



Introduction to ESG

Perspectives and challenges in a changing world...

PRESENTED BY:

MIKE ROMAN

PRESIDENT, CERTAINPOINT STRATEGIES, L.L.C.

SENIOR FELLOW, AMERICAN COUNCIL FOR CAPITAL FORMATION

Discussion Points

- ESG – what it is and why it is important to every business
- The evolution of ESG – How did we get here?
- The wave of change and new investors
- Market response - action and strategy
- Investor response
- ESG rating agencies, scores, frameworks
- U.S. Regulation
- Challenges and opportunities
- What to watch
- Action Plans



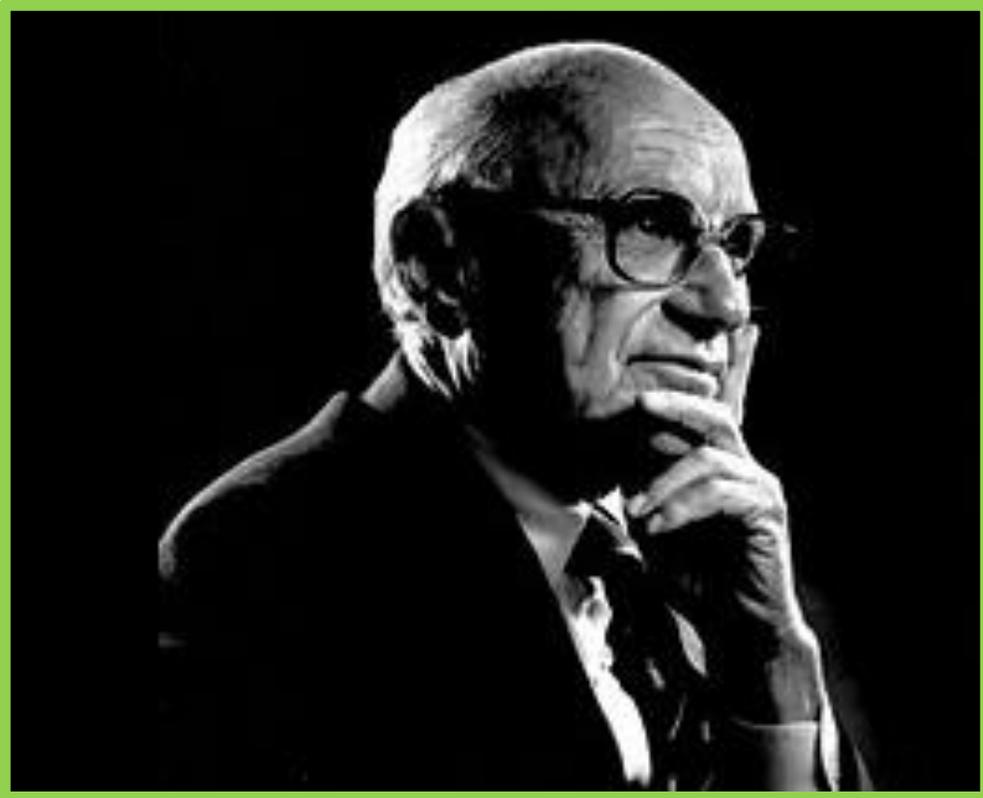
ESG factors “101”



ESG criteria establish standards for a company's operations that environmentally and socially conscious investors use to screen potential investments in three categories:

- **Environmental** factors look at the conservation of the natural world
- **Social** factors examine the treatment of people and recognition of diversity both inside and outside the company
- **Governance** factors consider company leadership, how a company is run, internal control, application of ESG, and shareholder rights.

Milton Friedman - 1970



The Social Responsibility of
Business **"is to Increase Its
Profits"**

Friedman argued that a company has no
social responsibility to the public or society;
its only responsibility is to its shareholders...

Evolution of ESG

ESG is often used interchangeably with corporate social responsibility or corporate sustainability, however **ESG encompasses much more:**

1980s



Environment, Health and Safety (EHS)

Based on the development of environmental & employee regulations.

1990s



Sustainability

Focused on reducing environmental impacts beyond legal requirements.

2000-2010s



Corporate Social Responsibility (CSR)

Corporate philanthropy and employee volunteerism used to align social issues.

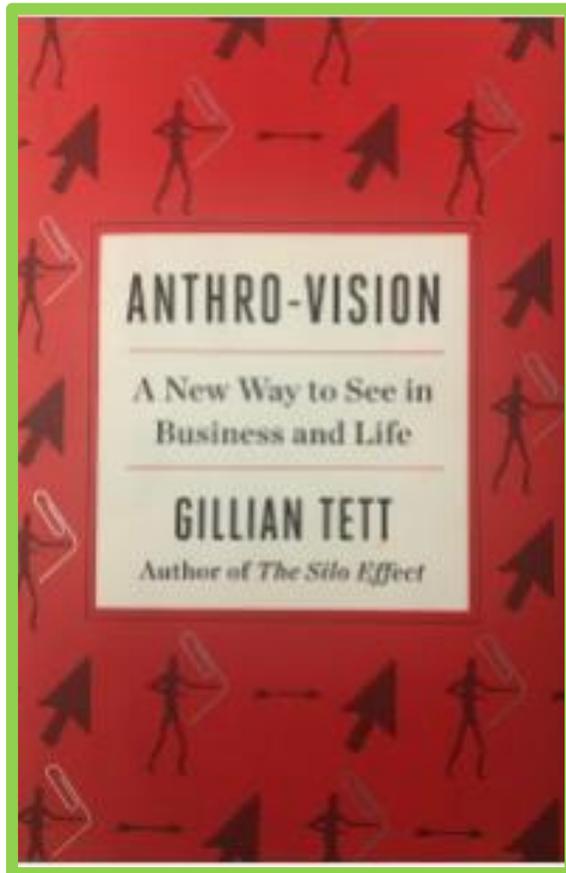
2020+



Environmental Social Governance (ESG)

Holistic concept related to competitive advantage and risk & reward management.

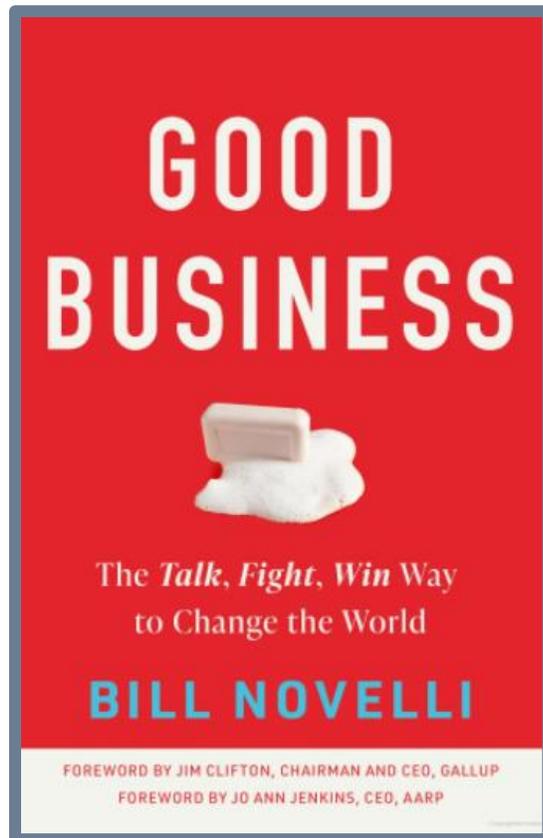
How did we get here?



Gillian Tett provides anthropological insight into ESG - context matters:

- “History shows that when a revolution takes place, it tends to succeed not when a tiny minority of committed activists embrace a cause, but when a silent majority decide that it is too dangerous or pointless to resist change.”
- “ESG introduces “moral” sentiments which hopefully make markets and capitalism more durable and effective.”

How did we get here?



Bill Novelli has a similar take:

- “Shared Value Concept” – Michael Porter & Mark Kramer
Harvard Business Review – 2010:
- Creating economic value by creating social value yields shared value
- A company can improve its bottom line and shareholder value – “do well” by “doing good.”

Today - a wave of change...



Global challenges: climate change, increased regulatory pressures, social and demographic shifts and privacy and data security concerns - represent new and increasing risks.

Companies face greater scrutiny if they are not adequately addressing ESG risks.

COP26 and social unrest amplify focus and urgency.

A new generation of investors...



ESG Investing

The interest from millennial investors around the world is already driving rapid growth in ESG-focused investment.

Bank of America Merrill Lynch survey estimates \$ 20 trillion of asset growth in U.S.- domiciled ESG funds alone over the next two decades.

ESG brings a response...



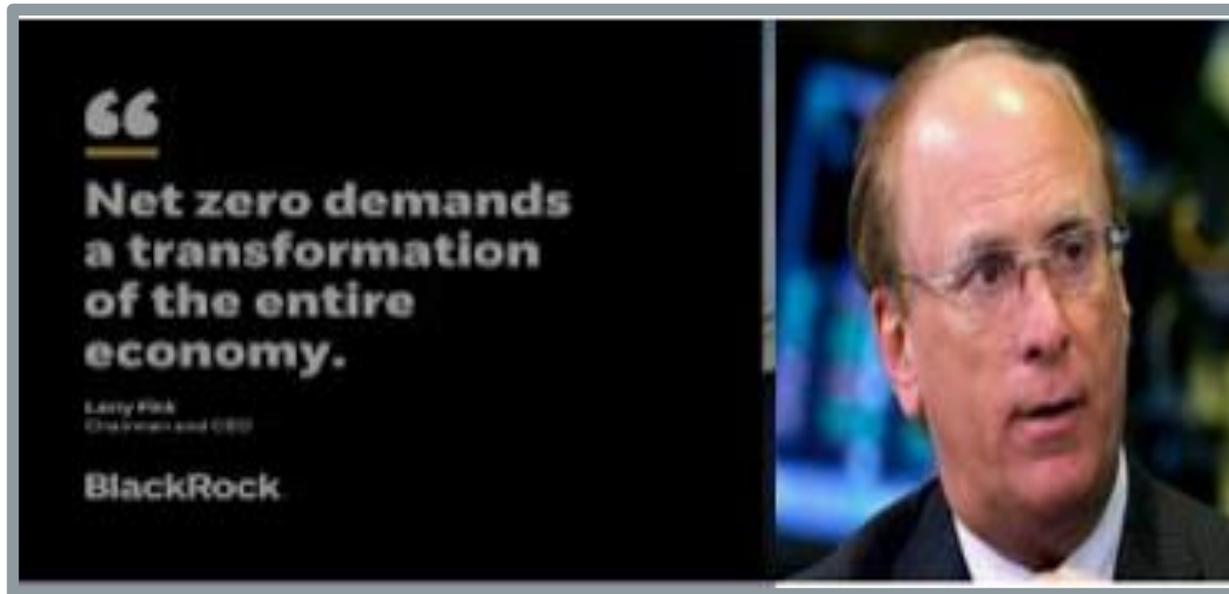
Jamie Dimon, Chairman and CEO of JP Morgan Chase & Co. Former Chairman Business Roundtable.



Business Roundtable Redefines the Purpose of a Corporation to Promote *'An Economy That Serves All Americans'*

“The American dream is alive, but fraying,” Major employers are investing in their workers and communities because they know it is the only way to be successful over the long term.”

And brings action...



Large institutional investors like BlackRock, have become increasingly focused on corporations doing their part to support broader societal goals rather than being narrowly focused on shareholder returns.

BlackRock CEO, Larry Fink

"Corporations should have a goal to maximize positive societal impact in addition to shareholder value."

Boardrooms design strategy...



55% of CEOs believe that long-term sustainable success means looking beyond purely financial growth.

The rise of stakeholder capitalism is being thrown into sharp focus through the ESG lens.

In today's boardroom, business strategies are no longer designed for the benefit of shareholders alone.

Investors respond...

88%

of investors believe companies that prioritize ESG initiatives represent better opportunities for long-term returns than companies that do not

Source: Edelman Trust Barometer Special Report: Institutional Investors



The crux of ESG involves investors identifying risks and opportunities that are not readily apparent in the traditional corporate financial disclosures.

Evolving ESG expectations reflect the notion that anything perceived by the market as materially affecting a company's long-term value should be measured, managed and reported on — including non-financial, social and environmental information.

Rating agencies...



ESG ratings agencies compile scores which can vary from agency to agency.

- Some focus only on environmental issues; others place value on social and governance issues.
- Weight of the various issues which can fall under the ESG umbrella is also up for debate; creates confusion and concern.
- Many of these issues require increased coordination among ratings agencies – which is still lacking.
- Many have called for standardized metrics across sectors and countries – but this is challenging.

Rating agencies...



- **Sustainalytics** - a Morningstar Company, provides independent ESG and corporate governance research, ratings and analytics that support global investors.



- **MSCI** - Provides ESG ratings designed to measure a company's resilience to long-term, industry relevant environmental, social and governance (ESG) risks.



- **ISS ESG (Institutional Shareholder Services)** - Empowers investors and companies to build long-term sustainable growth by providing high-quality data and analytics.



- **V.E** – a part of Moody's ESG Solutions. serves the growing global demand for ESG and climate insights including ESG scores, climate data, sustainability ratings and sustainable finance.

Source: The Playing Field
(a Squarewell study),

ESG Scores...

Environmental

- GHG Emissions
- Energy Use
- Energy Mix
- Water Use
- Climate Oversight
- Climate Risk

Social

- CEO Pay
- Gender Pay Ratio
- Employee Turnover
- Diversity
- Child Labor
- Human Rights

Governance

- Board Composition
- Supplier Conduct
- Ethics
- Anti-corruption
- Data Privacy
- ESG Reporting

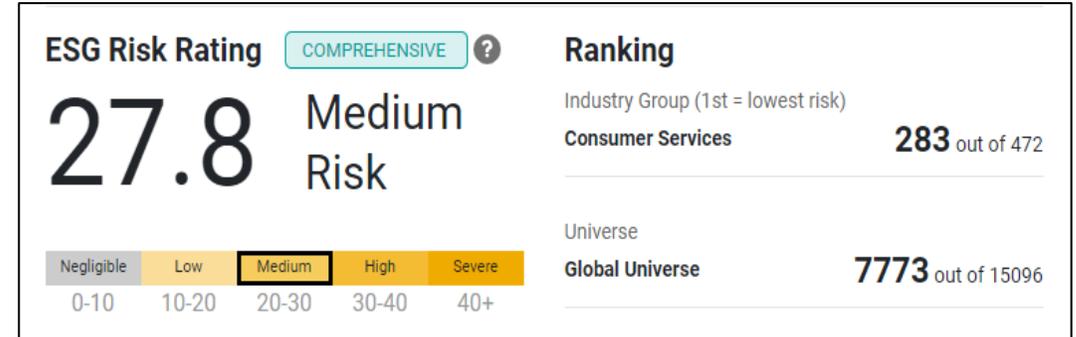
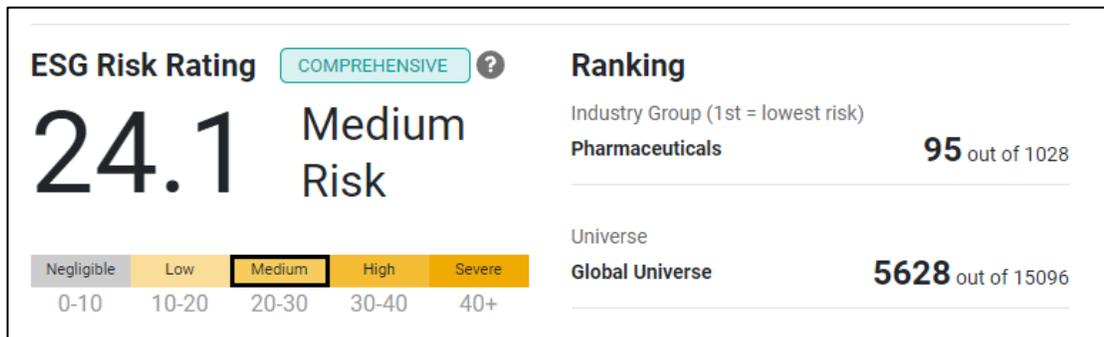
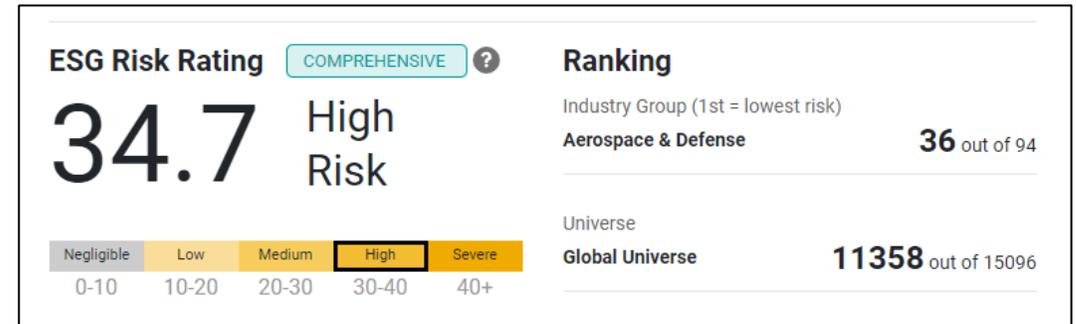
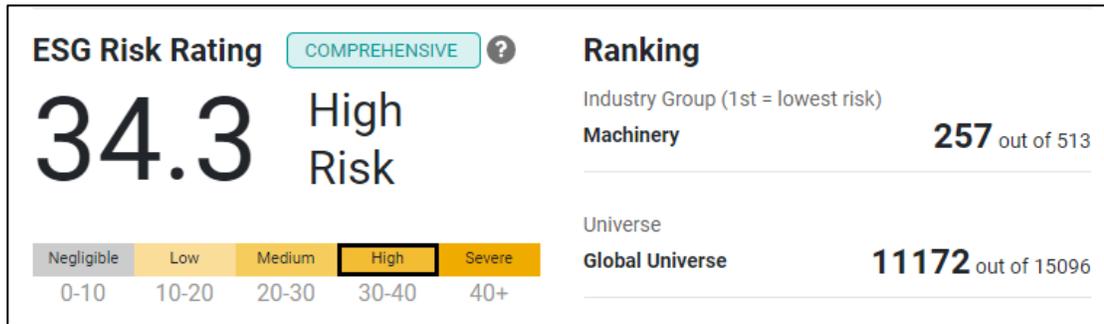
An organization's ESG score measure shows relative performance on a wide range of environmental, social and governance - related topics.

- Key issues are identified and rated.

- Ratings are weighted based on industry factors and timing.

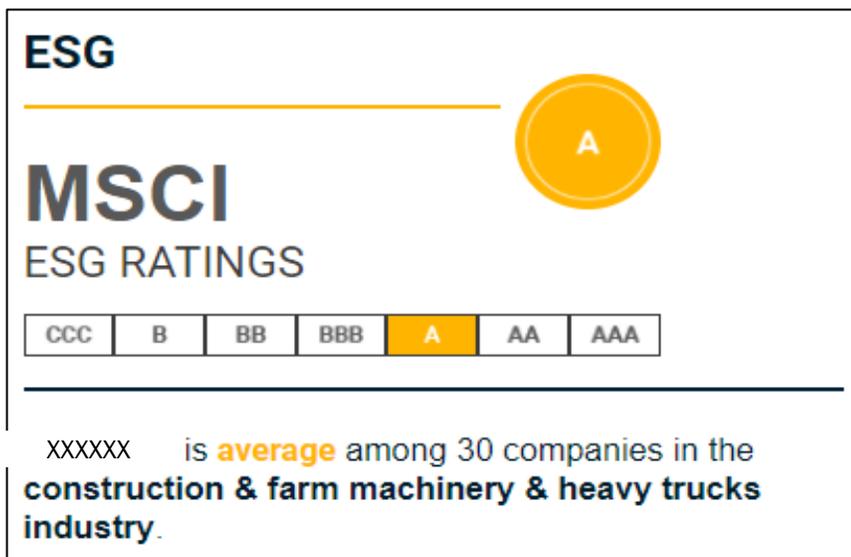
- Industry adjusted numerical scores are applied.

ESG Scores – Sustainalytics



Assessing Exposure + Management = Risk

ESG Scores – MSCI



| Comparative Performance | ESG Rating | Numerical Score |
|-------------------------|------------|-----------------|
| Leader | AAA | 8.571-10.000 |
| | AA | 7.143-8.571 |
| Average | A | 5.714-7.143 |
| | BBB | 4.286-5.714 |
| | BB | 2.857-4.286 |
| Laggard | B | 1.429-2.857 |
| | CCC | 0.000-1.429 |

Using ESG Scores - Sustainalytics

Corporates

Leverage Sustainalytics' ESG Risk Ratings to understand and promote your corporate ESG performance with internal and external stakeholders.

- [Connect with us about an ESG Risk Rating License](#)
- [Learn more about our ESG Risk Ratings](#)
- [Explore Supply Chain ESG Solutions](#)

Banks and Lenders

Banks and lenders can use our ESG Risk Ratings and data as a part of a broader analysis of their clients as well as for innovative product solutions such as sustainability linked loans.

- [Download our product brochure to learn about our product solutions](#)

Investors

The ESG Risk Ratings can help investors to identify, understand and manage ESG risks at the security and portfolio level with the aim of improving the long-term performance of their equity and fixed income securities.

- [More about ESG Ratings for Investors](#)

Global shift to compulsory climate reporting

Framework known as the Taskforce on Climate-related Financial Disclosure, or TCFD, moving from a voluntary approach to being the main regulatory response to climate risk.

EUROPEAN UNION

EU has officially adopted the TCFD but is implementing Sustainable Finance Disclosure Regulation, which has a broader reach than the climate-focused TCFD.

UK, CANADA, FRANCE, GERMANY, ITALY, JAPAN

In 2021, the G-7 backed the idea of compulsory TCFD reporting.

AMERICA

USA

US has provided pandemic bailout funding to TCFD-aligned disclosures.

Government of Canada has said it is "working towards aligning its future disclosures" with the guidelines.

UNITED STATES

In 2021, the SEC asked for public input about climate change disclosures, including the TCFD.

Secretary Janet Yellen has also indicated her backing for sustainability reporting, singling out the TCFD.

AMERICA

Canada

Central bank plans to require banks to disclose in line with the TCFD.

Mexico

Mexico recommends development of a regulatory/supervisory strategy following TCFD recommendations.

PACIFIC

Japan

Financial Council of Experts has recommended enhanced disclosure based on TCFD recommendations

for market-listed companies.

NEW ZEALAND

In 2021, it became the first country to introduce mandatory TCFD "comply or explain" disclosures for financial institutions, requiring about 200 large financial institutions to make climate-related disclosures starting in 2022.

EUROPE, THE MIDDLE EAST AND ASIA

AFRICA

International treasury has recommended standards on environmental and social risks incorporating TCFD recommendations.

IRELAND

Ireland will enshrine TCFD reporting into law and make it "binding."

UNITED KINGDOM

UK will make TCFD-aligned disclosures mandatory across the economy by 2025, with many of the requirements in place by 2023.

18, 2021.

Includes select countries that are moving to make climate reporting under the TCFD framework mandatory

or voluntary.

Contact: Elizabeth Thomas

elizabeth.thomas@allenandoverery.com; S&P Global Sustainable1



Global Frameworks

ESG

is global

Global standards organizations...



The Sustainability Accounting Standards Board SASB

- In 2018, the Board published a set of ESG standards specific to 77 industries.
- Each with financially material topics and associated metrics.
- Designed for companies and investors needing to analyze how ESG may impact performance.
- Complements other ESG initiatives.

Global standards organizations



Global Reporting Initiative GRI

- Created in 1997.
- Was first and widely used to give companies metrics to show their responsible environmental practices on a global and holistic basis.

United Nations Sustainable Development Goals SDG

- Adopted by member states in 2015.
- Broader social, environmental scope.
- While a global ESG framework, it lacks guidelines to measure specific industry actions.

U.S. Regulation...

Past:

The SEC under the leadership of former Chairman Jay Clayton, considered existing securities laws and financial materiality standards as sufficient.

Present:

Driven by developing ESG trends and investor demand, SEC Chair, Gary Gensler, created a Climate and ESG Task Force and a request for public comment on climate change disclosures

guidelines are imminent.



Challenges & opportunities...

Challenges

- Well-meaning investors possibly being misled by conflicting ratings.
- How to best standardize rules governing claims made by banks, asset management firms, and other financial entities regarding what they can categorize as “green” within their portfolios.
- Significant difficulties when comparing metrics across business sectors and in different countries.
- Ensuring ESG principles and frameworks do not restrict access to capital, capital costs, and allocation, resulting in supply constraints, added operating costs, and contributing to inflation.

Opportunities:

- ESG development can be a catalyst for constructive conversations and collaboration spurring balance and alignment of qualitative and quantitative metrics globally.
- Application of flexible, aligned, and principles-based reporting systems.
- Ability to improve and promote business perception, market position, and financial performance.
- Attracting and retaining talent.

What to watch...



- **Energy and aerospace / defense investment** - currently under scrutiny impacting access to and the allocation and cost of capital.
- **Financial institutions** - challenged by shareholders and Federal Reserve to balance financing and investment needs with ESG.
- **Proxy firms** - may be seen as forcing Board changes that compromise sound operating practices.
- **Stranded assets** – driven by unanticipated or premature write-downs, devaluation, or conversion to liabilities.



Action plans...



Effective implementation and execution of ESG processes is a multi-disciplinary activity

- Board leadership is imperative.
- Identify organizational ESG leadership
- Work with audit firms to address scoring and reporting.
- Work with industry associations to communicate and coordinate needs.
- Investor relations engagement is imperative.
- Develop public /community relations, advocacy, and education strategies.
- Understand your suppliers and supply chains - in ESG scope as well.



Thank you!

Mike Roman
President, CertainPoint
Strategies, L.L.C.

Senior Fellow



Mroman@ACCF.org
703.635.8674