CASH WITH A CONSCIENCE –
THE POST-GLOBAL FINANCIAL CRISIS ERA
Sustainability, Corporate Social Responsibility (CSR), Environmental Governance and the fast world of private investment and M&A's are perhaps not considered the most natural of bedfellows. However, the continued fall-out from the Global Financial Crisis (GFC) is that cash, whether from equity or debt, comes with broader questions.

Questions such as whether the cash will increase the carbon footprint, or be used to create pollutant assets, or acquire businesses with scant regard for human capital conditions. They also include corporate governance, corruption, staff turnover and the use of natural resources.

Our research of sustainability practices and reporting of the world’s leading 50 financial institutions, found that cash used for debt provided by the global banks, had more of a ‘conscience’ than the investor’s equity.

In our day-to-day operations, our leading financial industry clients are commissioning us more and more to monitor compliance with the Equator Principles on major infrastructure deals. On the other side of the deal, our Real Estate investor clients are reporting increasing rigour and greater challenge from their banks with respect to the environmental terms of their finance.

Interestingly, European investors appear to be more committed to environmental and sustainability criteria than their US counterparts.

Whether this is a consequence of ‘implicit’ (source Matten & Moon) CSR policies backed by government legislation, or a consequence of a different, geopolitical zeitgeist is yet to be seen. However, we do predict a global trend, where the lines between creating value for business and shareholder return, and creating value for global communities, will be closer than ever.

OUR RESEARCH
Arcadis researched the world’s top 50 financial institutions. This included banks and investors separating out Limited (LP) and General Partners (GP). We focused on their reporting transparency concerning sustainability impact and performance from their investments and debt. In short, this was both the non-financial and the financial performance of Environmental, Social, Governance (ESG) issues.

The primary focus was on European and US based institutions.

WHAT IS ENVIRONMENT, SOCIAL, GOVERNANCE (ESG)?
INCREASING INDUSTRY FOCUS ON ENVIRONMENT, SOCIAL, GOVERNANCE CRITERIA

Working closely alongside the world’s leading financial institutions, it is apparent that ESG criteria are becoming an increasing priority. They are essential to ensure that, through meeting key criteria, the internal ‘house is in order’. Increasingly, our research demonstrates that ESG principles are being applied to determine how we, as a society, create and share value in our organisations through sustainable deals, in the communities in which we live and work.

Our research indicated that over 200 institutions have signed up to the UN sponsored body; Principles for Responsible Investment. If the Global Financial Crisis gave the investment industry a temporary excuse to pay lip service to ESG, then our research demonstrates that this time is clearly coming to an end.

Four recurring themes were evident in our research, as outlined in our findings that follow.

1. DEBT FINANCE HAS MORE OF A ‘CONSCIENCE’

90% of the global banks researched measured sustainability related impact and performance. Interestingly, this measurement covered their revenue producing front-office activities as well as their back-office corporate governance responsibilities. Not only must banks operate sustainably in their own operations, but their products must apply the same principles.

The formal reporting measures covered a mix of:
- Carbon Principles
- Equator Principles
- Green Bond Principles
- United Nations Principles for Responsible Investment (UN PRI)
- Natural Capital Declaration.

These metrics can be broadly classified under the industry known terminology; Environment, Social, Governance (ESG).

Alongside this, 70% of these banks reported against the Global Reporting Initiative (GRI). This measures sustainability-related impact and performance, linked to the business practices of the banks.

Interestingly, our research did not find the same levels of reporting and transparency from the Limited Partners and General Partners.
2. EUROPEAN INVESTORS ARE DEMANDING MORE THAN THE US

Results differ by region with European lenders appearing to be ahead of the curve; more likely to use responsible investment guidelines than the US and more likely to be UN Principles for Responsible Investment signatories. Overall, the region performs 50% better on sustainable investment across many factors, including:

- Having and publishing a sustainability statement
- Appointing a senior person responsible for ESG
- Keeping a strong focus on environmental impact reporting

There could be a number of reasons for this discrepancy, such as, North American banks focusing on internal over external measures, a simple difference in the geopolitical climate, or perhaps a difference in regulatory and legislative procedures.

Whatever the reason, we don’t envisage this gap to be sustainable. With three of the world’s leading global, US based banks Citigroup, JP Morgan and Morgan Stanley as key sponsors of the Carbon Principles, there is clearly a drive towards enhanced due diligence in connection with funding for both source-energy and energy-generation projects.

We believe such initiatives will eliminate the gap in apparent commitment between European and US investors in as early as the next three year business cycle.

With an increasing focus on driving economic growth for both business and the communities in which they operate, synergistically, we can expect even greater focus on ESG principles, linked increasingly to driving financial return.

3. HIGHER RETURNS CAN BE ACHIEVED WHEN APPLYING ESG RELATED CRITERIA

Interestingly, research showed that an increasing number of funds reported higher returns in the long-term from their investments when ESG related criteria were applied. Funds such as Amundi are leaders in this area.
4. IT’S NOT THE INVESTORS’ ESG REQUIREMENTS THAT MATTER, IT’S THE BANKS’

To date, most LP and GP investors have focused inwardly on matters relating to sustainability. They are more likely to produce sustainability reports on their internal actions than the performance of their investments.

The evidence from our research clearly indicates that the banks have greater ESG requirements and transparency than the investors, whether LPs or GPs. This means that some investors may be surprised by the terms applied by the banks when it comes to financing transactions or investment programs.

Some investors may find that they are subjected to “ESG risk” premiums from the banks. At worst, they may find banks are unwilling to provide debt finance full stop.

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LP AND GP REPORTING MEASURES THAT ARE BEING ADOPTED

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WHAT DO WE EXPECT TO HAPPEN NEXT AND HOW WILL THIS IMPACT FUTURE INVESTMENTS?

A closer collaboration pre-transaction is required between investors and their funding partners to understand the ESG terms of the debt finance, in order to avoid disappointment and ultimately lower returns on equity.

Whilst both GPs and LPs are signing up to principles for responsible investment, and memberships are working towards better sector-wide approaches to responsible investment, without a joined-up approach it will be difficult for a universal ESG standard to be reached. ESG is a standard that clearly articulates the criteria which investors should use in selecting and monitoring the conduct and performance of projects funded by third parties.

AN OPPORTUNITY

The renewed focus from key lenders presents an opportunity for a new global ESG industry standard to be created. See our suggested ESG checklist. If asset performance data can be collected, this should help promote the long-term financial benefits to investors from the use of ‘cash with a conscience’.

The message is simple: if equity funds want easy access in future to debt finance for their investments, they need to start measuring ESG based on the metrics of their banks, not their investment partners.

THE ESG CHECKLIST: CONSIDERATIONS

1. Environment
   - Existence of policies and certification
   - Natural resources consumption (incl. water)
   - Energy efficiency
   - Carbon management
   - Impact to the environment (air and water emissions, waste)
   - Development of green products and service
   - Contaminated land risks
   - Soil and groundwater potential and known liabilities
   - Bulk chemical storage
   - Environmental permitting and compliance
   - Building contaminants
   - Flood risk

2. Social
   - Existence of policies and certification
   - Health and safety
   - Staff turnover and absenteeism rate
   - Training and qualification of workforce
   - Maturity of workforce
   - Social climate
   - Relationship with business partners
   - Employee diversification

3. Governance and ethics
   - Compliance with applicable laws
   - Corruption
   - Role and responsibilities of governance bodies
   - Transparent financial communication
   - Litigation risks
HOW CAN WE SUPPORT YOU?

Arcadis is the leading global Design & Consultancy firm for natural and built assets. Applying our deep market sector insights and collective design, consultancy, engineering, project and management services we work in partnership with our clients to deliver exceptional and sustainable outcomes throughout the lifecycle of their natural and built assets. We bring greater transparency to clients on both ESG costs and long-term performance benefit. By supporting your discussions with banks, we ensure that finance is available without an “ESG risk premium”. Our global expertise in assessing, reducing and monitoring environmental risk, coupled with our deep asset knowledge, and experience advising financial institutions, enables us to deliver exceptional and sustainable outcomes for our clients. www.arcadis.com. Arcadis. Improving quality of life.