Comments on:

The Economic Consequences of Firms' Commitment to ESG Policies

by

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Overview

- The paper examines financial and environmental consequences of firms borrowing through loans subject to the Equator Principles, an industry-based and voluntary environmental and social risk management framework.

- Thank you for the opportunity to discuss the paper. I very much enjoyed reading the paper and would highly recommend it to others.

- A huge amount of work has gone into this paper, in particular, constructing the data set such that all of the hypotheses can be examined.

- My background could be summarised as practitioner first, academic second, so my comments will be from this perspective.

Key conclusions of the research

- An increase in environmental protection provisions in loans contract for borrowers from banks that have adopted EP.
- A decrease in the cost of debt (loan spread) for firms that have raised loans from EP adopting banks.
  - The decrease is greater when the borrower actively switches to a lender that adopted EP.
- A decrease in the cost of equity for borrowers from EP banks.
- An increase in environmental performance for EP borrowers after the contract.

Equator Principles

- "The Equator Principles (EP) are intended to serve as a common baseline and risk management framework for financial institutions to identify, assess and manage environmental and social risks when financing Projects." (https://equator-principles.com/)
- Revised (strengthened) in 2006, 2013 and 2020.
- My interpretation: the EP provide a management framework for tangible risks that directly affect the default risk of projects, particularly given the trend to greater regulation of the environmental and social impact of major infrastructure impacts in many countries.
- EP align with banks' incentives, allow better risk management enabling banks to lend at lower spread to LIBOR

Nature of the 4196 loans

- EP designed to apply to projects (project finance advisory services, project finance, project-related corporate loans, bridge loans).
- However, the EP have been more broadly applied to a variety of bank intermediated financial products.
- Projects have relatively clearly defined social and environmental risks and outcomes, but non-project related (corporate) lending less so (and may be more easily greenwashed).
- What is the make-up of loans in the sample?
- Are certain types of loans driving the results?
- If the loan is for a project, are the company control variables appropriate?

Do the results in part reflect banks' battle for market share?

- "The [loan spread] effect is stronger when the borrower actively switches to a lender that adopted EP, indicating that the results are at least partially driven by the borrowers and not the banks."
- The sample covers 2001 to 2007, around the period the EP were introduced.
- Mid-2004 to 2007 was a boom period for bank lending, where banks often compete to grow market share.
- Were the EP a valuable competitive advantage for adopting banks in their tool-kit for growing market share? Does the switch to an EP lender primarily represent banks competing for clients?

Robustness checks on environmental performance?

- Some NGOs have challenged the EP, particularly integrity, monitoring and materiality.
- Robustness check on the environmental outcomes using data from another source?
- Examine social outcomes using information on disputes with local communities?

To include “G” or not to include “G”?

- The EP specifically apply to environmental and social risks.
- Governance is often the ignored member of ESG.
- Although it could be argued that the management, monitoring and disclosure provisions of the EP represent a governance improvement, I am wondering whether the paper should refer to E & S not G.

Other comments

- Are loans with non-EP banks necessarily non-compliant? EP banks have (apparently) released some information on loans that they have rejected. Could this information be usefully incorporated?

- I can fully understand the focus on initial stage of the EP, but the reader may be left wanting to see results for a longer sample given the 2006, 2013 and 2020 revisions and the growth in banks participating.

- The reduction in cost of equity for EP borrowers statistically significant. Is it of an economically meaningful magnitude?

- Provide diagnostic/specification tests for the models.

Thank you

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