

What Is ESG in Finance?

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ESG in finance can refer to, among other things, financing tools such as Green, Social, and Sustainability Bonds and similar ESG-related debt instruments, as well as the separate discipline of ESG Investing. ESG stands for Environmental, Social, and Governance. Investors are increasingly applying these non-financial factors as part of their analysis to identify ESG-related risks and opportunities in particular investments. ESG metrics have not historically been included in financial reporting, though companies are increasingly making disclosures in their annual report or in a standalone sustainability report, and regulatory requirements for such disclosures, including from the SEC, are expanding.

Green bonds and other similar debt instruments are becoming an increasingly large component of fixed-income markets. Green bonds are for financing new and existing projects or activities with positive environmental impacts. Social bonds finance or refinance projects or activities that achieve positive social outcomes or address a social issue. Sustainability bonds are used to finance or re-finance a combination of green and social projects or activities. Sustainability-linked bonds are structurally linked to the issuer's achievement of climate or other goals, and typically the coupon is increased or decreased during the term to incentivize achievement of such goals.

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