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European Leveraged Finance Association

ESG Data Collection: Current deficits and how these can be addressed

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Executive Summary

- Environmental, Social and Governance (ESG) factors have quickly grown to be a critical part of credit analysis in the European leveraged finance market.
- While ESG integration in the market is rapidly increasing due to both regulatory and market drivers, investors find ESG disclosure by borrowers lacking in consistency and ease of access.
- The fact that this lack of consistency found even within the same industry suggests that data providers can play an important role in supporting investors' data needs.
- However, our research of three data vendors finds that there are discrepancies in data coverage across asset classes and that vendors focus their efforts on larger companies.
- In this Insights report, we summarise the current state of availability and quality of ESG data, the current level of ESG disclosure by borrowers, and what can be done to increase the quality and quantity of ESG data in order to better meet investors' needs.
- As part of our mission to support strong market practices in disclosure, transparency, and engagement, in the first quarter of 2022 ELFA will launch updated ESG Fact Sheets with a table for data relating to KPIs to ease the process of data collection by borrowers.
- We also plan to extend our engagement under the ESG Disclosure Initiative to ESG data vendors and invite market participants interested in taking part in this working group to get in touch.

Introduction

Much has been written about the challenges around ESG disclosures for leveraged finance investors. Fortunately, much is being done to address these challenges, and momentum is clearly heading in the right direction.

ELFA's ESG Disclosure Initiative has been designed to support this progress, and feedback from the market indicates that it has been instrumental to facilitating collaboration on ESG disclosure between investors and corporate borrowers (including through the ESG Workshops). This engagement has resulted in ESG Fact Sheets that will soon cover over a dozen sectors and a guide to ESG disclosure for company advisers that is currently in the process of being updated.

However, although disclosure is increasing, issues have emerged with the consistency and useability of the data disclosed by borrowers on ESG KPIs.

For example, the data points that borrowers choose to provide vary in scope and measurement even among borrowers within the same industry. Even where the data provided by borrowers is comprehensive, often investors must verify methodologies used to collect the data and track it against historical records – a task that takes time away from their key value add in analysing the ESG data.

This problem is further exacerbated by the fact that ESG data vendors don't yet provide the coverage that they do for investment grade borrowers across the rest of the leveraged finance borrower spectrum.

We believe that everyone has a role to play in improving data availability, collection and making the data as useful as possible and each market participant can benefit from greater collaboration. In this report, we describe ways in which market participants can support better ESG data disclosure and describe ELFA workstreams designed to address these issues currently in progress or in the planning stages.

ESG disclosure lacks consistency and is not always easy to access.

Unfortunately, preparing quality ESG disclosure is not as simple as publishing a range of ESG KPIs on different pages in a sustainability report. The data must also be useable, which requires consistency from year to year and from borrower to borrower. It must also be reasonably easy to access and extract, with solutions available to fill in data gaps. Today, even when ESG data is reported, useability frequently still lags.

This is in some ways to be expected. There is no official standards board for ESG disclosures, nor is there an agreed-upon format in which disclosures must be provided. Whereas balance sheets and income statements take a predictable form, the structure of ESG reporting has almost infinite different forms.

There are several projects which aim to address these issues, including the creation of the International Sustainability Standards Board (ISSB), and the launch of the ESG Data Convergence Project. These are clearly positive developments and ELFA is seeking to collaborate with these and other organisations on the specific issues the leverage finance market faces.

In the meantime, however, we believe there are some easy wins to make data more easily accessible. For example, ideally data should be summarised neatly in tables with clearly defined metrics, disclosures explicitly addressing each KPI, and historical results published using a methodology consistent with that used for the current year. However, often data is buried on different pages across a 100+ page sustainability report, spread across multiple pages in the sustainability section of a borrower's website or sprinkled throughout a lender presentation.

This can result in investors spending time piecing together disclosures across several of these sources in order to compile the data relevant to their analysis.

Different borrowers disclose different ESG information, even within the same industry.

The data points borrowers choose to provide vary in both scope and measurement. One borrower may choose to provide emissions data, while another might focus mainly on health and safety. Disclosure may differ even within the same KPI. Taking emissions as an example, one borrower may provide data showing absolute emissions, while another shows emissions intensity of sales, and a third shows emissions intensity of production. In some cases, data only covers certain business lines or geographical operations, and historical data may be hard to come by. Further complicating matters, smaller companies do not have the same ability to collect, report and verify data as larger companies, though sometimes the less complex nature of disclosures by smaller companies may offset these issues.

Even when data is comprehensive and neatly summarised, someone must still verify if there are any inconsistencies in the methodologies used by different borrowers and find a way to normalise them. More mundanely, someone must pull the data out of the reports and load it into tools to analyse and track it. Given the plethora of ESG issues applicable to most borrowers, this is not a quick task to perform (even when the data provided is sufficiently comprehensive).

ESG reporting is relatively more advanced for most investment-grade borrowers, making them easier to analyse from an ESG perspective. But it is not just the greater level of disclosure by investment-grade borrowers that eases investors' ESG analysis – the coverage of investment-grade borrowers by ESG data vendors is also considerably better.

Minimal coverage of European leveraged loan borrowers by ESG data vendors stymies investors' analysis of these companies.

The table below shows coverage by three major ESG data vendors for three debt indices, i.e. the CS Western European Leveraged Loan Index, the ICE BofAML Developed Markets High Yield Constrained Index and the BBG Global Aggregate Corporate Index. It clearly highlights the discrepancies in data coverage across asset classes. The example for Vendor A also shows that rating coverage does not necessarily mean all data points are available.

Coverage Levels	Vendor A		Vendor B	Vendor C
	Rating	Toxic Emissions / Waste	Rating	Rating
CS WELLI (Loans)	10%	7%	7%	4%
ICE/BAML HY (HY)	79%	57%	47%	40%
BBG Agg Corp (IG)	95%	77%	79%	62%

To illustrate the challenge, take an example of one European loan issuer. The company publicly publishes an annual sustainability report that provides many useful ESG KPIs, including greenhouse gas emissions covering all three scopes, electricity consumption, water use, waste volumes, injury statistics and more. However, despite the provision of this information, ESG vendors do not tend to cover the company. In some cases, this could be because a borrower only makes its sustainability data available to the loan syndicate (or otherwise requires an NDA), but that was not the case here – this borrower' sustainability data is publicly available on its website. As a result, analysts wishing to use the company's data must comb through the report and collect it manually.

This is a critical problem for ESG data in leveraged finance. The value-add of investment teams should be analysing and understanding ESG data, not scrubbing it and typing it into a data system. Further, it is inefficient to have every investor perform this exercise instead of a few dedicated specialists.

This is where ESG data vendors can add significant value as they can devote entire teams to gathering and cleaning data. When requested by investors, they can also fill in gaps using models built on that information which can be sold to the market so that every investor does not have to replicate the same exercise itself.

To date, most ESG data vendors have focused their efforts on larger borrowers, especially those that are publicly listed. This is understandable, given that ESG investing took off in the equity market before moving into fixed income. The investment-grade market is also larger in size, and the disclosure is, on average, better (largely due to regulatory requirements applicable to such issuers).

However, both the demand for, and supply of, ESG data in leveraged finance is proliferating. In Europe, this is likely to be supercharged as the Sustainable Finance Disclosure Regulation (SFDR) and other elements of the EU's sustainable finance action plan go into effect. For maximum impact, this must be accompanied by greater coverage of the leveraged finance space by data providers.

What can be done to improve ESG data collection?

Borrowers, their advisers, and ESG data vendors all have a role to play in improving data availability, usability and disclosure. What is encouraging is that most market participants want this to improve, both in terms of data availability from borrowers and data usability for investors. But what can different market participants can do right now?

Corporate borrowers: To make coverage by data providers easier, provide ESG disclosure in as public a way as possible, and aim for disclosures that are as comprehensive as possible. They can also make the disclosure easy to use, for example by having a KPI table in the sustainability report containing all of the numerical data, both for the current and historical periods.

There are also simple things that can make the data more easily machine readable, such as avoiding charts, not having font that is too small or too big and presenting the units in a consistent fashion across KPIs. Most importantly, they can work proactively with both data vendors and investors to make sure the disclosure covers what the majority of participants need for their ESG analysis.

Investors: Continue to engage with borrowers on what disclosure is necessary and how the disclosure would be the easiest for them to use. At the same time, investors also need to encourage data vendors to increase their coverage and help them allocate resources to the parts of the market where the coverage gap is greatest.

Data vendors: Be open-minded around how they might adjust their methodologies to address the fact that borrowers in the leveraged finance markets tend to be smaller, while at the same time not compromising the integrity of their products. This requires engagement with both investors and borrowers, something that we acknowledge will take time and effort that we are willing to help with as we expect will yield significant benefits for all market participants.

How ELFA is seeking to address these issues

- updating our ESG Fact sheets with a data focused KPI Excel table to make it easier to get the collected data to investors in an easily accessible format
- continuing engagement with borrowers, banks and owners to support improvements in the ESG disclosures; and
- extending our engagement to ESG data providers to encourage greater consistency and increased coverage of the leverage finance market.

Market participants wishing to get involved in our ESG data workstream can send an email to elfa@elfainvestors.com for more information about next steps.

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