

## Agenda

- ESG definition and drivers
- 2. ESG hot topics and trends
- 3. Corporate treasurers ESG agenda
- 4. Bank treasury products
- 5. ESG products Accounting implications

#### **Key takeaways**

- 1. There is significant momentum across the business towards 'greener' and more ESG-centric activities aimed at addressing ESG risks and opportunities.
- 2. Commitment of corporate treasurers to ESG agenda is steadily increasing as the expectations from the shareholders, regulatory bodies, clients/vendors and employees also increase.
- 3. Banks are providing a wide range of treasury products that adapted the ESG product framework and may help accelerate the broader revenue and growth goals of the business. It is important to understand how those products operate and what accounting consequences they might have.



**Stefanija Cubelic**Director



#### ESG definition and drivers

The **CFA Institute** believes that **ESG factoring** (i.e., material ESG information and considerations) *is an important* component of a complete and thorough financial analysis for any actively managed fundamental investment portfolio.

Environmental	Social	Governance
<ul> <li>Climate risk</li> <li>Carbon emission</li> <li>Energy efficiency</li> <li>Pollution and waste management</li> <li>Use of natural resources</li> <li>Clean energy and technologies</li> <li>Biodiversity</li> </ul>	<ul> <li>Human capital</li> <li>Labour relations and working conditions</li> <li>Diversity agenda</li> <li>Employee safety</li> <li>Product safety</li> <li>Human rights</li> <li>Child labour</li> <li>Corruption and bribery</li> <li>Anti-money laundering</li> </ul>	<ul> <li>Board diversity</li> <li>Business ethics</li> <li>Risk tolerance</li> <li>Compensation policies</li> <li>Escalation protocols</li> </ul>

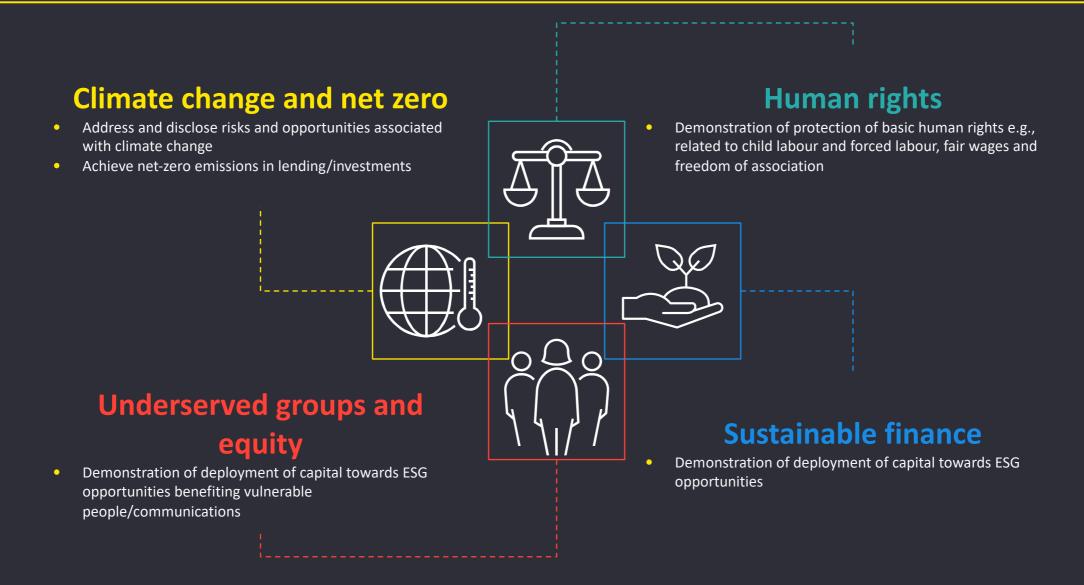


#### ESG definition and drivers





# ESG hot topics and trends





## Corporate treasurer ESG agenda

**Treasury governance** 

- Business relation partners
- Green treasury policy

**Investments** 

Strategic asset allocation

**Financing** 

- Green bond
- Green loan

**Operations** 

- Digital payments
- Online bank statements
- Other paper products

Reporting

Impact reporting

Based on a survey (finance and treasury professionals of top 80 large UK corporates), more than two-thirds (71%) of respondents expect to include ESG or sustainability features in their next financing.

71%

The latest finding follows a steady increase in treasurer commitment to ESG and sustainability over the past two years (50% in 2020 and 65% in 2021, respectively).

65%

At 47%, sustainability-linked loans are the most likely to be implemented by firms surveyed, followed by sustainability-linked bonds and green bonds, each at 28%, respectively. \*

47%



#### Bank ESG products

Sustainable Sustainable Sustainable Sustainable Digital transaction working financing and liquidity channels product capital product High/low value payment Green deposit ESG trade loans Commercial cards API Money market funds Cross border payment Green project funding Supply chain finance Online portals **ESG-linked derivatives** Trade services **RPA** Notional pooling Receivables Export agency finance Instant payments ΑI Sweeps Paperless/digital interaction and Expand strategy regarding green Link payments into ESG agenda via Enhance product offering eligibility Leverage Mastercard Priceless deposit account and green money capabilities capturing and reporting criteria, ESG data traceability, and Planet Coalition to Act on Climate adoption (bank statements, market funds to a broader support sustainable finance goal, Change to increase client ESG data onboarding documents) sustainability money market **ESG** objectives engagement and support clients' Simplify and optimise payment Online banking portal and account carbon reduction goals ecosystems to decrease operating Support, track, grow, and report on commercial card portal to further and technology cost, improve Promote notional pooling where volume, impact of green financing Sustainable supply chain finance to customer engagement via ESG applicable to increase the - e.g., financing for sustainably help Banks' clients engage their customer experience reporting e.g., greenhouse gas efficiency of liquidity management clients to achieve ESG objectives resourced goods/services emissions associated with card Promote the use of carbon-neutral services spend data centers that host payment Export Agency Finance – e.g., Explore other sustainability Sweep from green deposit account data information exchange, support initiatives to Trade Services line of RPA and AI to reduce manual to green/sustainable money documentation of impacts and credit supported by green deposit process market account finance tied to UN Sustainable account; digitisation of documentation, validation/green **Development Goals** certificates



# ESG Products – Accounting implications ESG-linked derivative financial instruments (IRS)

- Providing the customer meets the defined ESG targets in the specified period, interest rate (margin component) is reduced by the agreed bps.
- The banks often require independent validation (assurance report) that the defined ESG targets have been met (retrospectively).



- Derivative financial instruments need to be recorded at fair value.
- Fair value should incorporate the likelihood of achieving the defined ESG target (the TMS needs to be updated to cater for the additional valuation input).
- The customers relying on the banks for the fair value calculation would need to understand banks' valuation methodology (e.g., some banks may assume that the ESG targets will be achieved and hence will incorporate the "reduced" rate into the valuation model).
- Customer may determine the ESG component is immaterial and hence ignore it when valuing the instrument.

Measurement

- Derivative financial instrument.
- Split between assets and liabilities (on a contract-by-contract level).
- Split between non-current and current portion.

Classification

If the underlying hedge item does not contain the same ESG feature, there is an "imbalance" between the hedging instrument and the hedged item, which, if material, can disturb the economic relationship and potentially make hedge accounting more challenging.

Hedge accounting

 No difference to the "standard" derivative contract, the derivative is recorded at the trade date.

Recognition

- Accounting policy for derivative needs to be disclosed.
- Standard AASB 7 disclosures for financial instruments.
- AASB 13 disclosures, with an emphasis, if material, on valuation approach take when valuing the "likelihood" of achieving the designated ESG targets.

FS disclosures



# ESG Products – Accounting implications ESG-linked loan (holder/borrower)

- ESG loans (or sustainability-linked loans) are structured so that the interest rate varies depending on whether the borrower achieves the defined ESG targets.
- The contingent rate adjustments introduce additional variability to the cash flows of the loan (which is linked to the underlying ESG performance of the borrower) that may not be consistent with a basic lending arrangement.

How it works?

- If the ESG component/feature is "de minimis" or non-genuine, it can be disregarded for the purposes of the SPPI test.
- If the ESG component is material enough to result in the loan not passing the SPPI test, loan will have to be measured at fair value.

Measurement

 The ESG component, if material, may result in the ESG-linked loan not passing the SPPI test (return is not solely a return for the basic lending arrangement: time value of the money, credit risk, other lending costs (liquidity risk, administrative cost, profit margin)) which means the holder of the loan will need to classify/measure the loan at fair value through profit and loss (not at amortised cost).

The borrower continues to recognise the loan following the chosen accounting policy (amortised cost or fair value).

Classification

If the underlying hedging instrument does not contain the same ESG feature, there is an imbalance between the hedged item and the hedging instrument, which, if material, can disturb the economic relationship and potentially make hedge accounting more challenging.

Hedge accounting

No changes expected.

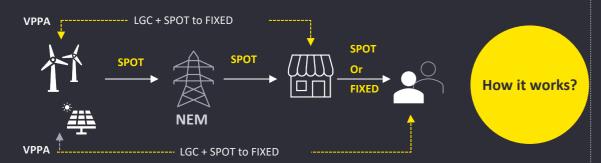
Recognition

- Accounting policy determining framework assessing the impact of the ESG features on the SPPI test needs to be disclosed.
- Standard AASB 7 disclosures for financial instruments are required.
- AASB 13 disclosures, with an emphasis, if material, on valuation approach taken when valuing the "likelihood" of achieving the designated ESG targets.

FS disclosures



### ESG Products – Accounting implications Power Purchase Agreements (synthetic or VPPA)



- Electricity derivative is measured at fair value with the changes in the fair value recognised in the PL, unless hedge accounting is applied.
- EC measurement depends on the chosen accounting policy and business mode
  - Inventory (cost vs NRV or fair value less cost to sell) or
  - Intangibles (cost less any impairment vs revaluation model).

Measurement

- VPPA is considered a host environmental certificate (EC) contract ("green component") with an embedded electricity derivative ("black component").
- The embedded electricity derivative needs to be bifurcated from the host contract and accounted separately (at day one).
- Energy certificates are classified as:
  - Inventories or
  - Intangible assets.

- Classification
- It is possible to designate the electricity derivative into a hedge relationship, providing that all the AASB 9 hedge accounting requirements are met (economic relationship, impact of the credit risk, eligible hedged item, highly probable forecast of electricity purchase, hedge accounting documentation, etc.).
- Detailed analysis is required before hedge accounting designation to assess all the criteria.

Hedge accounting

- Electricity component classified as a derivative financial instrument is recognised at the trade date.
- Environmental certificate (e.g., LGC) are recognised when purchased (at cost).

Recognition

- Accounting policies for embedded derivative and EC need to be disclosed.
- Standard AASB 102 or AASB 138 disclosure requirements for EC, depending on the chosen accounting policy.
- Standard AASB 7 disclosures for financial instruments.
- AASB 13 disclosures, with an emphasis on the Level 3 hierarchy related disclosures.

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