Sustainable finance insights

HSBC

Introduction

In this insight, we look at the recent developments in sustainable finance solutions, in the face of the COVID-19 pandemic.

The impacts of COVID-19 are far reaching and have caused a fundamental change in the way many businesses operate. Through our own observations and conversations with clients, we've drawn some key points in regard to how COVID-19 is changing the sustainable finance landscape and how we expect businesses to adapt and continue their sustainability and Environmental, Social and Governance (ESG) efforts.

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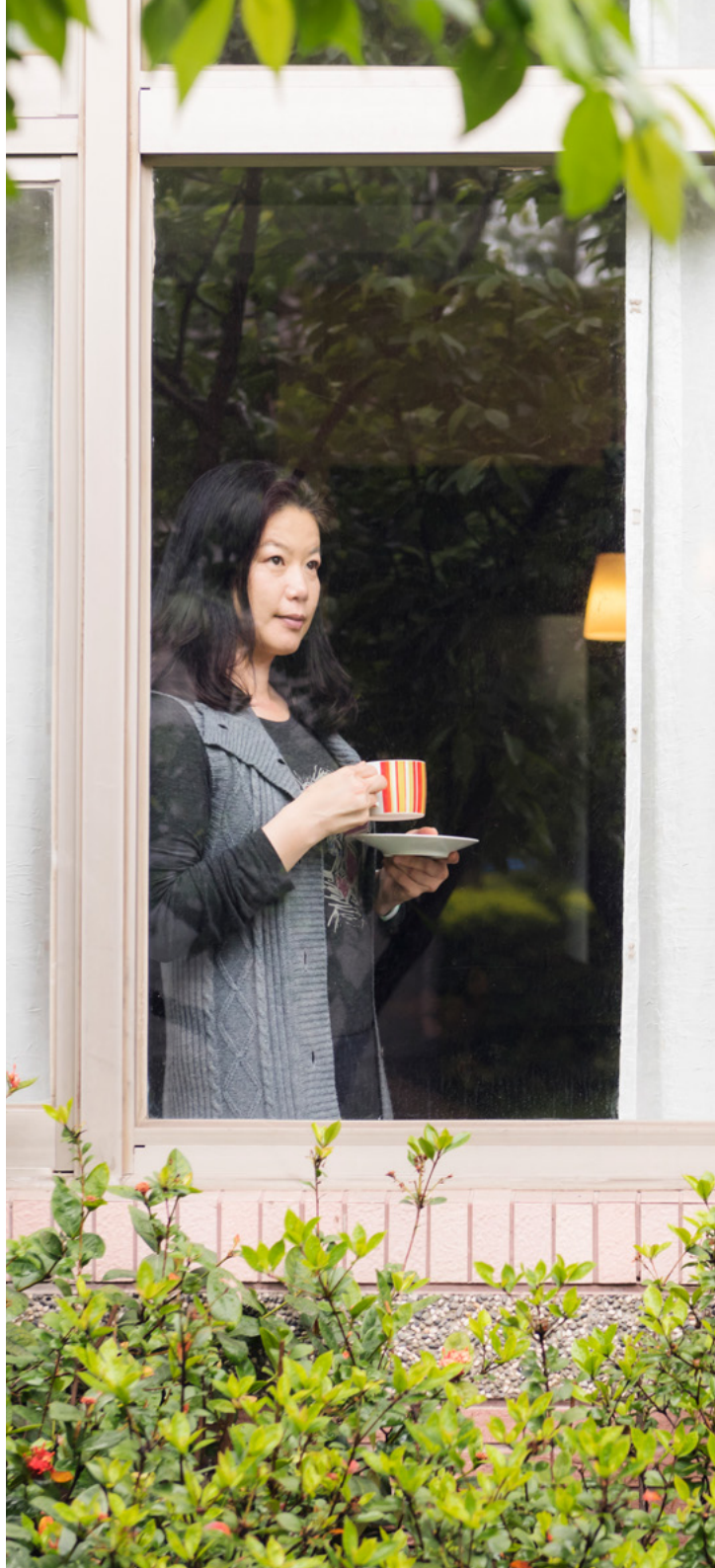


1 › Sustainability driving performance

Sustainability is as important as ever, perhaps more so in the world of COVID-19

We can draw parallels between COVID-19 and climate change. They're both known risks predicted by robust scientific research; they're global risks which require cross-border co-operation; and early, decisive action and planning can avoid the need to take even more extreme actions when these risks are realised. Once we approach something like normality again, there is little doubt that we all, including politicians and businesses, will be re-examining our preparation and resilience to high-impact events. This has already been the plea from the sector and climate scientists for a decade or more.

Whilst COVID-19 is clearly the urgent priority at the moment, the huge challenge of climate change has not gone away. Precious time will be lost if we are not able to continue the momentum which was seen pre-COVID-19.

With an increasing push on companies of all sizes to adopt sustainable practices, driven by heightened public awareness and increased pressure from a wide range of stakeholders, including the government, sectors have been making strides towards change, even throughout the crisis.

MSCI, an investment research firm, saw the accelerated outperformance of ESG-themed indexes as a result of the coronavirus outbreak – in other words, companies with high ESG rankings have outperformed rivals during the pandemic[1].

HSBC also looked at over 600 shares of global public companies with climate solutions as well as 140 stocks with the highest ESG scores, over an 11-week period, with the outcome showing that the climate-focused stocks globally outperformed others by 7% on average[2].

Separately, Moody's cited ESG factors as material credit considerations in 2019[3]. This potentially indicates the growing importance of ESG in the assessment of credit quality – this is due to stricter environmental regulation combined with greater general awareness of ESG.

This means interest in climate and ESG is likely to rise, with many investors and company CEOs arguing that a key theme of the coming months will be not simply rebuilding the economy, but creating a more sustainable world.

Sustainable finance can help achieve exactly that by improving sustainability performance while helping to transition to a lower carbon economy.

1. https://www.msci.com/www/blog-posts/msci-esg-indexes-during-the/01781235361
2. https://www.gbm.hsbc.com/insights/global-research/esg-stocks-did-best-in-corona-slump
3. https://www.moodys.com/research/Moodys-ESG-risks-material-in-33-of-Moodys-2019-private--PBC_1218114

2 › Short-term impacts

Dramatic shifts in environmental impact and climate action are short-term, and may even reverse

Lockdown has led to sharp reductions in economic activity and travel. Pre-covid, more than 31,000 flights were handled per day by the European network. This dropped to fewer than 400 flights a day across the continent at the height of the pandemic, a reduction of more than 90%.[4] At Charles de Gaulle Airport, the busiest in continental Europe, air traffic fell by 99% in April 2020. The pandemic also contributed to a massive reduction in road traffic as well, and there are indications of a positive environmental impact in the short-term. Pollutant concentrations of NO_2 was halved in April, compared to January 2020.[5]

It has not all been positive news, however, as an increase in greenhouse gases from other sources were observed across Europe, such as increased landfill waste due to cuts in exports, suspended recycling activities and increased use of plastics.[6] With this in mind there has been a real focus among business groups and the media to 'build back better', ensuring that long-term resilience and tackling climate change is at the heart of the recovery process.

In terms of sustainability and environmental action, despite some minor setbacks, we are seeing some continued momentum. The European Commission is pushing for climate action and encourages the increased implementation of sustainability guidelines for businesses. In September 2020, Ursula von der Leyen noted in her State of the Union address, "The Green Deal will be the backbone of the EU's recovery from COVID-19 as well as its growth strategy for the decades to come. We are already embarking towards a circular economy with carbon neutral production. We have more proof that what is good for the climate is good for business."

We have also seen more corporates announcing net-zero plans in this time and continuing to look to realise the commercial opportunity of transition.

Although COVID-19 may have disrupted climate plans in the short term, the challenge of climate change remains a slow burning risk which if not managed could have a huge impact globally. The economic disruption of COVID-19 is clearly likely to be very significant, current estimates are around $2 to $5 trillion dollars. The economic cost of climate change, even if temperature rises are managed to 1.5 degrees, is, according to the Intergovernmental Panel on Climate Change (IPCC), likely to be an order of higher magnitude, and will be accompanied by irreversible damage to biodiversity, sea levels rises, desertification, and long-term changes to weather patterns. All the signs are that the momentum across Europe to implement net-zero plans will continue to grow, and one can expect the continued associated rise in prominence of green loans and other sustainable finance solutions.

4. Eurocontrol: https://www.youtube.com/embed/oAEcLnF7d4A?autoplay=1
5. https://www.europeandataportal.eu/en/impact-studies/covid-19/covid-19-related-traffic-reduction-and-decreased-air-pollution-europe
6. https://www.europeandataportal.eu/en/impact-studies/covid-19/covid-19-related-traffic-reduction-and-decreased-air-pollution-europe

3 › Priority shift

Social and governance aspects of ESG are coming to the forefront during the pandemic

In recent years many corporates and investors had become increasingly focussed upon the ESG factor of sustainable financing, and a fast-growing trend in the Sustainable Finance market was for financing to link improvement in ESG metrics to financing cost.

Whilst the focus is often upon the "E", Environment, of ESG, recent events have brought to the fore the other elements in the equation, Social and Governance, and highlighted how interconnected we are as individuals and corporates.

We have seen some of our customers move with speed to provide, for example, much-needed medical equipment and increased focus upon employee mental wellness and providing financial security for employees in these difficult times. Resilience and contingency planning will have been tested during this period, and this is an aspect which will no doubt be revisited and strengthened post COVID-19. A corporate's supply chain, which will have often been under pressure throughout the pandemic, may manifest many of these ESG risks.

Managing ESG risks can create value for all stakeholders – employees, suppliers, customers, the wider society, and the environment – and can help businesses with the pressure of crises like COVID-19.

4 › Energy price fluctuation

Dramatic shifts in energy prices may further accelerate the pace of the transition to a lower-carbon economy and energy system

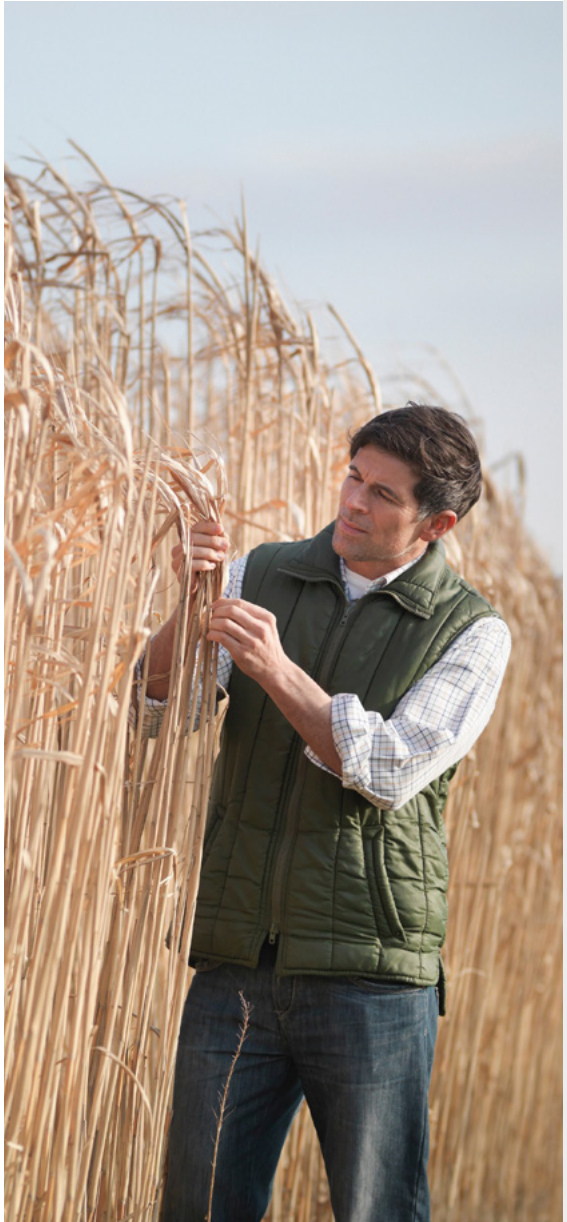
By far the most noteworthy impact in the energy market has been on prices. Starkly showing the significance of this impact was BP's announcement in mid-June that it would be revising down the value of its assets by up to $17.5bn[7]. Oil prices have reached unprecedented lows, even moving into negative territory. And we've seen year on year electricity prices trending up to 30% down, however some recovery in prices has been noted over recent weeks by market commentators and clients.

Many of the large investors in renewables projects are oil and gas companies. Falling oil prices may negatively impact upon their ability to finance new projects, although it remains to be seen if this is a significant factor in the pace of renewables deployment.

For projects in the construction phase, where labour and supply are paramount, we are hearing of some delays to operational dates. We've seen financing processes for several projects which started pre-crisis deferred, as owners and sponsors are not able to obtain sufficiently attractive terms in the current markets.

Despite these disruptions and delays, Europe does not seem to be faltering on its commitment to being the first climate neutral continent. More than 150 business leaders and investors have urged EU countries to set higher climate goals for 2030, backing a draft European Commission plan to aim for a 55% reduction in greenhouse gas emissions by the end of the decade, expressing their support for increased climate ambition.

7. https://www.forbes.com/sites/emanuelabarbiroglio/2020/06/19/bp-takes-a-175-billion-hit-as-giant-ditches-oil-exploration-projects/#4317585856fa



5 › The wider benefits

Greater resilience to market disruption among the many benefits of accessing sustainable finance

Entering into sustainable financing does offer a number of wide-ranging advantages for borrowers, some of which can mitigate issues surrounding large-scale business interruptions like the COVID-19 pandemic, including:

- providing greater resilience to market disruption
- strengthened reputation and building stronger, values-based relationships with all stakeholders, including their bank; and
- gaining access to a wider pool of investors – those with an ESG focus. A year ago, HSBC's Sustainable Financing & Investing Survey showed 75% of respondents regarded sustainability-linked loans (SLLs) as interesting, while 20% judged that they were unlikely to suit them. Now, 30% of issuers already have experience of SLLs or green loans.[8]

With these advantages in mind, we may see companies looking to sustainable finance to shore themselves up against future large-scale market disruptions.

8. HSBC Sustainable Financing & Investing Survey 2020

5 › Sustainable stimulus

Post-lockdown – an opportunity to embed green and sustainable finance into stimulus measures

It is likely that a balance will be sought between the immediate needs of recovery post-COVID-19 and the urgent need to implement plans to combat climate change. Which aspect is favoured in the short-term may depend upon how rapidly and effectively countries are able to exit their lockdown procedures, but we'll need to find a way to address both post-COVID-19 recovery and the climate crisis.

There may be a longer-term opportunity to embed green and sustainable finance into any potential stimulus measures which could include low carbon and resilient infrastructure. With the European Union firmly committed to climate neutrality, the focus could be on investing in sectors which contribute towards this goal.

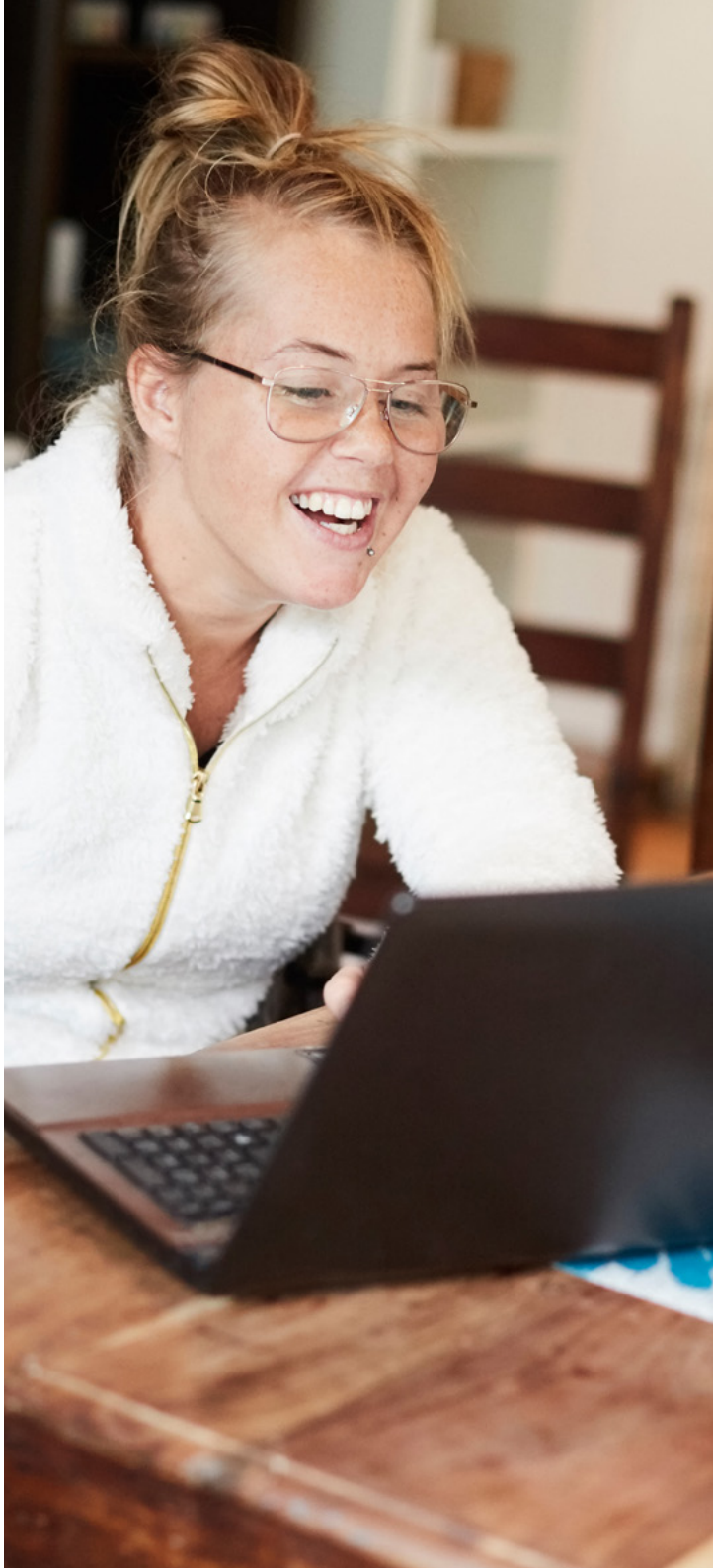
The EU Green Deal will revise all climate and energy legislation, enhance emission trading, boost renewable energy, improve energy efficiency, and reform energy taxation. It is an investment plan for Europe, and a part of the upcoming EU budget strategy NextGenerationEU, of which 37% will be spent directly on European Green Deal objectives. It will also take green financing to the next level, through the implementation of a 30% target of NextGenerationEU's 750 billion euros to be raised through green bonds.

In September 2020, France and Germany increased their green recovery plans, with billions allotted to green infrastructure projects and emissions reduction programmes.[9]

Much of Europe has tried new ways of working throughout lockdown, for example increased remote working for some businesses and the increased use of video conferencing for events, which if sustained could prove cost effective and reduce travel and associated emissions.

Although too early to assess the longer-term socio-economic implications, there are clearly some emerging themes including:

- re-prioritisation of health and wellness
- better awareness of climate change challenges and the need for a more sustainable economy
- emergence of new shared spaces and systems impacting public transport and contact-free economy
- the importance of resilient supply chains
- increased awareness and demand for more managed globalisation and inclusion of social responsibility.



9. https://www.businessgreen.com/news/4019709/france-germany-ramp-multi-billion-euro-green-stimulus-plans

Summary

Although public and corporate attention has undoubtedly shifted to the pressing issues of COVID-19, it is clear that sustainability remains a key area of focus and has moved from 'nice to have' to a critical element of corporate decision-making. The European Commission shows no signs of letting sustainability and net-zero carbon targets slip, and businesses are feeling the benefits of setting a clear sustainability strategy and aligning themselves with ESG targets.

Sustainable finance is a gateway into developing projects that support environmentally and socially sustainable economic activity and growth, allowing a business to track and monitor its progress towards set ESG targets and advancing its sustainability ambitions. ESG and sustainability not only remain important in these uncertain times, but may in fact provide the edge needed for some businesses to thrive above their competitors.

Green loans and Sustainability-Linked loans

Aside from bonds and trade finance, we have two key propositions to support businesses to achieve their sustainability ambitions: Green loans and Sustainability-Linked loans (or, ESG-Linked loans).

The key difference is that Sustainability-Linked Loans look at a company's overall sustainability strategy, whereas Green Loans require the loan to be used for a project with clear environmental benefits.

Some examples of HSBC eligible green loan projects include renewable energy, green buildings, clean transport, and development of eco-efficient products.

Examples of performance targets for ESG loans include reducing emissions, improving the energy efficiency rating of buildings, saving on water, and increasing the amount of renewable energy used or generated.

If you would like to discuss any of the topics raised here, please contact the Sustainable Finance team directly:

hsbc.com/our-approach/building-a-sustainable-future

Alan Duffy
CEO and Head of Banking
HSBC Ireland

Virginie Grand
Managing Director,
Global Banking
Sustainability Champion Global Banking Europe
E-mail: virginie.grand@hsbc.fr