

Long-term plan

Goals could be dependent on social care funding

Inspections

The regulator is working on a project to reduce the burden on providers

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Interest is surging in responsible investing and sustainable financing. CMS partner **Mike Delaney** provides a legal perspective on what this could mean for the industry



Ethical practices investing in ESG

What does ESG mean? It is important to set out the background to some of the phrases being used in this space and note that from a legal perspective there is no settled definition as to what responsible investing or sustainable financing means.

There are potential issues around future litigation but for now we will summarise a few key terms that are commonly used but note this area is awash with various phrases so beware.

It is arguable that the foundations for this sector began with 'ethical investment' where certain companies were excluded from portfolios or credit approvals because of their unethical investments (e.g. dealing in arms, tobacco and pornography).

This paved the way for 'responsible investment', which goes beyond excluding certain activities and focuses on measuring a company's positive approach to sustainability or ESG issues.

The lending community is putting this on its agenda with the move towards 'green loans' and 'sustainable finance' where lenders might provide lower cost products exclusively to those borrowers who demonstrate strong and ongoing sustainability credentials.

The calculation is a simple one: companies that act responsibly and ensure good governance minimise their risks.

Industry commentators now seem to be converging on the use of ESG which stands for environmental, social and governance and is an umbrella term for non-financial performance indicators that evaluate corporate behaviour.

This often reflects the 17 UN Sustainable Development Goals (SDG's), which are a set of global targets to ensure not only climate stability but also social protections.

The benefits are both on a macro- and micro-level.

SDG's include good health and

wellbeing, quality education, clean-water and sanitation, affordable and clean energy, industry, innovation and communities and climate action.

Companies in the social care and healthcare industries are already helping to achieve good health and wellbeing (SDG No.3).

Many are also playing a proactive role and developing good governance by incorporating aspects of gender equality, climate action and reducing inequalities to broaden their ESG impact.

Opportunity

There is no question that 'sustainable finance' and 'ESG linked performance' are popular buzzwords in the market today.

Law firms have also seen a considerable increase in fund formation activity in this area along with financial institution clients applying further resources to this field.

Companies are not just talking about this but increasingly putting it into practice showcasing their ESG principles in investor reports and raising new funds.

Pension investors are including a sustainability assessment of their investment decisions and many Statement of Investment Principles (which set out a schemes investment strategy) now consider ESG factors.

Retail investors, especially younger backers, are demanding exposure to assets that have good ESG credentials.

In the wider market, certain banks and financial investors are following this trend with the issue of green bonds and ESG linked revolving credit facilities or term loans that have margin ratchets depending on the performance of the borrower against sustainability factors.

The Lloyds Bank £1bn Green Lend-

ing Initiative is just one example of banks championing the growth of such lending.

Evidence across Europe indicates banks are considering adopting the wider ESG agenda when refinancing loans and obtaining credit approval.

This should benefit the health and social care sectors as lenders turn their focus from simply 'green assets' to the fundamentals of the company and its ESG credentials.

The real growth in this sector is likely to be triggered when the above subjective criteria become measurable on an objective basis. Independent analysts are coming into this area with new methodologies for assessing ESG criteria further enhancing transparency.

One example is that Fitch rating agency has announced it is offering entity specific research in this field and providing detailed ESG ratings. S&P and Moody's are expected to announce similar developments shortly.

Potential risks

One risk is that with the use of dense and confusing phrases combined with a lack of rigorous objective testing or government legislation there is a risk of mis-selling and the litigation that may bring.

People are concerned with 'green-washing' where certain companies or funds claim ESG credentials that are untrue, and a loss is suffered.

Recent developments in ESG may allow companies to unlock access to not only more investment but also potentially cheaper financing options.

With improved transparency in this area through enhanced analytical tools, increasing investor demand and the potential for new regulations that may force the pace of change that is only likely to increase.