WHITE PAPER | ESG DISCLOSURES

ESG Disclosures – Your ESG journey guided by our 5-step engagement

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Whether you are a young growth company seeking initial recognition, or a more established and well-known company, you probably find you are constantly competing for capital with others around the globe. One powerful way to distinguish yourself is with a carefully crafted ESG message. Increasingly, active managers apply some form of ESG screening in their portfolio selection, and for indexed or passive managers, ESG-related matters are high on their list of engagement topics.

At the start of 2020, $16.6 trillion in US professionally managed assets employed some form of ESG screening, a 43 per cent increase over the prior two years, according to the U.S. Forum for Sustainable & Responsible Investment (USSIF). Many of these investors use data from ESG raters and rankers, such as MSCI, Sustainalytics and ISS as part of this screening process, and they may exclude companies that score in the bottom quartile or decile among peer companies. This means that there is a public profile of your ESG data, whether or not you actively participate in surveys by raters or rankers or have a formal ESG disclosure process in place. While this public profile may be imperfect, the fact remains that it is being used now for investment selection by both long-term investors and activists alike.

Consider this: BlackRock, the world's largest investment manager, is one of many prominent investors that believe that climate risk is investment risk. Since they and other indexed investors can't "pick better companies", they instead push their portfolio companies to improve the quality of their practices and disclosures as a means to reduce risk and improve performance. This push applies both to climate-related risks that companies face, as well as opportunities for companies to participate and succeed in a lower-carbon economy. BlackRock and others also have announced their intention to hold directors accountable through against/withhold votes at companies that either fail to disclose sufficient information, or where they feel progress toward sustainability goals is lagging.

COVID-19 Impact on Investor Focus:

This past year, as the depth and duration of the pandemic became apparent, many companies went into survival mode, and investors afforded these companies some degree of forbearance regarding their progress toward longer-term sustainability strategies and reporting. Now/one year later, a different attitude is evident. The pandemic has galvanized institutional investor focus and they are renewing pressure on their portfolio companies to either initiate or expand ESG reporting, with initial focus on a) identification of material risks, and b) board oversight of the ESG process.

Ultimately, investors are seeking material, quantitative, decision-useful information that they can use in comparing relative risks across potential investments, and in measuring individual company progress toward reaching ESG goals.

A Confusing Reporting Landscape:

Many of our clients express concerns about the plethora of ratings, rankings and reporting frameworks. Some even state that a lack of clarity is inhibiting their ability to embark on their sustainability and disclosure journey.

There is some good news on this front. In September 2020, five major organizations -- the CDP (formerly the Carbon Disclosure Project), CDSB (Climate Disclosure Standards Board), GRI (Global Reporting Initiative), IIRC (International Integrated Reporting Council) and SASB (Sustainability Accounting Standards Board) 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.

Potential SEC Action:

On February 24, the SEC underscored its interest in stronger environmental disclosures. The Commission's Acting Chair Allison Herren Lee directed the Division of Corporate Finance to enhance its focus on climate-related disclosure in public company filings, with the objective of updating its 2010 guidance on this topic. We cannot predict how long this process may take, or what the outcome will be, but the fact that the SEC is focusing on climate-related disclosures is worth noting.

Don't Wait – Start Now!

While the convergence of voluntary reporting standards is a welcome development, neither that, nor any updated SEC guidance, should be used as a rationale to wait before initiating or progressing on your sustainability and disclosure journey. Remember that investors are watching NOW. We are already working with hundreds of companies to either initiate reporting, or fine tune and expand existing programs. We often hear these questions:

- Where should we start?
- What matters most?
- What should we disclose at our web-site, the proxy, 10-K and other channels?

DFIN, along with our sustainability reporting partners the Governance & Accountability Institute (G&A), apply a five-step process to address these issues.

Our Five Step ESG Reporting Process

1. **Select Material Indicators:** While the major materiality and reporting frameworks aren't yet integrated, there is substantial overlap among them. Focusing primarily on SASB, GRI and TCFD, we select five to seven relevant material indicators for your industry group and for which you have information to disclose
2. **Conduct a Peer Review:** Given the relative nature of ratings and rankings, analyzing peer disclosures (proxy, 10-K/AR, web-site) can both identify industry-specific topics not captured in step 1, and establish what is required to match or exceed the disclosures of your peers
3. **Identify Thematic Messaging:** Based on steps 1 and 2, you may have identified seven to ten topics as the foundation of your disclosures. Here, for communications purposes we distill these down to three to five thematic tenets (e.g. 'our people', 'our purpose', 'our planet')
4. **Create Content:** Working with you, our ESG consultants, analysts and writers advise on and/or draft content that meets the criteria above
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 equally applicable to proxy, AR, web-site and CSR report development. Following these steps helps ensure consistency of materiality prioritization, and of messaging, across documents and channels.

Considerations in Determining What to Disclose Where

Web-site

Remember that you don't 'get credit' for what you don't disclose, so publicizing existing policies can be the lowest hanging fruit and a good starting point. Consider making available data privacy, workplace health & safety, equal opportunity and anti-harassment/discrimination policies and documents, as well as employee codes of conduct and supplier codes of conduct. Remember that web-site disclosure can be maintained and updated more readily and cost-effectively than static formal reports or annual regulatory filings. For many companies, an ESG tab on their IR site is an excellent way to start. As messaging becomes more sophisticated, companies may consider creating a sustainability micro-site.

IR messaging

It's increasingly common for investors to ask E&S and board oversight questions at investor conferences and on engagement calls. Consider including a slide or two of ESG highlights within your investor presentation. Similarly, quarterly earnings calls are a terrific opportunity for updating investors on your ESG progress.

Proxy statement highlights

For companies newly embarking on this journey, the proxy may be their first such disclosure effort. With well-selected highlights, this single disclosure undertaking can be an effective way to move the needle on influential ratings and rankings. While there is no one perfect template, some of the most effective proxy disclosures discuss:

- **Board oversight**, including identification of any committee tasked with this, and the competencies and qualifications of board or committee members to effectively oversee these matters.
- **Board (as well as executive, and workforce) diversity**. Note that investors increasingly are asking companies to report on ethnic and racial diversity separate from gender, though clearly, they can overlap.
- **ESG and human capital program overview**. When we refer to proxy statement highlights we mean just that. Discuss identified risks, opportunities and priorities and if available, recent performance in these areas. But reserve the full story for the web-site.
- **Executive compensation**. Any ESG-related compensation metrics should be highlighted, such as health & safety, employee development and diversity initiatives.
- **Covid impact statements**. These may center around employee health & safety, expansion of remote work, and how productivity and morale were maintained. At many companies, this COVID story will heavily influence their human capital story.

These disclosures may appear in various locations including: substantive CEO and/or board cover letters and/or proxy summaries (highlighting the initiatives), in the governance and board section (oversight), and the CD&A (human capital, compensation metrics).

Annual Report/10-K

US companies typically lag their European and Asian counterparts when it comes to providing integrated reporting, which aims to connect financial reporting with a company's operations and non-financial data, including ESG factors that may affect its profits over the long term. It seems that most US companies aren't going this route, at least not in the immediate future.

But short of fully integrated reporting, companies can still venture beyond financial reporting conventions to include an expanded discussion of ESG risk factors and their companies' sustainability focus, thereby aiding investment decisions that consider a broader range of factors.

Effective November 2020, the SEC is calling for a principles-based approach to human capital disclosures. As set for in SEC rule S-K modernization, companies may have to include in their 10-K (or other filings) a description of 1) their human capital resources, and 2) any human capital measures or objectives that are a focus of managing the business.

Bear in mind that the proxy and 10-K are regulatory documents filed with the SEC, with heightened liability risks for false or misleading disclosures in such filings. 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 b) board oversight, and proceed cautiously around c) disclosure of future targets and goals.

Your Inaugural CSR Report:

This may be your most comprehensive compilation of your performance across a broad range of inter-related topics. Remember that your CSR report will be reviewed carefully by all stakeholders, including potential employees.

The amount of time and resources required to create a CSR report depends on the type of report you decide to produce:

1. SASB fact sheets, three to six pages in length, can take two-to-three months to create
2. Summary (or lite) sustainability reports, often 15 to 25 pages in length, typically take three-to-four months
3. Full blown CSR reports ranging from 60 to 100 pages, typically take six-to-ten months – or longer - to create, and generally involve broader internal and external teams

Remember that sustainability reports are not "set it and forget it". Whether lite or full, they typically require annual or biennial updating.

Inclusion of GRI, SASB and similar content mapping indexes can make any of the above more useful to a broad range of investors, data gathers and other stakeholders.

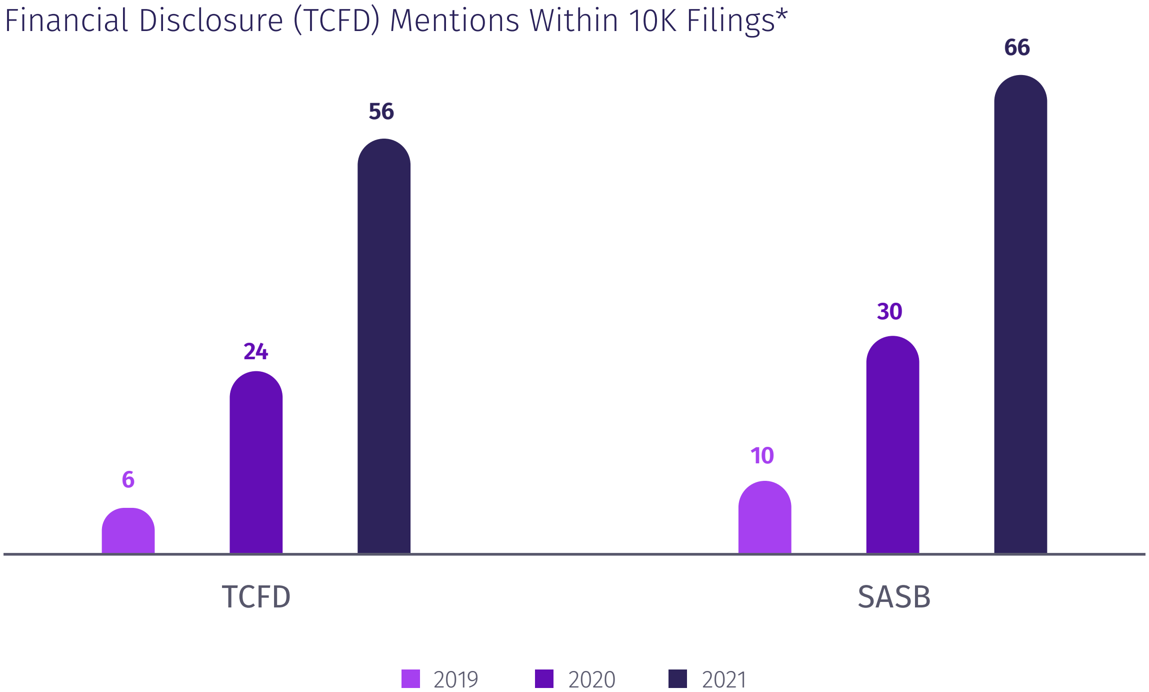
While we do believe that design can augment the message, over-design of such reports could be a mistake if it inhibits the AI and other data scraping methods raters and rankers employ to gather data. This may explain the lack of movement in ratings and rankings following publication of such reports that frustrates many companies.

Finally, it's important to remember the relative nature of these ratings. It's not just what you do – your peers may also to be advancing their disclosures.

Paying Attention to Peers

As noted earlier, a key step of our process is the peer company disclosure review. Regarding use of the leading materiality standards, DFIN notes that "mentions" of these standards within 10-K filings in the first two months of 2021 is significantly greater than in the comparable periods the prior two years:

Sustainable Accounting Standards Board (SASB) and Taskforce on Climate-related Financial Disclosure (TCFD) Mentions Within 10K Filings*



** Source data provided by EDGAR® Online a DFIN company and spans January 1st through March 2nd.*

DFIN: Guiding and Supporting You Through All Phases of your ESG and Disclosure Journey

DFIN has helped many companies get started on their ESG journeys, and we're here to help you to progress at later stages as well.

To discuss your situation and identify where we can add the most value to your current process, please contact: Ron Schneider, Director, Corporate Governance Services at: **ronald.m.schneider@dfinsolutions.com**

For examples of a range of DFIN client proxy ESG and HCM disclosures, see our Guide to Effective Proxies, 8th edition, at: **www.proxydocs.com/xDFINx**

Learn more about DFIN's end-to-end risk and compliance solutions.

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