DFIN

5-STEP ESG JOURNEY | ARTICLE

EMBARKING ON YOUR ESG JOURNEY - A FIVE-STEP ENGAGEMENT PROCESS

Whether you are part of a young growth company seeking initial recognition or a more established company, you probably find you are constantly competing for capital with other companies. One powerful way to distinguish yourself is with a carefully crafted environmental, social and governance (ESG) message.

Bear in mind that *having strong ESG (as well as human capital) performance* is one thing – but *getting credit for that performance* requires that you tell your story very effectively. For this reason, we focus equally on ESG performance and communications.

Increasingly, failure to disclose a coherent ESG strategy can mean companies are penalized in several ways, including:

1. Decreased demand for your company's stock

According to the U.S. Forum for Sustainable and Responsible Investment (USSIF), assets invested using sustainable investing strategies are growing rapidly:

- The total US-domiciled assets under management using sustainable investing strategies increased from $12.0 trillion at the start of 2018 to $17.1 trillion at the start of 2020, an increase of 42 percent.
- Funds invested with sustainable investing strategies are now 33 percent of the total US assets under professional management; in other words, one of every three professionally managed dollars is invested this way.

2. Activist targeting

Activist investors increasingly incorporate ESG issues into their platforms, targeting companies with stories perceived to be weak in this regard. Additionally:

- Shareholder proposals on E&S matters now exceed those on traditional governance matters, and in 2021 a record number (33) received majority voting support.

- BlackRock and other prominent investors increasingly withhold votes from directors at companies that they feel are not making sufficient progress on ESG performance or disclosure.

3. Increased cost of capital

Credit rating agencies, including S&P Global Ratings, Moody's, and Fitch Group, are increasingly incorporating ESG considerations into their credit rating calculations.

A Confusing Reporting Landscape

At DFIN, we are working with hundreds of companies to either initiate ESG reporting, or finetune and expand existing programs. Many of these companies' C-suites and boards express concerns about the plethora of ratings, rankings, and reporting frameworks out there, some stating that this lack of clarity is inhibiting their embarking on their sustainability and disclosure journey. We frequently are asked:

- Where should we start?
- What matters most in sustainability reporting?
- What should we disclose through our website, the proxy, 10-K, and other channels?

Fortunately, there is good news on this front. In September 2020, five major organizations -- the CDP (formerly the Carbon Disclosure Project), Climate Disclosure Standards Board (CDSB), Global Reporting Initiative (GRI), International Integrated Reporting Council (IIRC), and Sustainability Accounting Standards Board (SASB) -- issued a "Statement of Intent to Work Together Towards Comprehensive Corporate Reporting." This news was followed by the November 2020 announcement that the IIRC and SASB would merge and form the Value Reporting Foundation, with the aim of providing investors and companies with a unified, comprehensive corporate reporting framework.

As a sign of further momentum, at the UN Climate Change Conference (COP26), which concluded in Glasgow on November 12, 2021, it was announced that the newly created International Sustainability Standards Board (ISSB) will further consolidate ESG reporting standards and frameworks, including the Value Reporting Foundation and the CDSB. Stay tuned for further action on this front.

SEC Proposes Climate-Related Disclosure Rules

On March 21, the US Securities and Exchange Commission (SEC) proposed long-anticipated rules mandating climate-related disclosures in companies' annual reports and registration statements, including climate-related risks and financial metrics and greenhouse gas emissions. The SEC release announcing these proposed rules is here: https://www.sec.gov/news/press-release/2022-46

Importantly for companies – and investors – already using existing reporting standards, the SEC noted that the proposed rules are based in part on the recommendations of the TCFD, and the standards of the Greenhouse Gas (GHG) Protocol, and did not propose yet another set of standards. These rules are subject to a public comment period and face potential legal challenges.

While the ongoing convergence of voluntary reporting standards is a welcome development, neither that, nor any potential modifications to the SEC proposal, should discourage your company from initiating or progressing on your sustainability and disclosure journey.

Remember that investors and other stakeholders are watching now and so companies can't afford to wait.

DFIN, along with our sustainability reporting partners the Governance & Accountability Institute (G&A) and Diligent ESG, are working with hundreds of companies to either initiate reporting, or finetune and expand existing programs.

Our ESG Reporting Process

DFIN has identified five key steps for companies to focus and drive their ESG processes:

1. Select Material Indicators

While the major materiality and reporting frameworks aren't yet fully integrated, there is substantial overlap among them. Focusing primarily on SASB, GRI, and TCFD, we select five to seven material indicators relevant to your industry group and for which your company will have important information to disclose.

2. Conduct a Peer Review

Given the relative nature of ratings and rankings, analyzing peer disclosures (proxies, 10-Ks/ARs, and websites) can identify industry-specific topics not captured in step 1, and also establish what it would take to match or exceed the disclosures of your peers.

3. Identify Thematic Messaging

Based on steps one and two, you may have identified seven to 10 topics as the foundation for your ESG program and disclosures. Here, for communications purposes, we distill these topics down to three to five thematic tenets (e.g., "our people," "our purpose," "our planet"). These tenets are then harmonized and reinforced throughout all reporting channels.

4. Create Content

We help you identify subject matter experts (SME's) and establish working groups to collect, update, and maintain relevant data. Our ESG consultants, analysts, and writers then advise on and/or draft content that meets the above-described materiality and thematic messaging criteria.

5. Develop Infographics

Our creative designers transform ESG text and data into marketable documents via impactful design in harmony with your company branding.

The good news is that this five-step process is repeatable, and equally applicable to your proxy, annual report, website, and ESG/CSR report development. Following these steps helps ensure consistent prioritization of materiality topics – and of messaging – across your various documents and channels.

Considerations about Key Communications Channels:

- **Proxy statement highlights.** Well-selected highlights can be an effective way to move the needle on influential ratings and rankings. Important areas to cover in the proxy include board oversight, as well as the competencies and qualifications of board members; an overview of your ESG and human capital programs; and any ESG-related compensation metrics.

When we refer to proxy statement *highlights*, we mean just that. Remember to reserve the full story for the website.

- **Annual report/10-K.** Bear in mind that the proxy and 10-K are regulatory documents filed with the SEC, with heightened liability risks for any false or misleading disclosures. By exercising appropriate care, including outside legal review, company boards and management teams should be able to report on a) identification of material ESG risks and opportunities, and the now-required b) principles-based description of your company's human capital resources and related measure or objectives that are a focus of managing the business. It's important, however, to proceed cautiously around any disclosures of future targets and goals.

- **The website.** Most stakeholders search company websites for information about ESG priorities and reporting. Some companies create tabs on their IR sites to help stakeholders find the ESG-related information they're seeking, while others establish dedicated sustainability sites.

- **The ESG, sustainability, or corporate responsibility report.** The amount of time and resources required to create such reports depends on the type of report you decide to produce, whether it's a fact sheet aligned to SASB or TCFD, a summary (or lite) sustainability report, or a full-blown ESG/CSR report, which would typically include indexes to the major reporting standards. Remember that your ESG/CSR report will be reviewed carefully by all stakeholders, including potential employees.

Why Wait Any Longer?

There's no reason to postpone the next step of your ESG journey. DFIN is ready to help you establish a structure and repeatable process for both regulatory and voluntary ESG disclosures.

For examples of a range of DFIN client proxy ESG and HCM disclosures, see our Guide to Effective Proxies, 9th edition, at: **www.proxydocs.com/xDFINx**.

To discuss your unique situation and identify where we can add the most value to your current process, contact us!