Episode 3 - Sustainability Linked Finance: have you set your sustainability targets yet?

INTRO

Hello and welcome to the third episode in Addleshaw Goddard's series of podcasts on sustainable finance. In this episode we will be discussing sustainability targets and more specifically exploring the theme of "have you set your sustainability targets yet?". You are again listening to myself, Emma Whitehall and also Nick Parkin, part of Addleshaw Goddard's finance team. This is the third episode in our series, so if you've missed the first few then make sure you go and check those out.

Once again, we have lined up a number of excellent guest speakers, some of which you have heard from before if you have listened to our previous episodes and also some new ones. In this episode we will be hearing from Benjamin Rick who is the Co-Founder and CEO of Social and Sustainable Capital, Radi Ivanova Vice President in the Sustainable Products Group at Barclays, Vaughan Tyrell from HSBC, Jayne Cottam the CFO at Assura and Kate Lawlor the CEO of Bruntwood Scitech.

BARCLAYS

[NICK] So jumping right into this week's topic of sustainability targets, we have found that some businesses are finding it difficult to either set sustainability targets to begin with or are grappling with the lack of standardisation when it comes to metric reporting. We spoke to Radi Ivanova at Barclays about the fact that many in the finance industry are of the view that a lack of an agreed set of standards or standardised reporting is holding back sustainability progress within organisations. We asked her what kind of sustainability metrics do borrowers need to be able to achieve in order to be eligible for sustainability linked loans and whether Barclays look at whether companies have achieved sustainability accreditations such as B Corp.[1]

[9 mins 25 secs] So I think standardisation is probably what the market is really trying to achieve, but it's quite difficult to apply a single approach to all businesses and expect the same type of metrics across the board. I think there is definitely a sector overlaying to what appropriate metrics should be, and what material metrics should be included in a particular loan. The most important thing I guess from a client perspective is for the metrics to be quorum and relevant to the business, but also to be very much embedded in a pre-existing strategy as much as that is possible and I think there is probably certain sectors that lend themselves more to specific type of metrics for example in the retail space, sustainable sourcing related metrics are very relevant given the extensive supply chains of these clients and the potential environmental and social risks that sit within that supply chain. But there are also universal sustainability issues that are applicable across the full spectrum of borrowers, thinking about carbon emissions or diversity metrics related to either gender or ethnicity across different levels of an organisation. So it really depends I would say on the strategy of the borrower, their track record in terms of what they have prioritised historically and what they will prioritise in the future but also there is a bit of a sector overlay as well in terms of the materiality of the metric.

On the question around the certifications, we definitely consider to a huge extent what certifications environmental, social or sustainability the borrower has in place, that is done as part of an overall review of the standard profile of the borrower and definitely adds credibility to what they are trying to achieve from a sustainability point of view, and it also shows that they have put some thought, resource and effort towards achieving goals in advance of going down the sustainability linked facility route.

The other thing we noticed with some of these certifications and accreditations is borrowers are much better prepared to present to their banking partner a more complete dataset with a historic track record if they had to already track some of these and monitor some of these metrics for the purpose of

[1] Radi Ivanova [1:37 – 3:46]

certifications and they already have the reporting systems in place so these efficiencies really help when it comes to setting up a loan of this kind as well [11 mins 57 secs]].

HSBC

[NICK] We also spoke to Vaughan Tyrell at HSBC and asked him the same question, this is what he had to say.[2]

[12 mins 16 secs] While it is true that the world of sustainable finance and ESG is full of acronyms and a multitude of organisations talking about similar things which can make it confusing and hard to navigate. With the UK Government introducing the need to report against the Task Force of Financial Disclosure requirements in annual reports, many already do. This should help to provide some guidance and clarity on the expectations going forward. With specific reference to metrics for a sustainability linked loan, HSBC seeks to meet the requirements set out in the five pillars of the LMA sustainability link to loan principles. In summary, we will seek to review the overarching ESG strategy of a borrower KPIs will then be negotiated that are a core to this strategy and material to the business. These KPIs will be distilled down to annual sustainable performance targets that can be applied each year for the tenure of the facility. The sustainable performance targets must be material and stretching for the business to achieve. Targets that will be met through business as usual actions will not be considered to meet this requirement. In addition to identifying suitable sustainable performance targets, the business will need to provide a summary of what actions they will take to meet the targets. We will also look to ensure that the strategy has senior support within the business to ensure delivery. There are other points that will need to be discussed around structure, reporting and external verification before a sustainability linked loan can be put in place. Sustainable accreditations such as B Corp are beneficial and will be considered as part of the transaction. However, the current main focus is on the specific business and its strategy [13 mins 57 secs].

BARCLAYS

[EMMA] If you are a business looking to set your sustainability targets, don't be overly concerned about the current lack of standardisation in metric setting or reporting. It is clear from both HSBC and Barclays that the approach that is being taken is that which is best for the relevant sector or business in question. Accreditations such as B Corp are a good indicator of performance and commitment and perhaps a good place to start on your sustainable journey, but they are not essential to securing sustainability linked finance.

We also asked Radi how Barclays go about measuring progress towards the targets once they are set. Lenders are not climate scientists after all. Here is what she had to say.[3]

[13 mins 43 secs] Yes that's an excellent question, and I guess we look at measurement in two ways, one the actual calibration of the targets when we set them against the particular metric and secondary as well the actual verification of the underlying data which is a really important integral part of making sure that targets are indeed created and tracked with integrity. So on the first point around how we calibrate, we very much look to explore with the borrower why a particular target is beyond their business as usual trajectory. So where it's possible we recommend following a science based approach, specifically around carbon emission reductions so the science based initiative is an initiative that we see a number of borrowers now following. It is a joint initiative between the Carbon Disclosure Project, the UN Global Compact World Resource Institute and WWF and it is very much focussed on the targets of the borrowers are in line with what is expected under the 1.5 and 2 degree scenarios.

[2] Vaughan Tyrell [3:51 – 5:28]
[3] Radi Ivanova [6:07 – 7:50]

So that approach is a very robust approach and we have seen our clients across the credit spectrum even you know smaller businesses going down that route to make sure their targets are set with integrity, but if we were to look at a scenario where that wasn't a route that was possible at this point in time, we will very much interrogate and discuss with the client what are the actions that they are looking to take, how the trajectory defers from business as usual and historic track record and this is where it starts coming into play and very important, and we also calibrate with what we are seeing in terms of peers and other external benchmarks. In terms of actual verification of the data as we talked about now, there is a strong requirement for the data to be externally verified which is what we encourage and require borrowers to do as much as possible within the facilities that we sign into [15 mins 48 secs]].

SASC

[NICK] We have also spoken to Ben Rick, the Co-Founder and CEO of Social and Sustainable Capital which is a UK based social investment firm raising money and investing in not-for-profit businesses in the UK. As an organisation very much focussed on the S in ESG, Social and Sustainable Capital approach things slightly differently to other main stream investors when it comes to target setting, instead focussing on what impact outcomes the organisations they invest and achieve. Ben spoke to us about the type of impact outcomes Social and Sustainable Capital are looking for before making investment decisions.[4]

[10 min 56 secs] So, I think the key thing to say here is that SASC, as an investor, has always been really clear that we don't arrive with an impact framework that we drop on every organisation we work with. We've always had the view that if we're creating significant additional work for organisations to demonstrate their impact outcomes then that's probably not being helpful and not sensible in terms of resource allocation. So the first thing we do really in the process of working out whether we can work with an organisation is to understand what impact outcomes they're trying to achieve, what they're measuring and what they're reporting and we always try and build upon that information. [11 mins 43 secs]

ASSURA

[EMMA] As well as speaking with lenders on this topic, we also got the views of two high profile companies, Assura and Bruntwood Scitech, who are both well used to sustainable and/or social financing. Firstly, we spoke to Jayne Cottam the CFO at Assura, a real estate business in the medical sector, and asked her how Assura went about setting sustainability targets and whether the company had any help along the way. [5]

[7 mins 4 secs] It's very difficult when you have 609 buildings of all different shapes and sizes to set your sustainability targets and from our point of view we are not in control of what goes on in the buildings either so for example only about 40 of the buildings we have any control over the energy usage etc., and when a lot of the targets are set you get lots of these sustainable boffins going right we need to know your water usage, your waste water usage, your energy usage and we just can't get that information.

So we had to strip it all the way back and say right how can we get this and so the only thing we could come up with at this time or two main targets really, one around our developments so we use the BREEAM measures to make sure they are BREEAM "excellent" or above and then the other one was looking at EPCs so the energy performance certificates of each building and what we've been able to do we signalled to our shareholders and investors this was the direction of travel but just bear with us while we pull everything together and because we have 609 buildings we did get some help and it's probably taken us the best part of 12 months to go from signposting to actually getting some tangible

[4] Ben Rick [8:24 – 9:04]
[5] Jayne Cottam [9:27 – 10:49

information on which we can then drive our targets to get all of our estate to an EPC "B" or above in the next five years

[NICK] [8 mins 32 secs]. Where did you look for the help? Did you know where to start? Did you go to external professional agencies? [6]

[8 mins 40 secs] Yes, so it was quite challenging because you really don't know where to start and when you go into something and you don't really know what you're looking for you're always worried, particularly you know when I sit in my chair as CFO, is someone going to rip us off because we don't really know what we're doing and are we really going to get value for money. Now luckily there is a lot of other listed real estate businesses that are looking at this so we could speak to some of our peers, some of the larger FTSE 100, for example, linking in with their sustainability offices and a bit of recommendation through that and that's how we can drive some of it forward [9 mins 17 secs]].

[EMMA] Like Assura, many businesses will be worried about where to start and unsure of how to obtain the information they need to set their sustainability targets. But, as Jayne has said, once you drill down into the data you have available you should be able to set impactful, stretching and achievable targets which could make a huge difference to your business and its attractiveness to lenders when considering sustainable linked finance. Linked into this, many in the finance industry think that a lack of agreed metrics and standard reporting is holding back sustainability progress within organisations. Have you found that sustainability metrics and standards are inconsistent and has this affected your sustainability progress at Assura?

[9 mins 39 secs] From a reporting perspective on our finances, you set the framework and you work with the banks and the second party opinion companies to help formulate that framework so you're kind of all on the same page. If I actually look at other types of reporting so for example in our annual report or with shareholders that I think that is a problem and its because different investors use different metrics so is it the ISS metric, is it the GRESB metric, is it you know I can't think of the other one but there is a third one as well and every time we go and see them it's like well are you subscribed to GRESB, no we're not, we're looking at it okay well we only use that and we only use ISS and so for a company to sign up to all of those would (a) take up an awful lot of time and (b) cost us an awful lot of money so I think it is a problem and it must be a barrier particularly for smaller businesses because its which one do you go with, which horse do you back and I've heard that they're looking at standardising some of these because it is a problem but we're not there yet and it does cause amongst us as a business with investors when their expectations are different to what you can manage as well [11 mins]].

[NICK] Bruntwood have recently put a new sustainability linked loan in place so the target setting process is very fresh in the mind. Kate Lawlor the CEO of Bruntwood Scitech told us about her recent experience and views on the inconsistency around sustainability metrics and reporting and how it affected them[7].

[10 mins 36 secs] I wouldn't say it's affected our progress. I think we've made some really good inroads into measurement and reporting. If I think about the negotiation of the sustainability linked loan that we've just been through I think what was incredibly difficult is wider understanding of the practicalities of applying some of the targets and methodologies and terminology into real life you know you sort of you go about setting some of these targets and you talk about you know carbon intensity metrics and what that covers and an ideal world is the fact it wants to cover scope 1, 2 and 3 but the practicalities of achieving that are in some instances just kind of unachievable at this point in time, coupled with the fact that in a portfolio like ours which is pretty dynamic change, can come very very quickly and so I think that's probably been the harder element of it in terms of trying to apply relatively standardised metrics into a pretty dynamic environment that changes on a regular basis. But has it stopped any of our

[6] Jayne Cottram [10:57 – 11:31] [12:11 – 13:25]
[7] Kate Lawlor [13:40 – 15:05]

progress? No I don't think so. I think probably the bigger challenge for us was almost that baseline data because when you're having to go through that process I am going right ok well what is it, what's the baseline that we're starting from to know where we've got to improve? I think that's probably where our biggest hurdle came actually just making sure that that baseline data was collated and accurate which was no mean feat to be honest having never really had to record it to that degree before it was a very painful exercise [12 mins 27 secs]].

[EMMA] Following on from that, AG's research has shown that different finance providers prioritise different sustainability metrics. Our research has shown that banks top 3 asks are total tax paid, pay equality and diversity of board. This clearly falls more on the G side of ESG whereas Bruntwood's focus is more on the E of ESG. We asked Kate how much influence, if any, did the lenders have on the targets Bruntwood set.[8]

[13 mins 37 secs] Probably not very much because I think the targets that we'd already set ourselves were felt to be pretty stretching anyway and therefore it was almost more of a here's a menu of options of stuff that we're already doing that we think are stretching, which ones would you like to focus on and there was a bit of tweaking around the edges and some things were pushed here and peeled back there but broadly I think the bit that was reassuring for me was that when we were going through that process of picking the targets if you like picking the areas we wanted to focus on, the commentary that came back was that we were probably one of the more forward thinking and advanced clients that they had worked with on this which was great that was really reassuring and nice to know that we're doing a good job and we're heading in the right direction but did they have a huge amount of influence on it? No, not at all really [14 mins 40 secs]].

<u>CONCLUSION</u>

[NICK] A key takeaway for businesses is to make the right measurements for your business. Review your business and work out where your risks and opportunities are, so that you can work out what to measure and how to report on it. It’s important that businesses don’t leave this too late, robust sustainability reporting is already firmly on the radar of the finance sector and requirements will rapidly increase over the coming years. The Task Force on Climate Related Financial Disclosures reporting - which will become mandatory in just a few years - provides businesses with a useful framework, but only in the context of climate-related factors. The most robust strategies will take into account of other material impacts such as on people and communities and on nature.

And that's it for this episode. Thanks for listening, we've been Nick Parkin and Emma Whitehall. Tune in to our next episode when we'll be exploring the topic "no pain, no gain".

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[8] Kate Lawlor – [15:32 – 16:25]