All Ahead Full: Private Credit Outlook 2022 (Last of a Series)

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We planned last year to publish a special series on Environmental, Social and Governance (ESG). Unlike most topics in our commentaries, the origins and complexities of ESG were unfamiliar.

To the rescue came our Nuveen colleagues, a Responsible Investing team of close to thirty ESG professionals. Of course, risk management is core to Churchill's own practice, but the recent refinement of ESG data and insights allows us to enhance our approach to ESG diligence.

Per our *Chart of the Week*, ESG is a fundamental concern of investors today. Whether it will become as impactful a motivator of manager behavior will depend on regulation and client demand. But it clearly has landed in the top two or three asset management issues for 2022.

Origins. ESG in some form has been around for centuries. Early practices were rooted in screening out business activities misaligned with stakeholder values, harming the environment or society. From Mosaic law dating back to 1500 BC, to precepts in the Koran, to Henry VIII's legalization of lending, to 18th century England and the Methodist movement, right up to the 20th century's "socially responsible investing, now referred to as responsible investing.

Current Themes. Besides historic influences, climate change, diversity, equity and inclusion, and corporate integrity, are now the lens through which investors are assessing managers' ability to understand the associated risks and opportunities for every investment decision.

Disclosure and Regulation. Greenwashing (deceptive ESG representation and reporting) is drawing scrutiny from government and regulatory agencies. That plus investor demand for transparency is leading to higher disclosure standards for portfolio companies and managers. Rules and standards have not converged, making implementation and compliance a challenge.

Evolution By Asset Class. Traditionally ESG resided in public equity given shareholder's ability to change corporate behavior. The public fixed income market has now adopted and refined ESG datasets and frameworks to mitigate downside risk. Applying an ESG lens in private markets can add value for private equity investors while protecting lenders from default risks. As one asset sales head put it, "…lenders working together and influencing the decisions of companies is key for improving on ESG."

Screening vs. Selections. A manager's process places them on a spectrum from negative screening, which is more of a "box-checking" approach to actively seeking out companies who are strategically managing their ESG risks and opportunities.

ESG Outlook for Private Credit. Responsible investing is both "a world under construction," as one expert wrote, and a long-time practice. "I have been doing ESG for twenty-seven years; I just didn't know it," a top CLO manager remarked. We expect investors' demand for more clarity around ESG decisions and performance will further refine metrics and benchmarks for private credit managers as the year progresses.