodate sustainable goals, but green finance requires access to data that historically has been delivered on the "honour system" – statements made in prospectuses, annual reports, PDFs on websites, or press briefings. This system makes it difficult to extract and compare ESG data easily.

Conclusions

Overall, projections for the continued development of green finance are optimistic - with markets adapting to and accepting it. A good sign is investors and stakeholders want more data, more metrics, more information. Yes, there are barriers to overcome, innovations to develop and deploy – but the remit of the environmental consultant is to provide expertise, the newer and more niche that expertise is, the higher demand there is for it.

Market participants will increasingly utilise sustainability-linked instruments to fund new infrastructure schemes and innovative environmental technologies. They will develop a new range of social and governance key performance indicators, allowing investors and rating agencies to effectively monitor reporting metrics. Market participants with skills in ESG, finance, digital and data can own this space.