Sustainable investing

How investors are looking for a positive outcome

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Introduction

Over the last decade, the investment landscape has changed considerably.

Not so long ago, environmental, social and governance (ESG) issues were only considered by a small group of ethically and socially responsible investors.

By 2020, the ESG market was to hit USD 1 trillion - it is now on track to hit USD 53 trillion by 2025 according to Bloomberg and will make up a third of all global assets under management (AUM).

This is supported by research commissioned by DWF looking at the impact of ESG on 480 companies across jurisdictions, which says that 42% of companies admit that the shifting market dynamic is the main reason ESG is strategically important to their business today.

The market is growing.

From these figures it is clear that ESG and other sustainable finance is becoming an integral part of investment management and is not about to change. Asset owners and investment managers are continually developing ways to incorporate ESG criteria into investment analysis and decision-making. At DWF, we have been observing this change amongst our clients.

Additionally, the focus on climate change, a shift in economies and the continuing change in regulation has also contributed. Recent issues around human rights such as the global attention of Black Lives Matter, the #Metoo movements and the global pandemic have only ramped up the focus on ESG.

Sustainable "Megatrends"

Global business leaders, investors, economists and governments recognise the economic implications of social challenges and environmental issues, and consider the four key areas that are changing investors approach, known as the global megatrends:

Emerging and urban

- Nearly half of the world's largest companies are expected to be headquartered in emerging markets by 2025.
- Nearly half of global gross domestic product (GDP) between 2010 and 2025 will come from 440 cities in emerging markets - 95% in small and medium sized cities.

Technological disruption

- Over 1.2 million apps have been created since 2014 with over 75 billion apps downloaded, averaging on ten for every person on the planet.
- Social media is continuing to dominate as the source for crowd intelligence and influence, with new platforms being developed every day.
- AI is expected to grow rapidly. It is expected that by 2029 AI will have the same intelligence as humans, and will replace one third of all jobs.

Demographical changes and wealth inequality

- By 2030 the world's population is projected to rise by 1 billion.
- At the same time, the population is getting older with Germany's population expecting to shrink by one fifth.
- There is a continued concern that the rich will keep getting richer, and the poor will keep getting poorer.

Climate change and resource shortage

- There is a continued concern that we are pushing further than the planet has ability to cope with.
- Climate models suggest that temperatures are predicted to increase by more than two degrees if global action isn't taken.
- The demand for water is set to increase by 40% and energy by 50% over the long term.

According to the World Economic Forum, the top ten global risks over the next ten years are likely to be:

- Climate change
- Weapons of mass destruction
- Biodiversity loss
- Extreme weather
- Water crises
- Infrastructure breakdown
- Natural disasters
- Cyber attacks
- Human made disasters
- Infectious diseases

The investment landscape – a spectrum of capital

Whilst many believe that sustainable investing is a new concept, it has in fact been in existence since the 1960s when there was a rise in negative screening of companies in investment decisions. These were pre-set to exempt companies that would consider having a negative impact on society and the environment. Whilst the understanding is that negative screening is still the most popular, and likely easiest to implement within an investment portfolio, there are now other considerations.

These can be broken down as follows:

Traditional investing (Finance first)

Purely looking at financial return, mainstream investing.

Negative screening

Building portfolios that exclude certain companies and criteria e.g. tobacco, gambling.

ESG

Investing in companies that are considered responsible/ sustainable and have strong ESG practices e.g. B-Corporations.

Thematic investment

Investing in companies that focus on tackling macro-level issues e.g. Green Bonds which deliver environmental/ climate benefits.

Socially Responsible Investing (SRI)

Investing in companies to receive a blend of financial return and social impact. Also providing capital via loans/ bonds through impact investing.

CSR/ philanthropy (Impact first)

Purely focusing on social/ environmental impact. Providing charitable gifts, resource and expertise. No financial return.

What is the approach?

DWF research suggests that companies are now looking to diversify portfolios and this seems to be of particular importance outside of the UK. There are various responsible investment strategies that incorporate ESG factors into investment decisions that consider both the risk adjusted return, the stability of the economy and how it influences society and the environment. These include:

Socially Responsible Investing (SRI)

Investors tend to score companies using a chosen set of criteria usually in conjunction with sector-specific weightings.

Best-in-class investment

Investors score on an ESG ranking scale by sector and/or industry and normally target the top 25% of companies.

Sustainable investment

Investors select companies that support a sustainable economy i.e. minimising natural resources.

Thematic investment

Investors select companies that focus on a particular sustainable theme i.e. a company that tackles climate change.

Green investment

Investors allocate capital to assets that mitigate climate change, biodiversity loss and resource inefficiency.

Social investment

Investors allocate capital to assets that tackle social challenges i.e. micro-finance and access to clean energy.

Impact investment

Investors allocate capital that focus more on a positive social outcome i.e. housing, healthcare and education.

Ethical/Value driven & faith-based investment

Investors allocate capital to certain principles therefore excluding companies that fall outside the set criteria.

Who considers these factors?

Pension Funds, Insurers, Retail Investors (individuals), Wealth Management firms, Financial Advisers, Investment Platforms, Financial Services, Policymakers and regulators, Investees and Governments.

What is the financial services market considering?

Corporate and investment banks

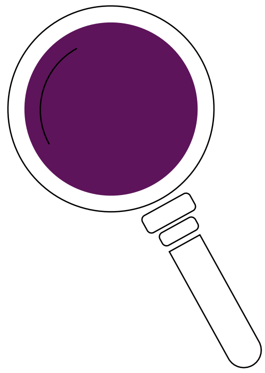
- ESG Bonds
- Financing of renewable energy projects
- Sustainability-linked loans
- Financing of infrastructure projects

Wealth managers

- Discretionary ESG mandates
- State-subsidised mortages

Asset managers

- ESG within Active investments
- ESG within Passive investments
- ESG within Alternative investments



Insights

75% of the market consists of institutional assets

An increase of 5% in retail investors since 2016

90% of millenials will invest responsively over the next five years

51% of the market is invested in public equity

36% fixed income

3% real estate

3% private equity/ venture capital

7% other

79% of investors expect businesses to increase their ESG efforts post-Covid

Negative exclusionary screening is still the most popular investment type

The first ethical fund was introduced in 1971 - the Pax World Fund

The market at a glance

- Growth of ESG assets has increased globally in almost every region.
- Today, in Canada, Australia and New Zealand, responsible investing make up the most of the total assets under professional management.
- Europe has the most responsible assets under management however there has been a decline which is believed to be due to stricter ESG standards.
- The USA has the largest ESG integration in to portfolios.

Spotlight on Green bonds & loans

G20's Sustainable Finance Study Group defines Green Finance as the "financing of investments that provide environmental benefits in the broader context of environmentally sustainable development".

The London Market Association (LMA) and the International Capital Markets Association (ICMA), the market leading bodies for the syndicated loan markets and the debt capital markets industries, have provided their members with guidance on green funding products.

Green loans and sustainable -linked loans

The Loan Market Association, together with the Asia Pacific Loan Market Association and the Loan Syndications and Trading Association, initially launched the Green Loan Principles and the Guidance on Green Loan Principles in March 2018, which was updated again in December 2018. They provide a framework of market standards and voluntary guidelines that participants are encouraged to adopt across the wholesale green loan market.

Often referred to under the same generic term "green loan", green loans and sustainability-linked loans are two different products. The difference between both products lies in the use of proceeds of funds.

Green loans are ring-fenced and limited to environmental projects but sustainability-linked loans focus on the overall performance of the borrower against certain pre-determined sustainability criteria.

The four Green Loan Principles

Principle One

- Proceeds are to be applied for green purposes and any relevant green project must provide clear environmental benefits.

Principle Two

- Green borrowers are also expected to communicate to their lenders information related to the process of green projects selection including details of their environmental sustainability objectives, assessments and processes for the determination of eligibilty criteria, and information related to wider green standards they seek to comply with.

Principle Three

- Proceeds of a green loan should be credited to a dedicated account, or otherwise tracked by the borrower in an appropriate manner in order to ensure transparency and promote the credibility of the loan.

Principle Four

- Green loan borrowers have additional reporting obligations with respect to the criteria described above, including the expected impact of the project. Such disclosure obligations are generally communicated on an annual basis to their lender.

The Sustainability Linked Loan Principles

A non-exhaustive list of ten common categories of objectives, including reduced greenhouse gas emissions, reduced water consumption and the amount of renewable energy generated or used by the borrower. They are likely to affect the interest but incentivising improved performance over time.

Green Bond Principles, green bonds and sustainability-linked bonds

The ICMA issued the Green Bond Principles which are voluntary guidelines intended to encourage transparency and disclosure, and promote integrity to facilitate the development of the green bond market. These principles provide green bond issuers with guidance on the four key components involved in the issuance of green bonds; use of proceeds, process for evaluation and selection, management of proceeds and reporting.

The Green Bond Principles include a non-exhaustive list of certain types of recognised "green" projects including, amongst others, projects related to renewable energy, energy efficiency, pollution prevention and control, clean transportation, sustainable water management, climate change adaptation and green buildings.

A revised process guideline came in June 2021 to give companies key recommendations for those considering issuing green bonds. The guidance suggests when issuing a new green bond to the market that they should align this to their wider business objectives and strategy regarding sustainability. This will be a key consideration for investors going forward and therefore it is important that this information is easily accessible.

The updated guidelines also suggest companies should consider an external review and/or audit of the proposed bond before issuing to make sure that it meets the required standards set out in the Green Bond Principles, to track the allocation of the funds and encourage best practice.

Social Loan Principles

These aim to facilitate and support economic activity, which mitigates social issues and challenges, and/or achieves positive social outcomes. Social loans are any type of loan instrument made available exclusively to finance or re-finance, in whole or in part, new and/or existing eligible social projects.

The Social Loan Principles include voluntary recommended guidelines, which hope to promote the development and integrity of innovative social loan products. Similar to other green finance products, social loans are based around the same four core components to be applied by market participants on a deal-by-deal basis.

Case study

Novelis MEA Ltd.

DWF acted for the UAE and the UK subsidiaries of Novelis, the largest aluminium recycler in the world and a long-term client of DWF across multiple jurisdictions in relation to the issuance and distribution of its EUR 500 million denominated senior green notes due in 2029 by its wholly-owned subsidiary, Novelis Sheet Ingot GmbH. The distribution of the green bonds were carried out in accordance with the Green Bond Principles published by the ICMA. The bonds have been admitted to a listing on the International Stock Exchange's (TISE) green market segment, TISE GREEN.

A portion of the proceeds raised was used to pay the existing facilities and the remaining proceeds will be used to invest in green projects based on the Green Framework that Novelis has adapted which aims to finance low-carbon, circular and sustainable economy that align with environmental and social priorities.

Case study

Neutral Fuels

In April 2019, Neutral Fuels, a member of TNG Holdings (The Neutral Group), an international cleantech organisation to build sustainability strategies for the logistics, energy and hospitality industries and to execute significant reductions in energy consumption and CO2 emissions listed the Middle East's first green bond on the Frankfurt and Dublin stock exchanges. With net zero biofuel facilities operational in Dubai, Bahrain and Delhi, Neutral Fuels is now entering the South African energy market.

DWF assisted Neutral Capital Finance PLC as issuer of a green USD 50 million medium term note Eurobond programme. These bonds will fund Neutral Fuels's expansion plans in the UAE and in the Middle East, Asia and Africa and will allow the company to build and operate a number of modular-based biodiesel production plants.

Further expansion has meant DWF are able to assist the group with the issue of the series 2 of the programme and the structuring of security over its assets across multiple jurisdictions, which we envisage to complete within the second quarter of 2021.

DWF research has found that 33% of companies are looking to develop green and/or ESG products.

ESG and the Islamic finance correlation

While the principles of Islamic finance can be traced back to the 7th century, both Islamic finance and ESG emerged as key globally recognised concepts in the 1970s. It is widely acknowledged that the underlying principles of Islamic finance are noticeably in line with all of the ESG principles. With clear similarities, both practices complement each other in achieving shared goals.

Key principles of Islamic finance

Transactions or banking products based on principles of Islamic finance require equality, social justice, upholding of accountability, transparency, and equal legal protection for all parties.

Islamic principles or "Shariah" prohibit interest-based transactions (riba), uncertainty in transaction (gharar) and gambling (maysir and qimar). The rationale behind prohibition of riba stems from the understanding that money is only a means of exchange with no inherent value, and that real value only belongs to real assets. Gharar is understood as a tool that perpetuates fraudulent and antisocial behaviour by encouraging excessive risk taking. Therefore, this principle prohibits the finance of risk trade. Maysir and qimar are both prohibits because they encourage acquisition of assets by gambles and chances. Each of these concepts are ruled out in Islamic finance jurisprudence by Shariah scholars because of the understanding that their existence have long-term negative effects on society.[1]

The Islamic finance financiers hold socially responsible investing vital, based on the adaptation of religious beliefs. To that extent, Islamic finance practices avoid investing in businesses that are harmful to society and the environment. Therefore, there are strict considerations made to the kinds of activities which are financed (for example, financing of tobacco or alcohol are prohibited) and to the manner in which a certain activity is financed.

The ESG qualities of Shariah-compliant companies

Several studies have suggested that Shariah-compliant companies score higher on ESG thresholds than non-shariah-compliant companies. The main underlying reason for this can be attributed to the screening strategies by Shariah boards in determining Shariah compliance. Where on the one hand, conventional modes of financing lean towards profit maximisation, often at the cost of social and environmental factors, Shariah boards gauge the viability of a venture on "ethical" grounds. In doing so, Shariah boards reject dealing in forbidden (haram) investments and apply ESG integration techniques to evaluate ethical concerns. It is therefore more likely that an Islamic bank may finance companies with better ESG practices than a company with questionable ESG integration.[2]

How the collaboration works

Principles of Islamic finance eliminate exploitative practices and shift the focus towards an enterprising and equitable profit and loss sharing mechanism between parties. Therefore, rather than furthering the levy of interest on loans, the Musharaka form of Islamic financing encourages contribution of cash to a joint venture, and therefore receiving a profit on the investment.

Where under conventional forms of financing, loans are approved by the credit departments of the financial institutions by evaluating the creditworthiness of the borrower, under Islamic finance structures, investment decisions are based on viability of the business. This shift in focus enables the investment parties to have a vested interest in the inherent value of the product or service, which furthers social cohesion between the investors and the businesses.[3]

Conclusion

There is a fundamental convergence between ESG principles and the principles of Islamic finance. At their core, both concepts aim to raise the bar of accountability for businesses in their endeavours - both to compel businesses to consider their impact towards the society, and aim to uphold the welfare of people and the environment. In the wake of the pandemic and climate change, as ESG becomes progressively mainstream, we predict that so will Islamic finance practices.

> "The focus of both financial institutions and corporates on ESG has increased. The government's focus on policies related to climate change and renewable projects has meant an increased interest in these projects and how they are financed within the financial services sector. The Islamic finance industry is quickly adapting ESG principles and there is a lot of interest in finding common ground between the two industries, which are naturally aligned. The key issue for financial institutions is the number of different definitions and frameworks to understand. These definitions are not well classified, making it difficult for firms to comply with the requirements."
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> Umera Ali, Global Co-Head of Financial Services Sector

[1] CFA Institute. "ESG Integration and Islamic Finance: Complimentary Investment Approaches." 2019.
[2] Refinitiv. "Islamic Finance ESG Outlook 2019." [3] DLA Piper. Applying two principles of Islamic finance to create meaningful ESG initiatives. 2 December 2020. 8 June 2021.

How are renewable energy projects more bankable?

While the narrative around climate change and the dire need for socially responsible investing is widely acknowledged and accepted, institutional investors have also recognised that climate change does not only adversely impact the health of the planet, but also jeopardises the wealth of investors.

Aside from the ecological impact of rising global temperature levels affecting the planet, there is growing evidence to support the fact that the economic implications of not investing in renewable energy is an economic opportunity missed.

It is estimated that a renewable (specifically solar or wind) project may produce up to six to seven times the energy required for battery electric vehicles than gasoline-powered vehicles can. Despite the flow-rate advantage for oil and petroleum products, the economics of renewables are near impossible for oil to compete with on a long-term basis.

Renewables enjoy this advantage due to having a short-run marginal cost of zero, a cleaner environmental impact, a lack of logistical and transport hassles, and the potential for disrupting the oil marketplace given the necessary scale.*

The global pandemic has also triggered one of the most notable disruptions in the oil industry when the price of crude oil in the USA went down in negatives in 2020, explaining the ever-increasing volatility of global fossil fuel prices. The global travel restrictions and the monumental collapse of the transport (particularly the airline industry) also meant that the oil, gas and petrochemical companies experienced a 45% decline in market value.

Investors have increasingly recognised the financial risks of carbon-intensive investments and divested their investments from fossil fuels. Experts expect this trend will most likely result in the elimination of subsidies, tax breaks and governmental concessions in fossil fuel production, worth trillions of dollars, which would further affect the bankability of investments made in fossil fuels.

Large financial institutions are starting to make a stance to end any association with fossil fuel projects.

The International Energy Agency notes that energy efficiency is time consuming, which could multiply employment opportunities six-fold improving energy affordability, decreasing reliance on energy imports, reducing greenhouse gas emissions and consequently carbon tax expenditure, freeing up funds for further technological innovations.[4]

Did you know?

Investments made in renewables in Germany and France yielded returns of 178.2% compared to the 20.7% return in fossil fuel investments.

Did you know?

In the UK, investment renewables yielded 75% return compared to the 8.8% return on fossil fuels. Moreover, in the US, renewables generated a 200% return on investment compared to a 97% on fossil fuels.

Did you know?

Cumulative profits from renewable electricity were up to 367% higher than the profits from fossil fuel in the past ten years.

Innovation 1

A variety of central bank, financial institutions and insurance companies have noted and incorporated climate risk into their financial planning assessments.

Innovation 2

The International Monetary Fund has integrated environmental risks as part of its economic analysis of countries.

Innovation 3

Senior executives of companies like Blackrock have announced that climate change has necessitated a fundamental financial reshaping of finance.

Innovation 4

Various lobbies are at the brink of levying restrictive trade measures against contributors of carbon emissions.*

[4] International Energy Agency. 2020. Energy efficiency and economic stimulus - Analysis - IEA. April 8. Accessed April 17, 2021. https://www.iea.org/articles/energy-efficiency-and-economic-stimulus.

Case study
NatWest

DWF acted for NatWest in a circa GBP 100 million financing of a series of battery energy storage sites (BESS) and gas peaking plants across the UK. This is a syndicated asset finance arrangement with a complex power purchase arrangement to support the revenue generation from the sites.

We have focused on all aspects of the transaction in connection with the facility agreement to be put in place as well as detailed site-specific due diligence for each of the sites in the UK. Focus has been centred on grid connection, capacity market revenue contracts, construction and operation and maintenance arrangements for each of the sites and appropriate market-standard warranties for the equipment being built out by the lender/developer.

ESG frameworks and standards

Over the past decade, companies globally are being encouraged or required to make climate-related financial disclosures. Disclosures by the financial market also respond to the importance that information companies disclose needs to be clear, comparable and consistent to facilitate informed investment decisions.

There is no global standardised set of standards or frameworks which companies can adapt to measure their ESG values. With numerous standards and frameworks in existence, we summarise below some of the most widely used and accepted:

DWF research has found that 79% of companies interviewed said they are already signed up to an ESG framework or intend to within the next two years.

Global Reporting Initiative

The first standard which was developed in 1997 and over the years had been adding on more guidelines and requirements for sustainability reporting on ESG issues. The GRI Standards focus mainly on non-financial sustainabilty reporting and provide specific modules that apply to various aspects of the overall ESG report.

Sustainable Accounting Standard Board (SASB)

Published a set of globally applicable industry-specific standards covering 77 different industries. These standards *"identify the minimal set of financially material sustainability topics and their associated metrics for the typical company in an industry".*

Carbon Disclosures Project (CDP)

The CDP is a non-profit charity that provides a disclosure system that is used globally by investors, companies, cities and regions as they try to manage the impact they each have on the environment. This framework has been used by companies and cities to report on climate change, water security and deforestation.

UN Sustainability Development Goals

Adpted in 2015 by member states, this framework sets out 17 goals to nations (rather than organisations) to work towards securing a sustainable future. Goals include ending poverty and hunger, improving health and education and having stronger environmental protection.

Task Force on Climate-related Financial Disclosures (TCFD)

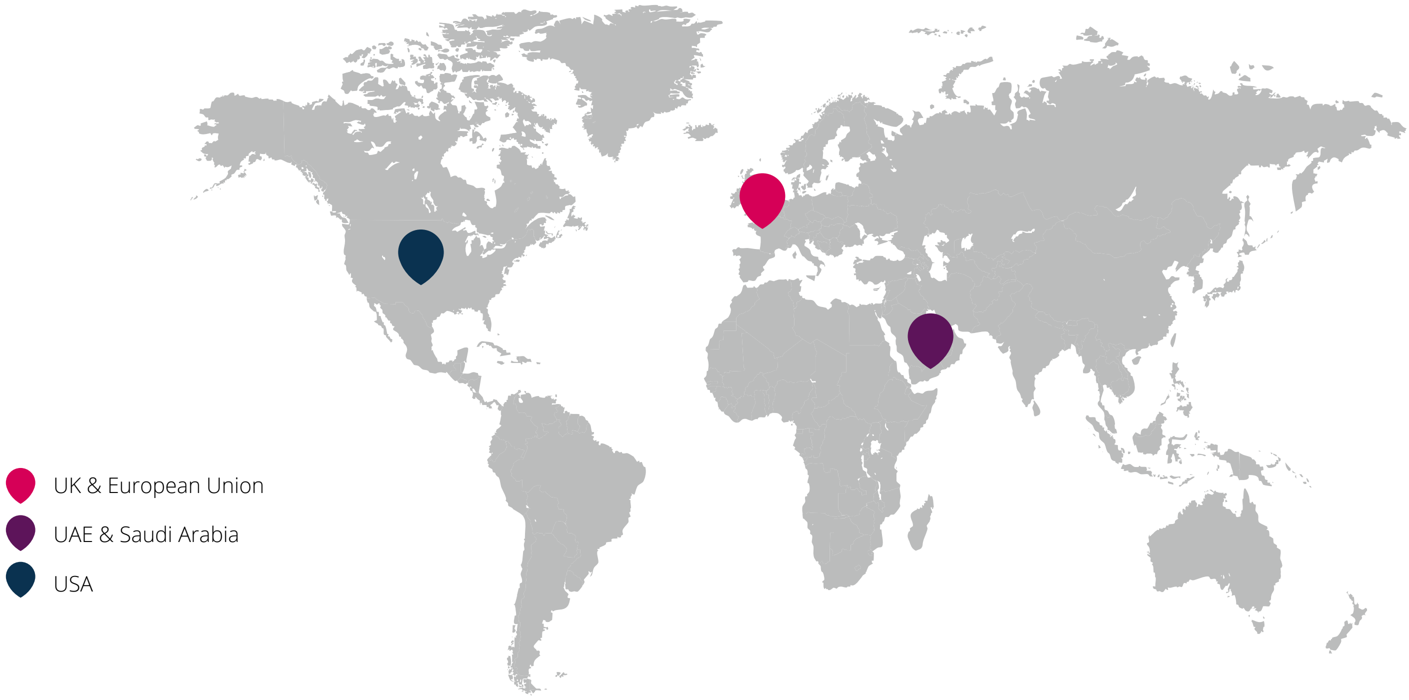
The TCFD issued its recommendations in 2017 to help lenders, insurers and investors, better assess and price climate-related financial risks and opportunities to their stakeholders. As of 2020, the TCFD-based reporting has become compulsory for those that have signed on to the UN Principles for Responsible investment.

UN Principles for Responsible Investment (UN PRI)

Launched in 2006 when a set of six main voluntary principles (Principles) were introduced to assist institutional investors in actively incorporating ESG factors into their investment and ownership decisions.

ESG reporting around the world

We will be taking a closer look at some of the key standards in the jurisidictions below.



European Union

The Paris Agreement, adopted in 2015 has only increased the EU's efforts to transition to a sustainable financial system with ESG considerations at its core. As part of this transition, the European Commission published the EU Action Plan of Sustainable Growth, with the aim to: (1) manage financial risks stemming from sustainability issues; (2) refocus capital flow towards sustainable investments; and (3) promote transparency and long-term thinking.

UK

The UK government states its intention to bring about a "green industrial revolution" to stimulate recovery from the global pandemic. This includes, in line with the recommendations of the TCFD, an intention to "introduce mandatory reporting of climate-related financial information across the economy by 2025, with a significant portion of mandatory requirements in place by 2023.

Commercial companies with a premium listing on the London Stock Exchange will be required to disclose within their annual financial report, how they are managing climate-related risks and opportunities with certain public companies under obligation to include non-financial reporting since 2018 - this is only going to increase over time.

The Department for Business, Energy & Industrial Strategy has published its strategy setting out the path to decarbonising industry, aiding the goal of a net zero economy by 2050. This is the first strategy of its kind and sets out a series of actions across the next three decades, which will deeply decarbonise the UK economy, whilst still placing an emphasis on remaining competitive, creating jobs and avoiding pushing emissions abroad (carbon leakage).

USA

Currently ESG reporting under any of the widely adopted frameworks is not mandatory in the USA. Therefore, companies that prepare sustainability reports or provide any sort of ESG disclosures as part of their annual reports have a free hand in terms of which framework they use and how much information they present to the market. Despite it not being mandatory, KPMG reported that 82% of American companies include sustainability information in their annual reports[5].

The U.S. Federal securities laws require disclosure by companies of certain environmental and social related information but these requirements are not particularly detailed or specific. The Securities Exchange Commission (SEC) issued guidance in 2010 to public companies regarding existing SEC disclosure requirements and their applicability to climate change matters but the guidance has not culminated into any mandatory requirements.

Influential institutional investors such BlackRock and State Street have made

[5] KPMG Survey of Sustainability Reporting 2020 https://assets.kpmg/content/dam/kpmg/xx/pdf/2020/11/the-time-has-come.pdf

public statements supporting companies making ESG disclosures aligned with both the SASB and TCFD frameworks.

UAE

The principle of sustainable development supports the plans of the seven emirates and the UAE's Vision 2021. The latest Abu Dhabi Sustainability Week (ADSW) was held in January, 2022, which focused on initiatives across three main pillars: Global Collaboration & Leadership, Economic Development, and Technology & Innovation. ADSW is a global platform for accelerating the world's sustainable development, and it was concluded with a firm commitment to undertake climate action and shift towards clean energy. Moreover, at the Expo 2020 Dubai, UAE recently announced its 'Net Zero by 2050' strategic initiative to achieve net zero emissions, which will make the UAE the first MENA nation to do so. This is building up momentum towards the United Nations Climate Change Conference COP 28, which is scheduled to be held in the UAE in 2023. Other initiatives by the UAE include the Green Agenda 2030 and the National Innovation Strategy.

To effectively implement the social development goals, the UAE has adopted a holistic approach, which involved the creation of a National Committee on Social Development Goals. Formed in January 2017, the National Committee comprises 17 Federal entities, each of which is leading a specific social development goal. The UAE Energy Strategy is based on growing the renewables sector in the UAE for meeting its energy needs. It is expected that clean energy will contribute 50% of the UAE energy needs by 2050, and the UAE government intends to invest AED 600 billion by then to meet the growing energy demand and ensure a sustainable growth for the country's economy. This would increase the need for green funding and financing in the UAE and it was noted that Sharia-compliant green bond issuance doubled in 2021 to that of 2020. In acknowledgment of the positive impact of companies' adherence to ESG criteria on the economy and society, the UAE Securities and Commodities Authority also now requires public joint stock companies listed in the UAE to adhere to specific mandatory ESG disclosure requirements.

Saudi Arabia

Aligning with Saudi Arabia's Vision 2030 and ongoing efforts to achieve green goals, Saudi Arabia's Crown Prince and Deputy Prime Minister HRH Mohammed bin Salman bin Abdulaziz Al Saud unveiled the Green Saudi Initiative and Green Middle East Initiative on March 2021. This was designed to reduce carbon emissions and to contribute towards global targets in climate change (including afforestation projects with the planting of 10 billion trees) and procuring 50% of the Kingdom's power from renewables to generate electricity. In October 2021, HRH Mohammed bin Salman bin Abdulaziz Al Saud subsequently announced Saudi Arabia's new aim as the Saudi Green Initiative, which is to reach net zero greenhouse gas emissions by 2060 in order to curb the imminent climate change.

Saudi Arabia is a member of the SSE and in line with Vision 2030 regarding promoting sustainability, the Saudi Arabian Stock Exchange (Tadawul) announced in 2020 that it would be co-operating with MSCI to launch an ESG themed index in Q1 2021. Subsequently, the Saudi Exchange issued ESG Disclosure Guidelines, which were introduced in an attempt to raise awareness on the importance of ESG, and to assist listed companies in navigating through ESG requirements, applications and benefits. The guidelines were developed in line with the UN SSE model guidance and will be continually updated to account for changes in the ESG landscape to ensure they remain relevant.

Currently, ESG reporting is not mandatory for listed companies in Saudi Arabia but there are a few companies who actively engage in ESG disclosures either as part of their annual report (Aramco) or as a separate sustainability report (Saudi Electricity Company). However, the Capital Market Authority (CMA), has recently amended the Corporate Governance Regulations (CGRs), applicable to all listed companies, which state that listed companies should establish a policy for balancing their objectives with those of the community as part of their social responsibility and establish programs and social initiatives.

> Through our research, companies have suggested that competing geographical standards is proving difficult to understand with 62% addressing this as a concern.

Benchmarks in the UK & EU

> DWF research has confirmed that the lack of universal benchmarking is one of the biggest external challenges facing companies today with over 50% confirming this is an issue. This resonates even more in the Middle East with some 63% confirming this is their biggest challenge.

EU Climate Transition Benchmarks

Companies must (i) disclose their quantifiable and time-based carbon emission lessening; (ii) disclose annual information on the development made towards such objectives; and (iii) ensure that such objectives do not negatively influence other ESG factors.

Taxonomy Regulation

The objectives are to mitigate and adapt to climate change, sustainable use and protection of water and marine resources, transition to a circular economy, pollution prevention and control and protection and restoration of biodiversity and ecosystems.

EU Paris-aligned Benchmark

Requires disclosure of the methodology and a statement explaining how the ESG factors are reflected in a standardised and comparable way. All benchmarks must align with the Paris Climate Agreement emissions reduction goals by the end of 2021.

Sustainable Finance Disclosure Regulation

Asset managers and investment advisers are required to develop policies and procedures to consider the relevance of ESG policies, make website disclosures and integration of sustainability risks in the investment decision making processes.

ESG Disclosure Score

Provides a mechanism, which allows investors to access current levels of quantitative ESG disclosure relative to an industry or a sector and attempts to assist in understanding what additional factors could be disclosed in order to allow investors to gain a better insight.

FTSE Russell's ESG Ratings

Allows investors to understand companies exposure and management of ESG factors. Reading a broken down into fundamental pillar and theme exposures and scores which are constructed on individual indicators that are applied to exclusive conditions.

The LSE Group Guidelines

Issues guidance which set out recommendations for good ESG practice. The global guide responds to mandate from investors for a more steady approach to ESG reporting.

Non-Financial Reporting Directive

Require public interest entities to issue data on the influence their undertakings have on ESG elements highlighting the EU's clear trajectory towards greater transparency and accountability on social and environmental issues.

Sustainability & ESG indexes

Other than numerous ESG frameworks, there are a number of ESG indexes, which offer investors the opportunity to benchmark companies, which demonstrate the best ESG practices, and to track their performance ESG commitments. There are currently over 1000 ESG indexes, which has led to some scepticism in the market with a number of experts questioning the data that leads to the scoring and ranking of companies.

S&P 500 ESG Index: Launched in April 2019, this ESG index is to offer investors who wish to align their investments based on their ESG values with a risk and return profile of companies similar to the S&P 500 while excluding companies that do not carry out operations in line with ESG principles.

Morgan Stanley Capital International (MSCI): This index measures a company's ESG risks through a scoring system. It classifies companies into following categories[6] based on their exposure to ESG risks against competitors:

Additionally, the S&P/Hawkamah ESG Pan Arab Index: Hawkamah the institute for corporate governance in Dubai collaborated with S&P Dow jones Indices to develop the first ESG index for the MENA region, which was launched in February 2011. The S&P/Hawkamah ESG Pan Arab Index rates the top 50 Pan Arab companies based on their performance against specific ESG metrics.

DWF research says that companies see ESG as an opportunity for organic growth, in particular within the Middle East (28%) and APAC (25%) whilst the UK see it is a competitve advantage (26%).

Leader

AAA | A

A company leading its industry in managing the most significant ESG risks and opportunities.

Average

A | BBB | BB

A company with a mixed or unexceptional track record of managing the most significant ESG risks and opportunities relative to industry peers.

Laggard

B | CCC

A company lagging its industry based on its high exposure and failure to manage significant ESG risks.

Insights

[6] MSCI website https://www.msci.com/our-solutions/esg-investing/esg-ratings

What are the benefits of ESG reporting?

Some companies are still reluctant to undertake ESG reporting for a number of reasons. These include the time-consuming and expensive nature of the reporting and the fact that there are a different standards and thresholds, which are confusing and complicated.

However, we believe the benefits of ESG reporting far outweigh the drawbacks, some of the advantages are:

Sustainability for the future

The level of transparency gives greater opportunity to search for alternative growth but also allows for better management, preparation and the mitigation of potential risk.

Better performance

Whilst there is doubt in the market and many experts believe ”sin stocks” still out perform any other stock, it is expected that those that embrace ESG practices will ultimately generate better returns in the long term.

Reputational benefits

ESG is strongly linked to raising brand perception and therefore generating better margins and customer satisfaction.

Targeting future investors

The focus of the investor is shifting with a large number of retail investors, in particular millenials and Gen Z’s who are looking for more values-based investing.

Retaining stakeholders

Demonstrating strong ESG principles is more likely to lead to longer-term and trustworthy relationships with customers and suppliers whilst also retaining and attracting talent.

Increased bankability/profitability

Recently, there has been emphasis on the study of ESG compliances and its impact on the business profitability. A recent Harvard Law report indicated that business undertakings that ranked higher on the Institutional Shareholder Services ESG Corporate Rating were found to have greater profitability; negative correlation with volatility; better allocators of capital; and better performing stocks.[7]

The increase is driven by heightened social, governmental, and consumer attention on the broader impact of companies, as well as by the investors and executives who realise that a strong ESG proposition can safeguard a company’s long-term success.

It has been reported that the current global sustainable investment aggregates to a value of more than USD 30 trillion which translates up to a 68% rise since 2014 and a 1000% rise since 2004.

88% of the 200 sources found that companies with good sustainability practices have better operational performance and 80% of the 200 sources demonstrated that improved sustainability practices had a positive correlation on return on investment.

Sustainability development goals could unlock opportunities worth USD 12 trillion in value, and create an additional 380 million jobs each year by 2030.

[7] Harvard Law School Forum on Corporate Governance. 2020. ESG Matters. 14 January. Accessed April 17, 2021. https://corpgov.law.harvard.edu/2020/01/14/esg-matters/

ESG and regulatory actions

As ESG becomes increasingly important globally, the regulations and guidance surrounding it, particularly in the financial services sector, are also set to increase.

In the UK, for example, the Financial Conduct Authority (FCA) has a sustainable finance strategy based on three themes:

Transparency: promoting good disclosures along the investment chain;

Trust: ensuring the market delivers sustainable finance instruments and products that genuinely meet investors' sustainability preferences; and

Tools: regulators working with the industry, and government, to develop guidance and tools to address the challenges of climate change.

The FCA has issued a number of publications on ESG in recent months; it is currently consulting on proposals to enhance climate-related disclosures by listed issuers and has recently set out its expectations of authorised fund managers regarding the design, delivery and disclosure of ESG and sustainable investment funds. One of the FCA's key concerns is that investors are clear on the green credentials of investments and the regulator has expressed, in no uncertain terms, that it expects clear and accurate ongoing disclosures to investors where, for example, funds make ESG-related claims.

The practice of 'greenwashing' is likely to be a focus for the FCA going forwards; where it considers that firms have misled investors regarding the sustainable nature of investments, enforcement action is highly likely to follow, something that firms will want to avoid given the cost of investigations and potential reputational impact of any public censure on this topic.

Given the political focus on ESG globally, enhanced regulatory scrutiny on ESG issues in the near future is inevitable, as are ever-increasing costs, and risks, associated with compliance (or lack thereof).

Financial services firms globally should ensure that they keep abreast of regulatory developments in each of the jurisdictions in which they operate, and that they review (and enhance) their processes, procedures and marketing materials accordingly, so that they do not fall foul of the evolving rules, guidance and statements in this area.

Advice should be sought where any potential rule breaches, or failures to make accurate climate-related disclosures are identified; swift identification and rectification of errors is likely to mitigate any associated costs, regulatory risks or reputational impact.

> DWF research has found that nearly 50% of all companies interviewed agreed that they have seen increased pressure from regulators over the last two years.

What do companies need to do to appeal to investors?

Investors want evidence based insight into the level of responsibility of a company, and therefore demonstrating the impact this has on their stakeholders.

> Our research suggests increasing shareholder value is one of the top priorities for companies today (34%).

Many businesses have been branded as simply "greenwashing" and giving a false impression to investors and other stakeholders. Therefore, it is key that companies focus on the fundamental areas that matter most to their stakeholders rather than trying to tackle every aspect of ESG which may be difficult to implement and subsequently can divert investors if they are unable to see tangible results, or a clear direction for the company which could ultimately lead to doubting their authenticity.

Many investment and asset managers are now recruiting large teams of strategists to go behind the data and scoring metrics to understand how sustainable and responsible a company really is.

The rise of the B-Corporation movement which was first established in the USA for those companies that want to balance purpose and profit is becoming a popular way to be recognised as a leader in sustainable business, however, there are various options available to companies to demonstrate and report accordingly, some of which we have covered in this report.

We believe as a legal business our responsibility is to work with companies to help consider these factors, identify the opportunity and overcome the risks.

The lack of employee engagement and changing culture and behaviours is still a challenge for companies, therefore we have provided some useful tips a company should think about to demonstrate their commitment to investors and other stakeholders.

Tip 1: Get Board buy-in

There is increasing pressures on Boards to implement corporate purpose as part of the wider corporate strategy, therefore it is important that c-suite leaders understand and communicate their sustainability goals internally and externally and include this in all business operations.

Tip 2: Identify a lead and create a team from across the business to support

ESG factors impact so many parts of the business so we recommend that companies include as many representatives that will be able to support including: Human Resources, Marketing and Risk & Compliance. Companies need to consider who will drive forward the ESG agenda.

Tip 3: Understand the opportunities, challenges and risks

It is important to understand and address each factor as to what it would mean for a company if they don't become more sustainable, and what it means if for a company if they do, as ESG will bring new risks that a company hasn't potentially faced in the past.

Tip 4: Identify a purpose

Why does the company exist? What does it stand for? What does it want to be remembered for in years to come? What is the story? How do they want to be seen amongst peers and competitors?

Tip 5: Engage all stakeholders

A company should consider all stakeholders. Asking stakeholders what is important to them helps companies understand where to focus their efforts. Companies should be prepared to provide education and training to their workforce and other stakeholders where necessary.

Tip 6: ESG strategy and policy

A company should map out their key priorites and over what period of time. Companies then need to consider the key objectives and action plan they need to put in place to get there and how to implement best practices. Companies can appoint third parties to support this and subsequently review their performance. It is also worth considering if an independent auditor has a role to play.

Tip 7: Allocate a budget

Implementing ESG can be expensive so it is key that a company considers all of the costs involved to be able to achieve their objectives. Areas such as carbon offsetting, recuitment and third party costs need to be considered.

Tip 8: Data is key to measuring good and bad performance

A company can be overwhelmed in the data that they need to collate so need to consider what is important as part of their strategy and therefore how they can successfully review their performance. There are many software platforms that can support with this to make data easily comparable and make sure that the right data is collated to save time and resource. Companies then need to agree how often performance will be reviewed.

Tip 9: ESG frameworks

Companies should consider if there are any frameworks that can help to focus their efforts and meet their reporting requirements. It may be the case that implementing various frameworks is necessary until a universal framework is created.

Tip 10: Ongoing reporting and monitoring

What will a company disclose and how will they communicate their sustainability and grab the attention of future investors? Companies need to consider how to integrate ESG reporting with

Case study
Asset financing company

DWF provided guidance and direction to a property asset financing company across France, Switzerland and Portugal on their responses on gaining their own investment on an ESG basis completing the required documentation from their funders and laying out the strategy and planning required to ensure compliance and future investment.

> "Working with clients to identify a purpose that can be easily understood internally and externally has been a key priority to get right. This is to help focus efforts and identify the relevant risks which therefore lead to opportunities for companies seeking new investment and future proofing their business."
>
> Kirsty Rogers,
> Global Head of ESG

Case study
Lloyds of London

DWF built, supported and delivered an extensive cross market Responsibility programme to Lloyds of London over an initial period of 18 months including – main board ambassador strategic discussion sessions, day long senior leadership sessions engaging in significant issues affecting the market and covering regulatory and SMCR issues, provided one to one director level support on equality and inclusion issues and provide ongoing support in relation to responsible processes.

DWF Responsibility emerged as a result of this work, and now provides umbrella ESG services to clients – focus for Lloyds was on compliance with non-financial conduct requirements, the Equality Act, Speak Up, and gender and equal pay as well as planning for the future. We are now in the planning stages of another significant programme of information sessions relating to people management responsibilities across the business.

Case study
The Sacred Groves

According to the UN-REDD programme 2008, deforestation and forest degradation account for approximately 11% of carbon emissions, more than the entire global transportation sector and second only to the energy sector. Halting and reversing deforestation has the potential to deliver up to 30% of the climate solution, making forests one of the most cost effective and immediate solutions to climate change in which corporations can also participate as part of their ESG framework.

The Sacred Groves is a social enterprise driven by the purpose of protecting the planet's forest and other natural habitats. Its state-of-the-art systems have been built to enable seamless participation of environmentally sensitive Guardians (individuals and corporates) in the process of protection, conservation and restoration. "Our aspiration by 2025 is to make a meaningful impact by protecting 100,000 acres of natural habitats across the world"- Monisha Krishna, Co-founder, The Sacred Groves. DWF has been supporting The Sacred Groves since its inception and with the recent, successful launch of the platform, there is a clear alternative for organisations looking to establish or diversify their ESG proposition.

How we can help

Our purpose is to deliver positive outcomes with our colleagues, clients and communities.

As the only main market listed legal business we understand the important of transparency, disclosure and the level of interest from stakeholders in how ESG and sustainability is integrated and reported on. Therefore, we can work with clients to do the right thing and act with integrity to be able to support each other.

We have products and services which complement our advisory offering to be able to support you including Responsibility, our programme which helps business leaders reset their culture and work with them to comply with director duties, simplifying the regulatory landscape, establishing pay strategies, managing supply chains, managing labour supply and data privacy and cyber security. We can provide advice on:

Corporate governance, compliance and risk

International investigations and fraud

Data protection and cyber security

Anti-Money Laundering (AML)

Proceeds of crime

Product regulation

Procurement

Environment & climate change

Green bonds

Green loans

Renewable energy projects

Waste management

Energy efficiency

Business & human rights

Ethics and intergrity

Diversity and Inclusion

Discrimination and equality

Immigration

Subsidiaries & communities

Grants

Charities

Pandemic relief

Corporate social responsibility

DWF's Financial Services sector

We have a practical understanding of the global commercial issues faced in the Financial Services sector through our deep-rooted, first-hand experience.

Our sector specialists provide robust and pragmatic advice to our clients spanning multiple disciplines, including:

- Acquisition finance
- Banking and restructuring
- Consumer credit
- Corporate services
- Data protection and cyber security
- Debt capital markets
- Disputes and litigation
- Employment and pensions
- Equity capital markets
- FinTech
- Fraud and financial crime
- Funds
- Insurance
- Islamic finance
- Private equity
- Project and renewable energy finance
- Real estate finance
- Regulatory, compliance and investigations
- Venture capital
- Wealth management

Our clients include a range of financial institutions, from traditional lenders - including corporate banks, funds, PE, VC, wealth management and asset finance businesses - all the way through to sector disruptors such as challenger banks, payment services providers, FinTechs, alternative lenders and non-banking financial institutions.

Through our understanding of the sector, we regularly provide our clients with legal insights, thought leadership and online content, which addresses global challenges and the latest updates to modern regulations. We also work with our clients to deliver tailored value-added services that would be the most beneficial to their business needs.

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DWF is a leading global provider of integrated legal and business services.

Our Integrated Legal Management approach delivers greater efficiency, price certainty and transparency for our clients.

We deliver integrated legal and business services on a global scale through our three offerings; Legal Advisory, Mindcrest and Connected Services, across our eight key sectors. We seamlessly combine any number of our services to deliver bespoke solutions for our diverse clients.

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