Treasury Trends

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Hitching treasury to the sustainability bandwagon

Treasury maintains an enviable place within an organisation, working closely across all key functions, as well as customers and suppliers, to ensure the financial health and success of the business. Given treasury's strategic role and key skill set in financial risk management, it is therefore not surprising to see it playing a key role in helping develop, track and achieve their respective organisation's sustainability goals.

Although forward looking organisations have been imbedding sustainability into their business strategies, policies and reporting for a number of years, 2021 can be seen as a watershed year, with record carbon prices, pending mandatory sustainability reporting requirements and an increasing global focus from investors and stakeholders all pushing to make sustainability a standing item on most Corporate Risk Registers and a priority for most CEOs and Boards.

Sustainability reporting is now a global practice

Whether reporting on the financial risks of climate change on business activities or connecting business goals with the UN Sustainable Development Goals, sustainability reporting has now been almost universally adopted. A recent global KPMG survey found that 80% of large companies worldwide now publish sustainability reports, the figure rising to 90% across the world's largest companies.

In New Zealand, the Government has announced plans to make climate disclosure reporting mandatory for around 200 entities, including all those listed on the NZX.

In Australia, while there is no legal requirement for sustainability reporting per se, existing legislation already requires public companies to disclose any information that shareholders would reasonably need to make an informed assessment of the entity's operations and business strategy. With the World Economic Forum recently concluding that environmental and social risks make up four of the top five global risks, the connection between sustainability and corporate financial performance is now well established.

What seems to be clear is that sustainability reporting is part of most developed countries' future, either as voluntary disclosing or as mandatory reporting imposed by government. With a number of different reporting frameworks on offer, increased harmonisation towards a global standard is also progressing, which will make it easier to compare information. The 'greening' of the global financial system is also supporting the growing momentum in sustainability reporting.

Sustainability governance framework

Developing a corporate sustainability strategy often begins with the recruitment of relevant expertise, typically via utilising the services of specialist third parties, although the Chief Sustainability Officer role is now common across larger organisations.

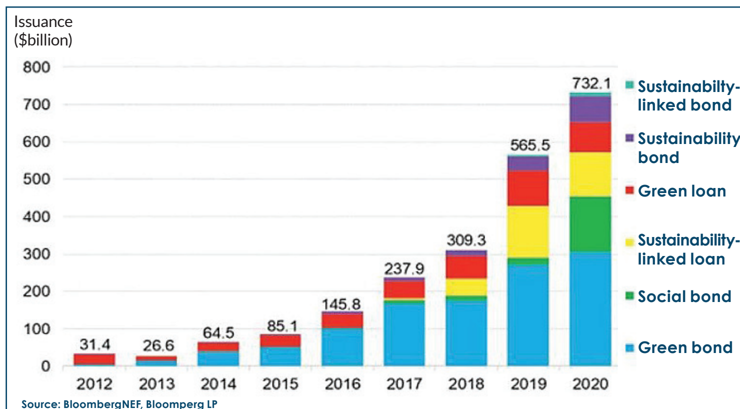
There are a myriad of sustainability frameworks to help structure and report on sustainability efforts, refining an organisation's overarching sustainability goals down into detailed action plans and targets, through to ongoing performance measurement and reporting.

The systems to implement the framework will typically align with existing corporate governance processes: policy setting and oversight via a Sustainability Committee of the Board; management holding primary responsibility for implementation and compliance reporting, often structured around a monthly or quarterly meeting and reporting cycle; audit and assurance for external verification of data and processes. This approach will be familiar to anyone already involved in corporate risk management and again highlights how a treasurer's main responsibilities are inevitably becoming linked to corporate sustainability efforts.

Sustainable debt markets

A specific area where treasury is adding to the sustainability drive is in the corporate funding strategy, via the linking of a borrower's broader sustainability ambitions to its funding arrangements. While still in its relative infancy in Australasia, the market has been growing exponentially, following the international trend. Banks are also increasingly engaged with these conversations and in pursuing funding opportunities fitting the 'sustainable' criteria, as they look to progress their own sustainable lending commitments.

With the financial services sector responding quickly to growing shareholder and stakeholder expectations around sustainability,



there are a growing range of funding structures. These typically fall within two broad categories:

1. **'Use of Proceeds' funding structures** — used to finance a specific asset or project with sustainability benefits (e.g. Green Bonds funding an existing 5-Star building);
2. **'Sustainability Linked' funding structures** — used for general corporate purposes rather than specific projects, but where the loan rate is adjusted up or down depending on performance against a set of pre-agreed sustainability criteria.

Sustainable debt instruments typically require transparency and traceability on the impacts and allocation of funds in sustainable activities, with ongoing monitoring, auditing and reporting processes therefore needing to be aligned. But with strong investor demand for sustainable investing, sustainable financing is quickly becoming more readily available and will extend into 'smaller' corporates as well.

Carbon price is now a material risk

For those emitters already captured by the New Zealand Emissions Trading Scheme ("ETS"), the recent parabolic rise in the price of carbon represents a very visible additional business cost, and one which requires all of the hedging policy, hedging strategy and accounting know-how already well utilised by treasurers in managing other financial risks. While less transparent for businesses sitting outside of the ETS, the indirect cost pressures are already being felt via higher fuel and energy costs for example, with the current carbon price adding around 15 cents to a litre of petrol in New Zealand.

Similar to managing FX or interest rate risks, there is no 'one-size-fits-all' approach to managing corporate carbon costs, with some larger emitters adopting multi-year hedging profiles, while others are working on a pass-through model. As always, a clear identification of your own specific risk profile is the first step in developing an appropriate policy, and then hedging strategy approach.

While the shape of Australia's carbon market continues to be plagued by policy uncertainty, the voluntary offset market is increasingly being utilised by Australian corporates as they look to progress their sustainability credentials.

Sustainability pressures and strategic choice

While it is up to every part of an organisation to advance its sustainability aims, treasury's role in corporate risk management means there are numerous opportunities for it to take a leading role in driving the overall corporate sustainability strategy. While this may feel like an additional burden on what is typically one of the most lightly resourced corporate functions, banks and specialist external advisors such as ourselves can be a valuable source of information and assistance.

It is clear that the need to address sustainability issues will only intensify over time, as investor focus turns to responsible investment practices, how an organisation treats employees and vendors, and its dedication to sustainability initiatives — it is therefore increasingly important to have the answers to these questions.

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