The Path to HARMONIZATION

What's next for ESG disclosure?

Brunswick's **AMELIA PAN** talks to **JANINE GUILLOT,** CEO of SASB (Sustainability Accounting Standards Board), whose organization might hold the answer.

Over the last two years, the pace of change on the critical topic of ESG disclosure has surprised even those closely involved in its progress. And there is every indication that momentum will continue in the coming year.

In 2020, I had three conversations with Janine Guillot, CEO of the Sustainability Accounting Standards Board, the San Francisco-based NGO more commonly known as SASB. We first spoke a few weeks before Larry Fink published his January 2020 headline-grabbing letter to CEOs: "A Fundamental Reshaping of Finance." Buried 18 paragraphs beneath the headline was a significant request that would shine a spotlight on her organization: BlackRock suggested every company in its portfolio "disclose in line with industry-specific SASB guidelines."

Mr. Fink was referring to a set of ESG standards created by the nonprofit. I asked her at the time why SASB had been singled out.

"Our mission is to help businesses around the world identify, manage and report on the sustainability topics that matter most to their investors," she told me. "We're trying to bridge the historical world of financial performance—which is perceived to be very short-term—and the long-term world of stakeholder impact. Both companies and investors need to understand how sustainability connects to long-term enterprise value creation. SASB Standards are a very powerful tool to do that."

The Standards to which Ms. Guillot alluded, and which Mr. Fink supported, are tailored for 77 different industries and focus on "financial materiality"—those ESG issues that directly affect a company's financial performance. That arms investors with the quantitative, industry specific, and financially material ESG data they crave—and which they are increasingly trying to weave into their investment decisions.

"Silos within investment management firms are breaking down, and governance and ESG teams are increasingly integrated with portfolio management and research teams," Ms. Guillot pointed out. "Today, the people actually making buy and sell decisions on securities increasingly believe that ESG issues can impact value."

Companies similarly benefit. SASB allows companies to communicate with all investors through a consistent set of ESG standards. "Often today, across the same industry, each company's disclosures on the same ESG topic will be different. The companies that are great performers can't get credit because their information can't be compared to their peers. If SASB's Standards can help companies report comparable, consistent and reliable ESG metrics, then companies can benchmark their performance and investors can allocate capital toward the best performers," Ms. Guillot told me. "That starts a virtuous cycle."

ILLUSTRATION: NIGEL BUCHANAN

That was January of 2020. By the time we caught up again over the summer, COVID-19 had upended the corporate world. I wanted to know if it had done the same for ESG disclosure. "The first week we were in lockdown I asked myself: 'Is what we're doing irrelevant, or more relevant than ever?'" Ms. Guillot said. "We've seen it is, in fact, more relevant. I look at all those elements of human capital—health and safety, leave, pay for hourly workers—and how crucial it is for companies to manage their workforces through this. We heard from our investor advisory group—who manage more than $40 trillion—that ESG disclosure isn't going anywhere."

I pressed her on this. Amid all the uncertainty of a pandemic, have investors' actions on ESG really aligned with their words? "There's no doubt we're at a stage where ESG implementation varies at investment firms, and you see that even across teams within the same firm. But I can tell you, investors are very, very focused on this. And for people in IR who aren't hearing questions about ESG: You will be hearing them in the future. I have no doubt about that."

If the pandemic reinforced the need—and investor appetite—for ESG disclosure, it hasn't clarified how companies should actually measure and report on those ESG issues. There remain at least a dozen ESG frameworks and standards that both companies and investors struggle to understand, let alone implement.

Ms. Guillot maintained that SASB's Standards were straightforward for investors to digest and for resource-strapped companies to deliver: "The SASB Standards are explicitly defined not to be an enormously heavy lift," she explained. "On average, each SASB Standard has six disclosure topics and 13 metrics. This is information you probably already have somewhere within your business—and if you don't have quantitative information, you probably have qualitative information about how you're managing the risk."

Given the Standards are cost-effective for companies and in high demand with their investors, why aren't more companies disclosing in line with it? "There's still skepticism," Ms. Guillot told me. "Do portfolio managers really care? Do sell-side research analysts care? There's also a question around risk, particularly legal risk. The default position has often been: Don't disclose information unless you have to. That's shifting a bit; do you run a greater legal risk by disclosing or not disclosing?

"Also, this field isn't as mature as traditional financial reporting. The metrics are newer. And because the metrics are newer, there are often concerns about the rigor, the controls over the information. How do companies get comfortable enough with their controls and governance over the information so they can put it into the public domain, especially in investor-focused communications?"

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In the autumn of 2020, five major players in sustainability disclosure, including SASB, announced a shared vision for how existing standards and frameworks can complement Financial GAAP and serve as a basis for a comprehensive corporate reporting system. A few months later, Ms. Guillot and I caught up once more, on the eve of yet another huge announcement: In mid-2021, SASB will merge with the International Integrated Reporting Council (IIRC), a global coalition of regulators, investors, companies, standard setters, the accounting profession, academia and NGOs. The move will create a new organization, the Value Reporting Foundation, which Ms. Guillot will lead as CEO.

The *Financial Times* rightly called the merger "an important development for ESG investing." That's because the IIRC provides a reporting framework that establishes what ESG topics companies need to report on; SASB's Standards mean that data will be reported consistently. "Bringing the two groups together should help make ESG investors' lives a lot easier," the *FT* concluded. By the of end 2021, SASB will operate within a new organization, but that won't affect the use or popularity of its Standards.

Such collaboration hints at what is likely to be the key trend of 2021: consolidation of different ESG standards and frameworks. Ms. Guillot predicted that "further harmonization" for ESG reporting is likely only a year or two away.

Where does all this leave companies? Why should they try to understand and report on ESG when there remains so much uncertainty about the best way to do so? "Control your story, control your story, control your story," Ms. Guillot said. "There's an entire landscape of ESG raters and rankings. Large global investors hold almost every listed company in the world. If your company doesn't disclose, someone—whether that's a portfolio manager or index provider or sustainability rating provider—is still going to try to reach a conclusion about your company's ESG performance. You're in a much better position putting some information out there than nothing at all," she advised. "Tell your story." ◆

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ENCAPSULATED BY AN ACRONYM, ESG IS ITSELF AWASH IN THEM: SDG, PRI, TCFD, SASB, GRI, MSCI ... TO NAME A FEW. EACH CORRESPONDS TO A DIFFERENT ESG STANDARD, FRAMEWORK, RATING AGENCY OR INDEX, WHICH IN TURN HAVE DIFFERENT FOCUSES AND REQUIREMENTS. YET A GROWING NUMBER ARE COMPATIBLE AND COLLABORATING, CREATING A COMPLEX, CONSTANTLY EVOLVING LANDSCAPE. HERE'S AN OVERVIEW OF SOME KEY NAMES SHAPING THE ESG CONVERSATION:

THE AGENDA-SETTERS

Three organizations tend to come up in most discussions about ESG and act as reference points and agenda-setters:

UNSDG (United Nations' Sustainable Development Goals)

The SDGs are often a starting point for a company's ESG activities. Adopted by United Nations member states to tackle the world's most pressing societal challenges by 2030, the 17 SDGs range from ending poverty and hunger to providing quality education, gender equality and sustainable communities. Companies commit to address the key SDGs most relevant to their business (*see how a grocery giant targeted food waste, SDG 12.3, on Page 49*).

PRI (Principles for Responsible Investment)

Representing more than $100 trillion in assets, PRI is an investor initiative supported by the United Nations that sets guidelines for asset owners and asset managers when making investment decisions. PRI's 2,800 signatories must report on their responsible investment activities every year. It recently announced that it will begin removing investor signatories that do not adhere to its requirements.

TCFD (Task Force on Climate-Related Financial Disclosures)

The TCFD provides a global framework for reporting on climate in financial statements. It looks to give valuable information to investors, lenders and insurers on a variety of risks associated with climate change. Amid growing regulatory and public pressure, more than 1,000 organizations now support the TCFD. For now, the TCFD remains voluntary but that will soon change; the UK's latest Green Finance Strategy mandates that by 2022 all listed companies and large asset owners disclose in line with the TCFD.

STANDARDS & FRAMEWORKS

At a more granular level are ESG standards and frameworks, which essentially set guidelines to help companies measure and disclose ESG activities. There are at least a dozen such standards and frameworks, ranging from a focus on climate to financials to economic and social impacts. The two most commonly used are:

GRI (Global Reporting Initiative)

Founded in 1997, GRI is the most widely used ESG standard globally and allows companies to communicate their material ESG issues (self-assessed) to a broad range of stakeholders. As well as mapping to the SDGs, companies can align with the European Union's Non-Financial Reporting Directive (NFRD), which requires large companies to disclose information on the way they operate and manage ESG issues. The GRI Standards focus on the economic, environmental and social impacts of a company, and hence its contributions—positive or negative—towards sustainable development.

SASB (Sustainability Accounting Standards Board)

SASB connects sustainability issues to financial performance. It focuses on ESG issues that are "financially material" and "industry-specific," meaning its Standards are customized to 77 different industries. Companies voluntarily choose to report against their Standards, and also determine how they disclose that information, whether via stand-alone SASB reports, in regulatory filings, or embedding the data within an annual sustainability report.

GRI's and SASB's Standards are designed to fulfill different purposes and are based on different approaches to materiality, yet many companies use both sets of Standards to meet the needs of various audiences. TCFD Recommendations and SASB Standards are also compatible and frequently used together.

RATINGS AGENCIES

Most companies experience ESG through ratings agency surveys. Unlike standard setters, these agencies rate companies and compile rankings. Two of the largest and most commonly cited are:

MSCI

The firm ranks more than 7,500 companies and 46 of the 50 largest global asset managers pay for those rankings. MSCI ESG Ratings are designed to help investors understand ESG risks and opportunities and integrate these factors into their portfolio. They analyze data across 37 key ESG issues, and rate companies against sector peers on a AAA-CCC scale, which is retained through ongoing monitoring. Significant score changes trigger a full review and re-rating.

SUSTAINALYTICS

Its ratings are based on a "two-dimensional materiality framework" that measures a company's exposure to industry-specific material risks, and how well they are managing those risks. It also includes the company's approach to corporate governance. Those scoring poorly can access a report and purchase detailed feedback and support.

Companies view a draft report, to which they can respond before it is made available to Sustainalytics' clients, which include many of the world's leading pension funds and asset managers.