Practical action for a world in flux | ESG EDITION

Weaving the golden thread between ESG and investors

BRODIE

Weaving the golden thread between ESG and investors

As ESG disclosure and its influence on access to capital becomes the new normal, a more strategic approach is vital in order to surface the right content, data and sentiment for investors and analysts.

Investors view the sustainability agenda through the ESG lens, but many companies are simply 'rebranding' their sustainability and CR activities without much thought to the needs and nuance of ESG requirements.

A vital new partnership is emerging between investor relations, sustainability/CSR and communications experts in order to navigate the complexities of ratings, benchmarks, listing requirements, reporting frameworks and other external communications that all affect investor analysis.

Here we unpack the components shaping the ESG agenda, identify the emerging trends, and share clear actions to build the golden thread between ESG disclosure and investor impact.

WE LOOK AT THE MAIN DRIVERS OF ACTION

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Getting the foundations right

ESG is part of the new normal

The past 25 years has seen a 10-fold increase in reporting requirements, but it's the past 12 months that has seen the greatest acceleration and change.

There has been a 50% increase in searches for ESG in the last 12 months, according to Google Trends.

86% of companies have ESG reports/ sections, this represents a rise from 20% in 2011 [1].

LOOK OUT FOR

The widespread adoption of ESG disclosure (e.g. SASB) in forthcoming sustainability and annual reporting as well as standalone ESG reports and web sections.

E-S-G. Each is unique

Of the 5 major ratings questions 35% are 'G', 46% 'E' and 18% are 'S'. But, the % split doesn't give the full picture.[2]

There is a bias towards Governance as a proxy for competent management of all issues, particularly where performance in 'S' is harder to quantify and 'E' becomes increasingly regulated.

There is increased sophistication of measuring and monetising the impact of environmental risk, and new models to capture social impact and value are enhancing investors ability to analyse company performance in the areas of E&S.

The conversation around 'S' is shifting Covid19 in conjunction with Black Lives Matter and previously #MeToo is shining a light on human capital and there is a demand for the social metrics to follow.

LOOK OUT FOR

Human capital strategies that draw together:

Sources

1 The Governance & Accountability Institute (G&A)

2 Valuing Respect: ESG Analysis (Erangey, 2018)

ESG is the new meeting place for IR, CSR, HSE and PR

The substance of ESG reporting is still being driven by CR/sustainability teams. But, it requires far greater collaboration to deliver the best outcomes for investors.

Globally, IR teams are responsible for 32% of ESG communications, 40% being sustainability teams, 17% being Corporate/ Company Secretary[3].

Sentiment is being increasingly used as an element in ratings (e.g. State Street[4]) meaning communications and reputation are being measured in new ways so clients increasingly need to be more communications savvy.

Top themes of questioning from investors[5]

Governance	Environment	Social
1 Compensation*	1 Carbon footprint/ emissions	1 Labour practices
2 Board structure	2 Environmental licenses	2 Community relations
3 Succession	3 Regulation	3 Government relations taxation/regulation
4 Board involvement in business	4 General environmental policy	4 Supply chain issues
5 Management composition	5 Water usage	5 Human rights
5 Shareholder views/ involvement		

**Companies are increasingly being asked about how the performance to tackle climate change is connected to renumeration e.g. BP's 2020 renumeration plan saw an increased from 10% to 20%. The breakdown is 50% 'Financial'; 10% Operational; 20% Safety; and 20% Environment.[6]*

LOOK OUT FOR

ESG steering groups being formed to co-ordinate actions to maximise effective investor communications.

Sources

3 IR Magazine, Global IR Practice: ESG Communications (2017)

4 State Street ESG Capabilities

5 IR Magazine, Global IR Practice: ESG Communications (2017)

6 BP Directors' remuneration report 2019

Understanding rating agencies

Rating agencies are collecting and analysing data in increasingly sophisticated and multi-dimensional ways

AI technologies and data scraping is now central to how ESG rating agencies access data and generate analysis. It enables firms to distil ESG signals from unstructured data such as news media, industry publications, NGO reports, and other digital sources.[7]

For example, MSCI uses technology and AI to extract investment-relevant insights from unstructured data with 60% of files validated via AI based checks.[8]

Raters also aggregate data and assess based on public filings, such as annual reports and sustainability or CSR reports, company websites and policies.

In reality it is GES, not ESG

There is an emphasis on the 'G' questions from investors and within the rating agencies. Governance is often used as a proxy for measuring performance in the environmental and social areas.

But there is a problem:

Governance has the lowest correlation when comparing ESG rating agencies scores across a common sample of companies.[9] This means ESG rating agencies cannot agree what the appropriate questions and indicators of good practice are in this area making it harder to target actions and content effectively.

Environment has the highest correlation, and therefore agreement of commonly asked metrics, across ESG rating agencies and Social is in the middle.[10]

LOOK OUT FOR

Greater use of easily searchable company ESG websites using a limited set of key words to aid AI and maximise scores.

ACTION

Think of ESG communications as a specific workstream and plan content to be discoverable and accessible for a specific ESG audience.

Sources

7 S&P Global
8 MSCI
9 MIT Sloan School of Management
10 Conflicting ESG Ratings article, Bloomberg

Not all ratings are created equal...

Competition in the ESG rating market is heating up. There are currently 600 ESG ratings.[11]

There is a lack of consistency between scoring methods, which can lead to companies being assessed very differently. For example, in 2018, FTSE rated Tesla last for global auto ESG. MSCI, meanwhile, rated it best. In Sustainalytics' rankings, it fell around the middle of the pack.[12]

There is a very low correlation between the methodologies, weighting of scoring across the different rankings.

Tesla's rankings varied hugely across different rating agencies

LOOK OUT FOR

Consolidation in ESG ratings and changes in the weight given to ratings by investors.

ACTION

Be sure to use investor calls to understand which ratings your key investors view as authoritative. Focus your ESG disclosure on the priority ratings for your investors and engage with the rating agencies to understand their methodologies.

Sources

11 Rate the Raters, Sustainability

12 FT Article: 'Lies damned lies and ESG rating methodologies

What are the rating agencies looking for and how different can they be?[13]

Framework	Description	Rating Scale	How it works?
Bloomberg	Collects ESG Data for over 9,000 companies. Integrated into Bloomberg Equities and Intelligence Services International scope.	Out of 100. Bloomberg also provides scores from third party rating agencies	Bloomberg ESG data covers 120 environmental, social and governance indicators including: carbon emissions, climate change effect, pollution, waste disposal, renewable energy, resource depletion, supply chain, political contributions, discrimination, diversity, community relations, human rights, cumulative voting, executive compensation, shareholders' rights, takeover defence, staggered boards, and independent directors. Bloomberg ESG rating will penalise companies for "missing data."
Institutional Shareholder Services (ISS)	Measures the depth, extent, and quality of public corporate disclosures on ESG issues, and identifies key disclosure omissions. ISS's 'Quality Score' provides in-depth research on corporate governance on over 5,600 publicly-traded companies globally.	1st to 10th decile – 1st indicates relatively higher quality governance practices and relatively lower governance risk while the 10th decile indicates relatively higher governance risk.	ISS analyses over 200 factors, divided into four pillars: board structure, compensation/ remuneration, shareholder rights, and audit and risk oversight. Depending on the governance standards in each region, the ISS voting policy, and the impact on governance practices, a specific weight will be placed on each factor. Companies are invited to review, verify and provide feedback through the ISS Corporate Solutions' Governance Analytics platform.
MSCI	MSCI ESG Research is one of the largest independent providers of ESG ratings. hey provide ESG ratings for over 6,000 global companies and more than 400,000 equity and fixed income securities.	AAA-CCC scale	MSCI looks at 37 ESG issues under ten themes: climate change, natural resources, pollution and waste, environmental opportunities, human capital, product liability, stakeholder opposition, social opportunities, corporate governance, and corporate behaviour. Data is aggregated and assessed based on 100+ specialised datasets from governments, NGOs, company disclosure via 10-K, sustainability reports, and proxy reports; and over 1,600+ daily media sources. Over 20 major Investors chose to use MSCI ESG data, including: BlackRock, State Street, Allianz Group, BMO Global Asset Management, Morgan Stanley, Nomura Asset Management.
Sustainalytics	Covers over 6,500 global companies across 42 sectors. Looks at industry-specific ESG indicators with at least 70 indicators in each. Also looks at systems to manage ESG risks and disclosure of ESG issues and performance.	Out of 100. Sector/industry-based comparison.	Sustainalytics covers at least 70 indicators in each industry. ESG indicators are split into three dimensions: • Preparedness: Assessment of management systems and policies to manage ESG risks. • Disclosure: Whether company reporting meets international best practice standards and is transparent in relation to ESG issues. • Performance: ESG performance based on quantitative metrics and qualitative assessment based on review of controversial incidents the company may have been involved in.

Sources

13 ESG Reports and Ratings: What They Are, Why They Matter, Harvard Law School

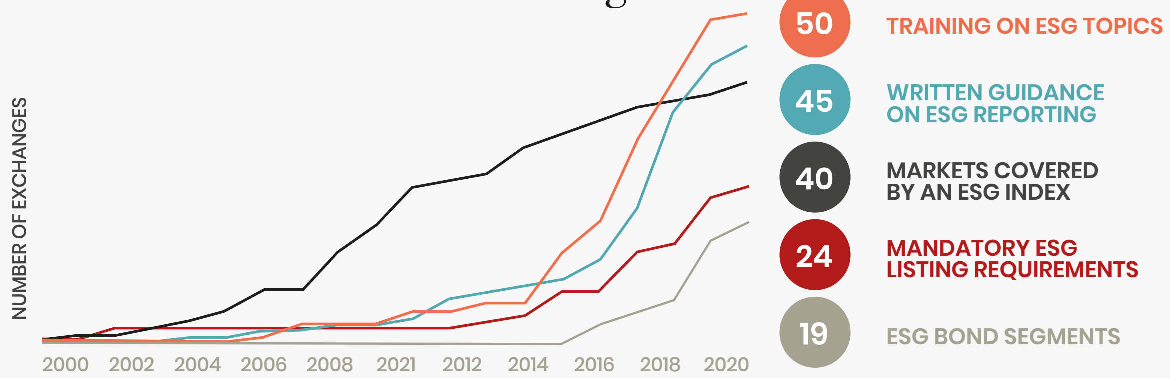
A dynamic regulatory environment

ESG listing requirements are becoming mainstream

We might expect Japan, US and France to have ESG listing requirements but Estonia, UAE, Sri Lanka and Hong Kong all now have ESG requirements too. There are now 54 stock exchanges that have ESG listing requirements, of which 35% have appeared in the last 12 months.[14]

Nasdaq has created an interface measuring the global sustainability effect of a portfolio and individual securities. The ESG Footprint[15] has 40 filtering criteria, using 60 different global data sources and uses a combination of Nasdaq proprietary raw ESG and machine-learning data.

Incredible growth in the interest and action on ESG from stock exchanges



The Sustainable Stock Exchange (SSE) Initiative a UN Partnership Programme organised by the United Nations Conference on Trade and Development (UNCTAD), the UN Global Compact, UN Environment Finance Initiative (UNEP FI) and the UN-supported Principles for Responsible Investment (PRI).

LOOK OUT FOR

The first company to be reprimanded for failure to meet listing requirements will take a big reputational hit. Also, smart companies on the path to IPO will embed ESG early to avoid complexity and cost at the point of listing.

ACTION

Most companies have only one or two listing requirements to follow directly but sophisticated companies will also consider the listing requirements in key markets to avoid falling foul of domestic expectations in foreign markets.

Sources

14 ESG Footprint Measure your portfolio's ESG impact

15 ESG Disclosure Guidance Database

ESG isn't a 'New York thing', it's a global thing

Over 80% of the world's top economies by GDP in 2016 mandated ESG reporting in some form[16]

USA

The first Congressional hearing of ESG issues happened in July 2019, covering five proposed bills:

- ESG Disclosure Simplification Act of 2019
- Shareholder Protection Act of 2019
- Corporate Human Rights Risk Assessment, Prevention and Mitigation Act of 2019
- Climate Risk Disclosure Act of 2019
- Country by Country Tax Payment Disclosure

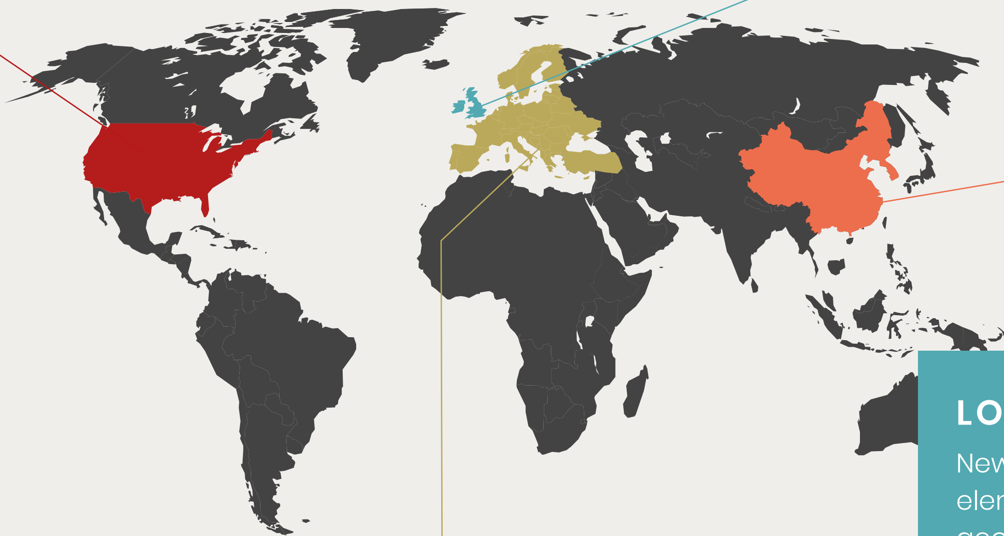
UK

Carbon emissions, human rights and diversity reporting is required by all listed companies in the Directors' Report with statutory annual reports.

All listed companies and large asset owners expected to disclose in line with the TCFD recommendations by 2022.

CHINA

The China Securities Regulatory Commission is mandating all listed companies and bond issuers to disclose ESG risks by 2020.



EU

The European Green Deal[17] is the roadmap for making the EU's economy sustainable. The EU will be climate neutral in 2050. A European Climate Law[18] is turning the political commitment into a legal obligation and a trigger for investment.

The non-Financial Reporting Directive (NFRD) aims to establish a minimum standard for ESG reporting across the EU.

New European Union taxonomy[19] will introduce disclosure requirements for "sustainable" index and benchmark providers by end of 2022. They will have to provide full transparency on their methodologies and data sourcing.

LOOK OUT FOR

New laws emerging on all elements of ESG in various geographies.

ACTION

Map the evolving legal landscape against your current activities and reporting to make sure you keep up-to-date on the rapidly evolving requirements.

Sources

16 Data from Corporate Register, October 2016
17 EU Green Deal, European Commission
18 European Climate Law, European Commission
19 EU Taxonomy
20 IR Magazine
21 SEC public statements

Understanding reporting frameworks

Start with SASB

ESG reporting has seen an explosion in reporting requirements. WBCSD has information on 2,000 ESG reporting requirements and resources from 70 countries.

This myriad of frameworks can be a bewildering alphabet spaghetti of acronyms. TCFD, UNGC, CDP, PRI, IIRC and on.

Major investor, BlackRock, set out the expectation that its companies should have an ESG report that aligned with SASB and TCFD.

LOOK OUT FOR

Greater uptake of SASB and battles over SASB's limitations as most companies need to incorporate disclosures from multiple sectors to effectively disclose their ESG risks.

"This year, we are asking the companies that we invest in on behalf of our clients to: (1) publish a disclosure in line with industry-specific SASB guidelines by year-end, if you have not already done so, or disclose a similar set of data in a way that is relevant to your particular business; and (2) disclose climate-related risks in line with the TCFD's recommendations, if you have not already done so. This should include your plan for operating under a scenario where the Paris Agreement's goal of limiting global warming to less than two degrees is fully realized, as expressed by the TCFD guidelines."

LARRY FINK CEO LETTER, 2020

BlackRock

As the newest of the major frameworks and built for the era of ESG, SASB takes into account sector priorities and aligns with a range of other frameworks e.g. TCFD, GRI and CDP and references metrics already in use by industry, from more than 200 entities.[1]

ACTION

Analyse your current reporting and actions against your relevant SASB sector guide to see how you currently perform and where you might have gaps.

Don’t end with SASB

SASB’s success is its ruthless focus on investor risks in light of global social and environmental trends. But there are other frameworks and guidance documents that dig into specific technical issues or tackle ESG from a different stakeholder perspective.[22] There is discussion between GRI and SASB about collaboration, currently the two organizations’ work together will focus on going into the marketplace with harmonized, complementary messages.[23]

‘E’: Climate Change

CDP’s disclosure requirements regarding emissions, water and forests and the Climate Disclosure Standards Board’s (CDSB) Framework for reporting environmental information and natural capital in mainstream financial reports.

‘S’: Human Rights

UN Guiding Principles Reporting Framework addresses reporting on human rights according to the UN Guiding Principles on Business and Human Rights.

‘G’: Governance

UNCTAD’s Guidance on Good Practices in Corporate Governance Disclosure establishes a benchmark for identifying corporate governance issues that could be included in corporate reporting.

ACTION

Conduct a strategic review and dig into issue specific frameworks (e.g. the UNGP Reporting Framework for Human Rights and CDP for water, emissions or forests) to understand best practice and identify how you’re performing in all areas.

Sources

22 SASB Overview
23 GreenBiz Article

Understanding the voluntary frameworks

Framework	Description	Format	Impact
Sustainability Accounting Standards Board (SASB)	Sustainability accounting standards focused on known trends and uncertainties that are reasonably likely to affect the financial condition or operating performance of a company and would therefore be considered material[24] under Regulation S-K.	Voluntary disclosure of relevant sustainability metrics in company financial disclosures, segmented by industry.	More useful information for investors and improved corporate performance on those environmental, social and governance issues most likely to affect value.
]Global Reporting Initiative (GRI)	Specific disclosure guidelines and requirements for compliant non-financial sustainability reporting on economic, environmental and social performance areas. The standards are modular and can be used in a selective fashion to meet the desired compliance level and disclosure needs of the reporting organization.	Voluntary disclosure through a formal digital or printed sustainability report, including all ESG topics deemed to be relevant to the organization and all related management approach components.	A sustainable global economy that combines long-term profitability with ethical behaviour, social justice and environmental care
Task Force on Climate-related Financial Disclosures (TCFD)	Comparable and consistent disclosures used to demonstrate corporate climate change risk assessment, scenario planning and resilience. Unlike other environmental reporting initiatives, TCFD requires organizations to report on their response to environmental pressures, rather than their impact on the environment.	Voluntary disclosure[24] within mainstream annual financial filings of the identification, assessment, management, and oversight policies and practices affiliated with climate-related risks and opportunities in the areas of governance, strategy, risk management, and metrics and targets.	Consistent, decision-useful, forward-looking information on the material financial impacts of climate-related risks and opportunities, including those related to the global transition to a lower-carbon economy.
CDP	Global disclosure program that enables participants to measure and manage their environmental impacts and link environmental integrity, fiduciary duty and public interest so companies, investors, and other global stakeholders can benchmark performance and make better-informed decisions on climate actions.	Voluntary disclosure of non-financial data, including greenhouse gas emissions and company environmental performance, focused on climate change, forests, and water security. Performance is benchmarked against industry peers, scored and ranked publicly. Company results are publicly available.	Using the power of measurement, standards and information, and leveraging market forces, to improve the management of environmental risk.

Sources

24 See SASB, Approach to Materiality and Standards Development

Excellent ESG communications

ESG and sustainability communications: either/or?

No. ESG reporting is not a replacement for sustainability reporting or broader communications. There are lots of different stakeholders with different needs and the reality is you need to respond to them individually. Investors require specific data and information, but don't forget:

You still need to have ways to excite colleagues and customers on issues they care about most

You need information that allows NGOs to see their key topics from sustainable seafood to animal welfare

You need a compelling narrative and a clear strategic framework that is aligned with your corporate purpose and the longer term vision for the company

Three elements of great ESG Reporting:

Leading companies like Walmart, are focused ESG reports or presentations of ESG- relevant data which aren't trying to compromise and be all things to all people.

While they weave together multiple frameworks, leaders like JetBlue, also overlay a clear understanding of what is material to the business.

Companies like PepsiCo have ensured that their information is accessible and web-based so it can be easily captured.

LOOK OUT FOR

Increased ESG communications and connected disclosures aimed at investors.

ACTION

Benchmark your current ESG disclosure and communications against best practice within your sector. Think about content, accessibility, navigation and alignment with corporate purpose.

Looking ahead and practical action

The ESG space is dynamic.

The various stakeholder requirements and expectations are becoming more sophisticated and investor relations teams internally will be on the front line of this evolution. Furthermore, regulations connected to action and disclosure surrounding ESG are rapidly evolving and it is essential to keep abreast of the emerging trends.

Fundamentally, it is not just about communication and disclosure. The increased disclosure and transparency may build accountability, but good quality information about meaningful and impactful work is the heart and future of the discipline. The very first step in building strong ESG performance is a focus on the fundamentals of governance.

To find out more about how BRODIE can support you and your colleagues with ESG excellence, please contact Georgie Erangey:

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Looking ahead and practical action

01 ACTION

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Practical action for a world in flux

ESG
EDITION

We are an international responsible business and sustainability advisory firm

We work with some of the largest, most advanced companies in the world across many sectors. We are helping them to succeed in the transformation of their business in the age of sustainability.

We drive three significant changes:

- Change corporate impact
- Change consumption
- Change for people

To find out more about how BRODIE can support you and your colleagues in ESG excellence, please contact Georgie Erangey:

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