Rivel Governance & Sustainability
Corporate Responsibility Advisory

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ESG State of the Union Update
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David Bobker
Managing Director
Governance and Sustainability
203.803.1515
dbobker@rivel.com

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GOVERNANCE & SUSTAINABILITY

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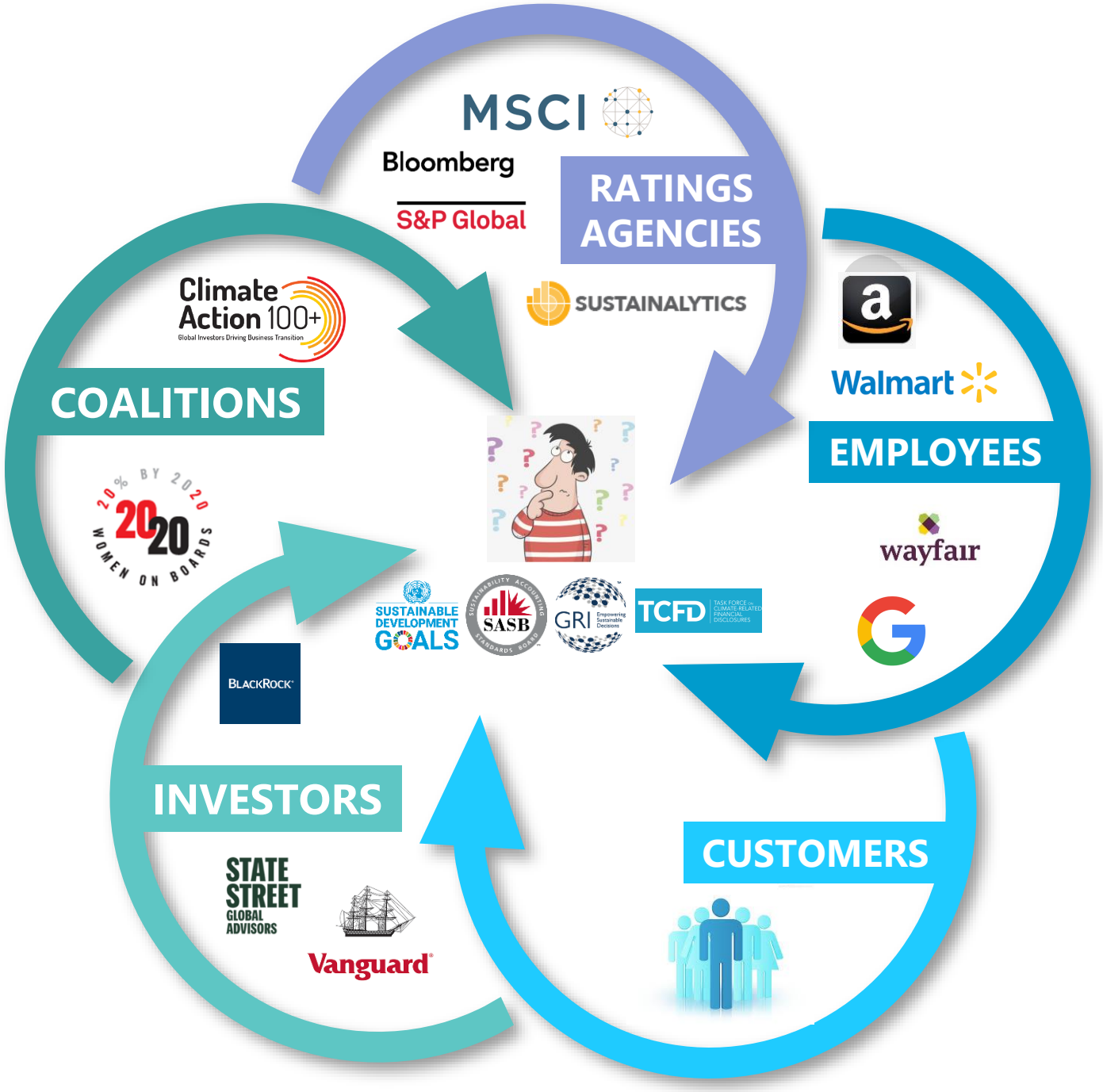
ESG Ecosystem

Evolution of financial reporting:

In 1975, an estimated 17 percent of assets in the S&P 500 were intangible. In 2020, this had grown to over 90 percent.

Significant and growing economic and social impact for all companies.



2020: By the Numbers

- 90% of S&P 500 companies are issuing some form of sustainability reports, compared to 20% in 2011.
- Assets under management in funds worldwide that weigh sustainability factors when making investment decisions is expected to rise to $40.5 trillion, up from $22.9 trillion in 2016.
- Estimated market for ESG data by 2021 is anticipated to cross $1 billion, up from $617 million in 2019. Biggest purchasers of this data are money managers developing investment products to meet market demand.
- ESG funds are set to hold more AUM in Europe than their non-ESG counterparts by 2025, according to a PwC report: expected to rise to €7.6 trillion, 57% of market share (15% currently).
- UN PRI signatories are expanding commitments across the asset management industry with an increasing percentage of AMs supporting PRI and TCFD, collaborating with CDP, and supporting many other initiatives. Over 3,000 asset manager globally, representing over $90 trillion AUM.

2020: The Issues – Responses to COVID-19

- **COVID-19 response and adaptation demonstrate business resiliency**
  - Investors want to understand how the company was able to respond to the pandemic and quickly pivot its operations to adapt to the new environment.
    - Validation that the company's current business resiliency program was successful, what the company has learned, and what improvements were put in place to deal with "once in a lifetime" events.
    - How will this impact the company's short-, medium-, and long-term strategy?
  - How the company is responding to the acceleration of the "future of work" (automation, remote-work, expanded talent pool)

2020: The Issues – Diversity & Inclusion

- **Widespread calls for management and boards to expand efforts to recruit and retain a diverse workforce**
  - Black Lives Matter movement across the US emphasizes need for better representation of diverse workers and leaders.
  - Efforts to increase representation of minorities and women in leadership and throughout enterprise.
  - Calls for disclosure of metrics, strategy and performance that demonstrate a genuine commitment to creating an inclusive workforce.

> *"The ongoing issue of racial equity has caused us to focus more closely on the ways in which racial and ethnic diversity impacts us as investors. As such, we are writing to inform you that starting in 2021, State Street Global Advisors will ask companies in our investment portfolio to articulate their risks, goals and strategy as related to racial and ethnic diversity, and to make relevant disclosure available to shareholders."* ***– State Street Global Advisors***

2020: The Issues – Climate Change

- **Climate change strategy and mitigation a top priority for sustainable business models**
  - Top consideration for most investors that seek to understand how companies monitor and manage climate change risks and opportunities.
  - Climate change widely accepted as one of the most significant risks to long term business resiliency, but it impacts some companies more than others.

- **Need to tell the story for LECO - relevancy of climate change to the company's operations**
  - Impact to the business – impact of the business upon the environment.
  - Exposure to climate change risks and opportunities (physical and transition), should be communicated to stakeholders.

2020: The Issues – Investor Demands & Expectations

Investors are seeking meaningful disclosure of relevant data, metrics and strategy around key topics, goals and targets, not just looking for statements.

- **BlackRock** identified 57 companies where they withheld support from directors in 2020. Stated at least another 191 in the crosshairs for 2021.
- **SSGA** continued focus on D&I – from policies and statements to strategy and metrics (plus policies and statements!)
- Most asset managers have or are creating proprietary systems to identify and analyze ESG risk and company performance. One great example is SSGA's **R-Factor**.
- Investors inquiring about companies conducting **ESG materiality assessments** to truly understand how they are viewed by stakeholders, how they engage and are they liking up to stakeholder primacy principles.
- Slight increases to both average environmental (31.1% to **33.3%**) and social shareholder proposal (25.7% to **28.5%**) support levels.

Rating Agencies

MSCI

- Rates companies on their risk exposure and risk management on a CCC-AAA scale (laggard-leader).
- Compares company performance to industry peers.
- Assess thousands of data points across 27 key issues that are assessed annually for each industry.

SUSTAINALYTICS

- Assess companies on exposure to and management of risks, focusing on three central areas: corporate governance, material ESG issues, and idiosyncratic issues (black swans)
- Ratings are categorized across 5 risk levels: negligible, low, medium, high and severe. Ratings scale is from 0-100, with 100 being the most severe.

Bloomberg

- Traditionally a rating on transparency, not performance. New ratings on environmental, social and governance risk exposure and linked to key reporting frameworks.
- Gender Equality Index (GEI) is a credible accolade, partners with other organizations for various indices.

ISS

- ISS Environmental & Social QualityScore measures transparency of reporting; measures more than 380 factors across E and S pillars. Specific factors analyzed vary by industry group.
- Scores companies on a scale of 1-10 (leader-laggard), indicating risk relative to peers.

Moody's

FitchRatings

S&P Global Ratings

- Very similar to other ratings, with general and sector-specific issues.
- FitchRatings identifies issues around the classification standards published by UN PRI and SASB.

Reporting Standards & Frameworks

Sustainability Accounting Standards Board

- 77 industry-specific standards meant to communicate material, decision-useful information to investors
- A mix of quantitative and qualitative disclosures

Task Force on Climate-related Financial Disclosures

- Framework to help companies provide decision-useful information on risks and opportunities from climate change
- CDP Climate Change survey has aligned with TCFD

United Nations Sustainable Development Goals (SDGs)

- Stakeholder-friendly framework comprised of 17 goals to advance the UN Agenda for Sustainable Development, aiming towards peace and prosperity for people and planet by 2030

Global Reporting Initiative

- Set of standards based on economic, environmental, and social topics
- Companies use the standards to communicate material ESG topics, related impacts, and how they are managed
- Targets multiple stakeholder groups

World Economic Forum

- Developed by the WEF with Bank of America, Deloitte, EY, KPMG and PwC.
- Created “stakeholder capitalism metrics” that include environmental, social and governance indicators and disclosures for “all stakeholders.”
- Attempting to bring together existing reporting standards and frameworks to push for standardization.
- Push to motivate and create a clearer path for corporate disclosure.

Standardization Challenges

- Problem persists with reality of standardization of reporting on intangible aspects that have such vastly different ESG impacts and outputs.
- Ignoring the many differences may only serve to lower the bar and reduce opportunity to tell the unique company story and embrace opportunity.
- Do they truly address all stakeholders needs/demands especially given how diverse they likely are for all companies?



Other Recent Developments

Amendments to Reg S-K requirements

- Adoption of principles-based approach to human capital management, if deemed material, under amendments to Item 101(c) of Regulation S-K.
  - *A description of the registrant's human capital resources, including the number of persons employed by the registrant, any human capital measures or objectives that the registrant focuses on in managing the business (such as, depending on the nature of the registrant's business and workforce, measures or objectives that address the development, attraction and retention of personnel).*
- SEC noted that a registrant will be required to disclose its part-time employees, full-time employees, independent contractors and contingent workers, in addition to employee turn-over, to the extent such information is material to understanding the registrant's business.
- SEC Chairman Clayton stated that he does "expect to see meaningful qualitative and quantitative disclosure, including, as appropriate, disclosure of metrics that companies actually use in managing their affairs."

Corporate reporting trends in Europe reflected in US

- Increased disclosure information pertaining to climate change mitigation, human capital management and risk mitigation in the era of COVID-19.

Increased adoption of SASB and TCFD

- In response to demand from investors and other stakeholders for the incorporation of ESG standards and frameworks in public disclosures.