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THE CRÉDIT AGRICOLE CIB ESG LOAN ROUNDTABLE

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CORPORATE & INVESTMENT BANK

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ESG loan market eager to bridge the transition to sustainability

How sustainability is redefining the world of finance is one of the crucial questions facing debt capital markets — in particular borrowers, banks and investors in the loan and leveraged finance markets.

GlobalCapital, with Crédit Agricole CIB, convened a group of borrowers and investors to discuss this fundamental question and explore the drivers behind the relentless march forward of ESG finance.

Participants highlighted the growth in popularity of sustainability-linked structures as a versatile tool in the loan market's arsenal, especially as a way to help companies as they embark on the transition to a low or zero carbon future — and even to hold them to account over KPI targets and commitments.

The speakers were interested in the prospect of regulation, and whether it could bring much-needed discipline and standardisation to the market, which all players would benefit from. The right kind of regulation, participants argued, would bring comparability, data and benchmarking and foster deeper liquidity and confidence in ESG finance. That might in turn reduce the cost of capital for borrowers and make the market more efficient.

The roundtable took place in mid-March. Participants were excited to see how the world would look after the Covid-19 pandemic. Most agreed it would be a more sustainable one, once economies began to feel the benefit from the vaccine rollout and exited from lockdowns, with a much greater focus on environmental, social and governance issues in every aspect of corporate life, as the urgency around climate change accelerated once more after being slowed down by the pandemic last year.

Participants in the roundtable were:

Emilie Bensimon, portfolio manager, private debt, Amundi

Koo Cho, head of energy and natural resources, EMEA debt distribution, Crédit Agricole CIB

Mark Ennis, director, capital markets, KKR

Pauline Fiastre, financing director, InfraVia Capital Partners

Gareth Hall, portfolio manager, global high yield, Barings

Polina Kargina, finance director, Yara International

Arnaud Létrillart, managing director, Western Europe loan origination, Crédit Agricole CIB

Sam Lukaitis, director, capital markets, The Carlyle Group

Darryl Murphy, managing director, Infrastructure, Aviva Investors

Antoine Rose, sustainable banking, Crédit Agricole CIB

Moderator: **Toby Fildes**, managing editor, GlobalCapital

GlobalCapital: **How has the Covid crisis brought forward or speeded up the ESG discussion?**

Polina Kargina, Yara International: On both the equity and credit sides, we spend much more time discussing ESG topics. A couple of years ago, it was a small part of the discussion during our capital markets day. Last year we had a specific ESG capital markets day, it is at the forefront of everyone's minds. This topic is also very dynamic on the regulation side. So we need the opportunity to properly communicate the development in this area.

Pauline Fiastre, InfraVia: I'm not sure it has speeded up our attitude to ESG since ESG development was already high on our agenda. The crisis is a real-time test of our investment thesis around sustainability of infrastructure assets. Covid-19 showed that infrastructure assets are really essential and critical — hospitals, telecoms networks, utilities, transport, energy production, for example.

Of course, Covid-19 has some impact on certain sectors such as transport. But in general infrastructure assets have remain solid and resilient amid the crisis. It also gives us the opportunity to think about some of the next steps — addressing further environmental, social and governance impacts, looking for further innovation, or investing in cleaner transport solutions, for example.

So yes, it is a test, and is also an incentive to do it even better.

Sam Lukaitis, Carlyle: It's a very interesting question. We've always had a significant focus on ESG. Going back 12 to 15 months, was there really a dialogue around ESG in the sub-investment grade credit world? Not really. That has really overlapped with Covid.

Sam Lukaitis
The Carlyle Group

Has Covid been the catalyst for accelerating that discussion? Potentially. We've had other, broader social justice issues bubbling up during Covid as well. I think it certainly has overlapped and probably has accelerated the dialogue to a degree.

Darryl Murphy, Aviva: I don't think it has particularly speeded up the conversation or awareness, in fact it has probably indirectly held up the conversation around climate change. Look at how COP26 was delayed last year. However, you can't fail to notice how much pressure COP26 is putting on governments and corporates, if you look at the number of people now coming out with Net Zero Carbon strategies. I don't think that's driven by Covid.

That's driven, in a sense, by what Covid is waking everyone up to, which is the impact of climate. It has probably indirectly been the kick up the backside that everyone's needed, to say we need to get on with it.

GlobalCapital: What the Covid crisis did last year was give a kick to the social part of ESG — if you look at the sharp increase in social bonds last year you have to say the 'S' was a core part of the capital market's response to the Covid crisis.

Arnaud Létrillart, Crédit Agricole CIB: 2020 was an extraordinary year, because green and sustainability-linked loans had taken off and suddenly they stopped. The focus was really on providing short term liquidity lines to our clients. And for five months we did nothing but that. Obviously all the short term liquidity lines didn't have any ESG components. But after a short pause, I'm glad to say that green and ESG loans are coming back in a big way — now, most of the loans we are arranging have some ESG component.

Arnaud Létrillart
Crédit Agricole CIB

Koo Cho, Crédit Agricole CIB: There is a world after Covid, but we are seeing a bifurcation between sectors that are Covid and recession-resilient — renewables and infrastructure, for example — and those that are more exposed, like airports, transport, retail and hospitality.

GlobalCapital: Why are borrowers and sponsors choosing sustainability-linked and green loans?

Kargina, Yara: That's an interesting question. For Yara, which is a company that provides crop nutrition solutions, we have had sustainability embedded in our mission for quite a long time — it has impacted a lot of our strategic development actions in recent years.

Of course the carbon transition has been an important topic. As a producer of ammonia, we are looking at green ammonia alternatives. On the farming side, our food chain business, we are providing solutions to improve the carbon footprint, mostly Scope 3.

So for us, translating our strategic goals and communicating that story on the financing side has been an important development. It involves committing ourselves to strategic targets, which is in itself an important decision for the whole company.

Our first step was issuing a revolving credit facility, which made a clear statement on our commitment to reduce our carbon intensity. Using the sustainability-linked structure means our financing now goes hand in hand with our overall sustainability strategy.

Lukaitis, Carlyle: We've had a big focus on ESG going back a decade, albeit under different nomenclatures. In more recent times we've had an opportunity to work with management teams of certain companies we invest in and translate some of these concepts and formalise them into our capital structures.

That reflects our focus on these objectives and is a way to create a kind of benchmark for success and set ourselves targets to hit.

Mark Ennis, KKR: Sustainable finance should provide us with wider and deeper access to pools of capital. It's also a way to really publicly demonstrate our commitment to ESG goals, ambitions and targets on a portfolio company level.

Porfolio company ESG disclosure will be one way in the public domain where we, KKR, are scrutinised by our debt investors. That public scrutiny is going to pressurise private equity backed companies to deliver on material and ambitious goals.

And hopefully all that then feeds back to the credit quality of our businesses, which will hopefully be reflected in our cost of funding and access to capital.

And all that, ultimately, leads to a rerating of valuations of our businesses when we seek to exit. It's all about creating more transparency around our businesses and then building up a greater level of trust with the capital markets.

GlobalCapital: What Mark is describing — how an issuer must present its ESG credentials going forward — is that going to become essential to debt investors?

Murphy, Aviva: I'm slightly nervous about the terminologies of green loans and related products. There are things which are maybe not so ESG-friendly, but are being described as such.

Institutional investors are arguably a bit different from the bank market. For us, there's an ESG threshold. We have a single measure, which is things having to meet ESG metrics.

Another really interesting area is sustainability-linked loans. We've used this recently in real estate debt. We have noticed an increasing demand from borrowers to agree to link the performance of the loan to measures to decarbonise the assets.

But from where I come from, the infrastructure world, the problem is twofold. Firstly, the assets in many cases don't necessarily have the same characteristics — you may not be investing in infrastructure assets that need to decarbonise, for example.

But even where you do, what might hold the structure back is the fact it's an incredibly competitive, liquid market. This deep market means borrowers might not feel so compelled to sign up to a sustainability-linked loan that is more complex.

Maybe we're coming to a tipping point in that direction. But I still think we're in the foothills of it becoming a more widely accepted concept in the infrastructure sector.

Fiastre, InfraVia: As a private equity infrastructure investor, for us, sustainability is not just a nice-to-have part of our investment strategy. It is a deep conviction that sustainability is a core part of our investment strategy in resilient infrastructure. It is a way to increase the lifespan of the assets we invest in, and create long-term value.

Recently we have adopted a UN Sustainable Development Goals-based approach to measure and develop the impact of our investments — whether we invest in green assets like renewables, or other essential infrastructure assets that need to decarbonise. It's all about making progress and building resilience.

This conviction is something we have shared with our investors and portfolio companies since our beginnings. So for us to borrow under a sustainability-linked structure is a way to share it with our financial partners as well.

Gareth Hall, Barings: We're seeing sustainability structures now being very prevalent in the syndicated leveraged loan market.

Generally, I think it's a fantastic development. It's great that borrowers are able to start to provide the relevant data to investors. Given demand is high for these products, it can also have a benefit for the cost of capital.

The important thing going forward is to make sure the KPIs [key performance indicators] are as relevant and as high quality as possible and are really making tangible changes for those businesses from a sustainability perspective. The structure is obviously in its infancy and will develop over time.

Emilie Bensimon, Amundi: We target mid-market borrowers in particular. While we have been integrating ESG in our due diligence process since 2014, we have seen dramatic changes over the last two to three years in the way our issuers approach sustainability.

Emilie Bensimon
Amundi

They are hiring people dedicated to ESG topics, they are defining their sustainability strategies with full involvement and support from top management and they are much more open to discussing ESG.

It makes our job much more efficient. Given that we work with mid-market companies, often family-owned, this level of transparency and sophistication with regards to ESG has not always been easy to achieve.

But we have seen a change triggered by the different stakeholders of the borrower. But also it has come from their investors, who are pushing for more transparency and sustainability. We welcome all this change and are very happy to support our clients in their sustainability journeys through green loans and sustainability-linked loans.

Létrillart, CACIB: At Crédit Agricole CIB, we started with the bond market and have expanded the ESG approach into the loan market.

For us, ESG is pretty much part of the credit risk. We are helping our corporate clients — who are often doing a lot already — to tell their stories to their lenders, by embedding the sustainability KPIs into their loans.

Cho, CACIB: ESG is just part of everything we do nowadays — and it comes from all sides. The client now has the expectation that there should be an ESG angle, we at the bank are focused on ESG at all times and of course our investors and lenders have that expectation of seeing some sort of ESG angle in the debt products.

Sometimes I find myself wondering where it is all coming from. Of course, it is clearly a combination of things — regulation is one key driver. But the urgency around climate change is real — there are actual credit risks related to physical damage, such as weather disruption to supply chains, for example. Then there is growing public pressure, perhaps even shaming, on how you deploy capital — I'm very aware of that covering the oil and gas sector. But it has become absolutely central to how we approach our business.

Antoine Rose, Crédit Agricole CIB: Crédit Agricole CIB set up its Sustainable Banking team more than 10 years ago in order to develop Sustainable Finance products for our clients. This team of experts is now supported by a 100+ co-ordinators network spread across all the business lines and regions of the bank.

We are seeing very strong global momentum for ESG finance. We now have a full range of ESG products for our clients, the latest one being sustainability-linked finance.

GlobalCapital: So how is sustainability redefining loan finance, particularly through sustainability-linked loans? And what are the incentives for banks to participate in these financings?

Létrillart, CACIB: At Crédit Agricole CIB, the coverage and financing teams have yearly targets for the origination of green and sustainability-linked loans, with a targeted discount on liquidity charge back allowing to improve the profitability of the loans.

The objectives are to double the size of the green loan portfolio by 2022 and to include ESG criteria in 100% of the large corporates financing activities and gradually for SMEs.

Ennis, KKR: Does that help your cost of capital or do you just look at it as better credit quality when you book those loans?

Létrillart, CACIB: We look at it from a credit quality perspective. But maybe Antoine has more to add here about the special tool we have?

Rose, CACIB: These loans are subject to specific monitoring under the control of the sustainable banking team. They benefit from a favourable internal liquidity cost, to help increase the share of environmental loans on the bank's balance sheet. We do this by refinancing these loans in the bond market by issuing our own green bonds. We have committed to building up our green portfolio to €13bn by the end of our medium term plan at the end of 2022.

GlobalCapital: Do you think over the next couple of years the European Central Bank will mandate an official form of subsidy, perhaps in the form of beneficial capital weights, for green financing?

Ennis, KKR: That's a really good question. Clearly, climate change and the broader green agenda is being driven strongly at the legislative level in Europe. There are a number of ways to incentivise and drive that agenda in Europe and that doesn't have to be purely driven by government.

Sustainable and green financing is an obvious way of incentivising corporates by lowering their cost of capital. Therefore, it is quite likely, we will see some form of subsidy or benefit provided to the European banking sector. Though given the developments in the broader market to date, we can see that pension funds and large LPs have been just as successful in pushing this agenda with the broader debt capital markets within Europe.

GlobalCapital: This is a question to our investors: How do you compare use of proceeds loans with sustainability-linked structures? Do you prefer one over the other?

Murphy, Aviva: The ability to structure sustainability-linked loans is actually quite limited in the infrastructure space. Use of proceeds is a different concept. I do exercise a bit of caution around this, because, from what we've seen so far, they're not really bringing anything different — just rebadging something, which is a general obligation bond or loan.

We're still struggling a bit with typical infrastructure assets — anything over and above a simple test of: does it meet ESG requirements or not — against the unwillingness of borrowers to have something more prescribed, particularly in the area of sustainability-linked structures.

Bensimon, Amundi: We have funds that invest in green use of proceeds debt and we have money invested in sustainability-linked finance too.

Sustainability-linked financings are currently preferred by the mid-market issuers in the private debt market, for two main reasons.

The first is that smaller issuers do not necessarily have the project size to issue a green instrument. So they favour the flexibility the sustainability-linked format gives them.

The second reason is that sustainability-linked financings are a great incentive tool for issuers internally, as it allows them to translate their ESG strategies into concrete gains, because if their KPIs are met, they can have a discount in the pricing of the loan.

We have heard about that a lot — an alignment of interest between employees and the company's ESG strategy is valued by issuers.Last year, in the Euro private placement market, sustainability-linked financing represented 78% of total issuance, whereas it was more like 20% in 2019, so a huge rise.

Green financing, by comparison, benefits from greater transparency. In the mid-market, they can easily be implemented on green sectors, which have a huge need for financing. We have seen renewable energy companies coming to us, agro-food companies, all these sectors for which it's very easy to implement a green financing.

The two types of financing are complementary and that's why we are active on both.

Cho, CACIB: On your question about what the incentives are for banks to finance green deals, I think the ESG is a really great layer on top of what should be solid credits.

Koo Cho
Crédit Agricole CIB

For example, in the infrastructure world, when you look at renewable projects, you can't get greener than that. But ultimately, investors are looking for great credit deals.

As much as we want to do good in the world, renewables deals, for example, where you have contracted revenues from regulated tariffs and they are senior secured, are a fantastic asset class. Even before the ESG or green angle, as an asset class, some of these renewable projects are really robust from a credit point of view.

Murphy, Aviva: What we're describing here is great for borrowers. The end product of what Koo is talking about — great credits with a very attractive green layer on top — results in intense liquidity. Everyone wants the asset class for its green characteristics and that drives down pricing for the borrower.

In our mind, it makes it challenging from a relative value point of view. It's maybe not so good for debt investors, but it's a function of the demand for that type of asset.

GlobalCapital: Sustainability-linked loans are a key part of everyone's world now. But how should a borrower or sponsor go about determining the right KPIs to use?

Polina Kargina
Yara International

Kargina, Yara: Materiality is an important factor. The KPIs should reflect the core parts of our strategy of how we are improving. It needs to be something that is quite recognisable and understandable externally — transparency and explanation of the measurement are important.

GlobalCapital: Are banks and investors being effective in making sure the KPIs are sufficiently demanding, because that has been one of the criticisms occasionally — that some companies' KPIs just aren't hard enough?

Hall, Barings: I think you hit the nail on the head about how prevalent this structure is becoming. Pretty much all new issuance in the syndicated leveraged loan market has an element of sustainability-linked margin or KPI in the capital structure.

Investors I speak to, and internally, we're becoming more sophisticated about how we analyse those metrics. It's critical, as this market develops, that those metrics are broad and sufficiently challenging, but realistic for the issuers, and they really focus on the key sustainability risks of that business or sector. As opposed to easy wins for a company.

Analytics around that will become more and more sophisticated. It's certainly something we're developing internally.

Fiastre, InfraVia: We signed a sustainability-linked loan with Crédit Agricole as ESG co-ordinator in January. This was in relation to an existing facility at the level of our funds which bridge the capital payments we receive from our LPs. We amended an existing one of these into a sustainability-linked facility. What we had to do was to select a number of ESG KPIs and make sure they were sufficiently demanding, because that's the whole purpose of it — we need to have ambitious targets but that are still achievable and make sense.

As part of our investment process, once we have invested in a company we set up an ESG assessment, strategy and roadmap, with selected ESG KPIs to monitor it. For this sustainability-linked loan, we selected five ESG KPIs, which are implemented consistently across our portfolio of companies, such as gender diversity, carbon footprint, health and safety or cybersecurity, which is a governance-essential part of our Sustainable Development Goals assessment, and which we see as critical to the robustness of our infrastructure assets. Because we are developing these in real life, I think they were acceptable for the banks as the relevant ESG KPIs.

Ennis, KKR: As Gareth outlined earlier, there's a big debate right now in the sub-investment grade market. Overall, it's a good development, but it's nascent and there are going to be teething issues and a lot of debate around how ambitious and authentic the KPIs are.

Mark Ennis
KKR

But there's an inherent effort from both the issuer and lending sides to try to agree on a common set of KPIs in different industries. That will take time, clearly.

For instance, we are very hesitant to roll out a sustainability-linked term loan, just for the sake of the marketing that goes with it. It has to overlay a broader and established ESG framework within a business, and not just be done just for the sake of driving an ESG agenda, because it's suddenly the buzzword in the market.

We've spent time on this, and have done a handful of these structures, where the portfolio companies have established KPIs, and can demonstrate that the KPIs are ambitious targets that are not just 'business as usual' that would be hit automatically. They've got to be ambitious. These ratchets should go both ways as well — up and down — so it's not just one-way traffic, which perhaps has been incorrectly the focus so far from investors.

There is genuinely an alignment between issuers and lenders, but it will take time for us to get to a common ground. It's probably a longer debate as to comparability and data and how the overall market can get comfortable with this structure.

GlobalCapital: But do investors really care about the margin ratchets, given that so far they tend to be only up to 25bp, or in other cases 5bp, in either direction?

Murphy, Aviva: We definitely care! You still have to look at your investment metrics.

We have yet to do this in infrastructure. However, the problem I have is that I'm not interested in targets that are effectively business as usual. I'd find it pretty hard to see KPIs linked to the social and governance sides, because we would take those levels of performance as necessary, as a basic standard that borrowers would be expected to meet.

To be honest, if you're going to move the dial, you're got to be talking about carbon reduction. That's what we should be driving. I'm not really that interested about anything else. We should be striving to create something that's holding borrowers to account around their efforts to reduce carbon.

Bensimon, Amundi: KPIs are important, and they need to be specific. We've been helped by the ICMA Sustainability-Linked Bond Principles, published last year, which have been very helpful in standardising the process.

We favour adding margin ratchets that are ambitious enough, by which I mean between 10bp and 20bp. In case of missing ESG indicators triggering an interest rate premium, the standard is for the borrower to reinvest the 'premium' so that it could fix the problem, to cure the underachievement.

However, we think we should consider receiving part of the interest rate premium if a borrower does not hit a KPI, because we see it as an increased credit risk. We see it as fair reward for taking this risk.

Fiastre, InfraVia: Emilie's point is a very interesting one. Because you can question why a bank or debt investor should get to make more money out of the failure of a borrower to meet its ESG KPIs. But I agree with Emilie — deviating from the set targets results in an increase of the risk profile. And if there is an increase in risk there needs to be some form of compensation for it.

Cho, CACIB: This is a really big subject, a bit like Pandora's Box. There needs to be a fine balance of ensuring KPIs are ambitious and material, but also achievable.
To Darryl's point about carbon, I sometimes wonder how much importance we should give to each one of the 'E', 'S' and 'G' letters. When you think about carbon, a lot of drivers are regulation, public perception, doing good. But climate change for me is a massive driver. The 'E' for me is extremely important in any KPI discussion.

GlobalCapital: Koo, given your expertise in the oil and gas industry, what role will sustainability-linked finance play in the energy transition?

Cho, CACIB: Actually, I'd quite like to put that question back to the investors. Covering oil and gas and also power and renewables, I see the whole range of how investors channel capital into the oil and gas sector — from one extreme that is exclusion to the other extreme of still investing in fossil fuels such as coal (although this is one specific investor and perhaps a bit of an outlier).

But in between, you have a vast range — shale, upstream, LNG, pipelines, regulated gas utilities etc — and the approaches are very different.

But oil and gas is going to have to be part of the solution. We know that we cannot just turn it off, because all the lights would go out. So I'd be interested to hear what our investors think, how they view the sector and what approaches they are taking. For example, do you think divestment is the right approach?

Murphy, Aviva: Koo sets a very good challenge there. Our approach is that ESG is fully integrated — it's embedded into the investment decision. We've had a number of situations in the midstream oil and gas space, where, on an ESG basis, some assets may be accepted over others, normally on the basis of whether the borrower has a sufficient transition plan, and is it accepting that it needs to change its assets over a period of time. Where issuers have no plan, and we don't feel they've really taken it seriously, then we wouldn't invest, full stop.

Darryl Murphy
Aviva Investors

The mood music for us is that it's becoming increasingly difficult to do an oil and gas transaction.

Sustainability-linked loans could play an interesting role as that bridge, because it would be much easier for me to sell internally that we are effectively impact investing, actively holding an issuer to account to transition, rather than them just saying some soft words that they are trying their best and they've got these policies in place. So it can play an important role.

Hall, Barings: I'd agree with that. At Barings we're very focused on transition, on engagement, which is critical with the companies we invest in. And I agree that sustainability-linked loans or bonds provide a neat solution to funding some of these companies where that could become increasingly difficult from a sector perspective.


Gareth Hall
Barings

GlobalCapital: How near are we to a situation in which these companies might not be able to raise money unless it is for a green use of proceeds or a sustainability-linked piece of finance?

Murphy, Aviva: It's real. We made our position clear in listed equities that if big oil and gas majors don't take action, and don't make clear what their carbon plans are, we will divest. And that will follow through to the debt markets as well. So that is the trajectory and no one can be complacent on this.

Cho, CACIB: Investors are much more aware of how they are going to be perceived, depending on how they deploy money in this sector. I do think transition loans, sustainability-linked loans and communication with respect to a clear plan to transition may help channel equity or debt into the sector. Whether we like it or not, society is run on oil and gas and therefore it has to be part of the solution.

GlobalCapital: Polina, Yara is not in the oil and gas sector. But in the future will all your finance have to be in one way or another ESG-linked?

Kargina, Yara: It's difficult to predict. But right now, these types of financing instruments are getting more and more attention. Meanwhile, companies are beginning to take a more holistic ESG approach to the business. So, while it is difficult to say, financing will evolve as companies' ESG requirements evolve.

GlobalCapital: So far we've talked about how people's attitudes are changing and shaping behaviour. But how will regulation drive the market? Do you think the EU Taxonomy will help or hinder the sector?

Ennis, KKR: We welcome regulation because it's going to shut down the wild claims of sustainability out there. For example, at the moment a company can slice and dice its carbon emission numbers a dozen different ways. So as an institution we welcome that everyone's brought to bear on a similar level, especially around comparability, data and benchmarking.

Fiastre, InfraVia: The Taxonomy is really interesting, it's a good step, even if today it's only focused on climate change mitigation and adaptation. It doesn't cover all the universe of infrastructure sectors yet. For green infrastructure, there is a definition of thresholds and metrics, and it helps avoid greenwashing. It sets a clear mission with targets.

It's also helpful for debt investors, as compliance with Taxonomy is a labelling in some way, so it's good for increasing the appetite for assets compliant with it.


Pauline Fiastre,
InfraVia Capital Partners

It might however shift some capital or appetite away from essential sectors which are still not covered by the Taxonomy, so while we think it is a good step forward, it is important that the Taxonomy widens to incorporate more criteria beyond climate change, and this should be the case in the near future, notably with the inclusion of social criteria.

GlobalCapital: But you could argue that the green finance market has grown very nicely over the last 10 or 12 years without specific regulation or a Taxonomy. Why do we need something that's going to contain it or restrict it?

Murphy, Aviva: I agree wholeheartedly with what Mark was saying about it bringing standardisation and shutting down wild claims.

The Taxonomy is fine. But there are always going to be problems and debate around certain sectors, or subsectors. One example is the debate around nuclear, where it quite critically hinges on whether it falls into EU Taxonomy or not.

I am a fan of standardisation on this, because there are too many different methodologies out there. Data is an enormous issue. No one really knows how to collect data, there's no standardised approach in terms of what we should be measuring and how. The market needs guidance as much as possible.

So that's why I'm a big fan of more regulation rather than less. That's the only way in which we're going to take it from where we are today into something that's much more mainstream.

Bensimon, Amundi: Yes, data is key. As an investor, when we need to report to our LPs, there are as many ESG reporting terminologies as we have LPs! So adding standardisation of what we measure would be of great help.

Lukaitis, Carlyle: It's going to be really interesting to see the EU Taxonomy in action.

On the other side of the discussion [about standardisation], we've never back-solved [external] ESG metrics into a business. The things we have focused on and translated into the capital structure have been sustainability objectives that management has been focused on for a long time, often really key and in some cases, quite unique to that particular business model.

The Taxonomy is interesting, very helpful, and can probably enable more of a like-for-like read-across within sectors. But there's also merit in assessing each business in its individual light.

For example, we have just agreed to exit a packaging business that has recycling standards and objectives it's trying to meet, but does produce plastic bottles. But the really unique thing about it was that it operated an on-site model. So instead of driving heavy liquids around and having lots of secondary packing, all the packaging was being done on site.

So we worked with management on trying to figure out, if this company did not exist, what the net carbon impact would be from a competitor moving into the space, and it was CO2 emissions equivalent to 8,000 transatlantic flights, which we thought was really impressive.

So while the Taxonomy is going to be really interesting and helpful, you do still need to peel back the layers a little bit and work out, beyond the external perception, the true sustainability proposition of the underlying business model.

GlobalCapital: Is there a danger that the Taxonomy might just stop people from being bothered to do that?

Lukaitis, Carlyle: I don't think so. We'll continue to be really focused on each individual company that we're thinking about acquiring and assessing it in its own right and thinking about it, benchmarked to its peer set. Clearly, the Taxonomy is going to provide more of a framework for that thought process. But I don't think it's really going to alter our approach.

Hall, Barings: The way we approach credit is always company-specific. You have to look at the fundamental credit risks alongside the key sustainability risks. All of that is encompassed into your investment view, and that's not going to change with the Taxonomy.

Equally, it does bring with it an additional push on data and disclosure in the sub-investment grade market, which everyone has been asking for, for a long time. So that side of things will improve with this regulation. But it's still fundamentally critical to look at businesses on a case-by-case basis.

Cho, CACIB: In my opinion, this huge wave of ESG and sustainability is coming because people know that regulation is coming too. Regulation is one of the key drivers of what's making everyone so focused on ESG. This is a result of many things, including the consequences of nations making pledges towards the Paris Agreement.

GlobalCapital: Do you expect there to be more innovation in this market, and if so what sort?

Rose, CACIB: Globally, sustainable finance is heavily linked to innovation. Both use of proceeds bonds and the sustainability-linked format are innovative in their own ways. With use of proceeds bonds the transparency is a form of innovation.

But we need more innovation, especially around the collection of data, as that will help investors to better compare and contrast and help them make investment decisions.

Antoine Rose
Crédit Agricole CIB

Létrillart, CACIB: Do we think that borrowers will be willing to disclose these data?

Kargina, Yara: Yes, it's important. Transparency of how the metrics are derived is important for us and with more standardisation and more clear definitions of data it will also be easier to collect the information that needs to be presented.

Bensimon, Amundi: In the mid-market, we are really thinking about standardising processes. Issuers receive a lot of demands from investors, and they're all different. One investor will have one questionnaire and reporting requirement and another investor will have another. So we are trying to think how we can standardise this, to be faster in the due diligence process and in monitoring during the life of the credit. While it's not exactly innovation, it is at least progress.

Murphy, Aviva: I agree with Emilie that there's a desperate need for standardisation. There's no stopping the momentum now. At the moment, it's very difficult for issuers, who are in danger of getting swamped by information requests, as lenders and investors have long lists of questions that are often completely different. So this has to change fundamentally.

And there has to be better use of data — not the 30 page questionnaire where, at the end of the day, you're not really any richer in terms of information.

The one area of real innovation could well be sustainability-linked loans and how they could play a crucial role in the energy transition. This is something that might be truly innovative, because asset managers are going to see the demand from their clients for green assets sharply increase.

This is ultimately going to come from the consumer. Those pension fund investors are going to have more pressure on them from their trustees, from their members. So this is going to go right back to the person in the street, who is going to want to know more about how their money is being invested. That's why it's important to get this reporting right.

GlobalCapital: We've talked about achieving a fair balance between the borrower and the lender or investor in terms of the KPIs being robust but achievable. Is that a balance that will ever be struck?

Murphy, Aviva: I like to think there will be some pragmatism. Maybe this is an area where regulation might help — just to point people in the direction as to what is particularly important. I'm sure borrowers would welcome that.

Lukaitis, Carlyle: It's quite exciting to be able to innovate. We've just put in place a revolving credit facility that has a use of proceeds construct around it. Sitting with the management team and doing a teach-in of their new facilities after the buy-out and what they have access to, we ran them through all the detail and explained to them that if they drew down the capital for a purpose that was going to reduce the company's CO_2 profile then there would be a cost saving attached to it.

That's a good dialogue to be having and it focuses the mind — it gives quite a lot of practical reality to the whole discussion. You can see management thinking, 'OK, what are some examples of the things I can do in this regard?'

Fiastre, InfraVia: A key part of the evolution is striking the right balance between the ambition of the ESG KPIs and making sure that management and staff have bought into them. As Sam says, the practical application is important, as they open up people's eyes. GC