Mind the Gap!

Overcoming Obstacles to Short-term ESG Investing

While treasurers have repeatedly shown interest in using ESG-related short-term investment instruments, actual investment levels have yet to match these aspirations. Recent research from ICD explores the gap between intention and execution in treasury investments.

Environmental, social, and governance (ESG) has risen up the treasury and finance agenda in recent years, with banks and financial service providers expanding the number of ESG-related products made available to corporate treasurers.

The short-term investment space is an area where many will have seen an increasing number of funds marketed as 'ESG'. For example, out of all of the investment products available on independent portal provider ICD, almost half (49%) are tagged to either ESG products or diversity and inclusion (D&I) products, with this representing around 30% of total assets.

By **Ben Poole**,

Columnist.

However, in ICD's 2021 ESG Survey,[1] published in July this year, an interesting wrinkle in the approach of treasurers to ESG investments emerged. While treasurers overwhelmingly stated their intention to invest in ESG short-term funds - with 46% of treasurers currently invested in such funds, and another 44% planning to invest in the next 12 months - ICD's platform told a different story.

Justin Brimfield, Chief Marketing Officer, ICD, explains: "In our 2020 annual client survey, we asked about ESG investments versus intended investments in this space. We found light investment but a powerful indication that companies were moving in that direction. Then, in 2021, we asked the same question, and while interest continued to build, we could see on the portal that the actual pace of investment was not in line with 2020's results. We didn't see the money come into those funds, and yet the intent was still high."

ICD Portal has around $200bn in assets and sees approximately $5tr. in trades every year, providing it with a clear market perspective.

"We found some fascinating insights into where things were getting stuck in the ESG investment process," notes Brimfield.

The search for ESG standards

The main perceived obstacle to treasurers investing in short-term ESG funds identified by the ICD survey is the lack of standards to evaluate the various offerings in the market. This was a problem for 46% of the treasurers polled. One significant area where lack of standardisation is evident is among the ratings agencies.

"The models of the major ratings agencies are tried and true, and corporates are used to seeing tight correlations between how the different agencies rate the same bond," says Brimfield. "However, in the ESG space, the ratings of the different agencies for the same products are wildly different, which presents corporates with a major challenge. It's why companies often struggle to find products that meet their needs. Some of those organisations that have moved into ESG investments have developed their own methodologies for evaluating various ESG investments but this has proven to be a time consuming effort and most organisations do not have the skillset or resources to develop a model."

A further area where standardisation is lacking is in the regulatory sphere, with different jurisdictions addressing ESG regulations at different paces. Europe appears to be well ahead of the US in this regard, for example. The EU's Sustainable Finance Disclosure Regulation (SFDR) was enacted to create a harmonised ESG framework for the European financial services industry in March this year.

"SFDR is all about driving capital towards sustainable investments and providing the structure and clear reporting standards to support that," explains Brimfield. "It helps discourage greenwashing and creates a higher standard to which investment providers in Europe are accountable."

The US is far from inactive though. Its Sustainability Accounting Standards Board (SASB) is an initiative to establish ESG financial standards. Having done much work outside of the short-term cash markets, it's now starting to focus on this sector.

"The Value Reporting Foundation (VRF), formed earlier this year through the merger of the SASB and the International Integrated Reporting Council, is helping to normalise how sustainability issues are likely to have a material effect on companies across different industries," says Brimfield. "It's developed a materiality map, looking at the material issues that are relevant to each industry or sector, and how those should be scored and evaluated. The market will continue to evolve though, and standards will emerge. It will be interesting to see whether or not VRF standards become the de facto starting point for other regions as they establish their standards for evaluating ESG investments."

JUSTIN BRIMFIELD

Chief Marketing Officer, ICD

There is some precedent. Among all investments in ESG-designated products on ICD's Portal in August 2021, 70% were in SFDR-regulated products in the offshore space. Overall on the portal, almost 84% of ESG-designated products were offshore.

"We're seeing this rise in products in the US, with nearly a dozen new or converted funds in the first half of this year," explains Brimfield. "But the EU is certainly ahead in those products, with investors being more aggressive in offshore products."

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Improving education for treasurers

Another major obstacle to investing in short-term ESG investment instruments, cited by 45% of treasurers, was limited knowledge of the products available in the space. Without that understanding, it is hard to know how different products align with individual corporate investment goals.

"We've been on the ESG trend since we started to see interest from investors in 2018. In 2020, we hosted a four-part webinar series on the topic, as education

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is critical," notes Brimfield. "There are buzzwords aplenty in this space, and treasurers were asking what ESG actually is, and how they could integrate it into their investment programmes. For the webinar series, some of the standards boards participated, alongside ESG-focused rating agencies, asset managers and fund partners. Our aim was to give the corporate and municipal audience - we serve both - the tools to help."

The impressive commitment to educating treasurers on how ESG can work in short-term investments netted ICD the Best CSR/ESG/D&I Thought Leadership Campaign at TMI's 2020 Treasury4Good Awards.[2] That drive to educate continues today as it supports treasurers on their journey towards ESG investments.

"A significant number of treasurers have now started the process towards incorporating ESG-designated products in their short-term investment instruments," says Brimfield. "But many haven't reached the point where they're comfortable or are even permitted to invest. The reality is that this is hard. It's a new product and a new way of looking at the marketplace. From the practitioners' perspective, the information available has been minimal. It's why it has led to much frustration."

Earlier this year, ICD expanded the screening tools available on its platform, tagging the various investment products to the appropriate designation, and allowing fund providers to better articulate where they fit into the broad spectrum of socially responsible investing, ESG, D&I and more.

"Screening gives treasurers the ability to quickly assess the products that tie back to their specific investment strategies," explains Brimfield. "It helps investors identify a group of funds that they can then dig into, to obtain further perspectives on, and look at the associated holdings. Essentially, it helps treasurers whittle it down from the wider investable universe to what most matters to them, so they can research these more deeply."

As alluded to by Brimfield earlier, securing internal buy-in or stakeholder approval for short-term ESG investments can be tricky. This is highlighted by the 40% who identified this as an obstacle to investment – the third biggest cause for lack of investment.

ESG within the organisation

Of course, treasurers are not reckoning with ESG in isolation within their company. Many of the drivers to investigate ESG investing come from elsewhere within their organisations. These include corporate social responsibility (CSR) programmes.

"CSR is becoming a major focus for every large multinational company, and perhaps even beyond that," comments Brimfield. "Policies extend throughout the organisation, with the message: 'here's our CSR approach, tell us how your group, business line or function aligns with that.' In the finance and treasury world, we're seeing this approach having an impact on how organisations are investing and how they are issuing debt, as seen with the rise in Green Bond offerings."

Indeed, investment is most often driven by a corporate-level initiative. Some 46% of treasurers said that the management team is involved in setting the ESG short-term investment strategy, ahead of the treasury team (36%) and the board (36%). The treasury team is a major stakeholder in this process, demonstrating the function's strategic role within the organisation.

However, sometimes the inspiration from within treasury comes from the most unlikely sources. As Brimfield recalls: "One of our clients, a Fortune 50 company in the tech space, placed the treasury function as the main driver for its focus on ESG. It seems that treasury had an intern a couple of years previously that had really strong beliefs around social and environmental issues. Treasury started to do some research, and from that starting point the company invested in ESG products. It demonstrates that it doesn't have to be a top-down initiative to make a difference."

Looking ahead to a maturing market

Despite the gap between investment intention and investment reality, ESG is here to stay. That 90% of treasury professionals in the ICD survey say they are either already invested in or want to invest in ESG makes that clear. The issue is that companies are hitting obstacles such as a lack of standards or a limited knowledge of the market.

"I'd hope that, as there is greater transparency in the way that these models are developed, and there are more consistent rules and parameters in place, that it will help give treasurers the data required to make informed decisions." says Brimfield.

ESG offers treasurers another way to screen risk beyond the traditional credit filters that they have used for years. This can lead to more informed investment decisions while also being aligned to their organisational CSRs.

"Treasurers should understand that they are not alone in this," concludes Brimfield. "Virtually all of your peers, in one way or another, are going through the review of ESG in short-term investments. Some are getting stuck along the way, but there are resources out there to help. Treasury peer groups are a great resource, for example, and we're helping clients to make sense of it all. Support is out there."

Notes:
1 https://icdportal.com/resources/icd-2021-esg-survey/
2 https://treasury-management.com/articles/celebrating-a-sustainable-future/