CORPORATE DEBT AND TREASURY REPORT

ISSUE 8

APRIL 2022

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Executive summary

- The positive outlook noted in our 2021 research has receded with a combination of post-pandemic supply chain and energy cost issues as well as inflationary pressures and other factors directly and indirectly posing challenges to a number of aspects of corporate treasury. Those challenges though are not expected to curtail the supply of debt but may impact on terms, pricing and the timing of raising debt.
- ESG and sustainability continues to be **the** topic of treasury conversations and its adoption and evolution will continue for some time, particularly as it percolates through all forms of corporate debt finance.
- Over 70% of respondents expect to include ESG or sustainability features in their next financing with the impediments to doing so weakening as ESG and sustainability in debt finance becomes better understood. Sustainability-linked loans and bonds amount to almost half of all Sustainable Finance of respondents. Notwithstanding the seemingly unstoppable trend towards implementing ESG and Sustainable Finance, a number of respondents queried whether it is justified given the time and incremental cost involved. The more fundamental trend is a company's attitude towards ESG and sustainability is increasingly likely to drive the binary decision by debt investors and lenders of whether to lend or not.
- Significant year on year increases in corporate expenditure are predicted both on investment (capital expenditure and working capital, the latter often driven through supply chain pressures) and distributions to shareholders.
- As expected, treasury appetite to use cryptocurrencies is extremely low with significant hurdles to be overcome if it is ever to become a typical feature of corporate treasury. This is a trend we will monitor over the longer term.

About our research and report

At the time of commissioning our survey the invasion of Ukraine had not taken place and, without wishing to mention this without acknowledging the terrible human suffering caused by that invasion, the immediate political and economic consequences of the impact of that are not materially addressed in our survey responses or in this report more generally.

This research comprises a survey of, and follow-up interviews with, finance and treasury professionals at over 80 large UK corporates (primarily FTSE 100, FTSE 250 and equivalents) conducted in January to March 2022.

We hope you find these findings informative and would like to thank those who participated in our research. In particular, we are grateful to those who took part in our follow-up interviews to discuss the survey results. Their views added depth to the research findings and their input has been invaluable. Thank you.

If you have any feedback on the research or its results, we would be very happy to receive it. We would also be delighted to hear from you if you are happy to take part in our research next year as we aim to make this report as useful to the treasury community as possible.

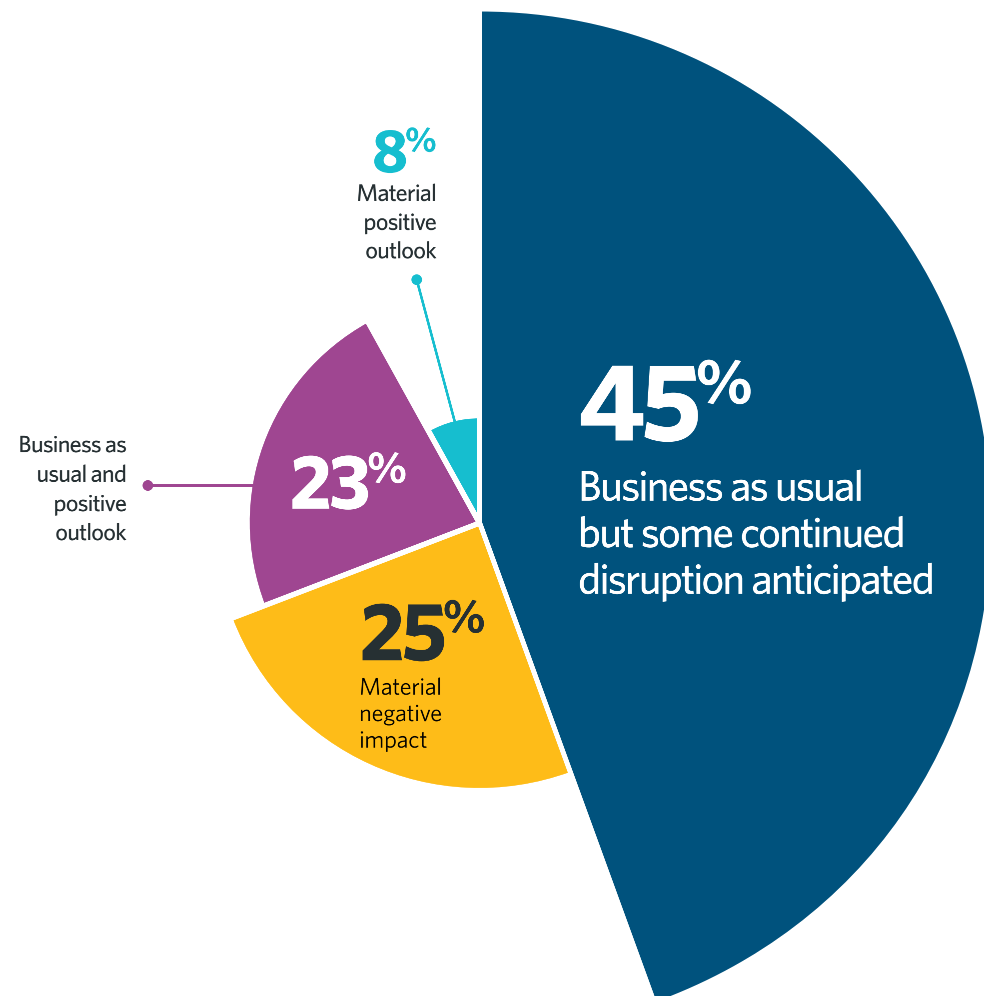
Some of the themes explored in this report are necessarily only addressed in headline terms. Over the course of the rest of the year, we will issue short form, practical insights on some of these issues and share views from other treasury professionals. If you would like to receive those please email laura.darke@hsf.com.

1 MACRO-ECONOMIC AND SOCIAL EVENTS

1 MACRO-ECONOMIC & SOCIAL EVENTS

1.1 IMPACT ON BUSINESS

What is the impact of current macro-economic events (CoVid, post-Brexit trading, supply-chain issues, rising inflation etc.) on your business?



- Perhaps unsurprisingly 70% of respondents noted a neutral to negative outlook. Despite the positive signs of the disruption caused by the CoVid pandemic receding, the threats of inflation, spiralling energy costs and ongoing supply chain issues (eg the recent Suez Canal blockage being one cited example and the shortages of certain raw materials being another) were noted as headwinds. This has been exacerbated for some by the invasion of Ukraine.
- Some respondents noted that just in time supply chains could no longer always be relied upon and they expected increasing levels of working capital employed as companies looked to build a larger buffer of stock/raw materials.
- Related to this, the risk of the Brexit UK-EU trade deal unwinding due to the operation or potential suspension of the Northern Ireland protocol was raised as a potential risk to continued business investment and overall business health.
- A number of respondents questioned how as many as 8% of respondents could be facing a material positive outlook currently. In our view this is likely to be sector specific, eg driven by energy and natural resources.

"it is time to double-down on your supply chain"

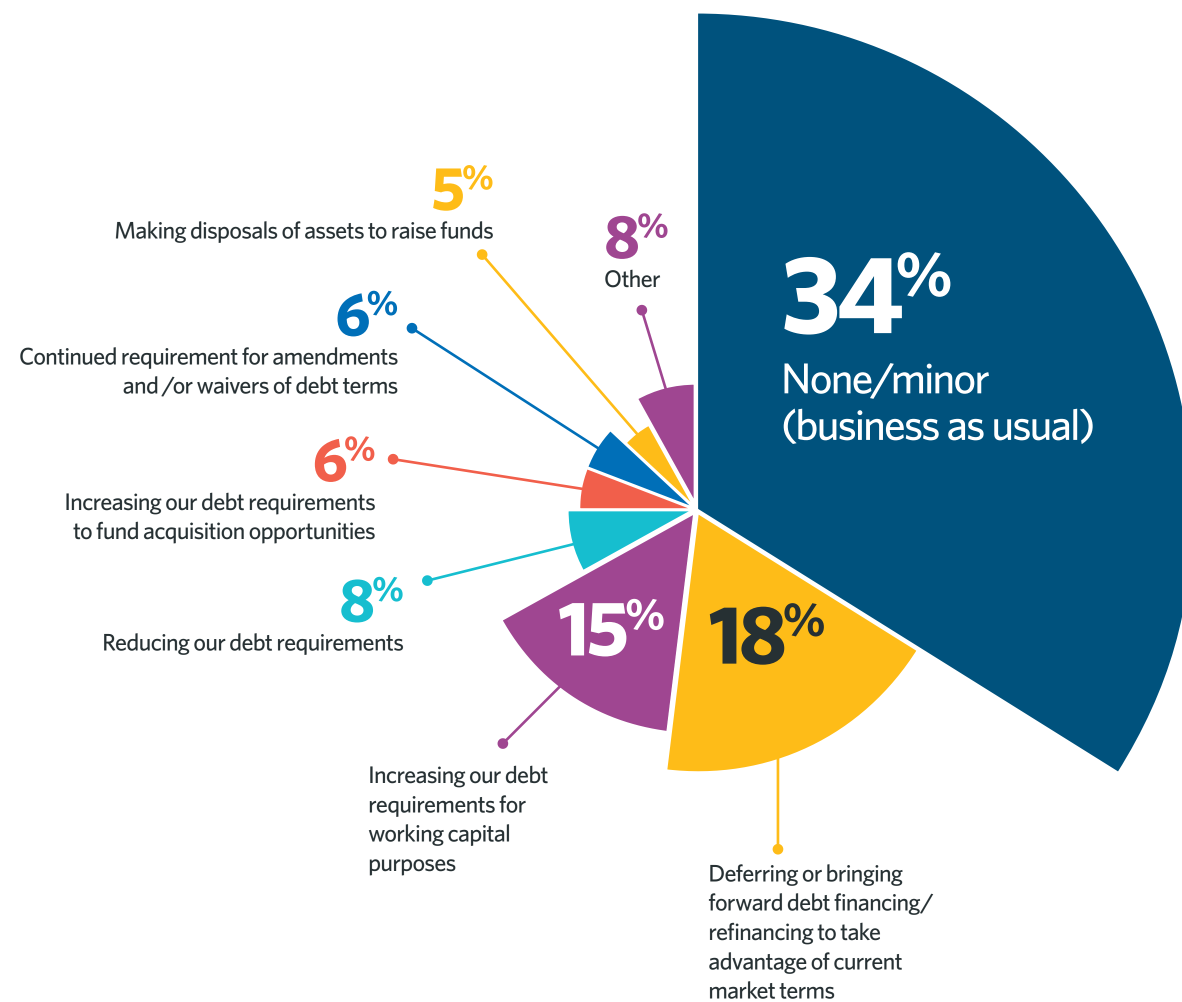
"which other countries will cause problems due to the West offshoring everything?"

"war is the third major crisis for the UK in the last few years and so maybe we should always be in crisis mode or assume another crisis is ahead and work on supply chain resilience, more working capital, more inventory"

1 MACRO-ECONOMIC & SOCIAL EVENTS

1.2 IMPACT ON DEBT STRATEGY

What is the impact of such events on your 2022 debt strategy?



- Notwithstanding the broader prevailing economic and political uncertainty, a third of respondents did not expect this to impact their debt strategy in 2022, reflecting a high level of confidence in the resilience of the debt markets.
- Views are however polarised; on the one hand some respondents noted that the pandemic had triggered the shoring up of balance-sheets thereby removing or reducing the impact of current events on their debt strategy but over a quarter of respondents were taking action to create liquidity or waive debt terms in order to maintain business as usual activity.
- Whilst a third of respondents reported increased year on year spending on acquisitions (see 2.6 (Expenditure) on page 16) only 6% were borrowing for that purpose.
- Anecdotally we do not see current macro-economic and political events having an impact upon the bank lending market and only having peripheral impact in the US private placement (USPP) market. However, the impact has been much more visible in public debt capital markets with significant volatility and periods where the markets have effectively been closed. This has resulted in issuers being quick to issue when windows of opportunity appeared.
- Many noted that they expected financings to be brought forward to seek to lock in costs of funding now given the expectation that rates would now increase in a number of Western markets.

"against the backdrop of 2020, the shoring up of balance-sheets has been done"

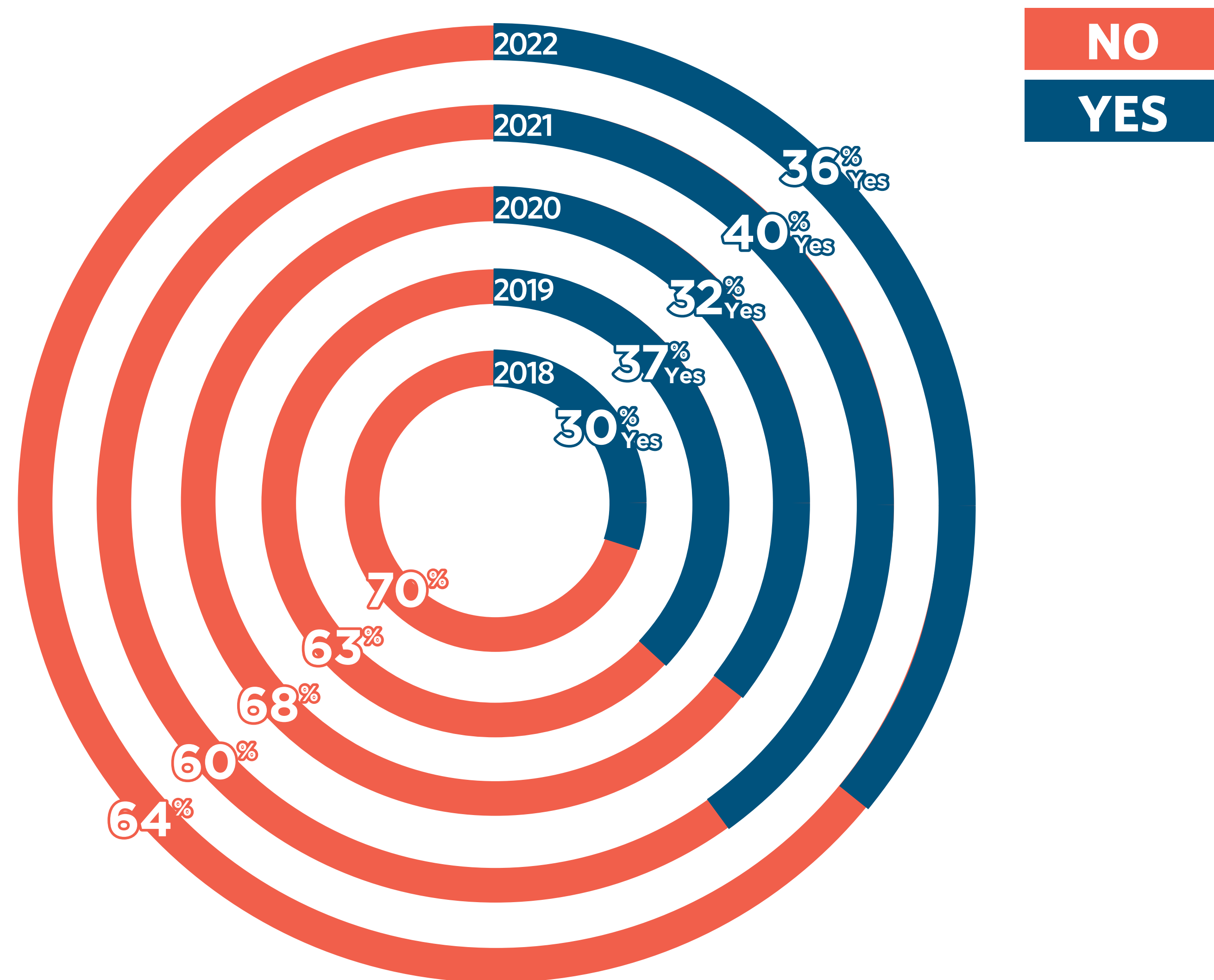
"refinance when you don't have to, don't wait for conditions to improve"

2
DEBT FINANCING

2 DEBT FINANCING

2.1 INCREASE IN NET DEBT

Do you plan to increase your net debt this year (other than as part of usual seasonal adjustments)?

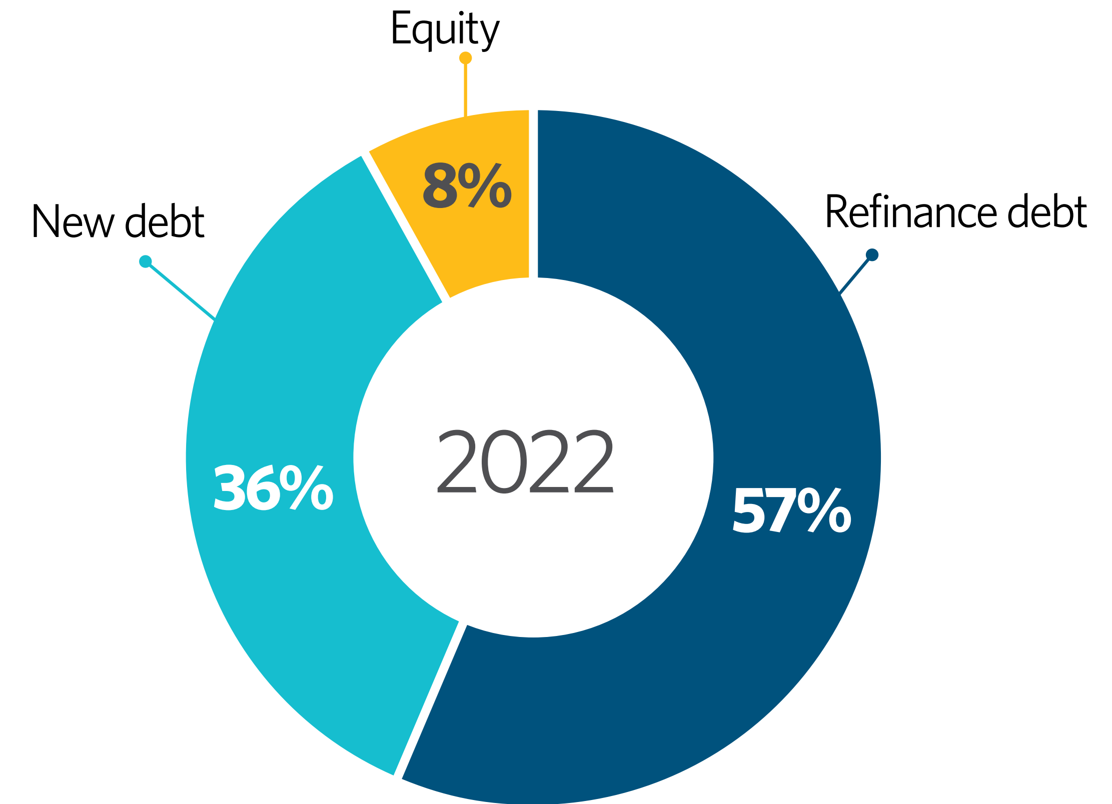


- Some noted that the fall in higher debt levels in 2020 might be explained by the later phasing of capital expenditure and other expenditure because of the CoVid pandemic and the desire to preserve cash, with that resulting in the higher than average increases in 2021 as the costs of the pandemic were funded with debt increases and with a return to more typical results this year.
- One respondent noted that the broadly flat results over many years reflected the fact that debt raisings were typically targeted at least 18 months ahead and, for those with diversified debt capital structures, with staggered maturities to reduce refinancing risk. As such, without systemic market events this average is unlikely to change over time.

Quotes are direct quotes from respondents | Percentages may not total 100 due to rounding

2.2 FINANCING

Of those planning to raise new capital in 2022, the split is as follows:



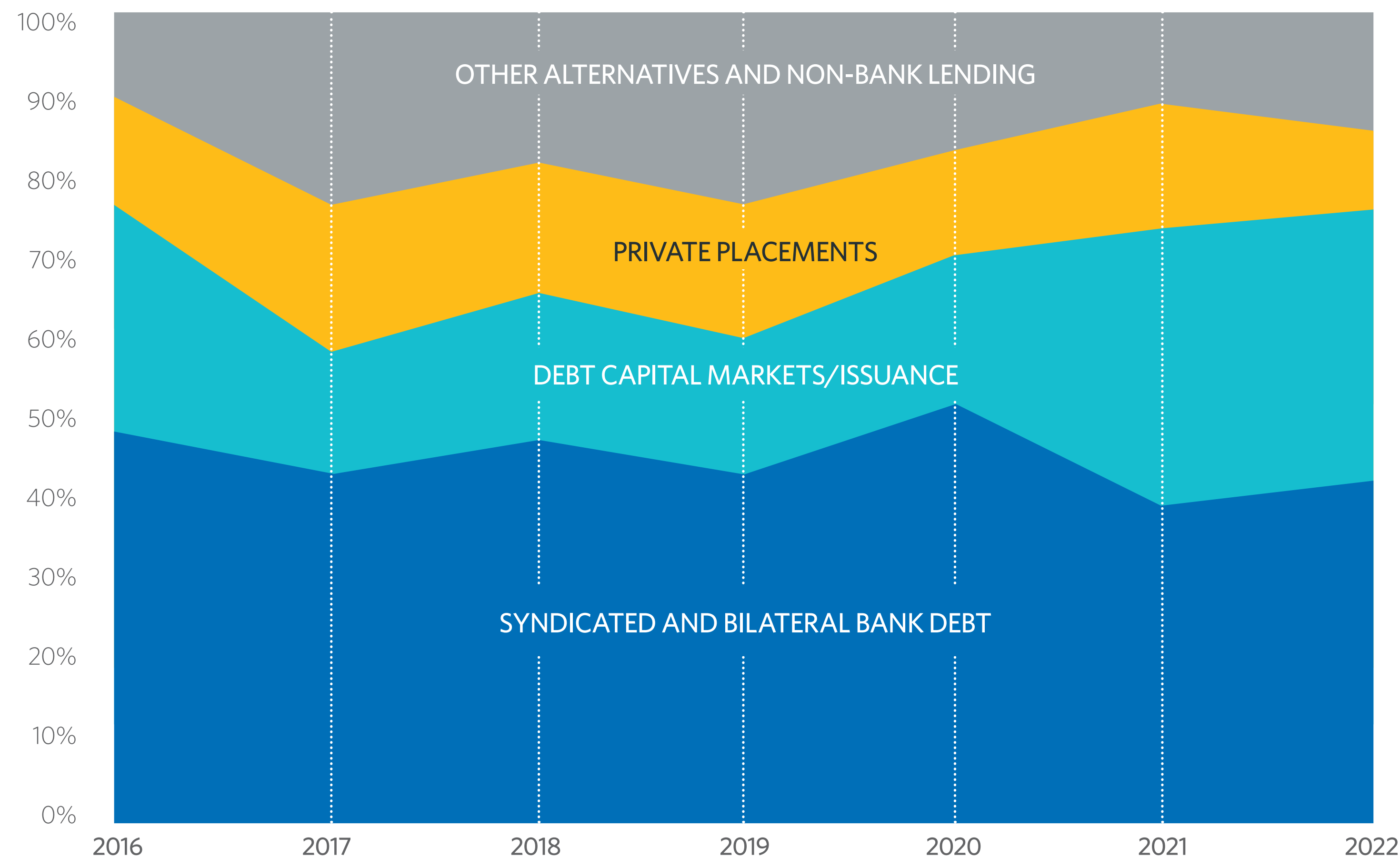
- The results are almost identical to last year, reflecting the ability to continue to raise new and refinance existing debt.
- Over 2021 we have seen stable debt markets with a return to pre-pandemic market trends in many respects. For example, the tenor of bank debt has increased to near pre-pandemic norms with four and five year facilities available (often with extension options) though with significantly cheaper pricing available for three and four year tenors. 2021 was a record-breaking year for the US private placement market with volume of issuances at approximately US$115 billion (as opposed to US$105 billion for 2020), with the financial sector, asset managers and REITs. representing the largest sector by volume*. The interest rate trend has provided some headwinds for long dated notes in the USPP market with yields increasing as expected. Issuers mostly were looking for longer tenors as opposed to investors opting for shorter tenors.
- Volumes in the European investment grade bond markets were overall slightly lower than 2020, given unusually high volumes over the course of 2020, but activity remained strong in the first half of 2021 with a decline in volumes from the second half.
- As noted above, the invasion of Ukraine has caused volatility and uncertainty in the bond markets and when coupled with inflationary pressure is resulting in issuance delays and other complexities in the bond markets.
- Respondents expected those issuing equity to be doing so to fund acquisitions rather than working capital or to bridge the gap caused by the unavailability of debt.

Quotes are direct quotes from respondents | Percentages may not total 100 due to rounding.
*Source: Q4 2021 investment grade private credit market update | February 2022 | SLC Management
https://www.slcmanagement.com/us/en/insights/all-insights/q4-2021-investment-grade-private-credit-market-update/

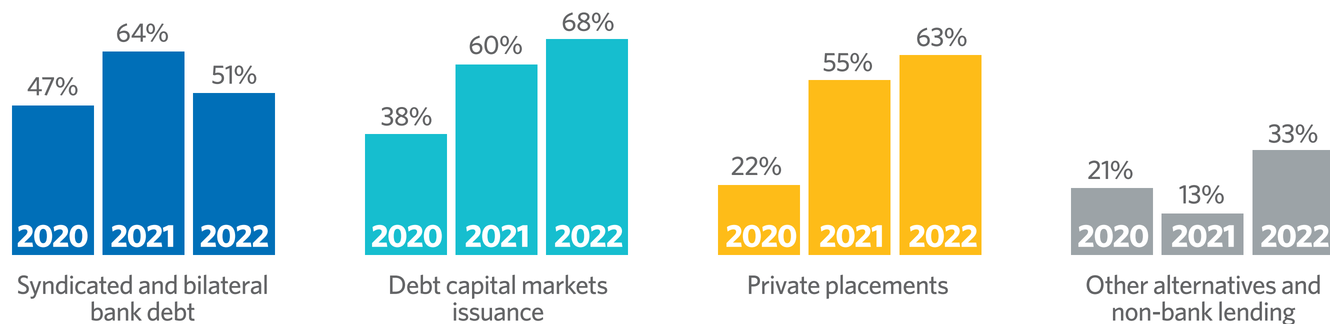
2 DEBT FINANCING

2.3 SOURCES OF ADDITIONAL DEBT

If you plan to raise new debt or refinance existing debt in 2022, how will this be achieved?



2.4 SUSTAINABLE FINANCE AS A PERCENTAGE OF NEW DEBT/REFINANCINGS



Quotes are direct quotes from respondents | Percentages may not total 100 due to rounding

- Respondents noted the year on year sustained focus on raising debt in the debt capital markets, highlighting that they had been largely unaffected by the CoVid pandemic but had been more fragile in the light of the invasion of Ukraine.
- Building on a theme noted last year in our report, those reporting accessing the USPP markets continued to decline and some queried why this was given the robustness of those markets. Others however noted that it was preferable to utilise DCM for longer term debt rather than the USPP markets due to the inherent challenges in obtaining amendments and waivers of covenanted debt with noteholders who are more distant than relationship banks.
- Others reported that they expected an interest rate arbitrage benefit of issuing USPP rather than DCM and that may well be decisive in the shorter term in focussing greater attention on USPP issuance.
- Some respondents raised again this year that supply chain finance had fallen out of favour in some quarters, one citing Carillion as a turning point for SCF.

ESG and Sustainability in debt raising

- The general trend towards ever greater proportions of debt containing ESG or sustainability-linked features continues. In addition, anecdotally, the reticence to engage in ESG and sustainability linked financing seen in some quarters in previous years continues to weaken.

Bank lending

- The 2022 trend of ESG retreating in bank lending is at odds both with the growth of ESG in other debt financings as well as other results in this report and our experience more generally.
- In this market we see increasing numbers of corporates opting for sustainability-linked loans with respondents noting banks fiercely competing for coveted ESG co-ordination roles (more so than other roles). Whilst for most banks this is a league table status and fee earning opportunity we are aware a small number of banks are not seeking fees for this service and are instead focussed on growing ESG and sustainability linked finance as a reflection of their corporate values.
- There was a sense from respondents that not incorporating sustainability linked features now when a corporate otherwise could do so could appear short-sighted in the short to medium term.
- The point was repeatedly made to us that sustainability margin adjustments only meaningfully apply to drawn debt and that, for standby RCFs, where the adjustment ultimately only feeds into the commitment fee, the amounts are too small to be meaningful. We touch on the development of ESG/sustainability linked finance and this specific theme below.

USPP

- The trend in USPPs is more pronounced and in the last two years we have seen a sharp increase in the importance of ESG and sustainability in those debt financings.
- This has particularly been the case for sustainability-linked and green/use-of-proceeds products, with issuers seeking to align their US private placements debt with other debt products and broader ESG agendas. However, the USPP market has so far operated on a margin increase basis for not meeting KPIs but not reductions in yields for meeting KPIs.
- As USPP notes are long-dated instruments, issuers have also focused on building in mechanisms that enable adjustments to KPIs over time as the business evolves.

Bonds

- As with previous years, ESG in the bond markets has been predominantly focused on green bonds. However, 2021 saw an increase in both social and sustainability issuance as well. While the majority of the social and sustainability issuance was made up of sovereigns, supra-nationals and agencies, an increased number of corporates looked to the sustainability bond market.
- Sustainability-linked bonds have come into keen focus during 2021, with a significant rise in volumes and we predict the sustainability-linked bond market will continue to grow over the course of 2022 and beyond. This is because sustainability-linked issuance allows access to the market by a wider pool of potential issuers due to the fact that specific projects are not required.
- Over the course of 2022 and beyond there will be increased regulatory focus on the nature of disclosure made by issuers of ESG bonds.

"the conversations were all about [ESG] when meeting investors, it wasn't about the credit"

"two years ago when we mentioned green they [potential private placement investors] just got their phones out – that's not the case now"

"we're seeing banks actively pulling back from 'brown' investments"

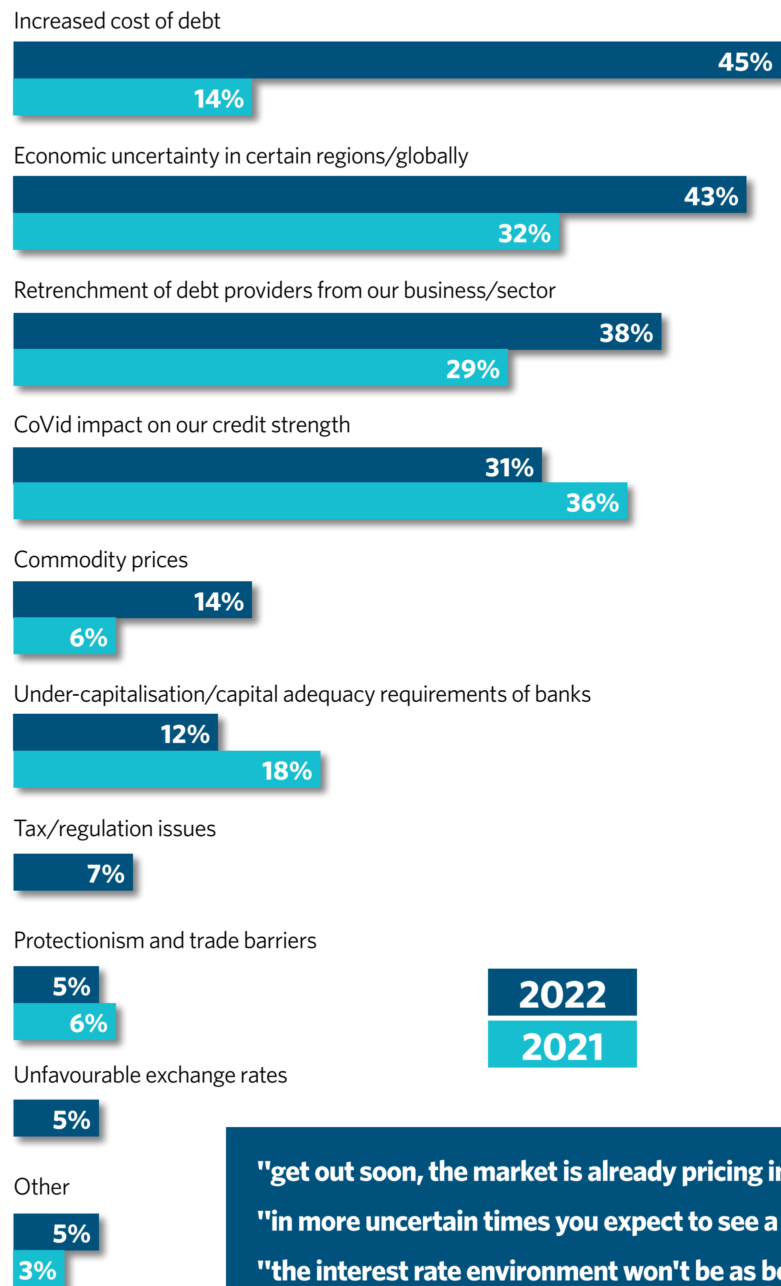
"every single bank wants to talk about ESG"

Quotes are direct quotes from respondents | Percentages may not total 100 due to rounding

2 DEBT FINANCING

2.5 IMPEDIMENTS TO DEBT RAISING

What do you consider to be the major impediments to corporates raising debt in the year ahead?



- The greater levels of optimism which we reported last year have receded with far greater numbers of respondents reporting a wider range of potential impediments.
- The increasing cost of debt is the most reported factor and significantly up on both last year and 2020 (7%). Some respondents queried whether this was really an impediment but it is a clear source of concern and there was a prevailing sense that it would not be prudent to delay debt raising in the hope of a reversal in this trend. Respondents noted a variety of reasons for this including rising inflation and the Ukrainian invasion.
- Allied to this, it is unsurprising that the wider economic and political uncertainty in many regions is a cause for significant concern, and, as noted by one respondent above, crisis management in treasury has become a consistent theme in the last few years.
- Retrenchment by debt providers has also become a recurrent theme as banks have sought to refocus how and where they deploy capital and, as a result, we see more movement in the composition of syndicates in syndicated bank financings than has historically been the case. In response, treasury teams have needed to ensure that they have a broad range of banking relationships to call upon in order to effect a smooth refinancing and to drive the best possible terms.
- The impact of the CoVid pandemic continues to weigh on a number of respondents' businesses. This may relate to the supply chain and other issues that have arisen as a part of the recovery from the pandemic.

"get out soon, the market is already pricing in significant rate rises"

"in more uncertain times you expect to see a flight to quality"

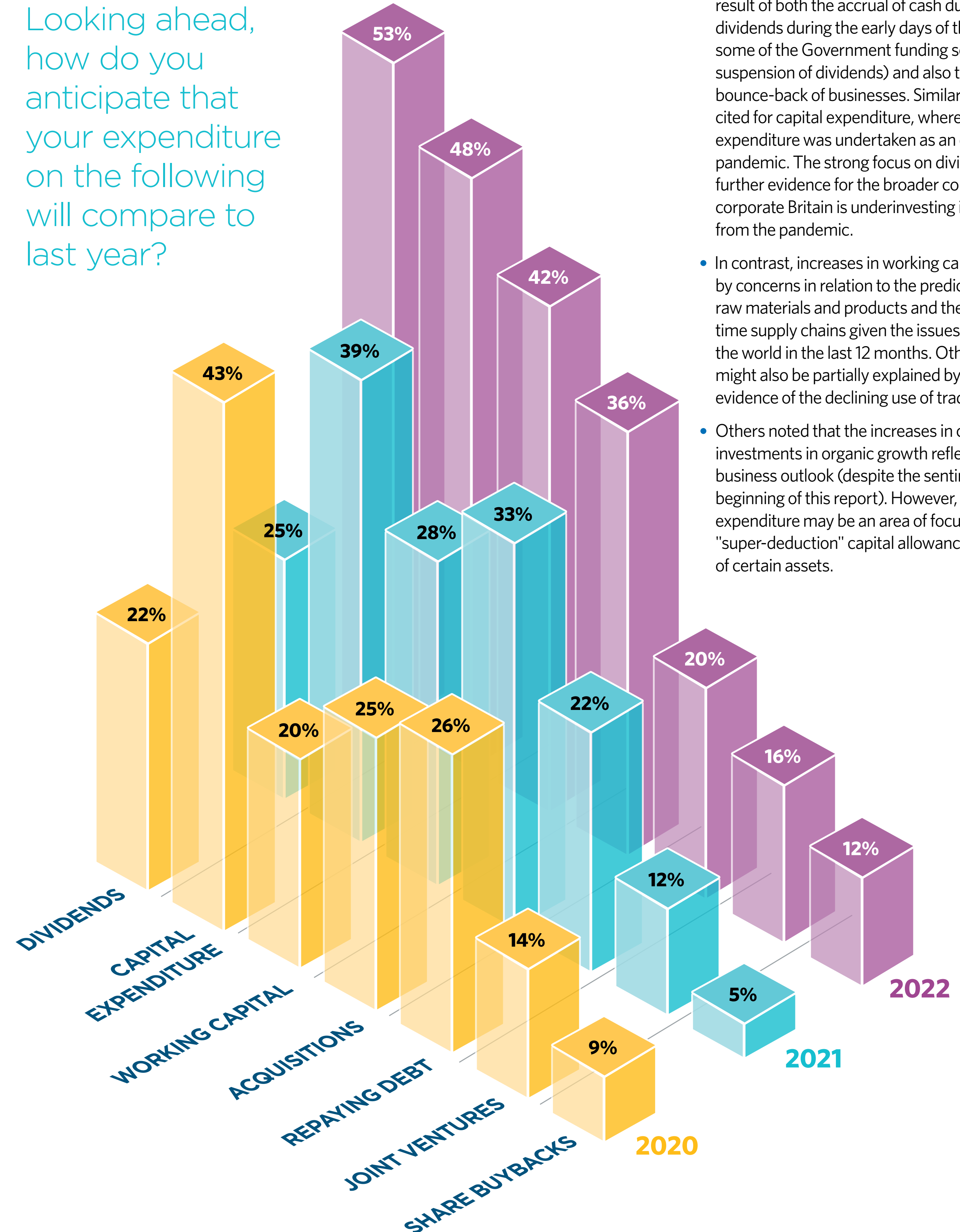
"the interest rate environment won't be as benign as it has been for the last 10 years"

"there may be challenges ahead in the euroland and sterling markets"

Quotes are direct quotes from respondents | Percentages may not total 100 due to rounding or due to the ability to select multiple options

2.6 EXPENDITURE

Looking ahead, how do you anticipate that your expenditure on the following will compare to last year?



- Significant year on year increases in expenditure are predicted. Looking at the specific areas, many respondents rationalised the increase in dividends as the result of both the accrual of cash due to the suspension of dividends during the early days of the pandemic (and some of the Government funding schemes required a suspension of dividends) and also the healthy bounce-back of businesses. Similar reasons were also cited for capital expenditure, where deferral of certain expenditure was undertaken as an early response to the pandemic. The strong focus on dividends will however be further evidence for the broader concerns articulated that corporate Britain is underinvesting in the bounce-back from the pandemic.
- In contrast, increases in working capital may be explained by concerns in relation to the predictability of delivery of raw materials and products and the reliability of just in time supply chains given the issues experienced around the world in the last 12 months. Others noted that this might also be partially explained by the anecdotal evidence of the declining use of trade finance.
- Others noted that the increases in capital expenditure as investments in organic growth reflect a more confident business outlook (despite the sentiments noted at the beginning of this report). However, this type of expenditure may be an area of focus for 2022 due to the "super-deduction" capital allowances available in respect of certain assets.

Quotes are direct quotes from respondents | Percentages may not total 100 due to rounding

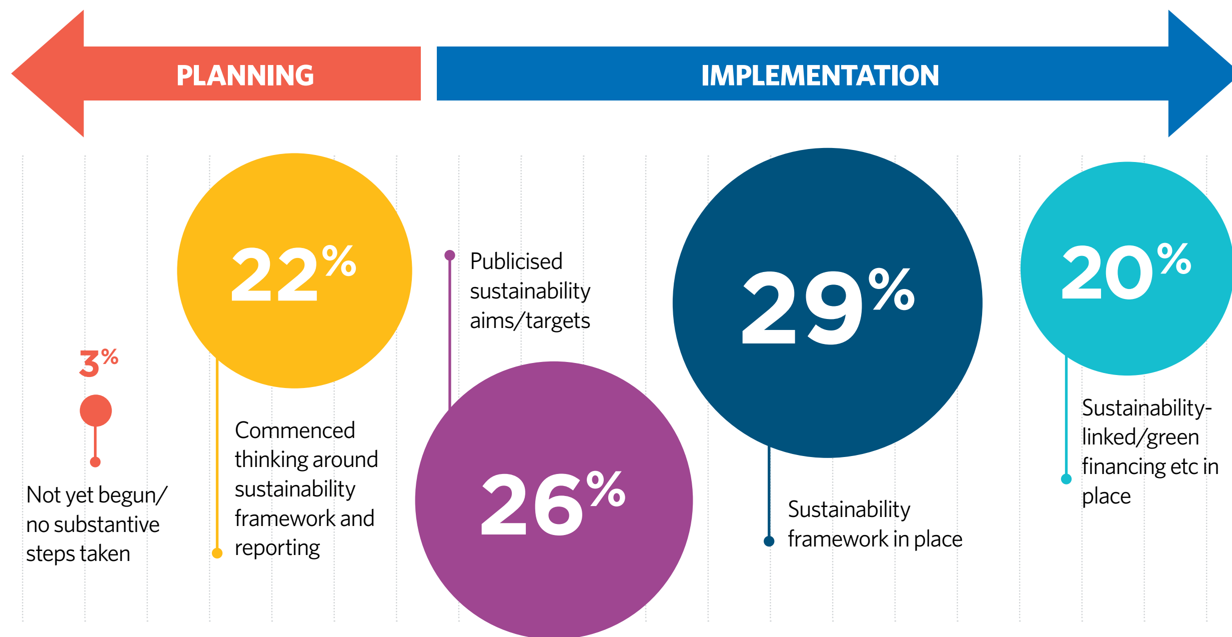
3
ESG AND SUSTAINABLE FINANCE

3 ESG AND SUSTAINABLE FINANCE

In this section, for simplicity, we use the term Sustainable Finance to cover the plethora of ESG, sustainability, green and other related financings

3.1 THE ESG /SUSTAINABILITY JOURNEY

At what stage is your business in its ESG/Sustainability journey?

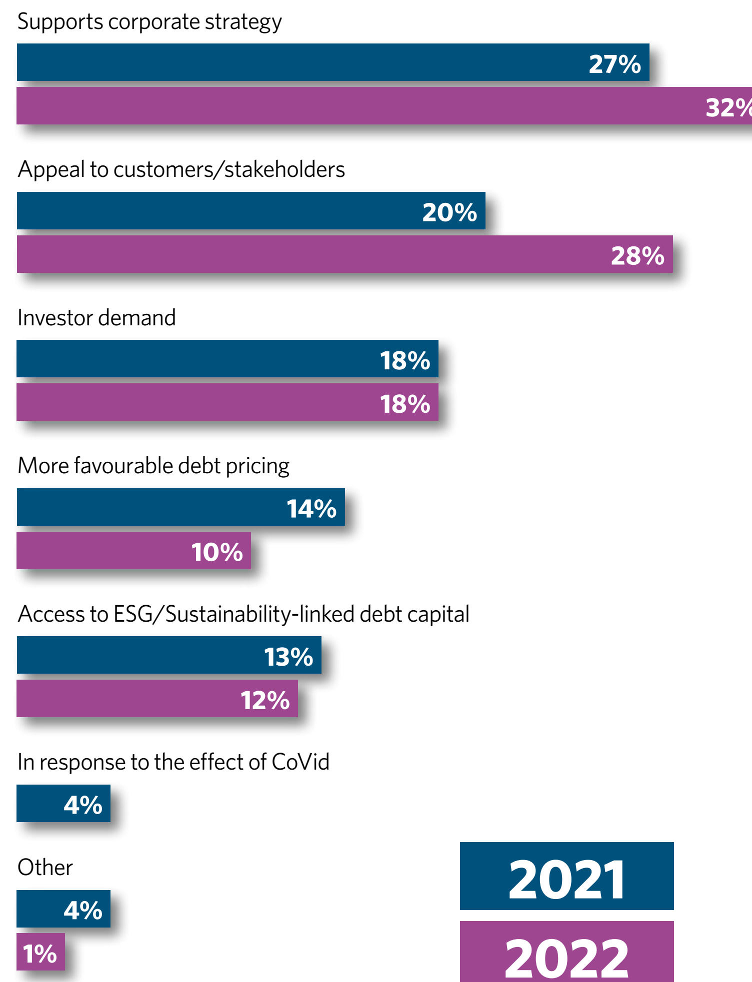


- With 75% of respondents either having issued Sustainable Finance or being in a position where they are likely to be able to do so (as they have either a sustainability framework in place or publicised targets) the growth of opportunity for Sustainable Finance continues to be very strong (though with only 20% of respondents having issued Sustainable Finance clearly there is still significant scope for progress).
- Whilst treasury is a key business function to drive a corporate's ESG and sustainability agenda this can only be progressed in tandem with that company's corporate development/ESG teams. Having a sustainability framework is typically a pre-requisite for Sustainable Finance.
- Some respondents noted that the time and cost of developing sustainability frameworks were significant and should not be under-estimated. Synchronising the implementation of that and raising debt continues to be challenging for a number of corporates.
- On a related theme, some banks (acting as sustainability coordinator) are pushing back on incorporating sustainability linked margin adjustments in loans unless the KPIs are agreed at the time (rather than including the mechanics which are activated once the KPIs are agreed). Whilst this is driven by fears of finger-pointing of green-washing and similar it is unfortunate as the opportunity is lost and there is, understandably, reluctance to re-open loan documents mid-life to address sustainability features. Admittedly this structure would not in any event be feasible for DCM and some USPP funding.
- Banks in particular are becoming even more policy focussed when considering Sustainable Finance and this is, in some cases, weighing adversely on corporate's desire to pursue the Sustainable Finance agenda in bank lending.

> **"it's increasingly part of our DNA, that wouldn't have been the case 2 years ago"**
>
> **"banks are putting real energy into it"**
>
> **"in the future it could be difficult to access funding without some ESG framework in place"**

3.2 THE DRIVERS OF CORPORATE ESG AND SUSTAINABILITY INITIATIVES

What are the key drivers for your ESG/Sustainability initiatives?



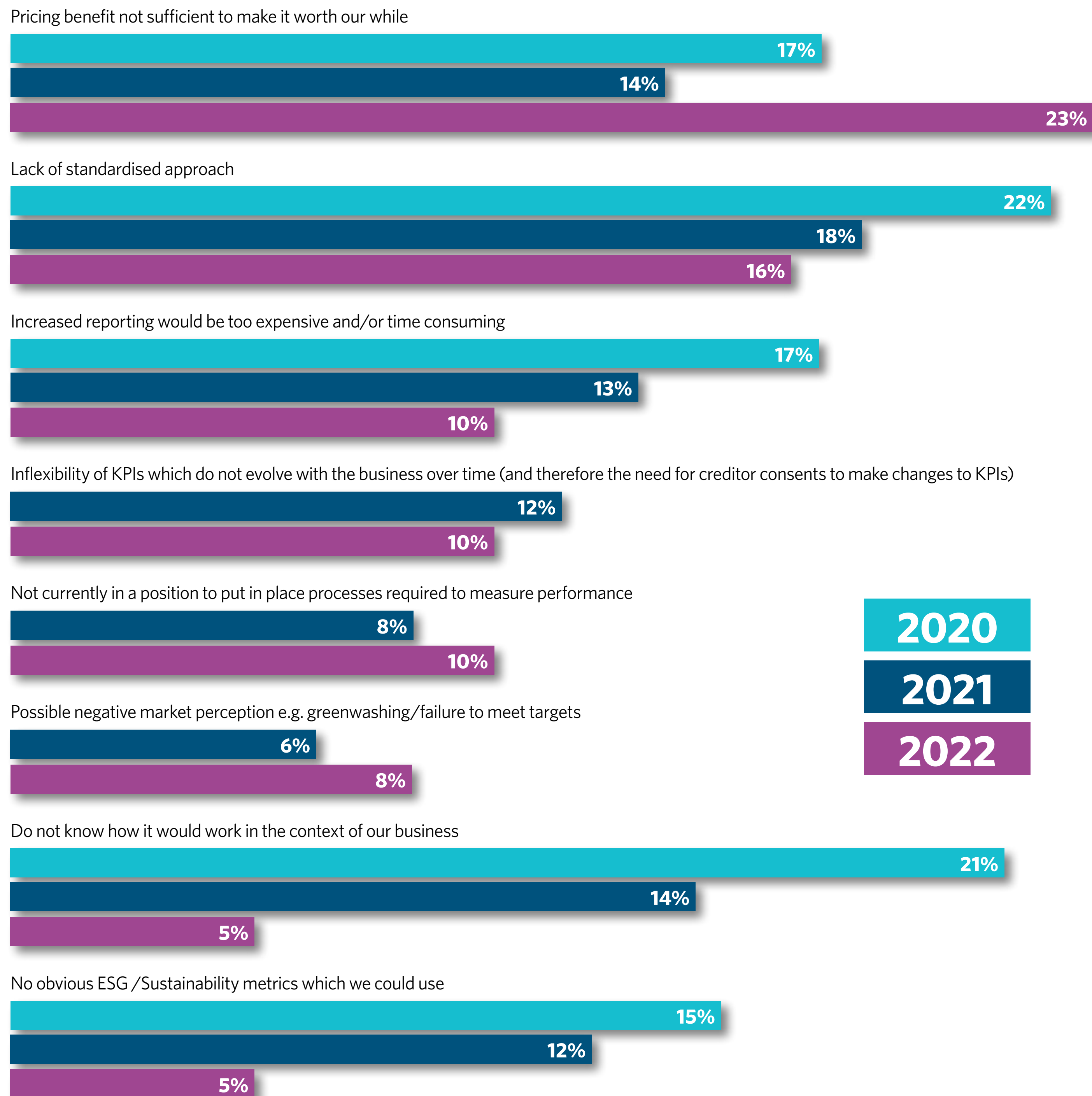
- As noted below, pricing advantages alone are not sufficient to justify the investment in Sustainable Finance and, consistent with that, respondents noted that pricing advantages are not a key driver here. That might support an argument that the most efficient/lightest touch treasury approach to ESG is to support the creation and implementation of the business's sustainability framework but not to pursue Sustainable Finance itself. A number of respondents felt that there needed to be greater pricing differentials in order for Sustainable Finance to drive meeting ESG commitments (though this was not perceived as something that would happen in anything but the longer term). This approach also follows the argument that investors will be convinced to lend and invest by the corporate's wider approach to sustainability rather than the terms of Sustainable Finance itself.
- However, contrary views were expressed that treasury teams had helped build momentum for the implementation of ESG and sustainability in their businesses and Sustainable Finance was a key output of that and evidence of a corporate holding itself accountable (however modest the pricing implications might be) to its ESG and sustainability goals.
- The growing drivers of supporting corporate strategy and appeal to stakeholders were not surprising and this accords with our discussions with corporate treasury teams.

> **"ESG in debt financing is primarily a PR tool. I don't believe any business will do anything differently because of metrics in their debt documents."**
>
> **"we have a sustainability linked bank loan in place. There are fewer obvious benefits from a sustainability linked DCM issue – as bond pricing does not drop if KPIs are met"**
>
> **"we saw new investors we hadn't seen before in our recent roadshow and that's a key driver of engaging on this."**

3 ESG & SUSTAINABLE FINANCE

3.3 IMPEDIMENTS

To the extent that you have not incorporated ESG /Sustainability elements into your financings, what are the impediments to doing so?



- Despite the general trend of fewer respondents reporting impediments to Sustainable Finance, the increase in those reporting that the pricing benefit is insufficient to justify the investment did not accord with respondent sentiment last year. This perhaps reflects that, when calculated from a cost: financing benefit perspective, the costs of implementing ESG strategies, frameworks, financings and reporting outweighs the financing savings available. In our experience this has often been the case as we noted in relation to the broader drivers for ESG financing above.
- Fewer concerns were voiced as to standardisation of approach, possibly as market participants become more familiar with the processes and documentation associated with Sustainable Finance and, for many, sustainability linked loans remain the best understood form of Sustainable Finance.
- The significant year on year falls in the number of respondents reporting that they would not know how Sustainable Finance would work in the context of their business or there being no obvious KPIs reflects how much better ESG and Sustainable Finance is understood in the treasury community.
- Though the numbers of respondents noting the cost and time of ESG reporting as an impediment was falling, conversely the complexity of reporting is increasing though it may be that standardisation of that over the longer term will result in that becoming less of an area of focus. In addition, as ESG reporting is often driven by other factors (eg investors and listing regimes) it is less perceived as a specific cost of implementing Sustainable Finance.
- To the extent that KPI performance is in part determined by whether a corporate was able to change behaviours in its supply chain, the data collation element of that performance is increasingly complex and new KPI performance calculation and verification services have grown off the back of KPI calculations and reporting.
- Whilst we touch on the inability of conventionally constructed KPIs to evolve with the business towards the end of this section of our report, some respondents noted that it was sometimes difficult to reconcile long term corporate ESG targets with the annual incremental targets sought in sustainability linked debt products.
- ESG continues to evolve and KPIs are becoming better understood by wider business audiences, particularly those relating to decarbonisation. Whilst the 'E' is the best understood and most consistently reported, the 'S' and 'G' factors continue to evolve and often tend to be more borrower/issuer specific.

"in addition to the small potential pricing benefit, there are no other perceived benefits to the group to make it worthwhile"

"we would not be in a sensible place to ignore this"

"the pricing benefit isn't there but it's not stopping us from pursuing ESG goals."

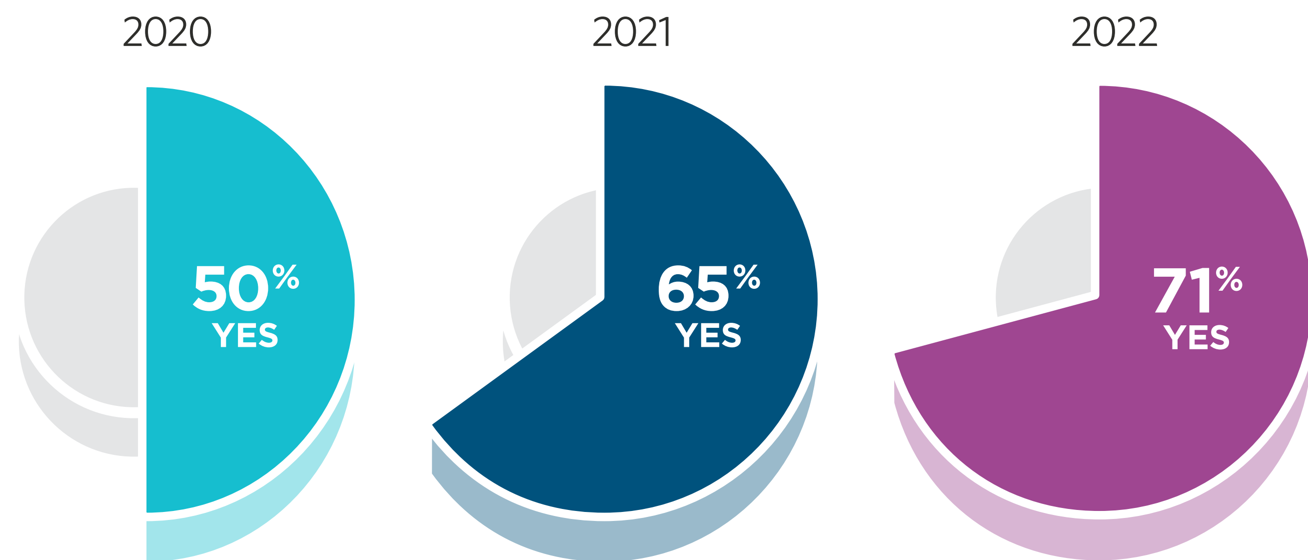
Quotes are direct quotes from respondents | Percentages may not total 100 due to rounding

Quotes are direct quotes from respondents | Percentages may not total 100 due to rounding

3 ESG AND SUSTAINABLE FINANCE

3.4 NEXT FINANCING

Do you plan to include ESG features in your next financing and what are the key drivers for this?



- Whilst the existing positive trajectory continues, in follow-up interviews a number of respondents indicated that the figure of 29% of respondents predicting that they would not include ESG features in their next financing remained higher than they would expect given the wider environment.
- This might be because of the tension between the required timing for raising debt and the longer term project to create a sustainability framework as noted above.
- From a sustainability linked borrowing perspective (ie incorporating ESG KPIs as opposed to use of proceeds financing) some question whether it is more important from a debt raising perspective to have a sustainability framework in place whether or not Sustainable Finance is implemented (on the basis that debt providers will focus more on that as part of their decision to lend rather than the KPI performance related margin adjustments). As noted elsewhere in this section, margin adjustments alone are not the driver of Sustainable Finance.

"you'll need to be very good at selling the ESG story, it will be a necessary part of the credit story"

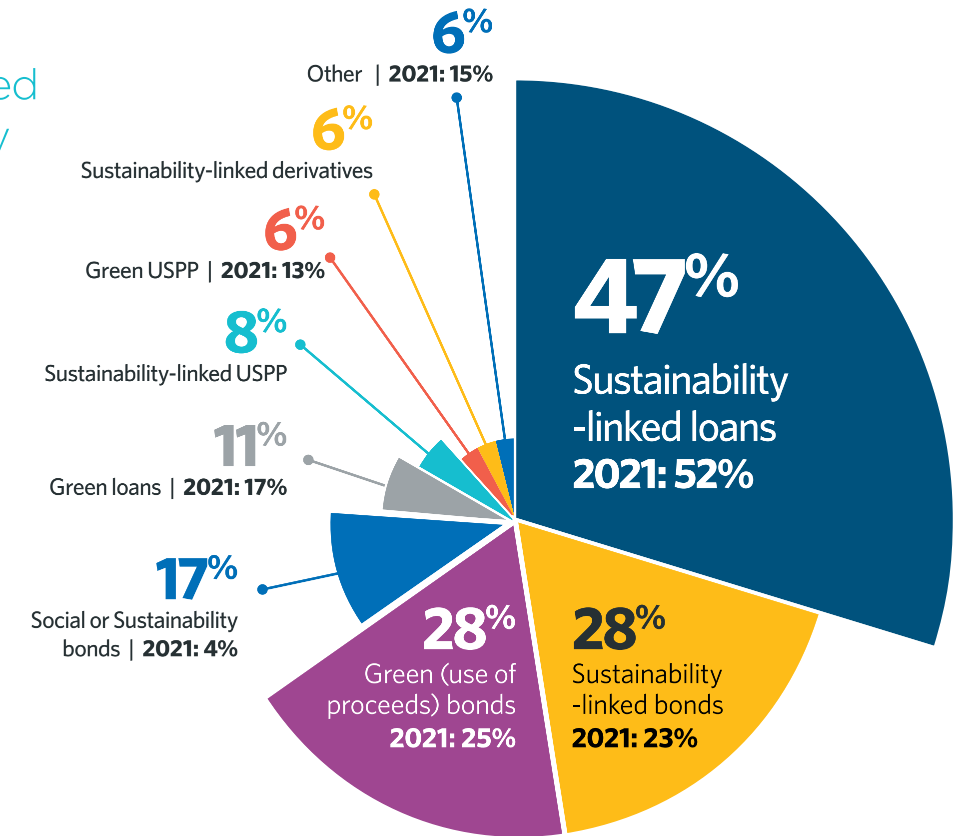
"sustainability-linked loans are becoming business as usual, it's no longer optional"

"you expect an ESG angle, it would be remiss not to include it"

Quotes are direct quotes from respondents | Percentages may not total 100 due to rounding or the ability to select multiple options

3.5 NEXT ESG /SUSTAINABILITY-LINKED FINANCING

Which of the following ESG/Sustainability-linked financings are you likely to enter into in the next 12 months?



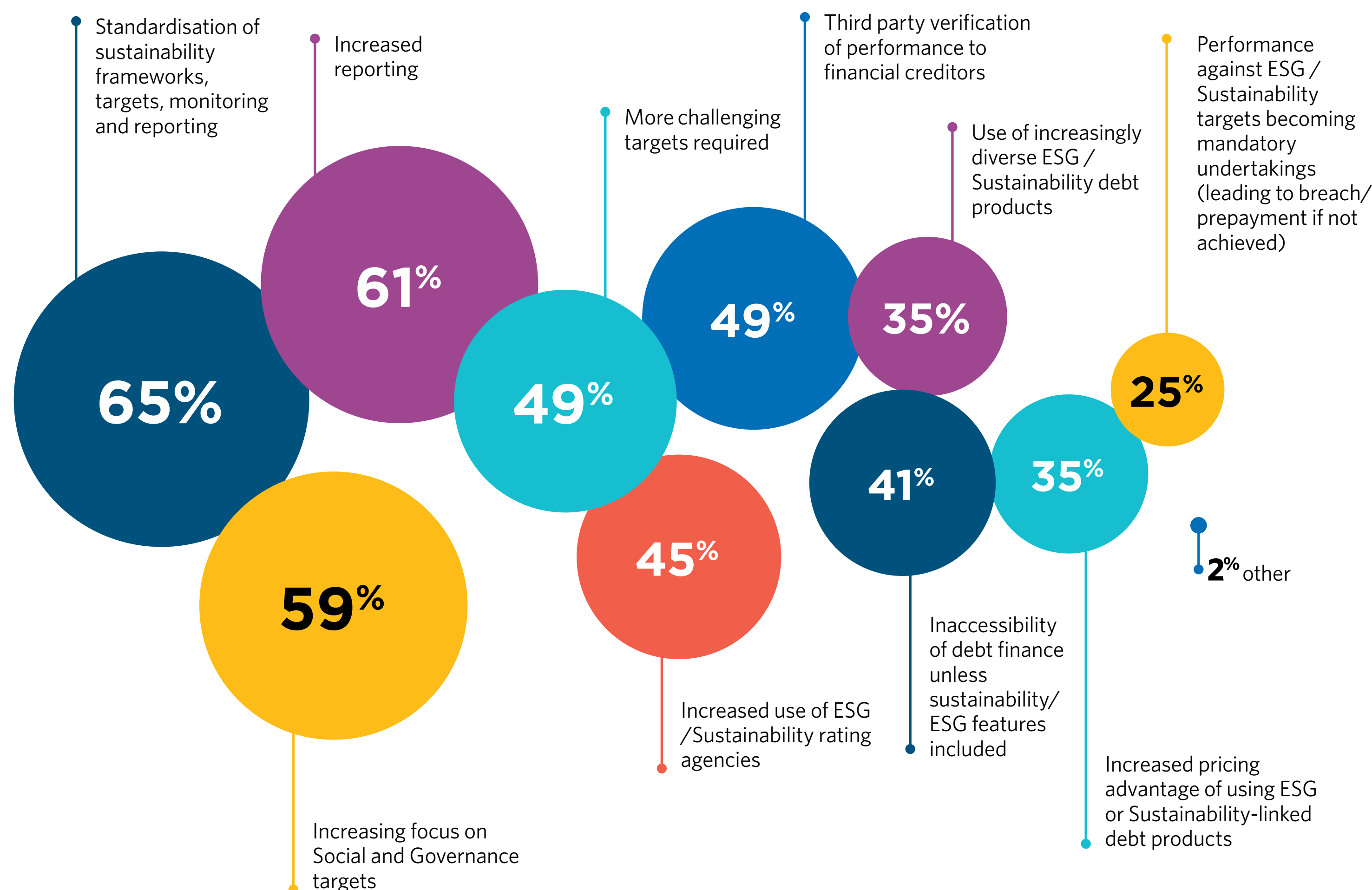
- We note a broader split across Sustainable Finance products compared to our results in 2021.
- As in 2021, sustainability-linked loans remained the most likely Sustainable Financing to be implemented, reflecting both the more standardised approach to those financings (with KPIs tailored to that corporate) but also the ability of that product to be utilised across businesses without the need to focus on use of proceeds and a relatively light touch reporting process.
- Some respondents noted that different types of Sustainable Financings would involve greater maintenance and administration than others. For example the level of time and management in issuing and monitoring compliance with a use of proceeds bond would be significantly greater than a sustainability linked loan.
- As corporates take the first step of implementing a sustainability linked loan we would expect that the evolution of their capital structures may reflect a focus on specific ESG related projects which are more suited to use of proceeds ESG financings (whether loans, private placements or bonds) over time.
- Some respondents noted that ESG had also permeated the deposit side of treasury operations with ESG-linked investments increasingly available (though often at a lower rate of return compared to conventional deposits).
- Some respondents noted that the US private placement market in some respects lagged behind other private placement markets (as well as the loan market and DCM) as the focus on ESG had taken hold in Europe earlier than the United States. The growth of ESG in the United States may therefore translate into larger volumes of ESG issuances in the USPP market as a whole in subsequent years, whether that growth is driven by issuer demand or increased receptivity of USPP investors to ESG products.
- Notwithstanding the decrease in potential green USPP issuances by respondents, the growth of sustainability-linked USPPs (as compared to 2021) reflects our broader experience in the market, with sustainability-linked private placements with one-way pricing more common than two-way pricing.
- With a rise in sustainability-linked bonds being issued by a wider range of issuers, it may be that some bond issuers prefer to issue this type of instrument going forwards, given there is no need to identify specific projects to be funded by that bond.
- The increased focus on social and sustainability (use of proceeds) bonds (as compared to 2021) is in line with our experience across the bond markets as many issuers now incorporate social and sustainable categories into their frameworks and transactions. This upward trend is likely to continue, particularly as regulatory developments such as the EU Social Taxonomy strengthen confidence in the market.

Quotes are direct quotes from respondents | Percentages may not total 100 due to rounding

3 ESG & SUSTAINABLE FINANCE

3.6 THE EVOLUTION OF ESG/SUSTAINABILITY IN CORPORATE TREASURY

How do you see ESG/Sustainability evolving in corporate treasury?



- Significant further evolution of various aspects of ESG in treasury is predicted. Some will place greater demands on treasury teams, others will apply to the corporate more widely though comparatively fewer respondents felt that ESG targets would harden into mandatory undertakings in financings or necessarily that pricing upsides/downsides would widen. Similarly, few thought that the reporting and verification regimes would expand to provide direct reliance to funders from verification providers.
- Whilst standardisation remains a core focus for the evolution of ESG financing, there are differing degrees of evolution across different Sustainable Financings and also different degrees of evolution across the various workstreams relating to those financings (such as reporting, disclosure, alignment with regulatory regimes etc). As such the standardisation process is likely to continue for some time (and for as long as the other factors reported opposite continue to evolve).
- In some senses the regulatory environment is not driving standardisation. In the loan market for example, whilst sustainability coordinators may make reference to the EU taxonomy or the LMA sustainability linked loan principles, the former rarely impacts on negotiations or documentation and the latter is often misquoted in terms of its scope or as being mandatory, but in any event is typically largely automatically reflected in documentation without material discussion.
- Others referred to the rise of ESG ratings and raised concerns that the processes used for rating the companies were not necessarily interactive processes, with only public information, without verification or commentary from the company in question, being used to establish the ratings.

"ESG is quite tough, there's a lot of work to do to make a meaningful difference"

"I am not convinced there will be lower pricing for good ESG performance"

"ESG is a huge part of good corporate governance"

"ESG is too large for treasury to drive in isolation"

Quotes are direct quotes from respondents | Percentages may not total 100 due to rounding or the ability to select multiple options

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3 ESG AND SUSTAINABLE FINANCE

3.7 NORMALISATION

Has ESG /Sustainability become the norm in your principal debt financings?

53% NO

47% YES

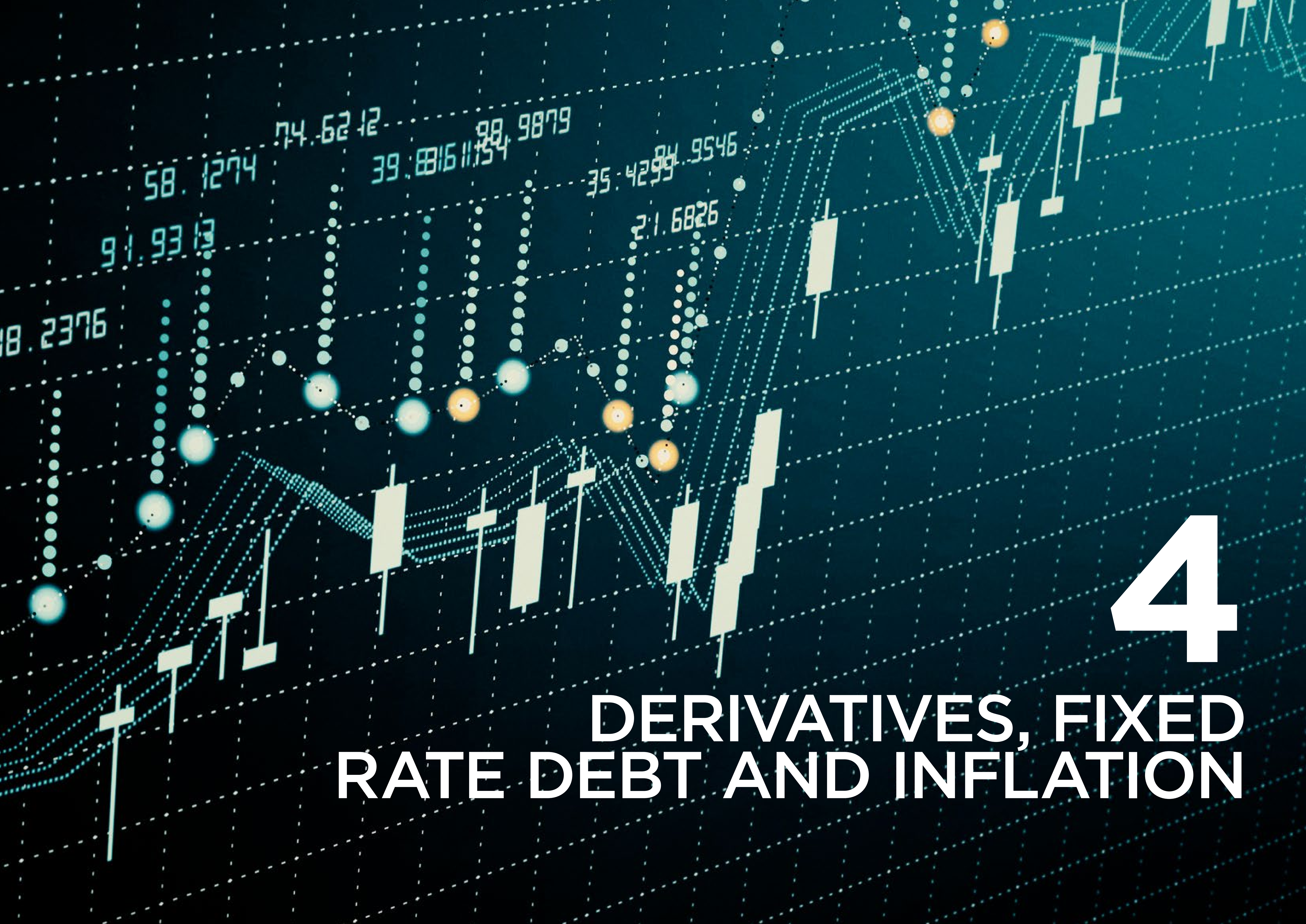
- At roughly equal proportions respondents reported very different experiences of the role of their treasury teams in the implementation of ESG strategy.
- **From the most involved:**

> **"Treasury has led the effort in developing the sustainable financing strategy from approving the strategy, publishing the framework, issuing debt and preparing reports"**
>
> **"we were amongst the first in the company to focus on ESG as it came in feedback from investors and ratings agencies"**
>
> **"Treasury is pushing forward the requirement for a framework to be in place with help from the sustainability team."**

- **To a wider team approach:**

> **"pivotal but in a support capacity to the business and the sustainability team"**
>
> **"sustainability goals are driven by a specialist team. Treasury are working alongside to establish a sustainability linked financing."**
>
> **"we are working closely with the group's sustainability team to ensure that what we do complements and reinforces existing sustainability team's initiatives... Treasury should not be pursuing or leading the ESG agenda."**
>
> **"we are supporting rather than driving the strategy and approach – treasury cannot on its own change the culture of an organisation"**

Quotes are direct quotes from respondents | Percentages may not total 100 due to rounding



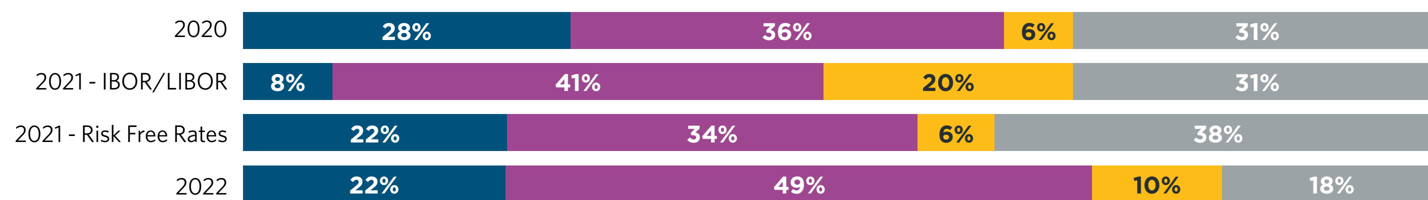
4 DERIVATIVES, FIXED RATE DEBT AND INFLATION

4 DERIVATIVES

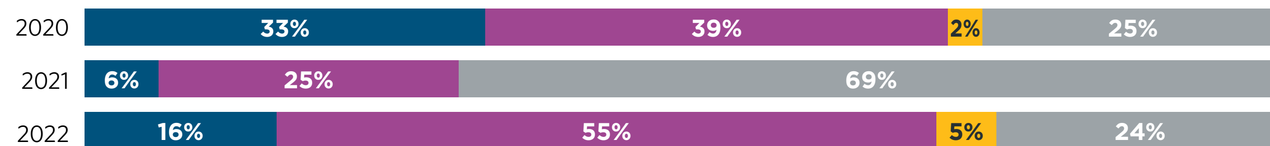
4.1 2022 DERIVATIVES FORECAST

Compared to 2021, do you anticipate that you will enter into more or less of the following treasury products in 2022?

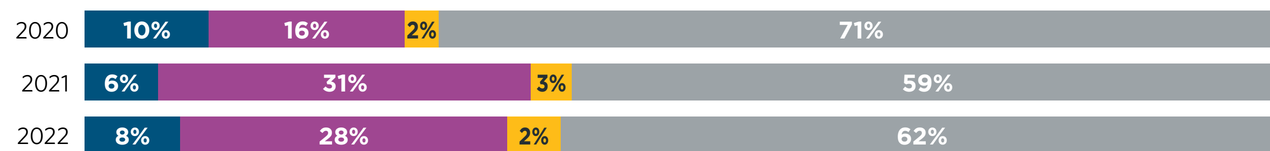
Interest rate derivatives



Currency derivatives



Commodity derivatives



Inflation linked derivatives

Energy derivatives

More likely | No difference | Less likely | Do not use

CORPORATE DEBT AND TREASURY REPORT HERBERT SMITH FREEHILLS

- The survey results reveal that whilst the number of respondents more likely to use interest rate hedging remains static year on year, the number of corporates not using interest rate hedges has dropped by 20% (38% in 2021 to 18% in 2022). This increase in usage reflects long running market expectations around central bank rate increases, particularly as major increases in inflation rates in many advanced economies are likely to lead to interest rate volatility. Respondents noted a need to lock in rates now in advance of the anticipated increases in the rate cycle, as well as the continued need to manage interest rate risk across the debt lifecycle as facilities are extended and refinanced. Some respondents also noted that low interest rates have been entrenched for over a decade now, leading to concerns that some treasury teams (and sell-side teams) might not have the necessary experience to be able to manage this risk decisively and proactively and would therefore require support in doing so.
- The survey also demonstrates a significant increase in the number of corporates using foreign exchange derivatives, with the number of corporates not using these instruments dropping by 45% (69% in 2021 to 24% in 2022). This large scale increase is unsurprising and is likely driven by currency volatility as economies emerge from the pandemic and fluctuations in global demand imposes strain on foreign exchange markets. The fact that respondents did not highlight commodity and inflation derivatives as an area of increase is perhaps more surprising, given sharp fluctuations in both of these asset classes, however some respondents did indicate they had increased their use of these instruments, which is an indicator that those using these instruments are likely to be in affected sectors.
- A new entrant in the survey this year is energy derivatives. An interesting result of the survey is that the number of corporates using energy derivatives are greater than more traditional asset classes such as FX, inflation and commodity derivatives. However, given the extreme stress in the energy markets over the last 18 months this does seem a natural consequence. One respondent noted the need to learn lessons from the "price shocks" in 2021 and as energy prices remain at all-time highs at the time of writing, this seems to be a trend that will continue, with respondents noting that, given "the volatility in energy prices it makes sense to be more in this market".

"years of low interest rates and whole generation [in treasury] that is not accustomed to interest rate volatility"

"there's regret risk for those that stay in floating rate debt looking at the forward yield curve...but if you'd acted on that over the last 10 years you'd have got that wrong"

4 DERIVATIVES

4.2 2022 ESG/SUSTAINABILITY AND DERIVATIVES

Have you entered into/are you interested in entering into ESG or Sustainability-linked derivatives?

75% NO

25% YES

- It is interesting to see 25% of respondents noting that they had either entered into or were interested in entering into an ESG derivative. In our experience this aspect of Sustainable Finance has been later to develop than say sustainability linked loans, with comparatively recent steps towards product and document standardisation, but reflects an enthusiasm to adopt ESG in derivatives. ISDA and other trade bodies have also been enthusiastically promoting the product, which should encourage take up in due course.
- That being said, a number of respondents noted hesitation around the technicalities of the product, and also how meaningful this was given the economics involved here. It is however noteworthy that a number of ESG derivatives have mirrored the sustainability loan techniques (such as ESG KPI linked margin adjustment mechanisms), and there seems a natural linkage for corporates to adopt between debt and derivatives which may lead to a broader level of take up and familiarity with these products.

"it's playing around the edges"

"ESG is more obvious in a bank financing"

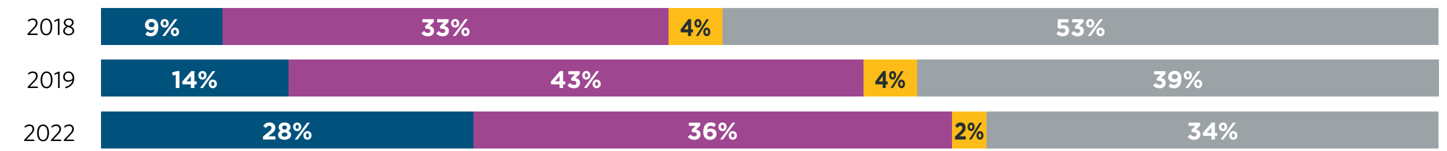
- Aside from bonds, inflationary pressures are not yet driving treasury teams to utilise significantly greater amounts of fixed rate debt than last year.
- Whilst retail bonds have largely fallen out of market favour some respondents queried whether a higher interest rate environment would see their return.
- The largely flat year on year approach to USPPs is interesting given that it has been a mainstay for longer term fixed rate debt for non-rated corporates in recent years.
- While a strong first half, the investment grade DCM had a quiet second half of 2021. In the first part of 2022 overall the DCM remains volatile for the reasons noted above.

Quotes are direct quotes from respondents | Percentages may not total 100 due to rounding

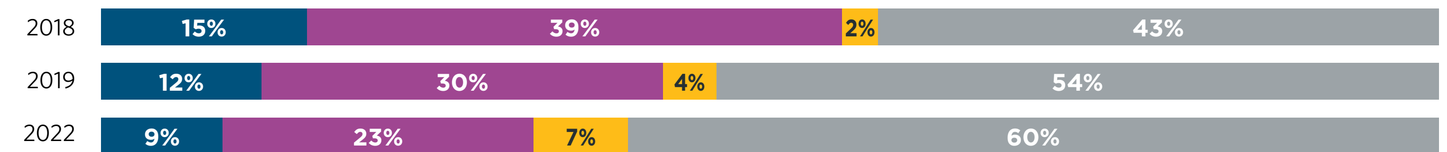
4.3 2022 FIXED RATE DEBT

Compared to 2021, are you more or less likely to consider the following fixed rate debt products in 2022?

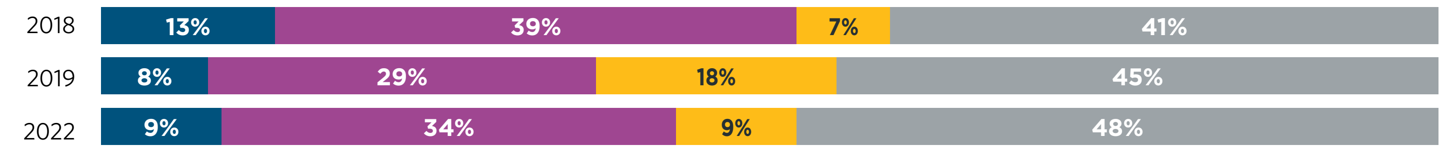
Bonds (other than retail)



UK Private placements



US Private placements



High yield bonds

Equity linked debt

Fixed rate loans

More likely | No difference | Less likely | Do not use

Quotes are direct quotes from respondents | Percentages may not total 100 due to rounding

4 DERIVATIVES

4.4 INFLATION CHALLENGES

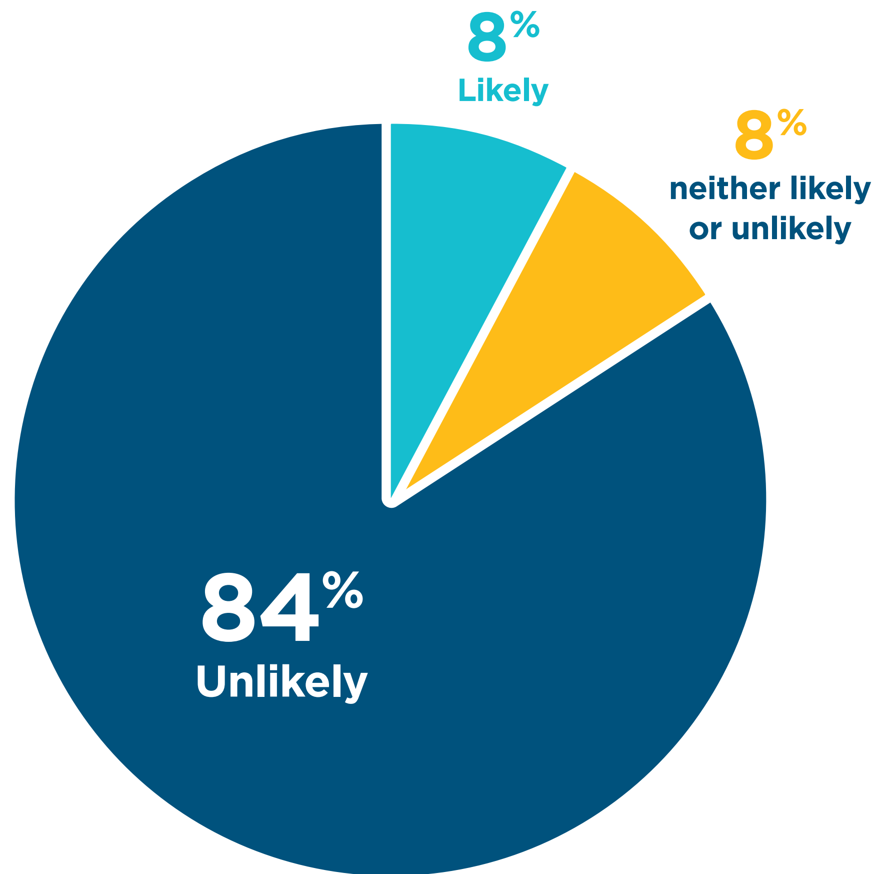
What do you see as the primary challenges to your business posed as a result of rising inflation?

5 CRYPTOCURRENCIES

5 CRYPTOCURRENCIES

5.1 USE OF CRYPTOCURRENCY

How likely is it that your business will be using cryptocurrencies within the next 3 years?



- We have introduced this question this year to start monitoring this trend and were surprised that as many as 8% were currently likely to use cryptocurrencies.
- Whilst there have been well publicised examples of corporates purchasing cryptocurrencies as a way of diversifying investments these have been few and far between.
- The permissibility of using cryptocurrencies in different jurisdictions diverges significantly (with El Salvador and China being at opposite ends of the spectrum and with many other countries prohibiting the use of cryptocurrencies) and significantly greater regulatory focus and oversight is expected in many Western countries in the near term.

"we wouldn't touch it with a bargepole"

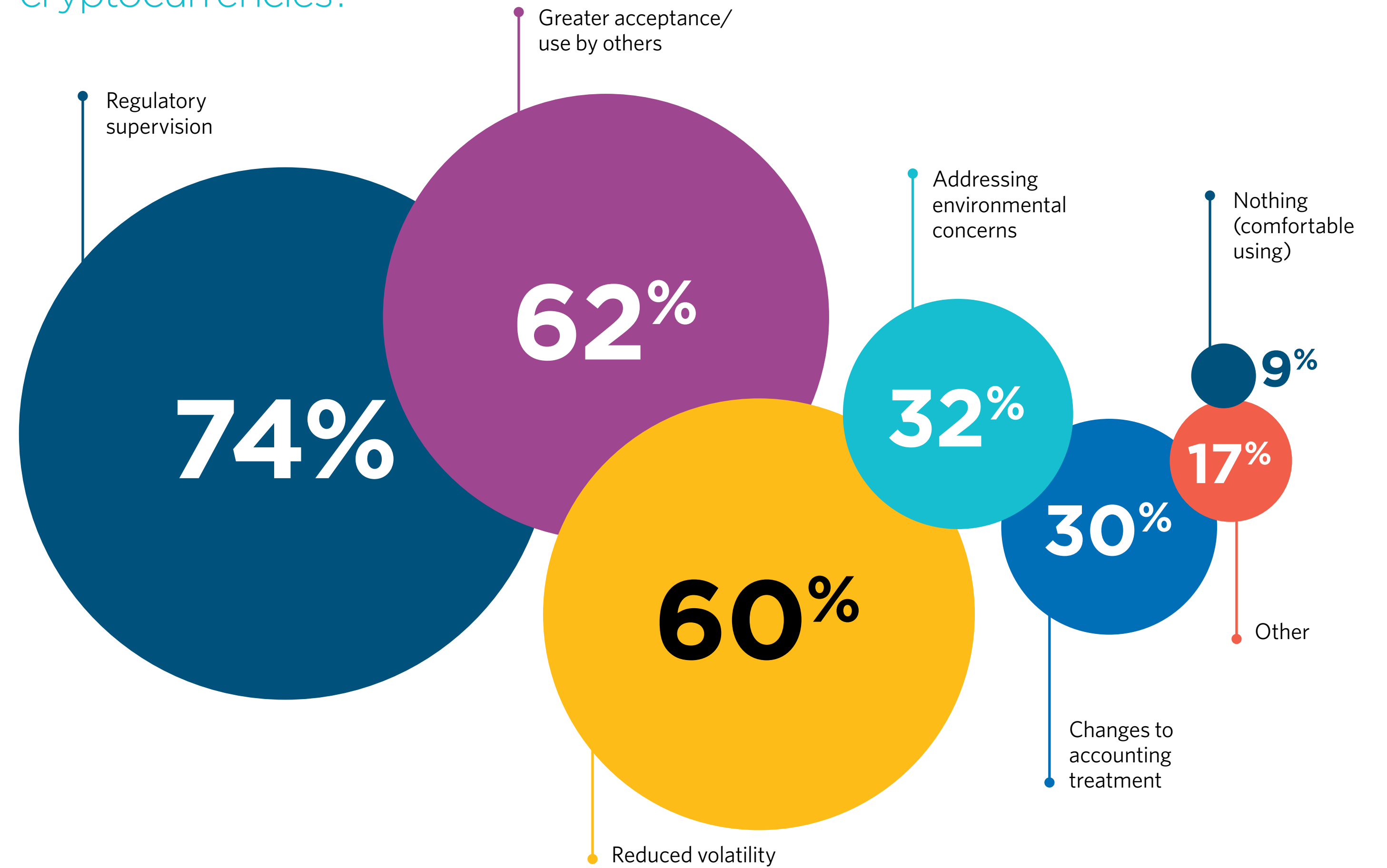
"it's too volatile"

"will be interesting to see the results in a few years time. For now though, I'm sure it's ok if you play computer games"

Quotes are direct quotes from respondents | Percentages may not total 100 due to rounding

5.2 THE EVOLUTION OF CRYPTOCURRENCY

What would need to change in order for your business to use cryptocurrencies?



- The areas of focus reported are not surprising but we query whether the focus on energy use in mining cryptocurrencies will, in the future, rise in prominence given the continued focus on ESG and sustainability.
- In terms of the highest areas of focus (regulatory supervision) respondents indicated that that was, at least in part, tied up with the varying levels of acceptance (or otherwise) in different jurisdictions and the headline risks around secrecy, security of crypto exchanges and the perception that cryptocurrencies may be used to circumvent currency controls. However, recent pronouncements by various Western governments, including the US and the UK, have been pointed to by some of those in favour of developing crypto-currency markets to illustrate growing recognition of and the desire to safely regulate the use of cryptocurrencies.
- The concerns around greater use of cryptocurrencies by others is a circular problem that will probably only be addressed by first movers after an acceptable level of regulatory supervision is achieved (though the decentralised nature of cryptocurrencies may pose obstacles here).

"crypto-currency is a speculative investment, it is not money"

"we would probably avoid such a use for fear of agitating local regulators"

"I still don't get the point, what is wrong with money?!"

Quotes are direct quotes from respondents | Percentages may not total 100 due to rounding or the ability to select multiple options

6

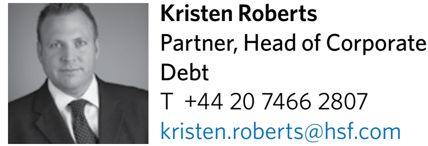
PRIORITIES AND THE EVOLVING ROLE OF TREASURY

6 PRIORITIES AND THE EVOLVING ROLE OF TREASURY

What 3 things are currently most important to you to focus on this year in relation to your debt capital structure over the next 3 years?

- Whilst a number of respondents noted no change, those reporting changes broadly fell within 3 areas: liquidity and capital management, strategy and ESG.
- In relation to liquidity and capital management the principal factors that emerged were consistent with those respondents noted in previous research in relation to the onset of the CoVid pandemic ie. greater focus on liquidity and working capital, forecasting and reporting.
- On strategy, respondents noted treasury teams becoming increasingly involved in wider business strategy discussions beyond the interfacing of that with treasury.
- The themes relating to ESG have been reported in part 3 of this report.

KEY CONTACTS



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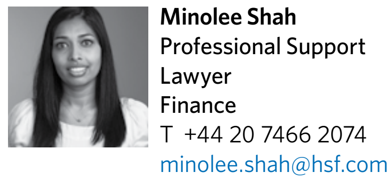

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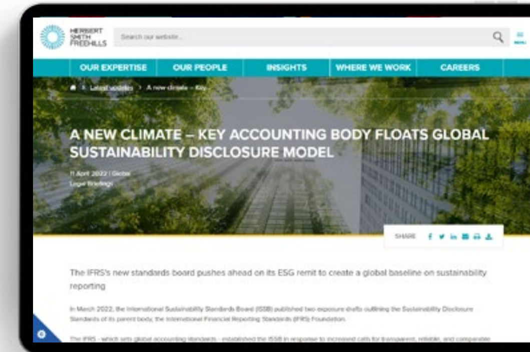

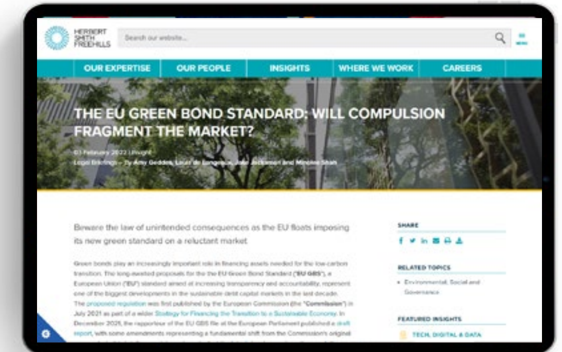

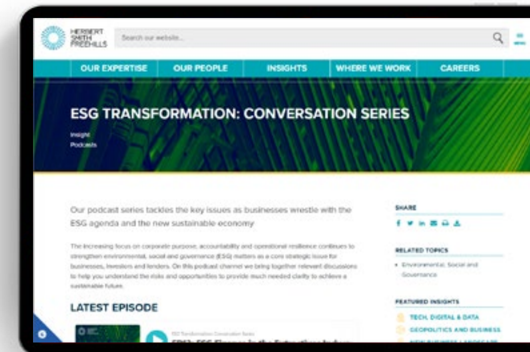

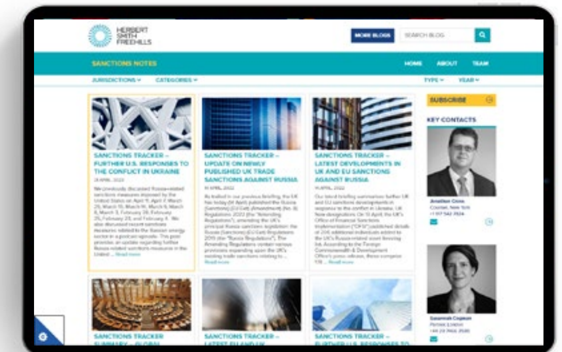

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