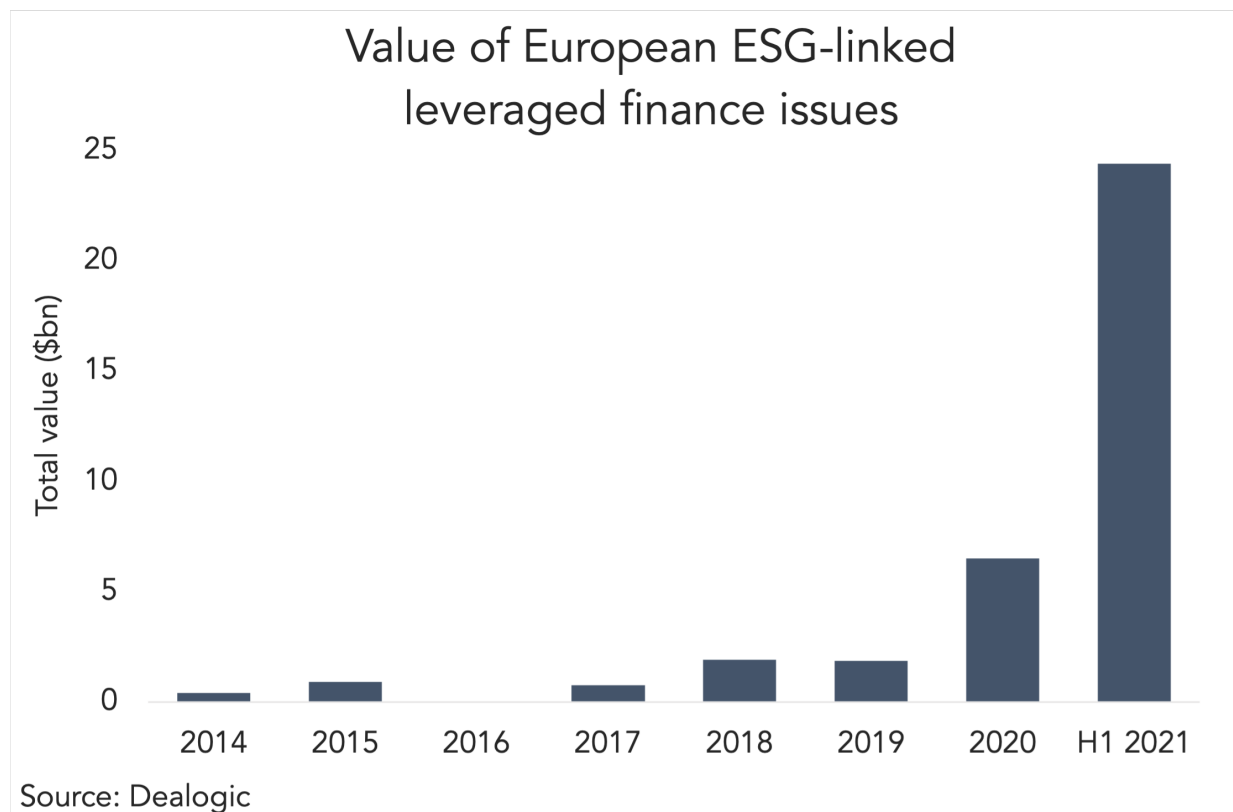


The challenge of meeting ESG ambitions

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Sustainability is increasingly being factored into investment decisions, but there is little uniformity in approach.

Everyone can agree that taking environmental, social and governance issues into account is now a greater priority for private debt fund managers than it has ever been in the past. But questions remain over exactly how seriously it's taken and the best way to incorporate ESG into investment processes.

The first of these questions was addressed by a report published by TMF Group, the UK-based administrative services firm. It found that companies with poor ESG credentials were likely to fail lenders' initial screening phase and few would make it as far as the conducting of due diligence. However, the report found that there are some exceptions where a company is deemed worthy of investment even if they have less than optimal ESG credentials.

How to incorporate ESG into investment processes was pondered at *Private Debt Investor's* 2021 Virtual Forum. While the private debt asset class has been lauded for innovative incentivisation methods in relation to ESG, these approaches are still of the experimental variety. "We don't have a regulatory or legislative framework we can point to," said one large fund manager at the event. Methods used so far were described as "still very much in the laboratory".

One of the biggest trends seen lately has been the emergence of sustainability-linked loans which measure the issuer against pre-determined ESG metrics, most typically in the form of margin ratchets. The chart above shows how popular these have become. But one investor at the event asked what kind of ratchet was sufficiently material to encourage good behaviour: “Is it five or 10 basis points, or does it need to be more? And what KPIs do you use to guarantee that initiatives are actually being implemented?”

Few would doubt the willingness of private debt fund managers to play their part in a more sustainable future. Exactly how this is best achieved will remain a talking point for some time to come.

(Past performance is no guarantee of future results.)