



ESG DISCLOSURE & INVESTING
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GREEN INVESTING IS ESG INVESTING

- Investors wanting a greener portfolio are typically looking at ESG factors disclosed by corporations or ESG indexes created by index providers
 - FTSE Russell
 - Morningstar
 - MSCI

WHAT ARE ESG DISCLOSURES?

E = Environmental

- Climate impact: Carbon emissions/footprint
- Climate risks and opportunities
 - Physical risk
 - Transition risk
 - Legal risk
- Compliance

S = Social

- DEI/Human resources (benefits, comp, training)
- Supply chains

G = Governance

- Management vs. shareholder control/diversity

SOURCES OF ESG STANDARDS

CDP (previously the Carbon Disclosure Project)(established in 2000), an international non-profit that sends annual questionnaires to companies and investors and scores organizations on environmental risks and opportunities related to climate change, water security, and deforestation.

Global Reporting Initiative (GRI)(established in 1997), an international nonprofit that created the first international guidelines for sustainability reporting in 2000, under which companies determine independently which GRI standards to apply to their disclosures.

Sustainability Accounting Standards Board (SASB)(established in 2011), a U.S. nonprofit that developed a voluntary ESG reporting framework in 2018 consisting of industry-specific sustainability accounting standards for 77 industries.

Task Force on Climate-related Financial Disclosures (TCFD)(established 2015), a multi-national inter-governmental organization established by the Financial Stability Board to make recommendations to improve voluntary climate change disclosures, which released a framework in 2017 to help companies evaluate and disclose financial risks posed to their business by climate change.

ESG REPORTING

- Voluntary sustainability reports
 - 2011: 20% of the S&P 500
 - 2019: 90% of the S&P 500 (G&A 2020 Flash Report)
 - 2019: 51% used GRI (75% for Global 250); 14% used SASB line item measures; 5% TCFD (*Id.*)
- Securities and Exchange Commission Reports
 - No mandatory ESG disclosure requirements
 - 2010 guidance encourages disclosure of risks and known trends and uncertainties when material
 - Five commissioners currently split on whether to issue mandatory rules – watch this space

INTEREST IN ESG INVESTING

- Investors are strongly interested in ESG investing: returns in the first quarter of 2020 showed that ESG indexes/ETFs out-performed conventional market indexes
- Strong indicators of future volatility, earnings risk, price declines and bankruptcies: proxy for good management and excellent lens for long-term value
- Investors are dissatisfied with the current quality of ESG disclosure/reporting (July 2020 GAO Report)
 - Accessibility
 - Comparability
 - Consistency/quality/reliability
- Larry Fink, BlackRock CEO, Letter to CEOs, January 2020: Failure to report according to SASB/TCFD standards will lead to votes against directors at annual meetings

CHALLENGES OF ESG INVESTING

- Multiplicity of disclosure standards
 - Different focuses among standard-setters
 - Competition among standard-setters
 - Beginning to cooperate to establish one set of consistent global standards
- Competing ESG factors
 - Emphasize E, S, or G?
- Inconsistency among reporting and measuring companies
 - Voluntary company reports use different metrics
 - Different Indexers treat same company differently by weighing E, S, G differently

FACTORS TO CONSIDER

- Recognize the difficulty of making “impact” in public markets. (Brest, Gilson & Wolfson 2018)
- Look for reporting according to SASB standards – designed for assessment of financial impact of ESG issues
- Emerging consensus that best-in-class investing based on consideration of ESG factors provides superior returns, while “screen” investing, in which certain industries are excluded entirely provides inferior returns, compared to market indexes*
- Index/ETF investing: very important to look under the hood to see which ESG metrics are being tracked and how they are being assessed