COP26 Special Report

# Responsible Treasury: Your Essential Guide to ESG

- Case Studies from ESG Leaders
- Sustainable Finance and Investing
- Setting Treasury KPIs for ESG and D&I

Eleanor Hill, Editor

# Who Cares Wins:

## ESG as a Driver of Efficiency and Outperformance

***ESG or Environmental, Social & Governance is nothing new. It's also nothing to be cynical about; it's the reality of doing business in a world that is bubbling over with emerging risks – ranging from a rapidly changing climate to shifting consumer behaviours.***

While it seems like a very recent phenomenon, the term 'ESG' was in fact used extensively in 2005, the year that Hurricane Katrina struck and the Kyoto Protocol entered into force, when the UN's (now visionary) *Who Cares Wins* conference brought together high-powered stakeholders, including institutional investors, asset managers, government bodies and regulators, to examine the role of ESG drivers in asset management and financial research. The majority of participants agreed that ESG would play a critical, long-term role, in investments going forward.

See page 15 of this Guide for insight from HSBC Asset Management into ESG-compliant short-term investments.

Since then, interest in ESG investing has rocketed. What was once perceived as the 'feel good factor' of sustainable investing has translated into concrete advantages, such as above-average returns, and greater resilience to market shocks. ESG has also begun to permeate all aspects of business – from supply chains to corporate treasury. Responsible organisations can benefit from upsides including (but by no means limited to):

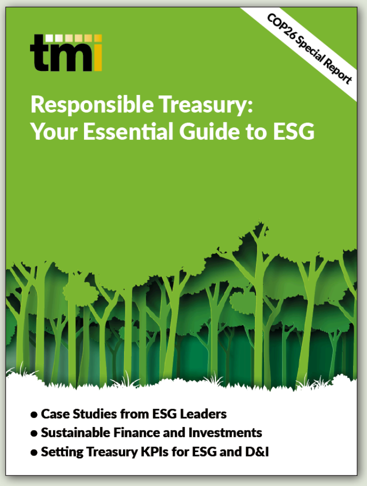
- More efficient processes and increased profitability
- Greater resilience and improved risk management
- Improved shareholder value
- Lower cost of capital
- New investors
- New customers
- Improved supplier relationships
- Reduced regulatory risks
- Improved employee retention, recruitment and wellbeing

Yet there seems to be something of a polarisation among the treasury community when it comes to their readiness to embrace ESG. Some treasury teams are pushing the boundaries of ESG so hard that they're ahead of many of the providers of ESG solutions. Some are being warned that they're being too ambitious (see the Smurfit Kappa case study on page 32 of this Guide) relative to the current maturity of ESG. Meanwhile, others feel that their sector isn't one that will readily embrace ESG; that ESG doesn't belong in treasury; or that ESG is nothing more than a tick-box exercise.

In this Guide, we will aim to convert the latter by outlining the true value of ESG in treasury, while helping those treasurers stuck in the middle ground of 'wanting to embrace ESG but not knowing where to start' to navigate the journey of becoming an ESG champion. TMI hopes you find this Guide insightful and inspiring and we would like to thank all of our contributors for sharing their expertise.

# Contents

TMI: RESPONSIBLE TREASURY




**Editor**
Eleanor Hill

**Deputy Editor**
Tom Alford

**Commissioning Editor & Operations Manager**
Caroline Karwowska

**Copy Editor**
Elizabeth Hennessy

**Columnists**
Ben Poole
Kam Patel

**Accounts**
Karen Roberts

**CEO & Publisher**
Robin Page

**Associate Publisher**
Sam Clarke

**Design & Production**
Glen Orford

**Sub-Editor**
Sue Campbell

**Digital Design**
Alex Tierney

**Digital Content Executive**
Will Hollands


ISSN No: 0967-523X

Treasury Management International Ltd,
Waney Edge Barn, Foxhill Lane, Playhatch,
Reading RG4 9QF, UK Tel: +44 (0)118 947 8057
e-mail: tmi@treasury-management.com
Internet: www.treasury-management.com

EU Office: Treasury Management International
Kft. 2161 Csomád, Verebeshegy u. 11., Hungary

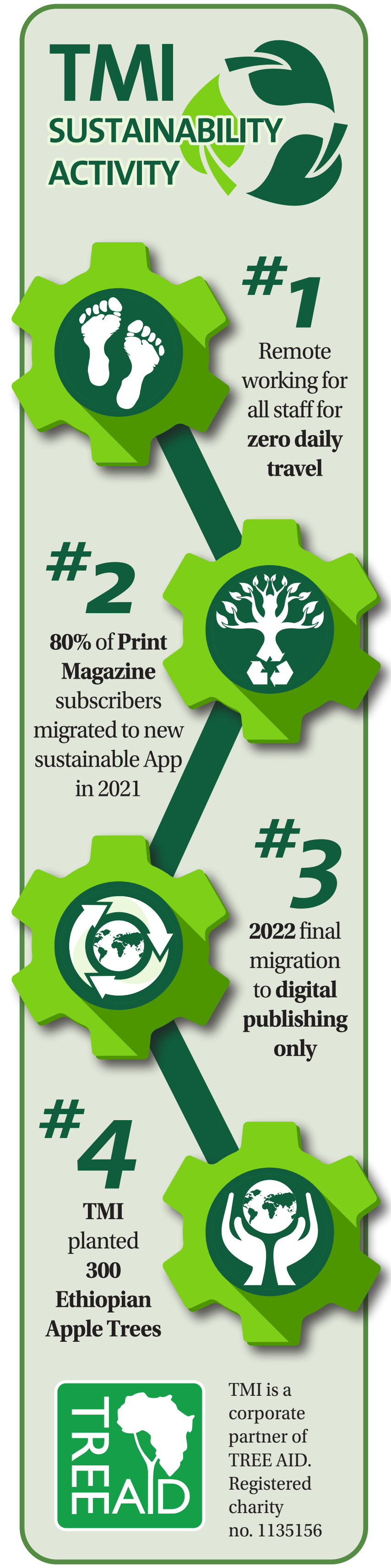
TMI TREASURY MANAGEMENT INTERNATIONAL ISSN 0967-523X is published eight times a year by P4 Publishing Ltd, Waney Edge Barn, Foxhill Lane, Playhatch, Reading RG4 9QF, UK. Subscriptions are available on a complimentary basis only. We do not receive paid subscriptions and the magazines therefore have no commercial value attached. Airfreight and mailing in the USA by agent named WN Shipping USA, 156-15, 146th Avenue, 2nd Floor, Jamaica, NY 11434, USA. Periodicals postage paid at Jamaica NY 11431. US Postmaster: Send address changes to TMI-TREASURY MANAGEMENT INTERNATIONAL, WN Shipping USA, 156-15, 146th Avenue, 2nd Floor, Jamaica, NY 11434, USA Subscription records are maintained at Waney Edge Barn, Foxhill Lane, Playhatch, Reading RG4 9QF, UK. Air Business Ltd is acting as our mailing agent.




# Contents







TMI
SUSTAINABILITY
ACTIVITY
#1
Remote working for all staff for zero daily travel
#2
80% of Print Magazine subscribers migrated to new sustainable App in 2021
#3
2022 final migration to digital publishing only
#4
TMI planted 300 Ethiopian Apple Trees
TREE AID
TMI is a corporate partner of TREE AID. Registered charity no. 1135156

1

Environmental, social, and corporate governance (ESG) is rapidly becoming a cornerstone of modern business – and a driver of value creation. But how does ESG dovetail with treasury and why should treasurers embrace it?

# The Value Case for ESG in Treasury

## Why ESG is Gaining Traction

***To help understand why ESG is increasingly relevant to corporate treasurers, a good starting point is to look at the wider momentum that is building behind ESG.***

One powerful driver of the C-suite's focus on ESG is the issuance of global standards and agreements in this space. Since the UN issued its 17 Sustainable Development Goals (SDGs) in 2015 and the Paris Climate Agreement was negotiated in December 2015, many large corporations have started to make a stand on these issues. In addition, legal and regulatory initiatives, such as the UK gender gap reporting guidance, are contributing to a growing focus on being a responsible company.

Another concrete driver is how the expanding business case for ESG as part of day-to-day operations actually leads to more sustainable business growth over the long term, explains Peter Jameson, Head of Trade & Supply Chain Finance, Asia Pacific, Global Transaction Services, Bank of America (BofA).

He believes that ESG, "should not be seen as a sacrifice or profitability trade-off the business has to make in order to comply with shifting societal expectations". Indeed, it is now widely accepted that successful ESG efforts can be profitable and make long-term commercial sense. It is also becoming more commonplace for companies to publicly acknowledge the 'business' dimension of ESG, not just the positive impacts within society.

Nevertheless, societal expectations remain a huge driver of ESG activity. Increasing numbers of younger millennials (Gen Y) and centennials (Gen Z) are coming into the workforce, bringing with them an expectation that their employers should act responsibly. In addition, as bank customers, the Gen Y and Gen Z cohorts also often favour companies that support responsible causes and embrace ethical working practices. With this in mind, it could be argued that all companies need to rethink the way they do business, and their role in the world around them, to continue on a growth path.

There have been numerous high-profile instances of such strategic 'rethinks' in recent years. Proctor & Gamble, for example, famously sold off Pringles, its most profitable brand, in 2012 to demonstrate its commitment to tackling obesity. This is highly relevant for treasurers since significant changes in business strategies will naturally impact revenues and supply chains, and so relate directly back to treasury.

Moreover, corporates would do well to pay attention to the buying behaviours of Gen Y and Gen Z since they are the next generation of investors. Leonie Schreve, Head of Sustainable Finance, ING, adds that a "rising number of investors are already growing their sustainable mandates and are actively looking for investments that meet the sustainable standards in the market".

For issuers, this leads to investor diversification, and in some cases to pricing advantages, she says, while attracting shareholders with a strong socially responsible investment (SRI) commitment. And appealing to this SRI investor base is yet another driver of continued ESG momentum.

## ESG growing in treasury

With the attention focused on ESG at the top of the organisation, it is no surprise treasury is becoming more involved. Despite the lack of research quantifying growth in this area, mentions of ESG in the requests for proposal (RFPs) being received by relationship banks offer concrete evidence of this trend.

Axelle Vigo-Lovy, Head of Proposal Management Desk, BNP Paribas Cash Management, says questions about ESG, such as the bank's level of commitment to the UN SDGs, are appearing more frequently in cash management RFPs. This was a driver for the bank's creation of a formal sustainability mission within the cash management business.

Vigo-Lovy has taken up this mantle herself, integrating it alongside her existing remit, meaning that treasurers can now access the expertise they require around ESG and cash management together. Many other banks now have a similar focus, with some saying all of their RFPs now have an ESG element.

It is clear ESG is becoming increasingly relevant for today's treasurer. Not least because building ESG into treasury activities is an essential part of a robust future-proofing process. It's about understanding how to adapt to the changing operating environment, and supporting the company's growth ambitions, while positively contributing to social and environmental change under the continuous critical glare of stakeholders such as investors, regulators, and the mass media.

## What ESG truly means

Although the broader goal is generally understood, the core elements of ESG can lack definition. For Melissa Moi, Head of Asia Pacific Environment, Social, Governance, Bank of America (BofA), the term broadly represents the non-financial factors that affect company performance.

'Environmental' typically addresses issues around the operational footprint, such as greenhouse gas emissions, landfill waste, and water and paper usage within the business, its suppliers and customers, she explains.

'Social' elements, says Moi, range from more traditional corporate social responsibility (CSR) engagements such as philanthropy and community work, to employee treatment and well-being, diversity and inclusion, and workplace health and safety. Cyber risk management also falls into the social bucket, given the ethical and human rights concerns that surround data privacy and data security.

'Governance', often the less-talked-about but nonetheless vital aspect of ESG, is about decision-making and the distribution of rights and responsibilities among different stakeholders. "It considers the impact, for example, of organisational structure and oversight, transparency and reporting regimes," she notes.

This is not an exhaustive description by any means. ESG covers a wide spectrum and the individual elements inevitably interact with each other – and impact how investors and other stakeholders respond to the business. "It is essential to look at the entire ESG grouping as one, rather than viewing 'E', 'S', and 'G' in isolation. Moreover, one element should not be considered 'more important' than another. Think of it as an ESG ecosystem, rather than silos," Moi observes.

1

# How ESG Impacts Treasury

***With sustainability-based strategies becoming essential for driving business growth and transformation, now is the ideal moment to re-examine the treasurer's role in supporting and enacting ESG.***

## The real value of ESG

Translated into corporate significance, ESG is first and foremost about managing risk and establishing response structures and measures, says Moi. "Considering ESG-related factors holds up a lens through which organisations begin to see and understand different risk exposures. A good example is the risk of disruption to business processes as a result of diverse factors ranging from adverse weather events to human rights issues."

There is, she notes, a strong link between business success and effective ESG planning. In fact, ESG increasingly creates opportunity, she believes. "Early adopters who understand consumer interests and investor preferences are better able to assess the impact and discuss matters such as climate change with their stakeholders – which can only be a positive move."

Those that move early on ESG are also better positioned to invest in research and development (R&D) or acquire appropriate technologies enabling them to respond to these different stakeholder pressures in ways that offer market differentiation. ESG is becoming a serious means of attracting new and different investor flows and ultimately adding value to products and services.

> *"Considering ESG-related factors holds up a lens through which organisations begin to see and understand different risk exposures."*

## Acceleration in supply chains

Elsewhere, the pandemic has intensified the focus on ESG, particularly in the supply chain space, says Jameson. With many of the bank's clients already thinking about re-organising their supply chains, he says the Covid-19 health crisis acted as a catalyst. The focus is less now on labour cost and more about being closer to the end user.

Although near-shoring re-emerged as a trend because of disruptions to supply chains as a result of global lockdowns, inevitably it is beneficial for carbon footprints, and this is also being factored into decisions. What's more, as new supplier bases are onboarded, there's more thought being given to ethical sourcing and the notion that much of an organisation's environmental footprint is external and in downstream supply chains.

To this end, Jameson notes too that there has been a huge uptick in interest in supply chain finance (SCF) as a working capital tool. This has a genuine ESG driver. "Many companies realised during the crisis that providing a sustainable cushion of working capital to their suppliers is in itself a sustainability tool," he explains. "Keeping suppliers afloat is about sustainability in every sense – supporting the community and ensuring business runs smoothly."

Another ESG-related area that has been accelerated by the health crisis is digitalisation. Shifting from paper to electronic workflows improves efficiency, reduces waste and reduces the corporate's carbon footprint. And the statistics here are eye-opening.

According to estimates from Gartner, a typical office worker uses 10,000 sheets of paper a year and up to 3% of a company's revenue is spent on paper, printing, and related filing and storage activities.

Importantly, digitalisation also facilitates inclusivity by lowering the barriers of entry for business customers and suppliers, with digital channels enabling greater access to new networks, regardless of geography.

## Global versus local

It's worth noting that location is a dynamic ESG element since different commitment levels have arisen between geographies. Europe has quite an advanced outlook, Moi feels, certainly in terms of investor requirements and the regulatory position of traditional institutional investors that have been driving the ESG conversation.

"What we're seeing now in Asia is an opportunity to take the lead from a regulatory perspective," she notes. With a number of authorities in the region exploring closer integration of climate-related risk, and stock exchanges requiring more ESG-related reporting as part of listing requirements, she believes this will drive the requirement for all participants to know and understand their ESG exposures.

Greater understanding will incentivise the development and adoption of sustainable finance products, such as sustainable loans, green bonds and social bonds. And with a number of countries in Asia having made commitments to net-zero carbon emissions – including Japan, Korea, New Zealand, Hong Kong and China – Moi says this will further widen the regulatory umbrella covering companies operating in this region. "In particular, large corporates headquartered in Asia are going to have to really up their game in terms of ESG governance and digital integration. Other geographies will follow suit, but perhaps not at the same pace."

## ESG within treasury

These changes signal the importance of treasurers embracing ESG as part of their own role, argues Jameson. While some may believe ESG is a matter for other functions to address, the treasurer's role as the 'central bank of the corporation' gives them more influence over corporate behaviour than many think.

"From my perspective, treasury is critical in all of this," he says. "They are at the centre of financial decisions. Whether extending better payment terms to ESG-certified suppliers or higher ESG-scoring customers, or placing ESG investments such as green deposits, treasurers need to be not only aware of and thinking about ESG but they also need to be at the centre of it."

Of course, green loans were the origin of much ESG thinking in finance, but Jameson says clients have gone beyond simple acceptance of the product and are giving serious consideration to both sides of the balance sheet. "They also want to understand how that loan is being funded by the bank," he notes. "They have progressed and are thinking about reputational risk too."

At a practical level, another way for treasurers to attain a significant boost to their understanding of ESG elements is by opening up digital channels and providing tools for automation. Indeed, when it comes to traditional banking in Asia, Venkat ES, Head of Treasury Product, Asia Pacific, Global Transaction Services, BofA, notes that local regulations can mean a heavy burden of document provision.

"There is a weary acceptance of paper-based processing in payment initiation, collections and statement processing across many Asian countries," he comments. "But data flow and visibility can be improved dramatically through the adoption of emerging technologies.

With a change in mindset that steers treasury away from paper towards digitalisation, more light will be shed on all supply chain data. This is vital from the perspective of understanding supplier's ESG credentials, but it can also lead to significant cash and working capital efficiencies. It's a double-headed benefit."

Like ES, Moi sees corporates feeling increasing responsibility for their own and their partners' ESG commitments. "They have to know and understand the standards, measurements, reporting and the traceability of everything that's happening," she says. "This is no longer a tick-box exercise that they can execute and walk away from. Treasurers have to play their part."

## Maintaining standards

Keeping tabs on changes made internally, and those of external partners, is inevitably more challenging as ESG sophistication increases. For some time, agencies have offered independent assessments and ratings. But reporting of ESG has seen a real leap forward in terms of quality in the past year or so.

"The standards by which companies report have developed significantly, in that they now feel the need to employ auditors and to be certified, means the quality of data emerging can be trusted," Moi says. As more stringent specifications are issued by investors, activist groups, and ratings agencies, credibility must be proven. Eventually, reporting standardisation across the E, S, and G dimensions follows.

Of course, this may be an issue for smaller suppliers that may not have the sophistication to meet reporting and certification requirements. But this is where tools such as sustainable SCF can help investment in resources, which then raises the quality of the entire supply chain. Under such an arrangement, suppliers are incentivised to meet certain sustainability criteria through more favourable financing rates. If these criteria are not met continuously, the financing returns to the less favourable base rate.

That said, the narrative around client exchanges is moving on, says ES. He notes that ESG is now cited as "a must-do rather than a nice-to-have". These conversations are shaping financial strategy, and treasurers are key to this change.

## Are you ready?

In an effort to integrate ESG into companies' business as usual (BAU) practices, Moi has seen leading corporates setting goals and changing business models to reach them. "During the pandemic, we've seen the need for companies to pivot, and to do so extremely quickly. This is only going to intensify as the internal and external ESG drivers become more powerful," she notes. "If you plan properly for this ESG-focused future, and factor in transition risk, then you will be well equipped to react in time to operational, commercial and regulatory risks."

ES adds: "It's highly likely that competitors will be looking at opportunities to invest in technology and R&D to meet ESG goals. And it is a certainty that as investors become increasingly sophisticated in their demands, so corporate reporting of accurate ESG metrics must keep up. More information and transparency is required."

There is significant progress in this space, bringing huge benefits to those already investing in sustainability. Leading treasury professionals are integrating ESG into everyday tasks and processes.

1

This demonstrates that treasury has a unique opportunity to be at the centre of sustainable changes, but how can more begin to leverage this opportunity?

## Where to Start: Finding Purpose in ESG

***With so much talk around ESG in treasury, it can be tough to know where to begin taking action. But there are three fundamentals that can help treasurers in this task.***

When starting out on an ESG journey in treasury, "finding a purpose" marks the first step, says Rakshith Kundha, Head of Trade Product Sales, Trade & Supply Chain Finance, Asia Pacific, Global Transaction Services, BofA. Here, the three basics of treasury – liquidity, movement of money, and short-term funding – position the function perfectly to contribute to a more sustainable approach to doing business.

By considering these three components individually, and exploring how each can add value to the organisation, it should become evident that treasury can potentially make a very real contribution to the business's overall relationship with ESG. In fact, there are many practical ways, beyond the obvious area of green bonds and loans, that treasurers can engage in sustainable activities.

**ESG investing: an in-depth look**
To learn more about the opportunities associated with sustainable investments, turn to **page 15** of this Guide, where HSBC Asset Management outlines the current ESG landscape.

### Refining investment decisions

One of the most visible areas where treasurers can embed ESG and create wider value for the organisation is sustainable investing, notes Alvin Poh, Head of Global Liquidity Platform and Head of Liquidity & Balance Sheet, Asia, Global Transaction Services, BofA.

He explains: "In the past 12 to 18 months, banks and money market funds have been introducing green and sustainable investment options, linking cash to renewable energy, for example. These are becoming increasingly popular with a range of corporates looking for new ways to drive value through their short-term investments, in what continues to be a tough interest rate environment. And corporates have the peace of mind that their money is safely deposited with their institution of choice – offering additional ESG benefits without compromising counterparty risk."

ESG-related money market funds (MMFs) are also emerging, as part of a recent shift towards a broader ESG perspective in the financial services product set. Here, the impact of corporate behaviour on issues including climate change, education, poverty, equality, and health are being addressed – through ESG portfolios. The robust due diligence performed on these portfolios proved attractive during the Covid-19 sell-off, since the funds proved resilient to market shocks.

Despite the attraction of sustainable investments, there are additional checks that corporates might wish to perform before investing, notes Poh. "First and foremost, assessing the increasing number of ESG investment options calls for policy direction," he says. "This should tease out the challenges and opportunities that exist, as they relate to the company's specific ESG goals, compared with traditional investment portfolios."

When considering available ESG investments, it is also vital for treasurers to retain an anchor on quality in terms of the investment itself and the green credentials that are applied to it by providers, as well as the issues being tackled. Many banks use an accredited external ESG assessor to certify whether the funds deployed by the bank meet its sustainability criteria – something about which all investors should at least be aware.

### Improving supplier relationships

Another impactful area where treasurers can contribute to the organisation's overall ESG goals is the supply chain. Several leading companies have a procurement policy around ESG, notes Kundha. "By and large, major companies tend to have labour or environmental policies requiring suppliers to meet certain standards, however many times these may be achieved through disincentives for non-compliance, as against incentives."

This presents an opportunity for treasury to work hand in hand with procurement to implement a sustainable payable finance programme. By setting certain ESG-driven benchmarks, a financial reward for compliance with desired behaviours can be offered.

Here, suppliers that meet the predetermined ESG criteria are able to access more favourable financing rates, whereas those who do not meet the criteria are able to access only the standard rate. This incentivises positive behaviours across the supply chain – and the treasurer can be in the driving seat.

Getting it right requires consideration of how ESG criteria are monitored. Corporates sometimes find it challenging to independently monitor compliance. Tackling this issue is critical. Fortunately, an increasing number of independent agencies are able to provide credible and coherent ESG evidence, he notes. Working with reputed agencies is a good way to move forward quickly.

Kundha urges treasurers to monitor their own organisation's wider activities. By identifying underlying flows that have an environmentally positive outcome, such as energy reduction schemes, the possibility of using new sustainable finance instruments opens up. "There's certainly enough appetite now for such assets," he comments.

## Engaging with digital

Aside from financial solutions, digitising paper processes is another area where treasurers can make an immediate ESG impact, says Param Thind, Head of Digital Channels & Revenue Management, Asia Pacific, Global Transaction Services, BofA. An obvious place to start removing paper is from day-to-day interactions. This could include the way invoices are issued, payments are made, and how information such as bank statements is received from banks.

These might seem like small changes, but they all add up, reducing the overall amount of paper usage across the organisation. It helps not just as part of the ESG effort but also in driving cost and process efficiencies. For those who are yet to fully digitise their treasury operations, Thind relays some best practice suggestions from large corporates he has worked with on dematerialisation and automation projects. He believes the starting point must be to look at all existing workflows and paper usage, not just within treasury and finance, but also within connected departments such as procurement and payroll.

This means breaking down every process where treasury is involved into its component parts. By doing this, treasury leaders can effectively create a process blueprint – which is a worthwhile exercise in itself. Through the creation of this 'master blueprint', treasury will also be able to identify and bring to the surface, all the cost and process inefficiencies that paper usage creates.

Once the paper processes are identified, the next step is to explore the different systems and solutions available to solve these issues. This is how treasury can begin to move further towards digitisation – and then digitalisation – adding greater value to the organisation in the process."

After all, says Thind, there are so many options for digital payment and electronic information exchange today that there is really no good reason to continue using paper. "What's more, a paperless workflow enables the use of new emerging technologies like machine learning and AI [artificial intelligence], thereby driving even greater efficiencies and business insights to support the wider organisation."

## Digital first

Everyone benefits from the switch to digital. Removing paper reduces the ecological damage caused by following outdated practices. What's more, digitisation provides a faster and more secure way of conducting business. It also enables cash to be applied more rapidly and for supply chains to flow more smoothly. Nevertheless, these benefits are vastly reduced when people create parallel processes such as printing and physically filing electronically received documents.

A change in mindset and culture is required to stop such practices, Thind urges. And he is hopeful that as new generations arrive in the workplace "they will push forward with digital-only operations".

Of course, the pandemic has been a catalyst for enabling digital workflows, with remote working being mandated in many countries. However, once office-based working returns, treasury teams, and corporates in general, need to take care not to slip back into old habits. Maintaining the paperless effort requires direction from the top, with a coherent ESG policy in place to steer progress.

## Improving policy approach

On the topic of policies, any treasury function that is serious about ESG must fully articulate its own ESG policy. Critically, however, treasury's ESG policy must link with the wider organisation's ESG goals – and be implemented across treasury centres in a coherent and consistent manner. A robust policy will guide treasury decisions on funding and investments, for example, but should not make it an island in terms of implementation.

If treasury's ESG vision aligns with that of the wider organisation, it will drive various internal conversations to ensure across-the-board orientation rather than a series of unilateral approaches. This happens most effectively where a cross-functional ESG-focused committee has been established.

The ESG committee should oversee and recommend objectives based on input from all stakeholders. Each will use the committee's direction to help establish the right overarching position for the business, but also shape that vision into how ESG can be achieved in a direct, function-specific way. And treasurers should most definitely aim to be part of a cross-functional ESG committee as they will be able to provide strategic inputs on the allocation of funds for ESG purposes.

Once defined, the organisational vision of ESG can be leveraged to inform the development of external partnerships going forward, with those that are in greater alignment being most favoured. This relates not only to supply chain partners that might be eligible for sustainable SCF but also to all vendors. Of course, the ultimate aim is to make ESG part of 'business as usual' for everyone.

**Defining digital progress:**

**Digitisation** – by moving away from physical processes to digital ones, operational efficiency is improved.

**Digitalisation**
Digitalisation transforms a business through technology. The business model is often changed as a result of digitalisation.

**Practical implementation**
In the next Chapter of this Guide, we will examine in more detail the ways in which treasurers can proactively embrace ESG – many of which have been mentioned above. Corporate case studies with an ESG focus can be found in Chapter 3.

# 2

**One of the keys to making a success of ESG within the treasury function is embedding it into the heart of day-to-day activities. In this Chapter, we examine concrete ways for treasurers to take a hands-on approach to ESG – ranging from sustainability-specific KPIs to ESG reporting and sustainable investing.**

# Practical ESG Applications within Treasury

There are many ways in which treasurers can support and embody their company's ESG goals. These include:

1. **ESG-compliant finance.** Today, treasurers have a growing range of ESG financing solutions to explore. This includes everything from green bonds to positive impact loans and social finance. While there are strict requirements that come with these financing options, and they may be more suited to certain sectors than others, all treasurers should be aware of the growing trend towards ESG-compliant finance – and how their business could benefit.
2. **ESG investments.** More and more treasurers are investigating ESG-focused short-term investment options for their excess cash. In future, more companies may also consider using surplus cash to fund their own SCF programmes as a means of supporting their suppliers – a role that falls under the ESG banner. Any treasurer responsible for a company pension fund may also wish to consider ESG investments. The momentum behind socially responsible investment is growing and it makes sense that this will soon filter through to the expectations of pension scheme members.

3. **Digital transformation.** Even in traditionally paper-intensive markets, it is possible to reduce the use of paper significantly and thereby reduce water usage and a company's carbon footprint – with the help of the right digital solutions and banking partner(s).
   Examples of ways to go paperless within treasury include (but are by no means limited to): embracing digital statements for reconciliations, electronic FX [foreign exchange] trading, electronic collections solutions, virtual accounts, and electronic tax filing.

4. **Know Your Counterparties** (see box). Transparency in supply chains is the order of the day. As financial intermediaries, treasurers have the ability to vet and carefully select their relationship banks and vendors – and can easily add ESG criteria to any RFP. Working in tandem with procurement, treasury can also help to encourage responsible supplier selection and supply chain practices. Knowing the company's investors is also becoming a more important aspect of issuance for corporates, and treasurers will likely see this trend accelerating in the years ahead.

5. **Social and diversity.** No matter how tight treasury's 'people' budget may be, all treasury leaders can influence the dynamics of their team – whether through encouraging wellbeing, promoting workforce diversity and inclusion, or supporting work experience placements and apprenticeships, for example.

6. **Governance.** Complying with all the relevant rules and regulations and ensuring the company's financial flows and processes are free from criminal activity are mainstays of treasury-related governance. But as the importance of ESG grows, treasurers will find that their governance responsibilities also increase. New tasks may include providing the investor relations department with accurate information about the company's green finance projects, for example.

## Know your counterparties: an ESG imperative

***Knowing who your counterparties really are is important because company relationships are under close scrutiny around ESG; good reputations can be tarnished by the wrong connections.***

### Know Your Bank (KYB)

Treasurers have the power to evaluate their bank counterparties and select partners and products based on specific criteria, including ESG credentials, that have the potential to positively impact the growth of the organisation over the longer term. Understanding a bank's commitment to ESG has never been so important.

### Know Your Supplier (KYS)

Suppliers can be a source of reputational risk too – which can, in turn, impact access to bank credit and investor confidence. "We've seen cases where companies are pulled up by the press for having 'unethical suppliers' in their supply chains. This is placing an additional focus on supplier screening processes and integrating ESG scoring into payment terms," says Peter Jameson, Head of Trade & Supply Chain Finance, Asia Pacific, Global Transaction Services, BofA.

A corporate treasurer who wished to remain anonymous for a TMI interview commented: "We operate in an industry where some of our competitors have been called out for failures in areas such as ethical work practices. Not having our name associated with any of these failings is a clear economic plus for us."

Having said that, this treasurer believes there should be common-sense limits in terms of the degrees of separation. "Frankly, and with the best will in the world, it is just not feasible to do complete investigative research into all the components that go into every part of a large and complex supply chain," he confesses. Nevertheless, "once abuses have been uncovered in its supply chain, every company has an obligation to stop them".

Principled conduct is a two-way street though. In addition to unethical practices by suppliers, payment terms offered by buyers are another potential source of reputational risk. "The mainstream press has highlighted a number of companies that either pay late or have extended their payment terms beyond what is deemed acceptable business practice," Jameson notes. "Treating suppliers fairly is therefore a growing area of responsibility for treasury, in collaboration with procurement."

Additional governance-related actions relevant to treasury include helping in the fight against financial crime; proper handling of politically exposed persons, in particular in relation to bribery and corruption; sanctions screening; and KYB and KYS initiatives.

2

# Treasury KPIs for ESG

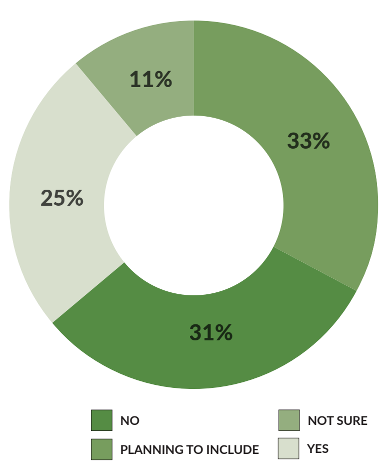
***With ESG initiatives now a boardroom priority – and an increasingly important part of the treasurer's strategic remit – it seems odd that only a quarter of treasury departments currently have key performance indicators relating to ESG.***

"The goal of measurement is to not only do things right; but do the right things – and continuously improve by doing that." This quote from Pearl Zhu, a digital visionary, corporate innovator and author, encapsulates the essence of key performance indicators (KPIs). These measures are designed to drive an organisation to consistently achieve goals, and strive to 'do better,' which in many ways is also the aim of ESG initiatives.

While treasurers are used to setting and achieving KPIs, ranging from forecast accuracy to retrospective hedge effectiveness, ESG-specific KPIs (often called Sustainability Performance Targets or SPTs) are a new concept for many treasury professionals. In fact, according to the recently released TMI and Barclays' European Corporate Treasury Survey 2021, only 25% of European treasury functions currently have SPTs in place (see fig.1). Of the 225 respondents to the survey, 33% are planning to include ESG measures in their treasury objectives in the near future.

**Source (figures 1 & 2):** TMI and Barclays' European Corporate Treasury Survey 2021.

**Figure 1: Are sustainability/ESG measures reflected in your organisation's treasury/finance objectives?**




## Driving ESG KPIs

To understand how best to implement SPTs within treasury, it is first important to examine the drivers behind the rise of ESG within the department, and the wider organisation. Helen Kelly, Head of Europe, Barclays Corporate Banking explains: "Over the past 12 months, ESG has become a true boardroom imperative. Looking back to 2020, ESG was a theme that was lingering on the fringes of the board's attention – but the Covid-19 pandemic catalysed an intense focus on communities and social challenges, as well as global supply chains, and supplier relationships and values. As such ESG is now front and centre for boards [see fig. 2] and this trend will only accelerate as we head into 2022." With this focus from the top on ESG and diversity and inclusion (D&I), and treasury's growing role as a strategic adviser to the board, treasury teams can no longer leave matters to 'the sustainability department' or 'HR.' Says Kelly: "There is no room for passing the buck anymore. Treasury teams are now expected to step up to proactively support the wider organisation's ESG and D&I goals."

**Figure 2: Is ESG/Sustainability a board-level priority in your organisation?**


ESG-related KPIs will vary from company to company – and all ESG activity within treasury must align with that of the wider corporation, and ideally with the 17 UN Sustainable Development Goals (SDGs). "Within treasury, sustainability works best when there is a specific ESG policy for the treasury team, built in conjunction with the rest of the organisation. This enables treasury to play its part, but also be on the same page as the C-suite. Having a standardised approach to ESG across geographies and treasury centres is also critical," says Kelly.

KPIs and/or targets can assist in this standardisation and centralisation drive. Some examples of ESG- and D&I-related measures that treasuries may wish to consider include:

- Percentage of financing that is ESG-linked
- Percentage of short-term investments held in ESG-compliant vehicles
- Carbon footprint of the treasury team
- Percentage of paperless workflows (and meetings)
- Percentage of women in the treasury team
- Percentage of ethnic minorities in the treasury team

Naturally, it will take work to define these targets. Treasurers will need to collaborate with internal and external partners to find the right goals and ensure they are adhering to industry best practice and guidelines. "It's also important to ensure that these are genuine, rigorous and measurable targets to mitigate the risk of greenwashing," cautions Kelly.

Jonathan Curry

# The Truth about ESG Investing

***Jonathan Curry, Global Chief Investment Officer, Liquidity and Chief Investment Officer Americas, HSBC Asset Management (HSBC AM), offers a no-holds-barred view of the sector's approach to ESG investing as it is today, and how it is changing to meet new investor needs.***

ESG investing practices can be traced back to the 1960s when socially responsible investors began purposefully but unilaterally excluding stocks from their portfolios where certain business activities did not sit well with their ethical stance.

In 2004, a formalised approach emerged when, supported by the UN Global Compact, the International Finance Corporation and the Swiss government, former UN Secretary-General Kofi Annan asked a group of more than 50 CEOs of major financial institutions if they would be willing to participate in a joint initiative to integrate ESG thinking into the capital markets.

Today, while ESG is increasingly a foreground activity for many investors, generally for corporate treasurers the building of ESG drivers into investment policy and investment decisions is still very much at an early stage, says Curry.

He observes "clear bifurcation in terms of the treasurers we are dealing with". Some he reports as being "quite far advanced in terms of developing policies and building portfolios", while others are still "very much in their infancy".

Progression, notes Curry, is linked in part with business need, the sector in which a business operates sometimes also influencing its readiness for ESG investing. Where ESG is placed high on the priority list for the wider organisation, then treasury will almost certainly be aware of how it will play its part, if indeed it is not already actively pursuing an ESG-informed investment policy.

"For those treasurers who are engaged with the sustainability objectives of the wider business, we've tended to see an initial focus on what can be achieved in the debt financing space," he notes. "But now there is notable growth on the investing side too, with treasurers increasingly asking us how they can incorporate their sustainability drivers into their portfolios."

## Early days

Of course, there are different investment opportunities from different sources. Some are balance-sheet driven from banks, such as green or sustainable deposits. In the 'off-balance-sheet' world, asset managers have been introducing ESG-focused money market funds (MMFs), for example. Indeed, HSBC AM recently launched its Sterling ESG Liquidity Fund, with seed investment from British multinational retailer Tesco amongst others.

As investor interest develops in on- and off-balance-sheet investments, so more products will be offered, raising the profile further. However, ESG investment product selection is currently more of a challenge than it is for non-ESG investment solutions, notes Curry. But this is to be expected.

> *"As investor interest develops in on- and off-balance-sheet investments, so more products will be offered, raising the profile further. However, ESG investment product selection is currently more of a challenge than it is for non-ESG investment solutions."*

"Non-ESG products are well-established, and there's more uniformity globally in regulation which in turn leads to more consistency among investment options," he explains. "To some extent, treasurers have acclimatised to a level of standardisation that is not yet evident in the sustainability space. While we expect to see increasing regulation in all the major jurisdictions, ESG investing is still in its infancy, and that is a challenge."

Another hurdle to overcome is the need for many treasurers to develop their knowledge of ESG research providers and ESG scoring , notes Curry. Built over many years of development and wide use across financial markets, Treasurers have a clear understanding of credit ratings, with three global credit rating agencies that all will recognise and be familiar with their credit assessments of different issuers, he notes. "But, as with levels of standardisation, that degree of familiarity is not yet apparent when it comes to the different providers that offer research and scores in the ESG space." Indeed, even where there is some familiarity with the methodologies and scoring processes used by certain ESG research providers, comparing and contrasting on a level playing field remains problematic

*"If a treasurer is looking to support the sustainability objectives of the wider business, then there has to be a means by which the fund is trying to promote change, and that has to be expressed through a credible engagement process; it can't just be about how the fund invests its assets."*

Yet Curry remains optimistic. "Despite current issues, my expectation is that over time, this state will improve as treasurers gain a better understanding of the different research providers and their approaches, particularly to ESG scores" he says. Indeed, alongside some consolidation that has already been seen in the researcher market, and increasing levels of international regulation coming on stream, he feels investor familiarity with processes and procedures will soon deliver a greater level of standardisation.

## Making change happen

But this is a future state. What treasurers must do now, says Curry, is ensure they understand each of their investment options. As a case in point, ESG MMFs present some material differences in terms of investment processes, he explains.

"MMFs in this space are far from standardised," he warns. "It's really important for treasurers to delve deeply into the investment processes that are at work. They need to 'look under the bonnet', to ensure they are able to make the informed decision that, by investing in a particular ESG investment, it will have the ability to promote positive change."

Of course, the promotion of change is key to any serious ESG investment. "If it does not do that, it's questionable why there is a need to invest in the first place," states Curry. To this end, he suggests that specific questions need to be asked about the investable universe that the treasurer has open to them, and about the level of engagement process that the fund will be employing.

"If a treasurer is looking to support the sustainability objectives of the wider business, then there has to be a means by which the fund is trying to promote change, and that has to be expressed through a credible engagement process; it can't just be about how the fund invests its assets."

## Policy matters

It's apparent that the wider ESG product set is not yet sufficiently mature to meet all treasury needs. Given the age of the market, relative to its non-ESG counterpart, this too is to be expected. A simple metric such as the size of ESG MMFs compared with non-ESG MMFs may impose some constraints at an investment policy level.

Policy may, for example, dictate that treasury cannot invest the amount of cash it would like to place in a particular ESG fund if it is still in its growth and development phase, explains Curry. It may also limit other sustainable investments in the cash space. Green deposits – perhaps the most prevalent of on-balance-sheet investments today – may therefore have capacity constraints.

Curry explains that the credible offerings in this space tend to directly fund green or sustainable loans. The size of the loan book, relative to the size of the standard loan book, will be smaller, so the volume of deposits that an individual bank can issue at any given point will naturally be limited. Again, over time, he believes the constraints will lift as ESG loan books expand.

The issue of fund size may seem to present a catch-22 for the market: if it's too small, it won't attract investors, but if it doesn't attract investors it won't grow. But Curry has a positive experience to relate. "Treasurers that we've engaged with regarding our new Sterling ESG Liquidity MMF, and the other currencies we are planning to launch, have been willing to invest in a fund that is smaller than their policy may allow," he reports. "In many cases, treasurers have been able to secure an exception to their minimum fund-size policy because they are specifically investing in a credible sustainable solution." That there is policy flexibility, certainly in the MMF space, is good news because it enables investors to support – and benefit from – new and credible ESG-focused solutions.

For HSBC AM, the primary difference between its ESG MMF and its regular MMF is the investable universe to which each is exposed. The screening process that establishes the ESG universe makes it around 30% smaller than its regular counterpart. It's a material change to that investable universe, but all other features of the fund are the same.

Indeed, in this case, whether it's the objectives of delivering preservation of capital and provision of liquidity, the cut-off time of the funds, the post-screening credit process, or the different ways to subscribe and redeem from the fund, they are indeed all the same. It's an advantage for treasurers.

"When a treasury client has sought approval for the ESG fund, the questions they may face around objectives and risk, for example, will attract the same response as for the regular funds that have already been approved; because the only difference is the investable universe and the size of the fund, if they can obtain policy exceptions for these, the process thereafter is relatively easy."

## Success in the making

The composition of a balanced and successful ESG portfolio depends on the wider sustainability objectives of the business and the availability of market options to meet these objectives. A widening range of 'greened' solutions – including now repo and commercial paper – increases the chances of success. But, as new products, all will likely face the challenge of size, scale, and availability.

At a product level, the primarily bank-offered range of sustainable on-balance-sheet solutions, for example, varies in quality. HSBC's own in-depth product analysis across a broad spectrum of solutions has led it to feel comfortable with the ESG credentials of certain solutions, while others suggest more work is required to meet the expected standards. "It demonstrates yet again that treasurers really must do their homework to determine whether, as an investor, each solution has credibility, meets the business objectives, and encourages sustainability," he counsels. "Only this way can a successful portfolio be created at the scale likely to be required."

*"From an issuer perspective, as sustainability increasingly becomes a focus for investors, those that do not pay heed to investor needs may find it progressively harder to fund themselves in the front end of the market."*

Mindful of quality issues, HSBC AM's new Sterling ESG Liquidity MMF has a specific investment process that focuses on a best-in-class investment approach. It uses screening measures to filter issuers that have an A1, P1 or F1 rating (the highest short-term ratings by S&P, Moody's and Fitch respectively), or their long-term equivalent, and which are demonstrably better at addressing ESG risks than other issuers in the investable universe.

*"The credible offerings in this space tend to directly fund green or sustainable loans. The size of the loan book, relative to the size of the standard loan book, will be smaller, so the volume of deposits that an individual bank can issue at any given point will naturally be limited."*

While he has previously noted that the ESG scoring system and screens reduce the money market investable universe for the fund by around 30%, Curry makes the point that a transformation of this magnitude enables providers such as HSBC AM to better engage with the excluded universe to try to promote positive change.

"And for this we have a well-defined two-step issuer engagement process that is now a key component of our investment process," he says. To meet sustainability goals, HSBC AM encourages issuers to address identified shortcomings in how they manage ESG risks, for the benefit of the investors. In addition it engages annually by letter with all banks in its investable universe on climate change related topics relevant to this sector. Banks representing by far the largest industry sector in a MMF.

This ensures that companies are aware that their ESG performance is factored into decisions on whether their short-term debt issuance is eligible to be purchased by the fund. By doing so, the aim is to increase the focus on better management of ESG risks and achieve more sustainable outcomes.

"Without a material change in the investable universe; it serves only to make engagement and promotion of change harder," comments Curry. "This is why at HSBC AM we follow a best-in-class investment approach, and why we believe stewardship and engagement are as critical a part of the investment process as the investments themselves."

## Market motivators

From an issuer perspective, as sustainability increasingly becomes a focus for investors, those that do not pay heed to investor needs may find it progressively harder to fund themselves in the front end of the market.

On the corporate side, increasing reporting and disclosure obligations around ESG are already a fact. These "will continue to grow significantly", Curry believes. Their impact is being felt not just at the wider business level but also in quite specific areas, such as how sustainable solutions are being used in both debt and investments.

*"With the right policy and framework in place on both sides of the balance sheet, it will be possible to begin selecting different investing and finance options that will help the business meet its wider objectives."*

Bodies such as the UK's Prudential Regulation Authority are already calling for climate stress testing among banks. The provision of Greenhouse Gas Protocol Scope 3 Emissions data from businesses, the European Union (EU) taxonomy (and the UK's own version set for 2022), and proposals for a new European Commission Corporate Sustainability Reporting Directive as a supplement to the current Non-Financial Reporting Directive, ensure pressure is mounting. With new requirements emerging in the US under the new Biden administration, ESG reporting is being forced rapidly up the corporate agenda.

Clients of institutions such as HSBC need timely data to meet their own ESG reporting requirements, Curry acknowledges. Response is forthcoming. "Both bank and asset management functions are investing in solutions and are working with our clients to enable them to meet all existing ESG reporting demands, and to help them prepare for any forthcoming changes and growth."

## Next steps

With so much happening in the ESG investment space, Curry suggests that the development of an investment policy and framework that widely reflects the individual corporate's sustainability priorities should now be on the agenda of every treasurer.

It will be necessary to secure the buy-in of senior management for this approach, he warns, because only then will the wider objectives successfully steer progress in this space. However, the needs of one business within a group may not be the same for another, and so he suggests tackling the issue on a 'case-by-case' approach may be necessary.

Nonetheless, there are some "easier wins" available on the investing side, using ESG MMFs or green deposits, for example. "In any case, treasurers must do their homework; they need to be able to understand to what extent each available option meets their specific sustainability needs and those of the wider business," advises Curry. The same due diligence is required around debt financing.

It seems like more work for an already overstretched function, but with the right policy and framework in place on both sides of the balance sheet, it will be possible to begin selecting different investing and finance options that will help the business meet its wider objectives.

If products are not available, then corporate clients should engage with the market to try to encourage progress. There is precedent, states Curry. Indeed, in the US there has been a strong pull in recent years towards MMF solutions with a focus on Diversity, Equity, and Inclusion (DE&I), augmenting wider ESG-based solutions. "The development of DE&I has partly been in response to specific client demands," he says. "And as needs develop, I'm sure we are going to see more of that in this space."

## Financing the Transition to a Sustainable and Profitable Future

***Transitioning to a more sustainable future requires financing solutions that support both the climate and society-linked goals. For investors, tools that enable them to assess companies on their sustainability credentials are crucial to their decision-making. Meanwhile, for treasurers, having access to the right sustainable finance solutions helps them support environmental, social, and governance targets across the organisation.***

The Covid-19 pandemic has exposed broader sustainability issues beyond the urgent climate crisis, leaving governments and companies scrambling to find solutions for issues ranging from water-usage optimisation and reduction of carbon emissions to supply chain management and worker rights.

Dr Roland Mees, Director of Sustainable Finance, ING, notes that the health crisis has been a catalyst for companies to accept that more action must be taken to protect the planet. "The positive aspect of the pandemic has been the moment of reflection," he says. "We have been forced to reflect on our situation."

During the height of the pandemic, the public and private sectors worked together to produce and roll out vaccines in record times. This example shows that, when a challenge is prioritised, it can be addressed quickly, particularly co-ordinated efforts to find solutions.

That approach can be applied to the wider climate and sustainability issues. Linking corporate finance to projects that can positively impact the environment and society offers a way to accelerate the transition to a sustainable future. There is an important role for treasurers to play here.

### Sustainability for better business

At a business level, there is a clear and urgent imperative to pursue sustainability targets. Research published by ING in April, based on a survey of 100 institutional investors and 450 companies, found that 72% of investors are setting themselves increasingly ambitious targets on ESG outcomes in their portfolios. They want to show that they are responsive to their stakeholders' concerns.

For investors, ESG success means having access to a more transparent set of tools for assessing whether the sustainability ambitions of companies

### Highlights of ING's April 2021 Sustainability Research

- **The bar is being raised: Covid-19 is a great accelerator of climate action.** Even as the pandemic has created financial upheaval for companies, most corporates surveyed (57%) say they are now accelerating green transformation plans. The investors surveyed are of similar mind, with 72% saying they want to see moderate or significant change in the ambition of environmental targets put in place by investee companies this year.

- **Employee wellbeing is the most urgent ESG priority for the year ahead.** Employee health and wellbeing (33%) will take precedence for corporates over the next year, even ahead of emissions reduction (30%). Investors also cite it as a top ESG priority, behind only climate and sustainable supply chains. Companies can expect a more profound interrogation of their human capital practices.

- **Ambition and accountability are under the microscope like never before.** Sustainability targets are under scrutiny: 72% of investors say they are increasing their ambitions regarding ESG outcomes in their portfolios. On climate, the debate over Paris Agreement alignment rages on, but one thing is sure: companies must provide more transparency to back up their claims.

- **More significant government intervention is expected in some markets, which may intensify climate transition risk.** Three-fifths (61%) of companies in the energy sector expect new government policy action on sustainability-based taxation, such as carbon taxes, which could accelerate climate transition risk. And as the new administration settles in, 54% of companies in the US think changes to policy on ESG issues could have a significant impact on their sustainability plans, compared with 41% in Asia-Pacific and 33% in Europe.

- **Sustainable finance is helping companies improve accountability, and investors say it will accelerate transition.** Nearly three-quarters (73%) of companies that have issued sustainable finance instruments say this course of action has improved their ability to put robust internal accountability metrics in place. And 48% of investors think sustainable finance will be more effective than conventional finance in driving the transition of carbon-intensive companies; just 26% disagree.

2

they seek to lend to are realistic. While, for companies, success means accessing sustainable finance solutions that are relevant to their goals. Being transparent about their performance as they pursue those goals is equally critical.

Leonie Schreve, Global Head of Sustainable Finance, ING, says that one of the principal drivers for borrowers looking to access funds from the sustainable finance market is a growing belief that "sustainable business is better business". Sustainability is increasingly proving to offer a competitive advantage. Analysis by the Boston Consulting Group published in October 2020 found that sustainable business model innovation helps companies create "environmental and societal surpluses" that drive "business advantage and value creation".

There is also strong demand from stakeholders for companies to address ESG issues. Adopting a sustainable business model now can help corporates to future-proof themselves. This is one reason why, despite pandemic disruptions, 2020 saw a 13% rise in green bond issuance to $305.3bn from the previous year and a surge in the sustainable debt market more broadly. Issuance climbed to $732.1bn for the year, up 29% from 2019, according to Bloomberg report in February 2021. "We've already seen an uptake of sustainable finance in the past couple of years, but I think last year started a rethink about the answers to the question, 'How should we do things differently?'," says Schreve. "There is really an immense drive now towards sustainability."

*"In 2020, social bonds proved to be a highlight in the sustainable debt market because companies used them to tackle the pandemic's human problems."*

## Exploring sustainable finance

Lenders and corporate treasurers need a clear blueprint to work from. Among the solutions that have gained traction in recent years are sustainability improvement loans, also known as sustainability-linked loans.

Mees, the architect and initiator of ING's sustainability-linked loan, which first launched in 2017, says that with these arrangements, businesses are offered a meaningful incentive to meet their targets. "This typically works as a 'nudge' for them," he says. "These loans provide companies with lower interest rates if they meet ambitious targets. If they fail to meet those targets, the interest rates will increase."

Variable-rate loans can be used for greenwashing by companies wanting to appear to be doing the right thing – unless the lender sets clear criteria. One way for lenders to avoid this is to assess the company's sustainability rating based on a score given by an external agency.

These agencies typically assess businesses on their impact on a range of areas, such as biodiversity, energy efficiency, water management, and social supplier standards. Investors also have other ways to assess companies, such as the work of the Sustainability Accounting Standards Board, which applies industry-specific measures of success to individual companies while accounting for both financial and non-financial data.

With the widening sustainability issues facing companies, other specific financial instruments have seen a boom in popularity. In 2020, social bonds proved to be a highlight in the sustainable debt market because companies used them to tackle the pandemic's human problems: $147.7bn of social bonds were issued in the 12 months, according to the February report from Bloomberg – an astonishing 720% increase on the previous year. In the first half of 2020, for example, regular issuers in the green bond market such as the Korea Development Bank and the African Development Bank focused their attention on social bond financing to mitigate the effects of the pandemic.

"We see a lot of interest in solutions where we can really accelerate specific social investments," says Schreve. "During the first months of the pandemic, we issued the first social Covid-19 bond to support investments in healthcare, social housing and employment." Here, banks can play a proactive role in developing new solutions to support sustainable transformation. Financing the transition will be accelerated when lenders actively develop financial solutions that help corporates with sector-specific needs.

## Profit and purpose

The explosive growth in the sustainable finance market has had clear benefits. ING's April research found that 73% of companies that have issued sustainable finance instruments have improved their ability to implement robust metrics for performance. Accountability is now less an abstract ideal and more a measurable part of strategy for treasurers.

But to maintain momentum, corporates must accept that this accountability is not just a box-ticking exercise but something that can support them financially: profit can come from purpose. For Marieke Blom, Chief Economist, ING Netherlands, in the next five to 10 years companies have to "really understand their relationship with society and the planet. It will force everyone making strategic decisions within a company to ask, 'How exactly do I relate to something?'," she says. "Traditionally, companies have mostly thought about how to make a profit, but this requires a different way of thinking."

The widening of the sustainable finance market will support executives in achieving their purpose while making a profit. Two-thirds of the companies surveyed by ING say that the greater variety of products now available alongside green bonds has made the sustainable finance market more relevant to them and their goals.

The onus is now on corporate treasurers to assess the various financial instruments currently in use across the entire scope of the treasury function – from bank accounts to investment instruments, from funding tools to supply chain management and beyond – to see where sustainable options exist. Treasurers should contact their banking partners to view their sustainability portfolio, talk through their organisation's ESG goals and activities, and suggest areas that are viable for sustainability-linked instruments. Treasurers are in the driving seat to help finance the sustainable transition and generate greater returns for their business as a result.

## Green Light for Green Trade Finance

***Green trade finance transactions require a trade finance instrument to support an underlying green project. But with no market standards yet supporting their use, accusations of greenwash threaten their integrity. TMI spoke to the Head of Trade Finance at one of the few global banks currently offering this option about how this view is being challenged and overcome.***

When it comes to green opportunities, the world of trade is huge, from sourcing and production to shipping and sales. It follows that funding this space also has enormous potential, both in terms of the good it can do, and the commercial opportunity it presents for bank and client alike.

The World Trade Organisation (WTO) has suggested that each year some 80 to 90% of trade is supported by trade finance. Solid statistics are scarce, but approximate valuations place this in the region of US$15tr. in bank-intermediated trade finance. And while the overall supply chain finance market is estimated by McKinsey to be a potential revenue pool of $20bn, it is often reported that there is a $1.5tr. gap in trade finance.

With such an opportunity matched by the current enthusiasm (and necessity) for the greening of trade activities, it is surely time for green trade finance to make a stand. Of course, consumer demand and regulatory pressure will be the final arbiter of uptake across the board, just as technology will likely be the key facilitator. But in every case, the action has to be real and credible.

> ***"To date, few tier-one players have a live offering in place. Without their concerted effort and involvement, the current lack of standards in green trade finance will persist."***

Indeed, proof of 'greenness' is essential for the credibility of all involved here, and on the technology side, fintechs such as Halotrade are using irrefutable blockchain data to track and trace goods from origin to consumer. In doing so, it is helping responsible sourcing to be reported as such, and potentially opening up access to more green trade funding on both sides of the deal.

Certainly, green trade instruments exist. Back in 2014, the University of Cambridge announced that it was working with the International Finance Corporation (IFC) in partnership with the Banking Environment Initiative (BEI), to launch the Sustainable Shipment Letter of Credit (LC).

The aim here has been to incentivise the trade of sustainably produced commodities (prioritised to the palm oil, soya, beef, and pulp and paper supply chains), with the IFC exploring price incentives for certain commodities under the Global Trade Finance Program (GTFP) and transported with a Sustainable Shipment LC.

However, the other major stakeholders in this movement are the lenders and they have to clearly demonstrate their commitment to make an impact. To date, few tier-one players have a live offering in place. Without their concerted effort and involvement, the current lack of standards in green trade finance will persist. This means open interpretation and those inevitable accusations of greenwash.

### Taking a stand

Currently, capital markets participants can operate under International Capital Market Association (ICMA) Green Bond Principles, and those in the debt markets have Loan Market Association (LMA) Green Loan Principles to guide them. For one bank at least, Société Générale (SocGen), the lack of a focused approach detracts from potential progress.

2

With this very much in mind, it has taken unilateral action, establishing a framework contract and eligibility criteria for green trade finance transactions, based on the EU taxonomy and contributing to some of the 17 United Nations Sustainable Development Goals (SDGs).

These may be considered the gold standard, for now. It also uses the first two standards already existing for the bond and the loan markets as well as – if applicable – a number of very specific elements to SocGen, given its experience and track records. In 2019, the bank started to implement a solution. It places traditional trade finance instruments –trade guarantees, letters of credit, standby letters of credit – associated with an underlying project meeting very strict guidelines. The project also has to be within one of five selected sectors, currently renewable energy, clean transport, waste management, hydrogen, and water management.

Its first green trade finance contract guarantee was issued at the end of 2019 for Siemens Gamesa Renewable Energy (SGRE), a provider of turbines to wind farms, for €230m. The product did not even exist prior to this landmark transaction.

## Building from scratch

Whereas traditional trade finance instruments are usually independent of an underlying project in terms of legal obligation, green trade finance necessarily rings the changes. To be certain that the instrument in place is supporting a qualified green project, it is important to run a detailed and in-depth due diligence on the underlying project, such as project purpose, location, stakeholders, and impact on the environment.

> *“To be certain that the instrument in place is supporting a qualified green project, it is important to run a detailed and in-depth due diligence on the underlying project, such as project purpose, location, stakeholders, and impact on the environment.”*

To define the due diligence procedure leading to label a green guarantee, the SocGen trade team worked with the environmentalist team within the bank to draw up the appropriate checks to be performed. Every green trade finance facility it offers must therefore be linked to an underlying transaction – a specific green project – with very objective and demonstrable positive impact goals that can be precisely defined and measured with pre-defined key performance indicators (KPIs).

At a contractual level, this required some deliberation. “Eventually we took existing contracts from the loan and bond markets and worked with our environmentalist teams to see how we could apply these to trade finance,” explains Marie-Laure Gastellu, Head of Trade Finance, SocGen.

Only with clear definition can proof of greenness be established. From the outset, the bank felt that by grounding its approach to green trade finance with the EU taxonomy it could achieve appropriate credibility, at least until shared definition and standards would be available among the industry. And by initially limiting the offer to the five sectors referred to above, the bank also felt it would be better able to maintain an objective view of ‘greenness,’ the projects being funded having an obvious positive societal impact.

However, for projects in this space where guarantees can last several years, the bank had to ensure that the green status of each project be maintained throughout its life.

To this end, the bank works with the client and its counterparty from the outset to identify precise and analysable green KPIs for each contract, and the client must agree to and at least match these for the duration.

Before a contract is negotiated, the bank ensures that there is commitment by the client to the agreed KPIs that follow, in the form of a Green Declaration. In addition to the green guarantee facility being directly linked to an appropriate project, the client must – at a global/corporate level – demonstrate prior strong engagement with sustainable activities through a well-defined and enacted corporate social responsibility (CSR) policy.

Of course, companies exhibit different levels of green maturity. The most mature will have sustainable practices embedded across their organisation. Gastellu says SGRE made a natural candidate for green trade finance simply because it was “very mature and fully engaged in its ESG journey” and has made significant headway already.

For a business that is natively active in renewable energy or clean transport, for example, demonstrating green credentials is easier as it is part of “the DNA of the company” to define KPIs demonstrating its positive impact on climate change.

More traditional corporates with, for example, a history of fossil-fuel use and which now commit to embark on a journey towards more sustainable practices (renewable energy for instance), can also be assisted with green trade finance on specific projects that meet the bank's requirements, but this requires more attention and commitment.

### Due diligence

It takes time to arrange a green trade finance facility for the first time. The initial SGRE green trade finance deal took SocGen and its partners almost a year to structure, with a significant amount of due diligence required. Indeed, assessments of both client and counterparty for each deal are inspected through a green filter. The underlying goods have to be considered, the project for which the goods are used has to pass the test, but also elements such as country of use are scrutinised.

"We have to make sure that there is nothing in the deal that could be detrimental in any way to the green approach," states Gastellu. "The deal becomes a very important asset for the reputation of both the corporate and the bank, so we must maintain that fully."

Ongoing assessment of a green trade finance deal is also essential, to ensure adherence to the KPIs. The bank considered using third-party specialist agencies, but concluded that in most cases it would undertake this aspect internally.

The reason for this harks back to the lack of standards in this space, with agencies (and banks) using their own proprietary approach to conduct their green evaluations. With SocGen adhering to the EU taxonomy, it feels it has the right approach for now. Indeed, notes Gastellu, "we have not faced a situation yet where a client requires us to bring in a third-party opinion".

Now the framework has been formalised, the process for setting up a deal is considerably quicker and easier. However, it might be expected that green finance products, especially in the relatively unexplored area of trade finance, attract a premium, given the extra work entailed. But this is not true, and there is in fact no need to do this, says Gastellu.

The market is moving in this direction and will see more trade guarantees that will be green-labelled because corporates are increasingly engaging in ambitious and demanding CSR journeys, making commitments to progress their positive impact, she explains. As an early mover in green trade finance, she knows SocGen is afforded "a very strong point of differentiation" for corporate clients, and that this alone could drive increased business.

### Opening up the market

With green trade finance guarantees already live, and LCs also now possible, the bank is considering how it can move to the broader trade finance space and is tentatively looking at how it can develop a solution for open account trading.

> ***"There is no open account solution yet, but not so long ago green trade finance guarantees didn't exist either, and these now have a healthy uptake."***

In this space, the need to define green becomes the most vital hurdle to overcome, notes Gastellu, because open account trading steps away from the clear boundaries of a project and into the general flow of commerce. Understanding and monitoring origin and destination of goods, the nature of the sellers and resellers, and of the buyers and end users, even the form of transportation of the goods, makes this a complex matter.

There is no open account solution yet, but not so long ago green trade finance guarantees didn't exist either, and these now have a healthy uptake. Indeed, having started in Europe, Gastellu now reports interest in Asia and the Middle East.

Believing green trade finance will become mainstream "in the next few years", she says SocGen is developing a framework for "positive impact trade finance facilities". This will use sustainability-linked instruments to help corporates create and work towards specific sustainable targets.

The movement is gathering pace, and banks, with an eye on the huge opportunities ahead – both from a societal and a commercial perspective –are finally beginning to deliver.

## Social Responsibility

***Alongside ESG investing and financing, the treasurer also has a significant role to play in fulfilling the 'social' element of ESG.***

For large corporates, this starts with supporting the company's supply chain by providing financial assistance to smaller suppliers via SCF programmes, for example. Some organisations are taking this one step further and embedding ESG criteria into their SCF programmes, offering financial incentives to suppliers that fulfil, and continually improve, their ESG credentials. One notable example of ESG as BAU in this context is Rémy Cointreau.

2

## ESG is a fine vintage at Rémy Cointreau

Luc Vlaminck, Group Treasurer, Rémy Cointreau, has succeeded in embedding ESG into treasury's daily activities, but then the concept of sustainable development has been part of the company's corporate identity for centuries. In fact, says Vlaminck, ESG is a crucial part of the French spirits group's business strategy and is completely integrated into everything it does, including its treasury operations.

"Within treasury, we naturally finance all of the company's activities, and that includes everything ESG-related. Part of our role, for example, is to ensure that the company has sufficient funding to buy new products from the wine growers every year. We often guarantee a certain price for the growers, thereby supporting their cash flows. But in return, we promote strict ESG behaviour, such as using as few chemicals as possible in the growing process to respect the terroir [regional environmental conditions that affect the wine]. In order to protect biodiversity, we also promote responsible and sustainable land and forest management, especially for the wood that is used to build our barrels," he explains.

In fact, at Rémy Cointreau, ESG is guided by the motto, 'Terroir, people and time'. "One of the main ways we promote sustainability is through our supply chain," Vlaminck explains. "We ask our suppliers to join Sedex [the Supplier Ethical Data Exchange]. This is a collaborative online platform that enables members to collect and share information and map risk in their supply chain. At Rémy Cointreau, we use the platform to manage suppliers' ethical and social performance helping to protect people and the environment."

Another stated aim is to ensure that employees remain motivated through clear ESG objectives and the ESG incentive scheme. "One of the biggest benefits our company has seen as a result of our ESG engagement is employee wellbeing," he explains. And while that might sound a little 'airy' – especially to a treasurer – in reality, it has a concrete impact.
"Also, diversity and inclusion are incredibly important values for us, as a family-owned company, and all of our ESG efforts make employees extremely proud to work here. This is a great help when it comes to talent acquisition and retention; in fact, I'd say it is a competitive differentiator."

What's more, ESG is directly linked to the financial wellbeing of the company, he explains. "We produce luxury products and our customers pay for the craftmanship of our spirits and the time we take to 'elaborate' them as well as the peace of mind that our responsible business attitude brings. The more sustainable we make the product, the more socially-conscious consumers will be prepared to pay for it. It's a no-brainer."

Another social aspect where the treasurer can make a difference is employee wellbeing. Rather than being an HR topic, this is paramount to the success and sustainability (with a small 's') of any organisation.

Treasury practitioners tend to operate in demanding, high-stress environments, so it is vital for treasury leaders to openly acknowledge the pressures on their teams, and the impacts these may have on wellbeing and productivity.

The ability to offer a sound work-life balance through flexible working hours has become increasingly important – not just from a wellbeing and efficiency perspective, but also from a talent acquisition and retention point of view. Of course, care for colleagues goes way beyond flexible hours.

### Mental health first aider

In every working environment there are pressures that can upset the balance of people's lives.
In the construction industry, the pressures on individuals can be immense but often there is no outlet or support. From the outset Tideway, the utility behind London's new 25km 'super sewer', has stated its aim of being different from a health, safety and wellbeing perspective.

It runs a full-day immersive training programme for everyone joining the company. This has proven so effective that it is now offering spaces at its training centre to employees of other companies, including contractors.

As part of the training, it tackles mental health. To deliver this, Tideway has joined up with the Mates in Mind charity, developing and delivering a programme specifically for the construction sector. In the same way Tideway trains physical first aiders, it now trains mental health first aiders.

With around 150 trained individuals across Tideway, the programme is able to reach out to many more people. It does so in an informal way, providing a safe space in which people can begin to talk about their worries. This has been particularly important during the pandemic.

## A force for good at Tideway

As Group Treasurer for Tideway, Inês Faden da Silva is helping to make a positive impact on current and future generations. She is part of the company's mental health first aider team, taking care of immediate concerns of colleagues, for their longer-term benefit, but as Treasurer, she has some far-reaching professional goals too.

Tideway's aim is to create a sustainable structure that will meet the demands placed on it by the city's rapidly expanding population well into the 22nd century, keeping tidal River Thames clean. Current project costs of around £4.1bn have placed the finance team central to the success of this goal. To date, £2.7bn in long-term financing has been raised.

As with every motivated treasury professional, the smooth running of the function goes without saying. But Faden da Silva, not content with overseeing the financing of one of Europe's biggest civil engineering projects, is also driven by a specific and long-held personal belief. It has seen her become something of a figurehead for sustainable finance, and has leveraged the long-term social value baked into Tideway's mission, introducing the theme into the very heart of the organisation's financial structure.

"Finance is at the centre of addressing sustainability. If we don't change the way we fund businesses we will never be able to solve the issues we all face, such as climate change and loss of bio-diversity," she explains. From a treasury perspective, sustainability has always been a priority for Tideway.

It has brought about successful cross-company collaborations and opportunities, creating a better understanding of the business and providing further risk mitigation. It also serves to expand the skill set of the treasury team, and helps align the wider finance function with the company's mission.

Sustainability permeates all aspects of treasury today, Faden da Silva notes, with it being frequently assessed and challenged on its ESG credentials and performance. In addition to financing, Tideway's investment portfolios are scrutinised for compliance with ESG policy: "It makes no sense to raise debt through green financing and then have no idea where our investments end up."

The firm's approach to sustainability is beginning to influence its choice of counterparties, including treasury-specific providers. Soon this will be common practice, Faden da Silva believing that "we're getting to the point where organisations will have to justify why they are not conducting their business in a sustainable manner".

Banks are catching up with this idea. When Tideway started talking about green bonds and sustainable finance around four years ago, there were mixed reactions. Faden da Silva recalls: "Some were supportive and already embarking on this journey; others were still rather indifferent, thinking only in terms of pricing. Today, most banks and investors are educated and committed."

Progress in this space is creating "an incredible thirst for data and information on sustainability performance by corporates", she notes. With debt investors and shareholders now demanding evidence to support their own commitments to sustainability, committed companies such as Tideway have learnt to organise themselves to best address these requests. “We’ve been doing this for some time; it’s become second nature.”

Of course, this is precisely what needs to be done to start making a difference; and making a difference is what drives Faden da Silva. By joining forces with other corporates and by speaking at events, she is helping to give treasury a voice among all stakeholders, not least the regulators. By doing so, she is steering the development of the entire sustainable finance movement in a positive direction – “it is, after all, the corporates that will need to make most of the changes”.

## Sustainability: Regulation and Reporting

***Regulation was always going to be part of ESG. European authorities in particular are keen to make their mark, and treasurers must be ready to respond.***

Evolving reporting requirements are another ESG-related consideration coming down the line. “Going forward, corporate reporting will integrate both financial and non-financial reporting,” says ING’s Schreve.

> *“While non-financial reporting might appear to be outside of the treasurer’s traditional remit, it is becoming the norm to see leading finance functions playing a vital role in the communication of sustainability-related information to stakeholders and the market.”*

Helen Kelly, Head of Europe, Barclays Corporate Banking, agrees, noting that while non-financial reporting might appear to be outside of the treasurer’s traditional remit, it is becoming the norm to see leading finance functions playing a vital role in the communication of sustainability-related information to stakeholders and the market. “CFOs are particularly focused on enabling stakeholders to make the decisions that matter to them, and ESG reporting is central to that goal.”

The growing importance of ESG reporting is borne out by TMI and Barclays’ European Corporate Treasury Survey 2021 results, with 14% of participants choosing this as their primary regulatory concern for 2021. To put this into context, 14% also chose AML/KYC as their top regulatory challenge.

Although sustainability reporting is still evolving, learning about the initiatives happening in the market can give treasurers an edge. According to Kelly, the key frameworks, standards, and directives include:

- The EC’s Non-Financial Reporting Directive (NFRD)
- The EU Taxonomy and Sustainable Finance Disclosure Regulation (SFDR)
- The Global Reporting Initiative (GRI)
- The prototype climate-related financial disclosure standard from CDP, CDSB, GRI, IIRC and SASB

There are many more initiatives happening across the globe and much progress still to be made among standard setters and regulators. But in a world where transparency and data are critical to building trust and recognition around a corporation’s ESG commitments, treasurers cannot afford to turn a blind eye to sustainability reporting. “As such, it is worth having early conversations with banks, vendors, and third-party sustainability experts, around the ways in which treasury can proactively participate in sustainability reporting,” suggests Kelly.

These integrated reporting initiatives will undoubtedly lead to ESG becoming more embedded into corporate life and treasury responsibilities. But this alone is not enough to genuinely move the needle on ESG. To make a real difference, greater co-operation between economic actors is needed, as are more targeted regulations and standards.

### A European view

In terms of Europe’s regulatory response to sustainable finance, the primary legislation that creates the framework for the EU Taxonomy is now in place, notes Tarek Tranberg, Public Affairs Leader at global electronic market maker Optiver and former Head of Public Affairs & Policy, European Association of Corporate Treasurers (EACT). A key aspect, the Taxonomy gives the market a standard classification system for sustainable economic activities.

In process now is secondary legislation to establish delegated acts, adding detail to primary legislation with technical screening criteria for two of the six taxonomy objectives – climate change mitigation and climate change adaption – now being finalised.

As a phased-in requirement, from January 2022 corporates will have to report under the taxonomy's disclosure rules the extent to which their turnover is derived from taxonomy-compliant activities, and the extent to which their capital and operational expenditure is mapped against Taxonomy-compliant economic activities, both under the two technical screening criteria. "While many corporates are aware of this, I'm not sure all are as prepared as they perhaps should be," Tranberg comments.

This represents the flipside of new reporting requirements for the investment community under Sustainable Finance Disclosure Regulation. Without sufficient information regarding the sustainability components of an investment manager's portfolio to be able to submit full disclosure, corporate disclosure requirements were inevitable.

With the Taxonomy as the centrepiece, everything links back to it, explains Tranberg. This connection is driving the EU's push for a green bond standard; a legislative proposal is due to create a framework under which issuers can demonstrate taxonomy compliance and claim eligibility for the EU Green Bond Standard label.

"The green bond market will probably see a significant boost across the EU in the next year or two," he notes. Indeed, it is part of the €750bn European Recovery and Resilience Facility designed to tackle the consequences of the Covid-19 pandemic, with a commitment made by the European Commission (EC) to raising around one third of the overall amount in EU green bonds.

*"As a phased-in requirement, from January 2022 corporates will have to report under the Taxonomy's disclosure rules the extent to which their turnover is derived from taxonomy-compliant activities, and the extent to which their capital and operational expenditure is mapped against Taxonomy-compliant economic activities."*

This commitment will bolster the initiative, but the EACT has pushed the EU for green bond programme flexibility. This would allow issuance where the activity being funded is not fully Taxonomy-compliant, and enable green bond labelling of a general corporate purpose bond. As Tranberg explains, most corporates don't raise funds for specific projects but rather channel the funds raised as required. "The notion of having to ring-fence funds for specific purpose is not always the most practical and is probably one of the reasons for low uptake."

3

**There is notable progress in bringing ESG action into the treasury space. In this chapter, leading treasury professionals demonstrate how they are integrating ESG into everyday tasks and processes. These case studies also highlight that treasury has a unique opportunity to be at the centre of sustainable change.**

# ESG in Action: Treasury Case Studies

## Corrie MacColl: Sustainability-linked Lending

***One of the current treasury tools of choice is sustainability-linked lending. The concept is simple yet has the potential to encourage deeper commitment to ESG-focused activities. Capitalising on a proven commitment to ESG, rubber industry giant Corrie MacColl describes how it obtained a unique sustainability-linked loan.***

ESG lies at the core of Corrie MacColl's business principles. A subsidiary of Halcyon Agri Corporation, the natural rubber producer owns and manages the world's largest rubber plantation, 100,000 hectares, in Cameroon.

"Cameroon is not a traditional source of rubber," admits Ryan Wiener, the company's Global Head of Strategic Marketing. "So our aim is to solidify its place on the map." Achieving this means going further than just producing rubber, he believes. "Our goal is to create a great product that doesn't just minimise the environmental impact of its production, but also positively influences its place and people of origin to create a natural rubber that is truly sustainable."

With this aim in mind, the company, which is the largest private-sector employer in Cameroon, has implemented a strategy to tackle the challenging task of marrying socio-economic development with environmental preservation. Over the past couple of years, among other progressive strides, Corrie MacColl has a zero-deforestation commitment in Cameroon, is a signatory to the United Nations Global Compact, and has launched BOUNCE, the world's first sustainable rubber movement anchored by the 17 UN Sustainable Development Goals.

## Embedding ESG in finance

With a high-level company commitment to sustainability, it is perhaps no surprise that Corrie MacColl has also applied its ESG principles to its finances. Specifically, in July 2020 it was announced that Deutsche Bank's Corporate Bank had provided Corrie MacColl with a $25m sustainability-linked loan (SLL) facility with a three-year tenor, and an accordion feature to upsize the facility to $75m.

The purpose of the facility is to finance the company's capital expenditure (capex) investments for its rubber plantations in Cameroon and Malaysia. Rubber prices have been low for many years and have even been below production cost for some time, which has created a challenging environment for Corrie MacColl – hence the search for external financing.

"We have had to significantly invest in our plantations, particularly in Cameroon where we took over management in late 2016," continues Wiener. "The sustainable projects that we have implemented over the past couple of years, such as our Social Action Plan and the preservation of 25,000 hectares of forest, have all helped to get us into a position where we would be eligible for a sustainability loan."

The proceeds of the loan will be used for the maintenance of Halcyon's rubber plantations while promoting its Cameroon Outgrower Programme, which aims to provide additional food security and boost the income of 13,000 local smallholder farmers.

"Unfortunately, when it comes to responsibility or sustainability, rubber is far behind other industries," says Wiener. "There are no industry-wide standards, which means that prices do not reflect sustainability investments. There is still a lot of work to be done socially with the surrounding communities, providing jobs and improving local living standards. That's why we wanted the sustainability-linked loan, to facilitate further investment in and around the plantations."

## Setting up the sustainable financing

SLLs are used to incentivise the borrowers' commitment to sustainability, and to promote and support environmentally and socially sustainable economic activity. Wiener explains: "The terms for these loans are linked to the borrower's sustainability performance. In our case, this is measured by our ability to meet certain, mutually agreed upon, criteria over the term of the loan."

Environmental Resources Management (ERM) in Singapore was appointed by Corrie MacColl's lender of choice, Deutsche Bank, to determine the key performance indicators (KPIs) and set the sustainability performance targets (SPTs) that formed the framework for the SLL. Following an extensive due diligence process, the assessment was carried out according to the following tasks:

- Review of the ESG metrics and targets included in the borrower's and Halcyon Agri Corporation's Annual Report and policies
- Review of performance indicators reported in relevant internationally recognised standards, guidelines and certifications
- Synthesis and analysis to establish company-specific ESG criteria

While ESG conditions attached to loan rates are not unusual in corporate lending facilities, it is the comprehensive nature of the KPIs that will set a new standard for the rubber industry, making this commercial loan unique. Commenting at the time of the loan announcement, Jeremy Loh, CFO, Halcyon Agri Corporation, noted: "It was important to us to ensure that we continue to support our clients in a sustainable way, supporting our overall corporate social responsibility strategy and in accordance with developing standards for sustainable financing in the rubber industry."

## Sticking to high standards

With the KPIs and SPTs decided and the financing agreed, the onus is now on Corrie MacColl to meet the agreed sustainability objectives throughout the lifetime of the loan. As such, reporting the firm's ESG performance is now an annual pursuit.

"The borrower is required to submit an annual report to the lender, which provides evidence of performance against each SPT," explains Wiener. "The external consultant, ERM, will complete an independent review of the borrower's performance against the SPTs on an annual basis."

For other corporates considering a similar type of financing, Wiener has the following advice: "The term 'sustainability' is thrown around a lot today. It is important to understand what it really encompasses, and to receive input from experts in the field, such as non-governmental organisations (NGOs) and civil society organisations. You can then apply that knowledge as part of your core for

3

profit. We will put this loan to good use so we can keep investing in the areas in which we operate and the people working with us."

## Port of Rotterdam: Taking Sustainable Finance to the Next Level

*Ports are a vital part of the global economy – so when one of the biggest in the world is striving to counter climate change, its actions should be watched closely. Tim de Knegt, Port of Rotterdam Manager Strategic Finance & Treasury, comments on how the financing of his epic sustainable projects is progressing.*

With UN figures suggesting that more than 90% of all trade is carried by sea, the importance of maritime transport is beyond dispute. Of course, ships need ports, and Port of Rotterdam is the largest in Europe and one of the busiest in the world. Spread across 127 sq km, it is used by bulk carriers, container ships, ferry services and cruise liners. It's also home to a broad range of manufacturing and (petro-) chemical businesses and storage facilities.

Given the necessary dominance in this environment of 'grey' assets – those that are constructed as opposed to natural – it's understandable that Port of Rotterdam, as a forward-looking organisation, is seeking to balance the port's activities with the 'green' goals countering climate change.

A large part of this plan centres on energy transition. This will see the port increasingly using natural resources such as sunlight and wind power, replacing old lighting with LEDs, using hybrid patrol vehicles, reusing residual heat in dockland machinery, and perhaps most intriguing of all, plans to locally capture and store $CO_2$ in empty North Sea gas fields. This is good for the environment, but it costs money.

With sustainable finance making bigger waves these days, de Knegt is one of the driving forces behind these green objectives at the Port of Rotterdam . Having engaged with financiers on green funding for some time, he notes distinct financial pathways opening up, but issues arise for all.

The corporate strand covers traditional finance products such as bonds and linked loans. Port of Rotterdam finalised a green revolving credit facility (RCF) in early 2019, arranged a Schuldschein transaction (the German private placement market) at the end of 2018, with plans for the next capital market transaction to be fully green, and it is looking at other green capital market issuances.

This has been easy enough to come by, given the port's credit rating, but to de Knegt, these types of instruments just scratch the surface of what is, or should be, possible with sustainable finance solutions. So far, funding has been aimed at specific and very visible but relatively small-scale activities or the refinancing of historical investments.

But, he says, where it really gets "interesting" is financing the vast ambition of the port's energy transition goal on a project-by-project basis. And by 'interesting' he means complex and, at times, quite frustrating. The question is how financing can move beyond the simple corporate strand, and start stimulating and bringing focus to new investments through a linked project finance strand.

### New thinking needed

Port of Rotterdam is in the process of several final investment decisions (FIDs), as per the CCS (Carbon Capture and Storage) project, referred to above. Dubbed 'Porthos' (Port of Rotterdam $CO_2$ transport hub and offshore storage), this is a collaboration between the Port, Gasunie and EBN. It is the partners' €500m response to the Netherlands' climate objective to reduce the emission of greenhouse gases by 49% in 2030 and by 95% in 2050, compared with 1990.

Porthos is an elaborate programme that will see the port-based locations of participating companies – Air Liquide, Air Products, ExxonMobil and Shell – capture $CO_2$ that is released during their production processes. This will be sent to a collective pipeline that will run through the Rotterdam port area before heading out for storage in the North Sea seabed. Over a 15-year term, some 2.5 megatonnes of $CO_2$ will be stored per year.

"The way that we need to structure support projects to get the most environmental benefit is not necessarily the structure needed to get it non-recourse financed," explains de Knegt. What is required to attract debt funding of the size needed for projects such as Porthos is for all risks to be mitigated at financial close. This is a challenge . "We've found it very difficult to maintain the agility and project speed needed to make the most environmental impact, while at the same time getting it financed through traditional routes."

Energy transition projects inherently contain three core risk elements: technology risk, market risk, and regulatory risk. "These three don't sit well with non-recourse finance," notes de Knegt. "That's where the challenge is for me. I can do everything on a balance sheet basis, but if I do that, at some point the transition process will slow down due to capital restrictions." And without maintaining momentum, projects and thus the transition process will stall.

Knowing more or less when or what triggers mitigation of risks, de Knegt is trying to find ways of recycling Port of Rotterdam's capital. He is currently looking to start out on a balance sheet basis, financing all-equity upfront, but then as soon the risks have been mitigated, refinancing to allow some of the equity to be released to be able to kick-start the next projects.

"If we're not able to unlock external funding upfront, we'll have to unlock it during the process," he states. There is hope of getting to a point soon where treasury can have the financing agreement, or at least have agreements that trigger availability of funding, so that once the risk mitigation triggers are hit, the capital is released. "It's not the case yet."

Other than that, he has seen no current financing arrangements that benefit energy transition, "for instance where payments are determined by the price for Emissions Trading System [ETS] certificates, like inflation-linked instruments".

## Dealing with the disconnects

Having had numerous discussions with various banks, Invest-NL (a Dutch public-private institution for providing energy transition finance), and ministerial-level consultations with the Dutch Government, the thinking is that while there are no debt instruments available for the energy transition risk profile, the importance of knowledgeable and financially strong consortia becomes ever clearer.

On the regulatory side, there remains a disconnect between policy and instruments, notes de Knegt. As an example, the EU Renewable Energy Directive provides incentives for increased value to renewable products, ensuring a minimum market volume and supporting investment. Countering this is a proposal to ensure renewable and non-renewable products cannot be sold separately, removing the product's value and the 'investability' of its renewable production process.

"The policy arm seems to destroy the value of the investment proposals where capital is being made available. The misalignment is quite frustrating," he comments, adding that the ability to finance sustainable projects, and the right policies to promote it, need to coincide on a local, provincial, national, and even EU level.

Until there is joined-up thinking, financing on a project level remains "quite difficult". What de Knegt is trying to do in the interim is move towards a balance between simple corporate lending, portfolio lending, and project lending. "We want to see how these interact, so that we can progress without being held back by either the risk appetite of the financier, or the policies that are being made by government."

*"Port of Rotterdam finalised a green revolving credit facility (RCF) in early 2019, arranged a Schuldschein transaction (the German private placement market) at the end of 2018, with plans for the next capital market transaction to be fully green, and it is looking at other green capital market issuances."*

There is a further issue with which Port of Rotterdam must contend. It is trying to build infrastructure (pipelines, roads, railways etc.) that will support it for the next 50 years, with the expectation that these constructions will not reach peak usage for at least the next 25 years. De Knegt says investors often balk at such long-term views. A similar effect is seen in sustainable finance where the real benefit will be seen in the long term. For this reason, he feels that green finance today is "mainly marketing-driven". Greenwash, it seems, is still alive and well.

## Alignment and balance

Indeed, some companies are sending out the wrong signal about what sustainable finance is, believes de Knegt. Reports of large corporate buyers being granted sustainable loans based on improving their supply chains' environmental impact are welcome.

But when a business does little more than impose tighter ESG-based restrictions on its small suppliers, while enjoying all the benefits of the loan (not least its huge marketing value), it is at best unhelpful.

It happens on the investor side too, with de Knegt citing numerous conversations revealing little or no practical in-house sustainability effort or interest on the part of the investor. "They're only interested in our credit rating," he says, adding that a business such as Port of Rotterdam can find the money anywhere.

# 3

"What I'm trying to do now is find partners that are aligned with us from a holistic perspective." The trouble here, he feels, is that too many investors and potential corporate partners are still aligned "in words, not deeds".

Of course, it is easy, when considering the energy transition plans of an industrial location such as Port of Rotterdam, to question what 'green' really means at all. Certainly, in some cases it might mean 'emission-free'. But being green in a grey, heavily industrialised world could also be defined by using the best available technology to begin reducing emissions.

De Knegt knows he must balance available funding between projects of varying shades of green – not just pick the obvious 'shop-window' candidates – if he is to speed up the transition process. This is where his 'holistic' approach comes into play.

Rather than seeking funding across several different and sometimes competing areas, it is necessary to see the full range of activities as an integrated whole, he explains. In his view, being green means having a comprehensive strategy, covering all activities. "It enables us to show investors what our end goal is, and the path that we're taking. Yes, it can be the basis of issuing a green bond or whatever, but what it really enables us to do is take full responsibility for what we are trying to achieve."

Although financiers can see and understand the holistic energy-transition model de Knegt has constructed, he says many still focus on the three core risks of certain projects – technology risk, market risk, and regulatory risk – offering finance only once these risks have been mitigated. But the money is needed now to get specific projects to a stage where they are stable from a risk perspective. It's a Catch-22 that takes time to overcome.

"Wind turbine finance for at least a decade was all-equity financing. We're slowly getting to the stage where traditional project finance can be used, now that financiers perceive the markets to have stabilised, and now it can speed up," he explains. Do we have that kind of time for all the other projects to catch up?

From his position within Port of Rotterdam, and the broad view across the supply chain that this offers, de Knegt clearly has a different perspective on green finance. And his big plans remain undiminished by the current frustrations.

In general, he is positive about the use of green instruments and will be using them more often, initially as a marketing instrument, "but I'm hoping we can begin moving from these corporate instruments, to portfolio instruments, and finally to project instruments". It's an example of realism that we can all follow.

## Unpacking Smurfit Kappa's Ambitious Sustainable Finance Facility

***By setting five key performance indicator goals for a sustainability-linked revolving credit facility – and requiring success in all of them to gain the maximum margin benefit – Smurfit Kappa's treasury team has demonstrated how a cross-functional project can unify an entire business. This award-winning financing project has also illustrated how treasury can not only embrace and drive ESG, but also push the boundaries of sustainability norms.***

Sustainability is in the DNA of Smurfit Kappa, the Dublin-headquartered paper-based packaging multinational. The firm designs, manufactures and supplies its products worldwide, operating in 36 countries across Europe and the Americas. Producing 7.7 million tonnes of packaging per year, the company recycles 6.3 million tonnes of recovered paper annually. Smurfit Kappa is also responsible for 67,000 hectares of certified forest plantation.

Emer Murnane, the company's Assistant Group Treasurer, elaborates: "We've had ESG embedded into the way we work for a long time, even before it became the prominent structural driver for businesses that it is today. In fact, since 2005, we've been reporting on our sustainability developments through our annual sustainable development reports. Our entire Sustainable Development Report is third party assured by KPMG per the Global Reporting Initiative (GRI) Guidelines (Comprehensive)."

The company recently upgraded its sustainability targets in a commitment called Better Planet 2050, which contains ambitious targets across many strategic areas. The initiative covers everything from $CO_2$ emissions to the certified chain of custody, which guarantees that materials used come from sustainably-managed sources. Water usage is also addressed in several ways, including the water intake at the firm's mills, the quality of water returned to the environment, and the associated waste handling. Beyond the environmental issues, the new targets also cover a range of diversity and inclusion (D&I) and community and social responsibility topics.

### Unleashing sustainable financing

With Smurfit Kappa making its Better Planet 2050 commitments, treasury saw a chance to contribute towards these goals in a significant way. In January 2021, the company announced it had amended its revolving credit facility (RCF) to incorporate its sustainability objectives into its financing. The €1.35bn sustainability-linked revolving credit facility (RCF) embeds the company's sustainability targets in five key performance indicators (KPIs) that can potentially change the margin by approximately five basis points depending on how many of the KPIs Smurfit Kappa successfully attains.

Murnane explains: "The RCF was a way of embedding the ESG focus that we have as a company into our financing. It focused on the environmental aspects of the circular economy, how we produce our product and also the health, safety and wellbeing of our 46,000 employees."

The facility margin is now linked to five annualised ESG-related KPIs:

1. **Forestry:** More than 95% of deliveries to be Chain of Custody certified by 2025.
2. **Climate Change:** A 55% intensity reduction in fossil $CO_2$ emissions in the Smurfit Kappa global paper and board mill system by 2030.
3. **Water:** A 60% intensity reduction of organic content of water returned to the environment from the global paper and board mill system by 2025.
4. **Waste:** A 30% intensity reduction in waste sent to landfill by the global paper and board mill system by 2025.
5. **Health and Safety:** A reduction in the total recordable injury rate by at least 5% per annum.

"When this was discussed initially, advisers noted that our five KPIs were particularly ambitious," Murnane continues. "However, we purposefully wanted all five KPIs to be incorporated and to be of equal importance in terms of margin impact. For us, it was the right decision that we must achieve all five KPIs to get maximum benefit. This is important because we are demonstrating to our employees, our customers, suppliers, and our debt and equity investors that all areas of our strategic ESG priorities represented by the KPIs are important to us."

**Main sustainability targets of Smurfit Kappa's Better Planet 2050 Initiative**

| STRATEGIC AREA | EXISTING TARGET | ACHIEVEMENT* |
|---|---|---|
| $CO_2$ Emissions | Net Zero by 2050 with a 55% reduction in fossil fuel emissions intensity by 2030 | 37.3% reduction in fossil fuel emissions since 2005 |
| Chain of Custody | >95% of packaging solutions sold as Chain of Custody Certified by 2025 | 93.8% packaging solutions sold as Chain of Custody Certified in 2020 |
| Water | 60% reduction of chemical oxygen demand (COD) intensity by 2025 | 38.2% reduction in COD intensity since 2005 |
| Waste | 30% reduction in waste to landfill intensity by 2025 | 23.7% reduction in waste to landfill intensity since 2013 |
| Health & Safety | Reduction in Total Recordable Injury Rate by at least 5% per annum | 29% reduction in Total Recordable Injury Rate in 2020 |

| STRATEGIC AREA | NEW TARGET, REPORTING FROM 2021 |
|---|---|
| People | 25% of management positions held by women by 2024 |
| Communities | €24m will be donated by Smurfit Kappa between 2020-2025 to support social, environmental and community initiatives |
| Water | 1% reduction in water usage intensity annually |

**According to the latest publicly available figures published in Smurfit Kappa's Sustainable Development Report 2020*

3

## Linking up and liaising

While there is sometimes a danger that treasury can be seen to be operating in a silo, the success of the sustainability-linked RCF at Smurfit Kappa came down to treasury's ability to interact with a variety of business units across the organisation.

Murnane elaborates: "We worked closely on this project with other areas of our business such as our sustainability team, our corporate planning team, and our finance team. We believe that this project effectively communicated to all of our internal and external stakeholders our determination to prioritise ESG goals and KPIs by introducing financial incentives to reach our targets and financial penalties should they not be reached. This also has the knock-on effect of getting buy-in to our ESG ambitions both across the business and across our wider stakeholder groups, and we have received very positive feedback around this cross-departmental collaboration, not just from our banking group but from within the organisation as well."

> *"We worked closely on this project with other areas of our business such as our sustainability team, our corporate planning team, and our finance team."*

The close work with the sustainability team, in particular, gave treasury great insight into which KPIs to build in. "It's always difficult to annualise something that is a long-term target," continues Murnane. "Our aim was that the KPIs would stretch us but also be achievable. That is where the very close relationship we have built with our sustainability department came into play. Because they have a great deal of knowledge built up as a result of reporting on these metrics over many years, they were in a perfect position to help us set these benchmarks at challenging, but ultimately achievable, levels."

Frank Greene, Smurfit Kappa's Group Treasury Manager – Debt Funding & Risk Management agrees: "The opportunity to work on a cross-functional project like this with our sustainability colleagues was a special privilege. The need to live in a more sustainable world and tackle the climate crisis are some of the most critical issues of our time, and so to be able to contribute positively by doing our small part in helping to address these global issues while working as a treasury professional was very rewarding. Embedding the KPIs in our financing was also an excellent opportunity to move outside the treasury function by delving deeper into our operations to learn more about our wider business and the sustainable product we produce using ever more sustainable production processes. "

The Smurfit Kappa treasury team was also tasked with selecting specific banking partners to advise on the RCF. This in itself can be a challenge given the solid reputation of many large relationship banking groups. Murnane explains: "Choosing a banking partner for this project was very difficult because given the calibre of our relationship bank group in this area. We eventually selected Rabobank and ING to be our advisers. They have been hugely supportive and fantastic to work with."

## Recognising a job well done

Setting up the RCF and gaining approval from the banking partners was a massive achievement for the Smurfit Kappa treasury team. So much so that it went on to be recognised by the Irish Association of Corporate Treasurers (IACT) – the project, which Dublin-based law firm Matheson supported, picked up the inaugural IACT Treasury Award in May 2021. Six criteria were used to judge the award contenders: innovation, reach, ESG, excellence, economics and inspiration. Having won the IACT Treasury Award, the Smurfit Kappa project then also went forward to represent Ireland at the European Association of Corporate Treasurers (EACT) Award 2021.

# Etihad: Flying High with Sustainable Finance

*A desire to expand its Abu Dhabi-based Eco-Residence for cabin crew led Etihad to become the first airline globally, and the first business in the United Arab Emirates (UAE), to raise funding tied to the UN Sustainable Development Goals (SDGs). A partnership with the First Abu Dhabi Bank and Abu Dhabi Global Market delivered the end goal, highlighting the region's expertise as a hub for sustainable financing.*

Etihad Airways, the national carrier of the UAE, takes sustainability extremely seriously. The aviation giant follows the 'triple bottom line' approach to ensure social, environmental, and financial sustainability – and aims to do business in a way that adds value to employees, communities, and the planet.

With this approach in mind, in January 2020 Etihad became the first airline in the world to secure funding for a project based on its compatibility with the 17 SDGs. The company successfully borrowed €100m (AED404.2m) – thanks to its partnership with First Abu Dhabi

Bank and Abu Dhabi Global Market (ADGM) – to support expansion of the Etihad Eco-Residence, a sustainable apartment complex in Abu Dhabi's Masdar City for its cabin crew. The deal will enable Etihad to fund long-term leases of the new complex.

For those who are not familiar with ADGM, it is an international financial centre and free zone located on Al Maryah Island in Abu Dhabi. Fully operational since October 2015, ADGM is a key pillar of Abu Dhabi's Economic Vision and offers long-term partnership and collaboration – locally, regionally and internationally. ADGM has been involved in several 'firsts' from launching the inaugural application programming interface (API) framework in the MENA region, to establishing the world's first digital courtroom.

## Building the right framework

This global aviation first was possible, not only because of the partnership of ADGM and First Abu Dhabi Bank, however. Credit has to go to Etihad for the development of its robust Sustainable Development Financing Framework. As Daniel Tromans, Director of Treasury, Etihad, explains: "This framework represents a vital cornerstone of the company's pursuit of sustainable funding. It articulates the type of projects we want to engage in as part of our broader commitment to the SDGs. And once we have identified suitable projects under the framework, they are eligible for financing using the proceeds of sustainable financing."

Developing the framework, and reaching the point of putting it into action, was no mean feat, however. "The framework was developed based on best practice by treasury, in close conjunction with colleagues in the sustainability team," Tromans explains. The framework covers Etihad's overall position with respect to the SDGs, aligned with broader Etihad Aviation Group sustainability strategies.

In demonstrating the types of projects that the company wants to raise finance to support, the framework highlights seven priority categories. Each of these are linked to specific SDGs, as well as to the International Capital Markets Association (ICMA) Green bond and Social bond principles.

The seven categories in question are:

1. Green Buildings
2. Investment in Women
3. Biofuels
4. Reduction of Carbon Footprint
5. Waste Management and Recycling.
6. Humanitarian Efforts
7. Wildlife Protection

Etihad's Sustainable Development Financing Framework also carefully details the project selection criteria, as well as the governance and reporting that the company has committed to. The Etihad Eco-Residence met the requirements for two of the UN SDGs – Goal 7, Affordable and Clean Energy, and Goal 9, Industry, Innovation and Infrastructure.

## Validating the framework

In order to ensure the validity of the company's sustainable finance endeavours, Etihad engaged Sustainalytics, a global ESG research, ratings and analytics firm, to review the Sustainable Development Financing Framework and confirm its alignment with the ICMA's Sustainability Bond Principles.

Having reviewed the framework, Sustainalytics issued a 'Second Party Opinion', which verified Etihad's sustainability credentials. "This backing was a key condition for the €100m sustainability loan, as it demonstrated to First Abu Dhabi Bank and Abu Dhabi Global Market that Etihad had adopted best practice in sustainability," notes Tromans. "We were also one of the first organisations in the UAE region to obtain independent validation of our sustainable finance framework, and we feel this is important in promoting sustainable innovation within the UAE."

***"In order to ensure the validity of the company's sustainable finance endeavours, Etihad engaged Sustainalytics, a global ESG research, ratings and analytics firm, to review the Sustainable Development Financing Framework and confirm its alignment with the ICMA's Sustainability Bond Principles."***

Tromans also reiterates that, "while the framework played a vital role in securing the sustainable funding for the Eco-Residence project, it is very much a long-term document. As such, it can – and will – be used again for further sustainable transactions. Etihad does not stand still, and treasury will be looking for more opportunities to support the business in meeting its ambitious sustainability goals".

3

## A global and regional pioneer

While there may still be bricks-and-mortar work to undertake on the Eco-Residence, the financial foundations are now firmly laid. And the transaction has set a high bar for future sustainable development in the UAE. Adam Boukadida, Chief Financial Officer, Etihad, says: "This project not only highlights Etihad's commitment to innovative and sustainable financing, but also underlines the growing specialisation of Abu Dhabi as a centre of excellence for financing sustainable projects, at a time of increasing global demand for ethics-based development."

Both Etihad and First Abu Dhabi Bank are signatories to the Abu Dhabi Sustainable Finance Declaration (signed in 2019).

The €100m deal to finance the Eco-Residence demonstrates the commitment of all parties involved to actually support and deliver on the declaration.

Furthermore, ADGM is working closely with other UAE authorities on developing a set of Sustainable Finance Guidelines to further advance the UAE's economic diversification agenda and encourage new investment opportunities that enhance the quality and depth of sustainable investments in the region. So, watch this space.

As Tromans concludes: "The success of this sustainable funding for Etihad is proof of what can be achieved by progressive partners in an innovative financial ecosystem. We are delighted with this project and look forward to pushing the boundaries of sustainable finance in the future – both regionally and globally."

## Drax: Innovating with ESG-linked FX

*Many treasurers are trying to find their feet in helping their companies deliver on sustainability. Having led the successful execution of an innovative project to implement ESG-linked foreign exchange derivatives for her organisation, Lisa Dukes, Director, Corporate Finance & Derivatives, Drax Group, encourages them to be bold, determined and not shy away from thinking outside the box.*

Power generators are under intense investor scrutiny over their sustainability credentials with fossil-fuel players, not surprisingly, a major focus. But the sector's greener contingent is by no means resting on its laurels, with the UK's leading renewable energy supplier Drax notably proactive on the sustainability front with initiatives that include a trailblazing ESG-linked foreign exchange (FX) derivatives initiative.

This is by no means the first ESG feather in Drax's cap, however. In 2019, the firm secured a £125m ESG CO2 emission-linked loan facility – a global first for a power generator. That same year, the company also announced its ambition to be carbon negative by 2030 using bioenergy with carbon capture and storage (BECCS) – another global first. Drax also rolled out the first sustainable CO2 emission-linked deferred letter of credit facility. And in late 2020, the group refinanced its existing revolving credit facility (RCF), replacing it with a new £300m ESG RCF, now enshrining ESG methodology across the full corporate finance spectrum.

Closely linking Drax's ESG initiatives to behaviours within the company has been key, says Dukes. "We're intrinsically keen on sustainability aspects of operations – it's a natural extension of what we do as a business. Innovating to create a positive sustainability improvement is therefore at the heart of what we do at Drax – it's expected of us and in line with what our shareholders and stakeholders want to see."

### FX drivers

As such, linking Drax's derivatives book to ESG was the next logical step given the size and focus of the company. In a nutshell, the solution applies long-term ESG key performance indicators (KPIs) to short-term FX trades with two of the company's main banks, NatWest and Barclays, chosen by the firm as partners for the development and execution of the initiative. The ESG-linked FX derivatives agreements cover forwards, swaps and options.

Reflecting on the initial stages of the initiative, Dukes says Drax's treasury decided early on to eschew focus on single-trade solutions in favour of tying the group's sustainability metrics to day-to-day derivative activity: "We wanted to promote positive actions for the future, drive the right behaviours generally, not for one single element. We were also very focused on making sure we wouldn't be creating more work for everybody involved." The flurry of activity by Drax in executing financial agreements with sustainability at their core has attracted considerable attention: "Two-thirds of our pretty large banking group, indeed even banks not in our current group, have reached out to see how they can support us with similar structures either in the derivative space or elsewhere.

"The initiatives have helped promote similar values among our stakeholders, including firms in the supply chain, encouraging them to go further in improving their own sustainability. Across Drax's activities, we're trying to promote a focus on sustainability that drives behaviours in the right way."

Mimi Rushton, Co-Head, Global FX Sales, Barclays Investment Bank, notes that FX can sometimes feel very transactional for many counterparties, with banks simply responding to client needs. "From our perspective, it was important not to create additional unnecessary work for Drax, to try not to rely on anything that was too manual or cumbersome for either side. I believe we were smart in thinking about how to accomplish this in the most efficient, pain-free way." The solution, she adds, is very much about remaining meaningful in the long-term, "as opposed to something that was ceremonial or just ticking boxes".

Tom Moody, FX Corporate Sales, NatWest Markets, notes that the main challenge was that most previous attempts to link FX with ESG relied on a use-of-proceeds approach. "But most companies run a centralised treasury for their FX operations, and so do not have the ability to apply use-of-proceeds. We took the decision to link FX hedging with firm wide ESG KPIs, thus linking a firm-wide FX hedging programme to firm-wide ESG goals."

Moody points out that the ESG-linked FX derivative idea didn't easily fit into any of the bank's existing product specifications. But after initial discussions, he says it was easy to convince people throughout the organisation "that we should prioritise the changes needed to develop and market the product, considering its potential for helping address real-world treasury needs".

In practice, Drax's ESG-linked agreements aim to incentivise reduction in carbon intensity on an annual reducing target that is designed to become more challenging if the company constantly over-delivers. That metric is validated each year against information published in its annual report and accounts and independently reviewed for accuracy and reliability beforehand.

Dukes explains: "If the metric is not met, obviously we wouldn't receive the sustainability premium. But the primary goal is not around financial profit or benefit – it's not significant sums of money that will make a dent in any party. But it is meaningful enough to care about. The aim is about making sure we keep ESG core to our thinking and actions. Even small incentives can encourage big changes in behaviour – that's the mindset we're really trying to promote."

Looking ahead, Dukes hopes to extend sustainability agreements beyond FX derivatives to other operations including interest and inflation. "We're looking right across the treasury spectrum, but our overall aim remains to continue to demonstrate that sustainability is part of our core and have it embedded within our trading philosophy going forward."

### Keep pushing boundaries

Moody is keen to reassure treasurers that tackling sustainability doesn't need to be onerous or debilitating. "Introducing ESG into treasury can be quick, easy and mutually rewarding. Most banks, including NatWest, now have in-house ESG experts, and it makes sense to engage them early in the process, so that the ESG FX solution is aligned with the overall ESG goals of the firm and is therefore easy to implement."

***"Drax's treasury decided early on to eschew focus on single-trade solutions in favour of tying the group's sustainability metrics to day-to-day derivative activity"***

For Rushton, it's a matter of not being constrained by a notion that something isn't achievable, especially if it hasn't been done before. "In this space it's incumbent upon all of us to be as innovative as we possibly can be and test each other. Be bold and have those conversations."

For Dukes, the key is always keeping in mind the purpose of ESG agreements. "You're entering into them for a reason, and you need to be very clear on that. Work with your longer-term stakeholders to help drive and deliver positive actions and performance, whatever those might be for your own particular business, and strive to encourage others to do the same. As treasurers, we've barely scratched the surface of ESG, so don't be afraid to think outside the box. If the answer is 'no', well that just means 'not yet' – so keep pushing the boundaries."

## Bridgestone: Deploying Sustainable Supply Chain Finance with External Ratings

***By linking pricing to independently verified sustainability criteria, treasurers can use supply chain finance (SCF) as a way to promote ESG goals both internally and throughout their supplier networks. Julle Pedersen, Treasury Director for Europe, the Middle East, India and Africa (EMIA), Bridgestone, shares the inside track on achieving precisely this sustainable SCF arrangement.***

With sustainability-linked funding and investment options becoming increasingly familiar tools for corporate treasurers, SCF stands out as an obvious

# 3

area where sustainability and finance can meet. This approach made complete sense for Pedersen since Bridgestone considers sustainability to be part of its DNA.

As a global leader in advanced solutions and sustainable mobility, Bridgestone sees ESG as "core in our strategy and culture," Pedersen explains. The company's sustainability strategy is driven by its framework 'Our Way to Serve'. It aims to improve the way people live, work, move, and play by focusing on mobility, people and environment.

Sustainable SCF reinforces these aims and was a natural fit for Bridgestone. But finding the right way to implement such a solution took a little research on Pedersen's behalf. He comments: "We started thinking about implementing SCF around two years ago. During that exploratory phase, I could not find a case study from a company that had leveraged external ratings as part of their sustainable SCF programme. Up until that point, most leading initiatives I'd heard of were internally rated and somewhat subjective. We already had our global sustainable procurement policy endorsed by business sustainability ratings firm EcoVadis, and I realised we could link the two together, so everything began to take shape from there."

> *"A critical feature of the sustainable SCF programme is the direct link between pricing and sustainability. J.P. Morgan has set up a pricing matrix that works in both directions, providing more favourable pricing for suppliers that are verified as hitting certain sustainability goals."*

## A blockbuster Request for Proposal

With the concept of sustainable SCF now tangible and credible, Pedersen set about connecting a coalition of stakeholders within Bridgestone to be part of the project. Pedersen notes: "Even back at the initiation phase, when we were running the RFP, we had IT, procurement, the back-office service centre, and myself involved – making sure that we had full buy-in from all stakeholders. RFPs in this space can be quite treasury-centric, but bringing everybody together enabled us to improve the solution and achieve full buy-in from across the company."

The initial RFP went out to around 12 financial partners. Some RFP participants were coalitions between fintechs and banks, others were pure bank propositions, and there were also some lone fintech participants. The latter dropped out fairly quickly, though, Pedersen notes and in the final reckoning, all the shortlisted contenders had a bank and a fintech or simply a bank behind them. After detailed scrutiny of the proposals, Pedersen opted to go with the partnership of J.P. Morgan and Taulia for the sustainable SCF programme, which uses a pricing matrix linked to EcoVadis data.

"We operate in an SAP environment, and we believe that Taulia's integration towards SAP is the best in the marketplace," Pedersen explains. "This integrated approach meant that we could eliminate the need for any file transfer testing. An additional benefit was the value delivered through Taulia's supplier portal –suppliers can use the platform to have full visibility of their invoices and the status of individual invoices in our process. Once onboarded, they can simply click if they want to have the early payment. It's as easy as that."

On the sustainability side, Pedersen says treasurers should now expect most of their banking partners to be able to deliver financial products that have an ESG link. He notes: "While we were driving the discussion on sustainability, I felt that all of the big banks were, in fact, capable of delivering what we required on the sustainability side. Even though none of them had done something quite like this before they all were more than keen to do it, given the obvious scalability of the approach." So, while sustainability was a key factor in the RFP, it did not actually end up differentiating proposed solutions. Indeed, the final solution pitched by the shortlisted candidates was largely designed by Bridgestone.

## Implementing and onboarding

With the J.P. Morgan and Taulia partnership selected, Bridgestone went live with the sustainable SCF programme in December 2020. While it is still early days, a great deal of positive progress has already been made.

"The good news is that the suppliers are truly engaged with the sustainability element, I haven't heard a single negative pushback on the sustainability side," Pedersen reports. "Of course, the implementation approach is designed in such a way that we're talking to the bigger suppliers right now, and the smaller suppliers will be engaged slightly further down the line. But it's all been very positive so far."

One of the benefits of the Taulia and J.P. Morgan partnership is the easy, digitised onboarding process. "Taulia has entirely digitised onboarding to the platform and is completely aligned with J.P. Morgan processes. As with any SCF solution, you need to make sure that the bank[s] backing the solution are comfortable with the documentation that is in place in the front end. Having J.P. Morgan joined up with Taulia at the back end, and comfortable with the documentation, is a significant additional benefit."

### Linking pricing to sustainability

A critical feature of the sustainable SCF programme is the direct link between pricing and sustainability. J.P. Morgan has set up a pricing matrix that works in both directions, providing more favourable pricing for suppliers that are verified as hitting certain sustainability goals.

"We have set up the pricing matrix in a way that it incentivises suppliers to improve their EcoVadis rating – the higher the rating, the higher the sustainability discount. If a supplier initially doesn't have the EcoVadis rating, they pay the base rate on a temporary basis. All participating entities are expected to achieve a rating within a reasonable time as we consider belonging to the programme a privilege offered to our partners," says Pedersen.

The biggest positive step in terms of the pricing happens when the EcoVadis rating is achieved. This is to promote transparency. "We consider transparency to be one of the most important elements of the programme as the external EcoVadis rating process unearths any issues – with visibility to all necessary stakeholders – and enables us to work together on the challenges with our supplier."

Beyond a supplier obtaining a rating from EcoVadis, there is another big step in financial benefits available if/when a supplier achieves a 'good' level of EcoVadis categorisation. Supplier data is reviewed twice a year by the ratings firm, and J.P. Morgan has established a data link with EcoVadis whereby they can both read the findings directly from the database. "We want to drive everybody to that 'good' level at a minimum, and if suppliers go up a level they will achieve further improvements in terms of the financing rate," Pedersen says.

### Everybody wins

As well as providing pricing incentives and encouraging suppliers to improve their own EcoVadis ratings, the sustainable SCF programme brings benefits for other stakeholders. For Bridgestone itself, there is the working capital benefit as it generates funds to spend on sustainable projects. J.P. Morgan also gets a win, in terms of the new business that the programme brings. The bank is also furthering the reach of Bridgestone's ESG efforts by donating to an ESG organisation as part of its commitment to the programme. "Last but not least, there is the sustainability aspect, which is a win for us all – for future generations and for the planet," Pedersen concludes.

## Sustainable Supply Chain Lessons from the Automobile Industry

*The automotive sector is in the midst of great change as motive power switches progressively from the internal combustion engine to electric. DBS, which is involved in financing this revolution in Asia, discusses its role in the sector.*

The rapid acceleration in demand for electric vehicles (EVs) has numerous drivers, not least the desire to eliminate greenhouse gasses from our environment and the rise of new technologies that make EV adoption a realistic proposition.

Despite, or perhaps because of, the massive global popularity of specialist racing series such as Formula E and Extreme E, the wider automotive sector has not been particularly well prepared, in production terms, to meet the enormous public enthusiasm for EVs.

If EV production is facing issues now, massive changes are needed urgently because estimates suggest that, by 2030, EV sales as a proportion of total global passenger car sales will rise to 48%. It was just 5% in 2018.

With the pace of technological development likely to keep accelerating in parallel with consumer appetite for EVs, Joseph Lee, Global Head, Treasury & Working Capital Advisory & Solutioning, DBS, believes that the entire automotive sector supply chain needs to gear up now if it is to satisfy demand.

### Shifting from ICE to EV

This may seem like a relatively simple challenge for an industry that for many years has thrived on well-honed production techniques. But in the face of a global pandemic, geopolitical instability, and economic uncertainty, the difficulties it faces are amplified. And, notes Lee, the change from the internal combustion engine (ICE) to EV has an entirely new (and substantial) cost-consideration: although there are only around 20 moving parts in an electric engine, compared with nearly 2,000 in an ICE, many are completely different.

Indeed, says Lee, while the complexity of the vehicle make-up reduces, cost reduction does

3

not necessarily follow. The main reason for this is that EVs use some currently very expensive components. Of special note to the accountants are the battery and the electronic system that monitors and transfers power.

The relative newness of such components has seen a major supply chain disruption develop, Lee reports. Resultingly, unfavourable commodity price shifts have intervened, and even simple components such as computer chips have fallen into short supply. This is restricting the ability of some manufacturers to produce EVs in line with demand.

With the disruption and dislocation of the supply chain, factories in the automotive space have been forced to relocate and this creates uncertainty in terms of future location and connectivity of these facilities into the supply chain.

## Increasing global footprint: new location considerations

"The future model, mindful of the disruptive geopolitical landscape, could see more factories built in Southeast Asia," says Lee, noting that Thailand, Indonesia and Vietnam are prime candidates. However, most stakeholders know that the level of investment and time needed to ramp up production will be considerable. "The challenge now is for players to determine where EV factories will be built, and then how they will approach logistics for major components, to maintain 'least cost-most efficient' production."

*"While the automotive sector's shift towards EV is in itself supportive of sustainability, aspects of supply chain management such as traceability remain key."*

But challenges often create opportunities, and for EV production this bears out, particularly across Southeast Asia where in Indonesia, for example, nickel for battery production is plentiful. The wider region is also densely populated with a young and increasingly affluent demographic that will generate huge demand for EVs.

DBS sits astride a region where both EV production and demand is set to rise, comments Lee. China's prominence in global EV sales is set to displace Europe as the market leader. An IHS Markit 2021 forecast predicts market shares of 44% and 28% respectively; it's movement that should not be ignored.

Evolving EV-driven market opportunities will, on the manufacturing side, fuel increasing commercial changes such as new mergers and acquisitions (M&As), strategic alliances and joint ventures, alongside intensified research and development (R&D) and location options. New and innovative models of vehicle ownership will arise in the consumer space, as will service offerings, including battery rental and recycling.

It's little wonder then that new overseas investment and activity in the region is growing. Hyundai has chosen Singapore as its EV Innovation centre, and has signed a memorandum with Indonesia for long-term investment in its EV manufacturing sector. Tesla is to set up its R&D centre in Bangalore, India. Traditional original equipment manufacturers (OEMs) in Taiwan have already started strategic alliances in response to supply chain disruption, and in India, Ola Electric has set out its plans to establish a global design centre for EV chassis production.

## Traditional meets modern: working capital management solutions

The perfect storm of opportunity that is rising in Southeast Asia needs financial fuel to sustain it. But new opportunities don't necessarily need a complete rethink of existing models, says Lee. Tried-and-trusted solutions can facilitate growth perfectly well, both in terms of EV development and market growth.

While production modelling techniques and sheer demand will eventually bring costs down, the need for automobile manufacturers and OEMs alike is for consistent funding of R&D, new production facilities and equipment, and the working capital required to sustain flows of inventory as production increases.

From a financing perspective, Lee believes that it will be vital for stakeholders to manage "a very lean working capital position", where incoming cash is quickly ploughed back into vehicle development, production and sales generation on the one hand, and in ensuring attractive investor returns on the other.

"We have been helping our customers in the sector through solutions such as supplier finance, helping buyers extend payables, and suppliers release their receivables earlier, ensuring working capital flows are maintained."

Supply chain finance (SCF) is a classic solution being applied in a very modern environment. As automotive OEMs are pressed into action to design and deliver new components to the automobile manufacturers, SCF becomes a vital component itself. It is, notes Lee, a means of sustaining the entire ecosystem of EV production, with suppliers reliant upon prompt payment to keep going.

"The move towards digitisation of trade and payments has stepped up in the past couple of years," comments Lee. With quicker onboarding and a blockchain-based traceability solution enabling "seamless and transparent" information exchanges and transactions end-to-end and in real time, DBS is helping to expedite payables and receivables processing, further boosting working capital management efficacy.

Working alongside the Monetary Authority of Singapore (MAS) and J.P. Morgan, the bank has also been exploring the use of blockchain as a means of enabling 24/7 settlement. This will start with a focus on facilitating flows primarily between Singapore-based banks in both USD and SGD, with the intent to expand coverage to other currencies, notes Lee.

For dealers and service centres, DBS has introduced an instant collection tool for loans. And, as new models of vehicle ownership roll out, micro payments (rental by the hour, or for use of EV-charging facilities, for example), and even subscription-based ownership are also being catered to.

## Powering change and sustainability with digital first

While the automotive sector's shift towards EV is in itself supportive of sustainability, aspects of supply chain management such as traceability remain key.

DBS' partnership with an automotive logistics client in China to tackle traceability is already in use. By using immutable data generated by the flow of produced goods, and which has been appended to a blockchain, the bank is able to offer finance to its client at appropriate stages. It does so with greater rapidity, and entirely without the risk inherent in the paper chain that would normally follow this process.

With the banking sector looking for more ways to offer seamless transactions, for example using robotic processing and artificial intelligence, it becomes ever more possible to plug into the ecosystems of consumers, buyers and suppliers, making an uninterrupted experience for all.

In terms of assisting change in the automotive sector, this translates into direct connection with marketing, sales and consumer financing systems, all the way through to the receivables functions of the OEMs. If a car buyer can choose a vehicle from myriad options and secure funding in a matter of minutes, and manufacturers can deliver directly, the whole process becomes an opportunity for an entirely new holistic experience.

## DNA reset

It's an experience that Lee says is seeing diverse players, including technology firms, chip producers, energy providers and commodity producers, vying for position as the DNA of the automotive sector resets for the future.

***"With many other sectors facing upheaval as they strive to meet environmental targets while operating in the face of shifting supply chains and globally volatile economic conditions, the automotive sector may yet become the model for other sectors to follow."***

With many other sectors facing upheaval as they strive to meet environmental targets while operating in the face of shifting supply chains and globally volatile economic conditions, the automotive sector may yet become the model for other sectors to follow. This will start to blur the distinction between the old and new verticals, delivering fresh opportunities to power change for the better.

# ESG KPIs in Action at Royal Avebe

*By directly linking clearly defined ESG targets to the credit margin of its recent refinancing, innovative Dutch potato starch and protein manufacturer Royal Avebe not only embedded sustainability at the very heart of its finance operations, it also won a national treasury award.*

It should come as no surprise that Royal Avebe, the Netherlands-headquartered cooperative of around 2,300 arable farmers in the Netherlands and Germany, has a keen regard for sustainability. The humble potato is the focus of its business, and every year its members' harvests are processed into a wide range of high-grade ingredients based on potato starch and protein. These extracts can not only be used to add value to a wide range of consumer food products but they are essential ingredients in pet food and various industrial applications worldwide.

With 1,300 employees and production sites in the Netherlands, Germany, and Sweden and sales

3

offices in the United States, Europe, and Asia, Royal Avebe continuously develops innovative opportunities and applications based on potato starch. Throughout these operations, the firm maintains a major focus on sustainable continuity, as Royal Avebe's Treasurer and Insurance Manager Hans Miedema explains.

"With our strategic direction, we aim to create more value for society and stakeholders: members, customers and employees, both now and in the future," he says. "This is only possible if, in addition to our financial results, we also take account of our impact in other areas."

This approach can clearly be seen in Royal Avebe's product portfolio, with a plant-based protein transition, through its production processes that take into account its carbon footprint, as well as water usage, waste and green production. This also extends to the cooperative's farmer base, which is always looking for ways to grow more but with less environmental impact.

Miedema adds: "In short, as a cooperative we believe that the social interest must be in balance with the financial interest. It is therefore in both the cooperative's interest, as well as stakeholders' and our broader environment, to pursue this approach. This is something we can support in treasury in a number of ways."

> *"As well as being good for the business and for the environment, Royal Avebe's ESG-linked refinancing also received great recognition within the treasury community, culminating in the project winning the inaugural Treasury Award from the Dutch Association of Corporate Treasurers (DACT)."*

## Joining the dots

Royal Avebe's green credentials received another boost in 2019 with the creation of a Director of Sustainability role. When Peter-Erik Ywema was appointed to the post, Miedema worked closely with him to look at how treasury could enhance its own sustainability efforts.

Miedema recalls: "Discussions with Peter-Erik provided me with more insight on the subject of sustainability. We had a number of brainstorming sessions in which we discussed opportunities for treasury subjects that could be linked to sustainability."

An early success story to emerge from these discussions was the move to green the cooperative's lease fleet. The operational lease of 10 electric Nissan vans became the first sustainability project that treasury was involved in. The initiative was a partnership with Nissan and Athlon, a subsidiary of Royal Avebe's partner bank Rabobank.

"Peter-Erik and I had been working on the greening of the lease fleet and found shared interests," recalls Miedema. "He talked passionately about his ambitions in the integrated annual report and I saw the opportunity to pursue a sustainability approach when our refinancing came along. I think we learnt a lot from each other and have been able to connect the dots on a number of projects over the past couple of years."

## Targeting refinancing

With sustainability now firmly on the agenda for Royal Avebe's treasury, Miedema was keen to pursue this during the cooperative's refinancing in 2020.

"Our ESG target-setting has evolved over time, from an initial thought to three concrete KPI [key performance indicators] targets, which came about through a combined effort between our partner banks and the participation of colleagues responsible for the related disciplines," Miedema explains.

The three KPIs that Royal Avebe arrived at are: 1) a reduction of the cooperative's carbon footprint; 2) a reduction in water usage; and 3) the increased participation of farmers in Royal Avebe's crop registration system, which enables the cooperative to monitor certain aspects of sustainable farming. These were initially embedded into the cooperative's integrated reporting and then applied to the financing with input from two of Royal Avebe's partner banks – ABN AMRO and Rabobank.

"Our banking partners were very cooperative," Miedema recalls. "Initially they proposed that we should develop specific KPIs for the sustainable financing goals. Following a series of discussions, we all concluded that opting for the KPIs that were already part of our strategy and integrated reporting process would work out as the most practical way forward. This helped us to create a firmer base for our reporting efforts and avoid creating separate systems and additional need for auditing."

With the ESG KPIs in place, Royal Avebe was able to work with its partner banks to agree to a €375m, three-year committed facility. This is split into a term loan, an asset-based line and a revolving credit line. Additionally, a €100m accordion facility was arranged to accommodate further expansion of the cooperative.

"As well as linking these KPIs to the credit margin in the refinancing, this style of target-setting should also help Peter-Erik in realising our common internal sustainability goals, as naturally the focus on these three key items has increased," Miedema notes.

## Industry recognition

As well as being good for the business and for the environment, Royal Avebe's ESG-linked refinancing also received great recognition within the treasury community, culminating in the project winning the inaugural Treasury Award from the Dutch Association of Corporate Treasurers (DACT). In a vote among DACT members, the Royal Avebe refinancing finished ahead of treasury projects by semiconductor supplier ASML and airport owner and operator Royal Schiphol Group, which were placed second and third respectively.

All entries in the DACT Treasury Award 2020 event were judged on several criteria, including Innovation, Inspiration, Environment, and Sustainability & Governance. A jury of professionals from the field ultimately singled out Royal Avebe's project, with the jury report remarking: "Directly linking ESG targets to the credit margin makes Royal Avebe one of the leaders in this market. That is why Royal Avebe is the rightful winner of the DACT Treasury Award."

Following the award announcement, Nicolai Knop and Rolf Michon, Debt Advisory Partners at Orchard Finance, which provided support to Royal Avebe during the refinancing, highlighted the spirit of collaboration between all parties on the project as a key factor in its success.

"The link with the sustainability strategy is a good example of a successful collaboration between the Treasurer, Hans Miedema, and the Director of Sustainability, Peter-Erik Ywema, of Royal Avebe and the sustainability experts at ABN AMRO and Rabobank." they said.

## Looking ahead to a sustainable future

With the financing locked in, Royal Avebe is now well placed to ramp up its green operations and increase its investments in its plant-based protein production, as Miedema acknowledges.

"Funding is essential to pursue our strategic sustainable goals," he says. "With the new ESG targets set and integrated in our LMA [Loan Market Association] documentation, the importance of these sustainable objectives becomes all the greater."

With the world rapidly changing and the focus on ESG issues only increasing, the Royal Avebe refinancing offers a glimpse of what cooperatives and corporates can do to support progress and work towards a sustainable future. Miedema is keen to stress that this is an ongoing journey that requires the commitment of all stakeholders.

"I believe we presently face a major societal transition, where social interests must be in balance with the financial interests of companies," he says. "That is something that no one can do alone. For example, we are now placing more sustainable focus on redesigning our plants to be smarter and incorporate more $CO_2$- and water-efficient operations. Banks, just as much as our customers, suppliers, employees and our member farmers, are essential partners in this effort."

On the treasury side of the business, Miedema has some ideas on how sustainability can be embedded into other areas.

*"We presently face a major societal transition, where social interests must be in balance with the financial interests of companies."*

"For our property insurance we teamed up with our lead insurer Swiss Re," Miedema explains. "Of course, pricing is always going to be an element in the equation, but Swiss Re's strategic focus on the environment, reducing the carbon footprint, tackling sustainability issues, and creating long-term value makes it a valued sustainable partner."

Royal Avebe's treasury department has also joined forces with the logistics function to examine opportunities to develop a sustainable supply chain using blockchain.

"We aim to be as innovative as we can be, given the fact that the outcome should be beneficial to Royal Avebe and to our partners," concludes Miedema. "Spreading a sustainable mindset across all areas of our operations is about creating opportunity and improvement."

4

Accelerating the ESG agenda will require considerable effort on the part of every corporate function, not least treasury. Here, we explore some of the work being done that will ensure a positive longer-term outlook for everyone.

# After COP26: The Future of ESG

If finance is to be one of the key points of entry for treasurers into the ESG arena, then the providers of finance need to up their game too. As we head into the next decade, and board level focus on ESG continues to intensify, Nick Pedersen, Global Head of Digital, NatWest Markets, expects to see much more solution innovation in this area, across product lines. "It is our role as banks, to rapidly adapt to meet corporate's evolving ESG needs," he states.

Rowan Austin, Head of Trade Origination and Advisory, NatWest, agrees, adding that "managing supply chains used to be about drilling costs down as low as possible. Now it's about overlaying ESG and resilience, to create a supply chain that is sustainable in every possible sense of the word."

While banks have been innovating heavily in the ESG space of late – with green and sustainable loans, bonds, deposits, supply chain finance and more – "there is always room for additional experimentation as we head towards 2030," says Conor Maher, Head of Transaction Banking Products, NatWest.

## Making change happen

While there are immediate ESG projects treasury teams can take on internally, such as reducing team paper consumption and choosing banking partners with the right sustainability credentials, the bulk of innovation will happen in the products space.

Pedersen comments: "Again, this is an area where treasurers can look to push their banking partners to be more creative and to overcome perceived hurdles. Regulators may also need to be lobbied, says Austin, who sees the lack of standardisation in the sustainability space as a hurdle to rapid progress.

Maher adds: "2030 is a landmark year that many climate goals are being aligned to. Corporate treasurers can no longer afford to think that ESG is someone else's responsibility – nor can their relationship banks. Together, there is a possibility to work towards solutions that can have a positive impact in the real world. Co-creation is the watchword."

## One US Bank is Taking an Executive Stance

***With a stated intention of becoming net zero by 2030, the long-term environmental commitments of Bank of America (BofA) are ambitious. To help steer progress and achieve its goals, it has recently formed an EMEA ESG Strategic Council.***

Led by a brace of senior executives – Julian Mylchreest, Executive Vice Chairman, Global Corporate & Investment Banking, and Fernando Vicario, CEO, BofA Europe DAC & Country Executive, Ireland – the council's activities will be wide ranging as it aims to support each element of ESG with equal fervour.

In its efforts to date, BofA has not been afraid to put money on the table. Its ESG journey started in 2007 when it committed to a \$20bn programme. In 2013 it added a \$125bn environmental business initiative. Today's ESG programme ramps up that commitment as it seeks to deploy \$1.5tr. of sustainable finance.

But money needs a plan, and BofA has three primary ESG goals set in stone, with the council charged with helping to deliver each. It will work to minimise the bank's impact on the climate, alongside its continuing assessment and management of climate-related risks. It will also be guiding the bank's support for clients as they transition to low-carbon operations. And, as an internal guiding light, the council will additionally help to drive the bank's public policy and advocacy activities along ESG lines.

BofA's existing resources in this space – its Global ESG Committee, Sustainable Finance Group, Sustainable Markets Committee, ESG Risk and Regulation team, and Public Policy unit – will all now be complemented by the new EMEA-focused Strategic Council. The latter will be key to ensuring strategic alignment across the bank's business activities in the region. In doing so, it will "best serve the bank, its clients, key stakeholders and communities," says Vicario.

### Taking the holistic view

By co-ordinating bank resources, and engaging with key stakeholders, the council can be seen as a timely market response to Europe's authorities as they continue proposing a raft of ESG regulatory changes for the corporate community to absorb.

There are currently three key regulatory tillers acting upon EU marketplace development. These are the EU (European Union) taxonomy (a list of environmentally sustainable economic activities), the EU Corporate Sustainability Reporting Directive (requiring verifiable and accessible non-financial ESG data to be provided to investors to enable informed decision-making), and the EU Sustainable Finance Disclosure Regulation (which demands that fund managers disclose their approach to sustainability risks in their investment processes and products). See the Sustainability Regulation and Reporting section in 'How Treasury can Engage in ESG', for comment.

*"By co-ordinating bank resources, and engaging with key stakeholders, the council can be seen as a timely market response to Europe's authorities as they continue proposing a raft of ESG regulatory changes for the corporate community to absorb."*

Of course, the council will need to work for the widest of audiences, mindful that accusations of greenwashing the ESG agenda persist. For Mylchreest, with ESG having rightly progressed all the way from a somewhat niche effort to become a mainstream matter that is front and centre with the C-suite, the time to bring together related and well-established pockets of expertise within the bank has come. It is, he feels, a positive response by BofA to the raising of the ESG bar – by public and private demand – that co-ordinates and makes accessible "the best that we have available across all channels".

The co-ordinated approach will see each element of ESG tackled with uniformity. "We're taking a holistic view; we don't believe one leads and another follows, they are all equally relevant," states Mylchreest.

### COP26 impact

That said, with COP26 (the 26th United Nations Climate Change conference) being held from Oct 31 -Nov 12 2021, there is an opportunity for

4

the bank to highlight further core environmental themes with its clients. "The 'E' will receive more attention at this time," Mylchreest explains, "but for us this is just a short-term function of a major event taking place on our doorstep, longer term we will be just as much focused on the 'S' and the 'G'."

Indeed, COP has the potential to make a difference and should not be downplayed for any reason. And this time around Mylchreest believes there is an opportunity for the response to be more evenly distributed among key stakeholders and, in particular, with more weight falling, he hopes, on companies and sector-wide alliances to step up.

While previous outcomes of COP – new frameworks, policies and targets – have been largely government driven, he sees an increasing number of cross-industry alliances and commitments influencing ESG thinking going into the event, which will be able to drive the agenda of action post-event.

"But it's important for us to align with our clients to make those action plans real, otherwise there's a risk of too much long-term alignment and not enough shorter-dated action," states Mylchreest. "We want to help them shape their response, and fund and support it." With the BofA council helping to align bank thinking and understanding with client drivers and expectations, he anticipates an increasingly positive outcome.

*"Post COP26, there is still a matter of balancing the three components of ESG."*

## Governance does matter

Post COP26, there is still a matter of balancing the three components of ESG. While it's clear that the environmental and social elements have a long held a stronger grip on public and corporate consciousness, Vicario believes that governance is now being driven forward by a robust political agenda within the EU, with the support of the European Central Bank (ECB).

As recipient of a number of the ECB's so-called 'Dear CEO letters', outlining the central bank's expectations of the region's banking community in terms of governance, Vicario is charged with co-ordinating and communicating BofA's response. These letters, he reports, are arriving with increasing frequency.

As an example, on 1 July 2021, the ECB communicated its report on the uneven impact of climate change on the EU financial sector, and is now seeking categorisation of that impact into physical risk and transition risk. At the same time, the bank launched a pilot climate stress test programme, which it said will become a requirement for systemically important financial institutions in 2022.

Less than a week later, the ECB published its new sustainable finance strategy. This introduces the European green bond standard, which although voluntary means every player in the capital markets space will have to adopt it because investors will demand it. A few days later, on 9 July, the ECB announced its commitment to the inclusion of climate data into its monetary policy.

Vicario comments: "It's clear that the financial services industry is geared towards becoming an agent of change and we are required by the various European bodies to accelerate the pace." While individual banks are undertaking a host of activities to ensure an effective response, he acknowledges that the broader work of ESG cannot be achieved in isolation.

European green bond standards, for example, now require external validation, especially as proof of compliance with the EU taxonomy continues to tighten. And stronger governance and greater stakeholder expectation is also driving a need for external auditing of annual reports and ESG statements.

Issuers in the capital markets are also being increasingly influenced by investor demands. It is the role of banks to help align the expectations of both parties. "We must ensure the rapidly evolving ESG-related regulatory requirements – and indeed the recommendations of the ratings agencies – are met," notes Vicario. "And as BofA commits $1.5tr. to the ESG agenda, it is critical that we ourselves continue to understand and adapt to market trends if we are to help our clients in their transitions."

## Sharing intel

As BofA's programme rolls out, success, says Mylchreest, stems from "pooling the best intel internally". This means drawing, for example, not only upon ESG-focused discussions with equities researchers but also from conversations with investors about their ESG frameworks, policies and drivers. It also involves partnering with external stakeholders, including leading academics in the field, to build upon and share intel so that "the right advice" is forthcoming.

In practice, the increasingly urgent and demanding voice of stakeholders (which ultimately is everyone) means financial institutions should be scaling up their ability to harvest and share knowledge with their clients. At a corporate level, for a client to demonstrate that its business is future-proof, Mylchreest comments that it increasingly means meeting all ESG demands. "If the multiple on its cash flow is higher as a result, its valuation is higher. If this is where it needs to pivot, we need to be able to help it make that move by funding and supporting that journey."

As part of an evolving response, the industry solution set has moved beyond the arguable values of carbon offsetting and now includes products such as social bonds, transition bonds, sustainability-linked bonds, green convertibles, ESG-compliant derivatives and ESG-compliant supply chain finance.

With "every element of ESG now well covered", Vicario believes that we're in the midst of "stakeholder capitalism at its best". However, with multiple stakeholders showing no signs of letting up any time soon, he fully appreciates that BofA's EMEA ESG Strategic Council has its work cut out. "We'll have to do a lot of heavy lifting to achieve our goal, but by doing so our efforts will translate into not only some serious additional support for our clients but a more sustainable future for our planet." Future generations will judge the results.

## Why Treasurers Should be Thinking About the Circular Economy

***Treasurers have so many responsibilities that it can be tough keeping up with wider business shifts. The move towards the circular economy, says Ermanno Camerinelli, has an enduring effect that will continue to gain in credibility and power.***

The circular economy is a model of production and consumption that involves sharing, lending, reusing, repairing, reconditioning and recycling existing materials, products and waste for as long as possible, thereby increasing their value. As an embodiment of the cradle-to-cradle model, a circular supply chain can lead to potentially infinite value creation and accretion using finite resources.

### Definitions

**Reusing**: For example, giving a second life to a product without it necessarily having reached the end of its life cycle. The reused product's new destination is the same as the original one.

**Recycling**: This involves reworking of components of a product that has reached the end of its lifecycle.

**Cradle-to-cradle**: This is about 'remaking the way we make things'. It involves community and product development that functions like a healthy ecological system where all resources are used effectively.

This is in contrast with the traditional linear economy approach, that provides five stages for the life of products: extraction of raw materials, production, distribution, consumption, and waste disposal. At the end of its life cycle, the product is transformed into waste, unusable for productive purposes: this is therefore called the 'cradle-to-grave' model.

*"Although the investment required to build a circular supply chain may appear substantial, the expected results are likely to be long-term, and there is potential to generate significant economic returns."*

There are many ways to implement the circular economy, from use of renewable resources or resources from renewable sources (upstream) to the creation of mechanisms of 'reverse logistics'. The latter is designed to recover products from the market and regenerate them to give them a new life (downstream), passing through all the intermediate stages within the chain, such as the exploitation of production waste that can be reprocessed to create new products or accessories for the product itself.

Although the investment required to build a circular supply chain may appear substantial, the expected results are likely to be long-term, and there is potential to generate significant economic returns (see opposite page for statistics).

### Practical considerations

The ability of a company to implement a circular economy strategy can have repercussions in many areas, from the reputational aspect to competitive advantage.

For instance, a company that does not know how to enhance and give a second life to production waste, or that has no incentive to recycle, will continually face considerable expenses at each new production cycle:

- During the search for new raw materials, companies operating a linear model will encounter risk of price increases due to the growing scarcity of certain resources in nature. But in the circular economy scenario raw materials are obtained from the reprocessing of the product itself, therefore costs and timing are potentially lowered.
- Equipping machinery for production can potentially lead to negative external events and sentiments, especially where greenhouse gas (GHG) emissions are concerned.

4

- Disposing of new waste is costly and potentially damaging in many ways. In the circular economy scenario, waste becomes an additional source of revenue; in fact, it can be resold and used as a by-product in a different chain to produce new goods.

It is worth noting that the various stages of the production process in a linear economy imply significant costs for companies both upstream, during the production phase, and downstream, through taxation systems on carbon emissions, landfill disposal and pollution in general (estimated costs for air pollution are $2.9tr. per year).

*"Arguably, treasurers are perfectly placed to understand how the positive impact of implementing a circular physical supply chain can translate into financial benefits."*

Of course, the transition towards a circular economy also incurs costs and other resource requirements. But, looking at the bigger picture, the circular model is desirable in two significant ways:

- From an economic perspective, it allows for estimated savings of €604bn across Europe, equal to 8% of total annual turnover. More specifically, this scenario could increase GDP by nearly 1% and create more than two million jobs compared with a usual economic model, while reducing total annual GHG emissions by up to 4% (the cost of $CO_2$ has reached €43 per ton and GHG emissions are expected to grow by about 1.5 billion tons). A circular model also improves access to capital for companies in the form of national and international green financing, which would enable them to recoup some of the investment for the transition to the new model.
- From a practical perspective, the circular economy presents an opportunity to optimise the business processes and embrace improved business and financial planning. After all, it reduces uncertainty about the availability of raw materials for production and thereby reduces price volatility. For the treasurer, this translates into streamlined and more predictable cash flows.

### Making the leap

While the theory of the circular economy has clear benefits, it is unthinkable that a single company, large or small, should bear all the costs and efforts of making its supply chain circular. Indeed, the model itself necessitates the co-ordination of activities among an ecosystem of actors (stakeholders), including suppliers, internal departments and production staff, financial institutions, regulators, logistics providers, and, above all, the final customer.

Designing an efficient stakeholder engagement system around the circular economy is therefore critical – and the treasurer has a role to play here. With the CFO on their side, treasurers can assist in spreading the word about circular supply chains making it possible for a company to achieve competitive advantage and resource savings, both in terms of the quantity of materials used and in terms of supply costs, which are not negligible. When implemented correctly, and with the engagement of all stakeholders, this will filter through to improved financials and better visibility and predictability of cash flows.

As of mid-2021, many countries have already run out of the natural resources available to them this year, and a similar scenario is destined to play out in other nations in the coming months.

As such, sustainability is no longer an option. Significant numbers of organisations and consumers are crying out for more virtuous behaviour to guarantee future generations the same, if not better, survival conditions as ours.

At this point, we must all ask ourselves what kind of world we want to leave to our children and families: a world in which to prosper or a world from which to escape? And perhaps this is a little more philosophical than a typical treasury discussion, but treasurers have the power to influence behaviours within their organisation.

Arguably, treasurers are perfectly placed to understand how the positive impact of implementing a circular physical supply chain can translate into financial benefits – and this is precisely the kind of insight that can help drive management decisions.

## How to Recycle Plastic While Tackling Poverty

***ESG has a huge role to play across a broad spectrum of future economic outcomes and Plastic Bank has an interest right across that spectrum. It is an international social enterprise organisation that is building recycling ecosystems in underdeveloped communities with the help of ESG-focused corporates.***

The problem of waste plastic is that it will quite literally never go away. Plastic does not decompose. All the plastic that has ever been produced that has ended up in the environment will remain there in one form or another forever. Waste plastic often finds its way into rivers, seas and oceans, breaking down into smaller particles and damaging or even destroying the delicate ecosystem, from surface waters to the deepest trenches.

At least eight million tons of plastic end up in our oceans every year, according to International Union for Conservation of Nature estimates. Unless action is taken, much of it will remain there, with dire consequences.

Recovery and recycling programmes are numerous around the world and these efforts must be applauded. But in developing countries, where there are few recycling plants let alone active waste management systems, the problem is growing as each day goes by.

To one extent or another, lack of money is the issue. So how can waste plastic become part of a system that not only removes it from the environment and reuses it but is also somehow financially sustainable? The answer is what Canada-based Plastic Bank is aiming to deliver.

## Collect and earn

Operating in low-income countries, the Plastic Bank system is a relatively simple means of removing discarded plastic, explains David Katz, Founder and CEO, Plastic Bank. The waste is picked up by individuals, wherever they may find it, and taken to specialist collection centres. "Collectors receive a premium for the materials they collect, which helps them provide basic family necessities."

The collected plastic is weighed and sorted before being transferred to local processing facilities. It is reborn as Social Plastic®. As a raw commodity, this is purchased as bales, flakes or pellets by manufacturers from a wide range of sectors, and reintegrated into their products and packaging.

Simple it may be, but the collectors earn an improved wage, says Katz, and the end users reduce their need for new plastic production while earning the right to use the Social Plastic branding. Of course, in all this, the environment is cleared of thousands of kilos of plastic waste.

Currently Plastic Bank has 499 collection sites across Haiti, Brazil, Indonesia, Egypt, and the Philippines. Plans for expansion will see it establish collections facilities in Cameroon, Vietnam, Thailand, Nigeria, Kenya, and Tanzania by 2022.

## Corporate role

"Plastic Bank builds ethical recycling ecosystems in coastal communities and reprocesses the materials for reintroduction into the global supply chain," explains Katz. With around 200 major global corporates and smaller entities onboard, he already sees Plastic Bank having a positive effect in the commercial space. Household names such as Henkel and SC Johnson are users of Social Plastic in their production facilities, for example.

Manufacturers are now being joined by an expanding roster of non-manufacturing firms, such as Swiss financier Lombard Odier, as more businesses are seeking to make a positive difference. Indeed, Lombard Odier's Blue Note structured investment programme is contributing to the extraction of around 790,000kg of waste plastic from the environment, with collections underway in Haiti and Egypt. Katz says other firms are similarly linking the collection of plastic to specific business activities.

## Modern alchemy

At this point it is worth noting that Plastic Bank is not a bank in the traditional sense of the word. However, through its actions, it is creating 'currency'. If value is attributed to plastic products, and that value represents a significant portion of income, the chances of it being thrown away will be dramatically reduced, notes Katz. By reversing the notion that plastic waste is worthless, Plastic Bank is attempting to transform it into a functioning form of payment.

*"Recovery and recycling programmes are numerous around the world and these efforts must be applauded. But in developing countries, where there are few recycling plants let alone active waste management systems, the problem is growing as each day goes by."*

In practice, accumulated plastic is redeemed by its collectors for digital tokens. These are storable in each collector's Plastic Bank e-wallet. In this state, tokens can be exchanged for hard currency, or be used to purchase a wide range of subsidised goods and services sold through each collection centre shop. Offerings range from essential food, fuel, and clean water to health and education services.

4

Plastic Bank has a not-so-secret weapon in that all of its plastic recovery processes are controlled through a blockchain-based application, which it has named Alchemy™. In the same way that SWIFT gpi tracks and traces a payment, Alchemy™ tracks plastic waste, from collection to re-use. The data generated by the system can offer commercial partners an 'impact dashboard', explains Katz. Using real-time monitoring, it graphically illustrates the social impact of that support through the quantity and source of collected plastic.

German hair care firm Wella uses Alchemy™ data to support its marketing campaign for its vegan, 100% recyclable consumer brand weDo. Having undertaken an impact study of product packaging, the firm has calculated that one bottle of shampoo bought equals eight bottles removed from the ocean. Alchemy™ data is therefore offering corporate sponsors immutable evidence of their sustainable activities. But the effect of involvement goes further, notes Katz.

## Social and corporate impact

The impact on the 25,000-plus collectors, without whom none of this would be possible, is impressive. In a recent meeting led by the team from Haiti, it was reported that the UN has recently upgraded the country from a position of 'extreme poverty' to one of 'poverty'.

*"Accusations of greenwashing still abound in this space. What is being demanded now is proof, especially by activist investors who can and will challenge boards."*

This is marked by an upward shift from an average daily wage of $1 per day, to $2 per day. Plastic Bank is playing a role in this progress with some collectors managing to earn $7 per day, with collectors' personal revenues improving by an average of 40%.

With a number of local projects also being managed by Plastic Bank, the social effects go further still. With the support of sponsors, it has some 105 schools' programmes underway, and health insurance and services are also now being provided to collectors.

The positive effect Plastic Bank's work has on corporate partners is also broadening, notes Katz. An external study carried out on its behalf last year looked at media coverage generated by corporate involvement. It showed that it added around $180m of earned media since its inception in 2013. When Procter & Gamble partnered with Plastic Bank on the launch its new shaving brand Planet Kind in the US, a single month of partnership generated $1m of earned media coverage.

## Get involved

While the difference between the numbers experienced at the opposite ends of the partnership spectrum will never add up for some, each stakeholder is necessary to make this work. For the corporate, involvement clearly generates positive media. But the increasingly essential nature of proven sustainability, with investor relations (IR) reports now demanding detailed explanations of activities, the work of Plastic Bank should prove an interesting proposition.

Accusations of greenwashing still abound in this space. What is being demanded now is proof, especially by activist investors who can and will challenge boards. Plastic Bank's activities are real and can be seen to be so. It has collected 29 million kilos of plastic since it launched, this is equivalent to 1.4 billion bottles. Every kilo is verified by blockchain.

From a treasury perspective, providers of sustainable finance instruments (such as linked loans) can use this information to verify corporate compliance with green key performance indicators (KPIs). Of course, the fact that a real difference is being made on two levels may be enough in itself.

# Roadmap to ESG in 2025: A Turning Point for Treasury

***For ESG initiatives to become part of the day-to-day activities of the business community, it will take continued strong leadership and guidance. Real-world examples demonstrate what the future of sustainable practice might look like, offering insights into how treasury professionals can drive change for good.***

By 2025, when hopefully the world will be in control of the current health crisis, Melissa Moi, Head of Asia Pacific Environment, Social, Governance, Bank of America believes that there will continue to be "a massive push from an ESG-related finance perspective".

From a treasury point of view, it will therefore be essential to look at how sustainable finance can be used as an opportunity. Especially since Bank of America research has shown how the cost of capital goes up when a business fails to be ESG-compliant.

"Treasurers need to be thinking about ESG now, and how they can plan for a more sustainable department by 2025, for example," says Moi. "This means leveraging ESG financing tools to incentivise more sustainable performance – not only within treasury's parent company and across subsidiaries, but also across supply chain partners."

Achieving this will likely require a fresh look at how investments and funding are managed across areas such as CapEx, M&A and R&D, especially where a business is learning to pivot away from carbon-intensive practices. But far from being a separate part of the treasurer's remit and thinking, the aim is for ESG to be embedded into everyday thoughts and actions.

## Making the transition

The aforementioned IPCC 2021 report, issued against the global backdrop of increasingly common cataclysmic weather events such as wildfires and flooding, is a call to action for all business leaders, but especially treasurers, believes Venkat ES, Head of Treasury Product, Asia Pacific, Global Transaction Services, Bank of America.

With the cost of capital rising and resources management intensifying, it is time for treasury teams to raise their day-to-day standards, he says. "Realistically, there is no reason why treasurers should not be considering an ESG approach to managing liquidity, including deploying surplus into genuine ESG-related instruments. The cash management products available from banks are maturing at such a rapid pace that by 2025, treasurers should have a whole suite of ESG solutions at their fingertips – offering all of the upside and none of the downsides that are often, wrongly, associated with ESG products."

Of course, notes Venkat, there is a reputational element for the corporate treasurer to consider when engaging in ESG-based finance. If the bulk of debt is ESG-focused, there must necessarily be ESG metrics based on wider corporate objectives and goals. Treasury and the business need to be fully aligned to ensure these are met, says Venkat. "Companies need to be constantly on their toes to ensure a positive outcome. This demands a lot more work on the evaluation journey over the next few years."

Part of this 'work' is to ensure the right key performance indicators (KPIs) are in place, not just in the wider organisation but in treasury too. "It's a fast-evolving space," notes Venkat. "In the past few years, we've seen exponential growth in the response to ESG issues, and KPIs are becoming an integral part of ensuring compliance with ESG commitments. That said, the precise nature of KPIs adopted may vary from industry to industry and company to company."

For example, an organisation Venkat works with that is historically a heavy user of fossil fuels and which now wants to move towards renewable energy, is in the process of defining metrics capable of demonstrating progress on what will inevitably be a long journey. Meanwhile, in the world of real estate development in Asia, where Venkat is involved in a project that is seeking to tackle climate and social issues from the outset, appropriate KPIs must be found to demonstrate genuine progress, as opposed to box-ticking.

*"There is a reputational element for the corporate treasurer to consider when engaging in ESG-based finance. If the bulk of debt is ESG-focused, there must necessarily be ESG metrics based on wider corporate objectives and goals."*

"KPIs are becoming an integral part of the goals of forward-thinking treasury teams," he notes. "New pathways are opening up as the message is becoming clearer and stronger, and this is converting into smart goals, with KPIs and metrics now being driven at board level, but also across the finance function and into treasury itself."

Within treasury, these KPIs might range from the percentage of surplus cash invested in ESG-compliant investments to the percentage of digital versus manual operations. The latter is a pet subject for Venkat. "Given the huge shift towards digital channels, treasurers should be able to move away from paper-based processing of routine payments and receipts within the next few years – if not sooner. Really, I'd like to see the vast majority of treasury processes being completely digital by 2025."

## Supply chain changes

Elsewhere, digitisation of supply chain processes, while not new, is playing an increasingly beneficial role in terms of sustainability. There is an obvious opportunity to remove paper from the chain but it goes deeper than that, says Moi. "There is increased attention on how companies manage supply chain-related human rights issues, with many taking responsibility for ensuring ESG compliance within their supply chains," she notes. Digital processes can assist with tracking, tracing, and reporting at every stage.

But with more data and insight, Moi cautions that there may sometimes be rather too much pressure on suppliers to comply. "What we're hoping is that this is taken as an opportunity

# 4

for large buyers to engage with their suppliers, incentivising their set-up of ESG governance structures, policies and reporting, and encouraging them to adopt a more sustainable way of thinking," she says. "Rather than buyers simply no longer working with suppliers that are unable to comply."

Indeed, in the context of the health crisis, Moi believes that there is an opportunity for corporates to demonstrate support for their trading ecosystems, especially their smaller suppliers. "We've seen some companies, despite obvious issues in their ability to continue operations as normal, make commitments to their long-term suppliers. By doing so, they are ensuring the livelihoods of those making the goods or providing services, and their communities are able to stay afloat."

Looking a little further out, there are opportunities too to explore how best to encourage smaller collectives, such as farming groups, to adopt ESG thinking through concepts such as priority sector lending.

Doing so can ensure these businesses are able to work together to provide raw materials, promoting financial inclusion of SMEs (small and medium-sized enterprises) and, with the right technology in place, providing individual participants with better insight into their cash flows.

This not only boosts supply chain strength and continuity for buyers, but it also ensures traceability of goods for more accurate ESG reporting. "When treasurers and their companies take a step back, they can go beyond thinking of ESG as 'recycling paper' or 'turning off all the lights when leaving the office'. Instead, they can begin to truly understand the impact their actions have across all of their assets," comments Moi. "They can then begin to reveal opportunities for significant change from social and environmental perspectives – with the added benefit of business gains."

*"When treasurers and their companies take a step back, they can go beyond thinking of ESG as 'recycling paper' or 'turning off all the lights when leaving the office'. Instead, they can begin to truly understand the impact their actions have across all of their assets."*

## Regulation is coming

Taking the right ESG action now may also pre-empt regulatory obligation later, or at least lessen the amount of work that is required to become compliant as we head towards 2025. That said, European regulators have a number of changes in the pipeline, notes Moi. The European Commission has already adopted a proposal for a Corporate Sustainability Reporting Directive (CSRD). This amends existing reporting requirements under its Non-Financial Reporting Directive (NFRD) to include all large companies and all companies listed on regulated markets, and requires all affected to publish regular reports on the social and environmental impacts of their activities.

"I think it's likely as well, coming out of COP26, that we'll start to see more regulators and governments engaging, given the start of the post-pandemic reset and the 'Code Red' of the latest IPCC report," she comments. "With more regulation will come more reporting."

Another major trend noted by Moi is the increased will in the investment community to sign up to a net-zero commitment by 2050, both by asset managers and asset owners. These stakeholders are naturally pushing for reporting compliance and an understanding of disclosures from a portfolio perspective. "With this comes a requirement for corporates to be able to report appropriately, in terms of their footprint, their policies and their governmental structures."

With all of these levers from governments, regulators and investors, corporates will soon need to at least have baseline reporting capabilities and a basic understanding of how they can align with globally recognised standards. "They will also have to work out how they can engage in conversations to help drive those standards from a practical perspective. This will require the development of their own internal processes to ensure they can respond to all these requirements, because soon they will be mandated," notes Moi.

# Appendix

## ESG podcasts

*For further ESG insights, listen to some insightful podcasts on TMI's TreasuryCast channel – it's completely free and no registration is needed. Podcasts can be listened to on Apple, Spotify and directly via the website.*

### Embedding ESG in Trade and Supply Chains

Surath Sengupta (HSBC) explains the ins and outs of t embedding ESG into trade and supply chains. Our guest also shares many valuable insights on how treasurers can improve their ESG metrics in the trade space, discusses the barriers to overcome when leveraging sustainable solutions, and considers if external collaboration between treasury departments and their suppliers is the key to ESG implementation success.

### The ESG Landscape – What Every Treasurer Needs to Know

Farnam Bidgoli (HSBC) provides an in-depth overview of the current ESG landscape, so that treasurers can build a credible sustainability strategy. Amongst an excess of ESG insights, our guest explains how treasury teams can prepare for upcoming regulatory changes including the EU Taxonomy, demonstrates how to leverage ESG KPIs, and clarifies how treasurers can transition to an ESG-led approach in their daily operations.

**If you haven't already found enough ESG insights in this guide, there are more available online. Or if you are short on time to read everything, you can listen to our podcasts and webinars where experts share their views and key ESG takeaways. Scan the QR codes to go straight to each piece of content.**

# Appendix

### Investing in the Future – from Diversity to Green Deposits

Nadine Lagarmitte and Suraj Kalati (HSBC) consider how corporates' attitudes to ESG are changing, including a growing interest in ESG investment. Our guests also explain the incentives behind HSBC's green deposit scheme, explore how ESG product development is evolving in response to tighter regulation, and share their key lessons for leaders looking to embrace the social values of ESG.

## ESG webinars

***TMI has also hosted two webinars on ESG, which can be listened to on demand. And readers can sign up to our complementary TMI webinar club to be notified of future webinars.***

### Exploring ESG Investing with Calastone

Security, Liquidity and Yield have traditionally been the treasurer's top investment considerations. But with the call for greater corporate social responsibility – and the solid performance of sustainable investments – ESG is now becoming a fourth investment dimension. How can treasurers integrate ESG into their policies and practices? What are the pitfalls to avoid? And where is the responsible investment journey heading next?

### Treasurer's Roadmap to Becoming an ESG Role Model with Aberdeen Standard Investments

Topics covered in this webinar include: the treasurer's role in making ESG part of BAU, ESG investing options, demystifying ESG ratings and best practice ESG learnings. A write-up of this webinar can also be accessed online (free to register): **https://treasury-management.com/articles/investment-challenges-and-opportunities-for-treasurers-as-esg-drive-accelerates/**

## Additional reading

TMI regularly writes on ESG and D&I topics. Check out the dedicated section on our website for the latest insights.

Also download TMI's app, sponsored by SocGen, for a sustainable way to read the magazine, wherever you are.

PUBLISHED BY TREASURY MANAGEMENT INTERNATIONAL