FACT SHEET | TEN KEY ESG CONCERNS

10 Key Environmental, Social and Governance Concerns

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Each proxy season offers a glimpse into investor priorities — as well as vote results demonstrating how strong the support for these priorities might be. In this regard, 2018 was yet another fascinating year with varied issues getting aired through proposals and boardroom modifications.

Here are 10 important trends to watch:

1. Environmental issues grow in importance. In the 2018 proxy season, environmental proposals "have a very strong presence," according to the "Harvard Law School Forum on Corporate Governance and Financial Regulation," with approximately 90 proposal filings related to climate change, including requests for carbon emissions targets and disclosures, 2-degree scenario reporting, and renewable energy reporting. In addition, 27 proposals filed in 2018 related to sustainability and 26 to other environmental issues.

Just as tellingly, environmental and social (E&S) proposals garnered strong support: 11 of 23 E&S proposals voted received support levels above 30 percent of votes cast, and five proposals received support of more than 40 percent of votes cast.

2. Sustainability is a board concern. Of the 600 largest U.S. public companies analyzed by Ceres, 31 percent had integrated sustainability into their board charters. For boards everywhere, this is an excellent moment to consider whether your company's position on sustainability is worth including in your charter too, according to "Ceres May 14, 2018 Report on Integrated Sustainability into Board Charters."

3. Gender diversity on boards should not be ignored. Vanguard and AXA — which have $5.1 trillion and $917 billion under management, respectively — are joining the Thirty Percent Coalition. The mission of the Thirty Percent Coalition, which was founded in 2011, is to promote gender diversity, including for women of color, on corporate boards. Vanguard and AXA's support is yet another sign that large institutional investors are getting deadly serious about putting pressure on public companies to increase board diversity. In addition, in 2019, new policies at ISS and Glass Lewis will go into effect that will allow recommendations against boards that lack diversity.

It's important to remember that women directors are gaining seats. In the first quarter of 2018, nearly one-third of director seats went to women, per "Equilar Gender Diversity Index Q1 2018." That said, only about one in six board directors today is female.

4. Investors still want to see an independent board chairman. In 2018, for the fourth year in a row, proposals to require an independent board chairman were the second most popular type of shareholder proposal filed.

5. Make sure you're not an ESG laggard. Pulling up the rear when it comes to ESG (environmental, social and governance) is not a responsible course of action. More proof needed? In late 2018, the Jana Impact Capital Fund reportedly plans to target underperforming companies that also lag in environmental and social practices. This is following a growing global trend to bring ESG into mainstream investing. In fact, "UBS Asset Management" recently began placing sustainability and environmental concerns at the center of decision-making for its entire active fund range.

6. Institutional investors demand greater ESG specificity. It's no longer sufficient to just have an ESG policy. Large institutional investors are being asked to approach ESG in specific ways. In June 2017, for instance, Trian adopted a policy encouraging companies within its portfolios to implement ESG-related initiatives that it believes will improve their long-term performance. Meanwhile, in its April 2017 ESG policy, Blue Harbour defined the principles that will guide how it evaluates material ESG issues during the investment process.

7. Investors are using ESG information in more than just one way. The growth of mainstream investor interest in sustainable, responsible and impact (SRI) investing has been quite dramatic. In a study of Canadian institutional investors, the response was consistent — 100 percent said that they sometimes or always look at environmental, social, and governance issues when assessing risk and deciding whether to invest in a company. That said, investors are getting this ESG information mostly from third parties. The number of ESG-related queries by third parties to public companies is also dramatically increasing — in both volume and depth of information requested. As corporate peers respond to these queries, the bar is raised for their industry.

Leading asset management houses, such as Morgan Stanley, Goldman Sachs, BlackRock and State Street, and mutual fund advisories, including Fidelity, Vanguard and American Funds, have adopted SRI analytics and ESG portfolio management practices, established guidelines and policies, and retained third-party analytics firms to assist in these activities. However, the accuracy of the ESG data collected by third parties depends heavily on the corporate issuers themselves, and issuers should therefore check all information for completeness, consistency and accuracy.

8. Key voluntary ESG-reporting frameworks drive tipping point in ESG disclosure. It may be hard to believe, but we've reached the tipping point where 55 percent of global companies are reporting ESG-type data. Of course, producing a corporate sustainability report and having a sustainability strategy don't necessarily equate to the same thing for your intended audiences. Investors need decision-useful data on key material issues that are strategic to the company, all with a clear link between ESG issues and corporate strategy, risk management and operational context.

This is where the key ESG reporting frameworks — the CDP (formerly, the Carbon Disclosure Program), GRI (Global Reporting Initiative), TCFD (Task Force on Climate-related Financial Disclosures), and SASB (Sustainability Accounting Standards Board) — are embraced by both corporations disclosing data and investors using the data disclosed.

- The TCFD, founded in 2015, has over 250 global supporters. This task force lays out four thematic areas, reflecting the fundamental elements of an organization's structure that climate disclosures should cover: governance, strategy, risk management and metrics and targets.
- CDP is a not-for-profit that runs the global disclosure system for investors, companies, cities, states and regions to help these entities manage their environmental impacts.
- The mission of SASB, which was founded in 2014, is to help public companies disclose material, decision-useful information to investors, guided by the U.S. Supreme Court's definition of materiality. SASB is expected to release modified standards for 79 industries in 2018.
- Founded in 1997, GRI is the first and most widely adopted set of global standards for sustainability reporting out there. GRI helps businesses and governments worldwide understand and communicate any impacts they are having on critical sustainability issues, such as climate change, human rights, governance and social well-being.

9. Growing demand for decision-useful ESG data is driving the proliferation of ESG ratings firms. Investors globally are integrating ESG ratings into their investment-making decisions to help identify risks or opportunities that may not be apparent in traditional financial analysis. Ratings firms collect and analyze ESG data using several approaches, including questionnaires, surveys, collection and standardization of public data, and government and NGO databases, as well as company disclosures and media sources. The five ESG data and analysis providers below are leaders in this space:

- **Bloomberg Professional Services Platform** collects very large amounts of ESG data from published and publicly filed company content and integrates both narratives and raw data into the firm's Equities, Bloomberg Intelligence, and Fixed Income platforms. Bloomberg distributes ESG data on the more than 11,000 public companies it covers.
- **Thomson Reuters Eikon** publishes news and financial data, and offers a desktop data tool called Eikon. The Eikon ESG data tool covers over 5,000 companies and uses over 500 metrics.
- **MSCI ESG Research** is a creator of indexes, positioning itself to be one of the leaders in ESG equity research and analysis on a global basis. Clients are generally asset owners and managers. ESG ratings encompass 6,400 companies (11,800 issuers including subsidiaries) and more than 400,000 equity and fixed-income securities globally.
- **Sustainalytics** is a widely utilized and global responsible investment research firm, specializing in ESG research and analyses. Sustainalytics assists its investor clients in integrating ESG analysis into their existing valuation models. This is done by experienced analysts who perform independent research.
- **ISS E&S QualityScore Disclosure and Transparency Signal** offers multiple research and analytical products to assist investor clients in assessing their portfolio risk exposure. ISS selects factors to analyze based on developments in disclosure standards and frameworks, such as the GRI and SASB standards and the recommendations of the TCFD.

10. As ESG is integrated into mainstream investors' decision-making processes, the boardroom may need to evolve its role in oversight and risk management. Many experts believe that sustainability reporting will need to evolve from ESG disclosures in qualitative terms to using quantitative measures that apply ESG frameworks, where appropriate.

Over the past several years, growing numbers of public companies have begun to disclose more about their performance against specific environmental, social and governance criteria. This will likely accelerate as interest and scrutiny from investors increase.

When gearing up for this heightened scrutiny, companies may want to:

- Create a sustainability disclosure working group that reports to the board and aligns resources and expertise from inside and outside the company.
- Engage an external advisor to assist in developing a materiality assessment of ESG data, while engaging a repeatable methodology and process, auditable by independent third parties.
- Review all current, corporate ESG communications channels, making sure data is consistent, accurate and complete. This review should include an assessment of ESG rating firms' data sets.
- Design, create and draft communications for all ESG data to be used by investors in plain English, linking disclosures to corporate sustainability goals, KPIs and executive compensation.

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