Digesting the 'alphabet soup'

There are a large number of ESG-related organisations, standards and ratings agencies. **Amelia Pan** looks at some of the most prominent in the market – and provides some clarity for confused IROs.

Daily, it seems, FTSE companies announce net-zero targets, invitations arrive for a new ESG conference, and companies field a new ESG survey or request.

Yet research by the IR Society last year found that a mere 13% of respondents had fully incorporated ESG factors into their investment stories. The same survey found that four in 10 IROs surveyed had not discussed the ESG analysis process with their top investors.

Their key audiences are talking about ESG – why aren't more IROs? Likely because they're unsure how best to do so. The field of organisations abbreviated by an acronym has become deluged. Commentators joke that the issue is an 'alphabet soup' of ratings agencies, standards bodies, NGOs and regulators that even experts struggle to digest.

Investors haven't found it easy either. Most analysts were trained to use the financial reporting standards developed over the last century, whereas the regulation of non-financial reporting is still in its early stages. With lack of consistency hampering comparability, and companies confused about which data points to disclose, even experienced fund managers find it difficult to collect reliable investor-grade ESG data, let alone confidently integrate it into their stock-selection process.

While the landscape remains confusing, the best approach for IROs is relatively straightforward: just get started. Consider ESG as another opportunity for you to control your story and reinforce your broader investment thesis. Engage with your shareholders and find ways to deliver easily digestible, thoughtfully integrated ESG information to them.

To help you navigate the ESG ecosystem, here's a quick look at some of the tools at your disposal, and the frameworks shaping the conversation.

The agenda setters

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

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THE FIELD OF ACRONYMS

- **Three organisations tend to set ESG agendas for discussion, these are: SDGs, PRI and TCFD.**
- **There are two commonly used standards for measuring ESG activities – GRI and SASB.**
- **Three of the largest ESG ratings agencies are: MSCI, Sustainalytics and RobecoSAM.**

SDGs (Sustainable Development Goals)

For many companies, the SDGs are a starting point for their 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 promoting quality education, gender equality and sustainable communities. Companies commit to address the key SDGs that are most relevant – with some even trying to map to all 17.

PRI (Principles for Responsible Investment)

Currently representing $86 trillion in assets, PRI is an investor initiative supported by the United Nations which sets guidelines for asset owners and asset managers when making investment decisions. The aim is to create sustainable financial markets by integrating ESG issues – PRI's 2,800 signatories must report on their responsible investment activities every year. It recently announced that it will begin delisting companies 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. Chaired by Michael Bloomberg and supported by Mark Carney, the goal is 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 organisations 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 will be expected to disclose in line with the TCFD. It's worth nothing that CDP (formerly Carbon Disclosure Project) has embedded the TCFD requirements into its reporting and many companies use it as a proxy for direct TCFD disclosures.

The ESG standards

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

GRI (Global Reporting Initiative)

The most widely used globally, GRI allows companies to communicate their material ESG issues (self-assessed) to a wide 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. GRI covers a wide range of issues, not all of which can be traced directly back to a company's bottom line. Some see GRI's breadth, however, as limiting its effectiveness.

SASB (Sustainability Accounting Standards Board)

Investors worth a collective $34 trillion advocate the use of another standard: SASB. Founded in 2011, SASB connects sustainability issues to financial performance, and connects businesses and investors on the financial impacts of sustainability. Its focus is on ESG issues that are 'financially material' and 'industry-specific', and its standards are customised to 77 different industries. Investors find SASB useful because its standards arm them with the comparable, consistent, and financially-material ESG data they crave. In his headline-grabbing 2020 letter to business leaders, BlackRock CEO Larry Fink said his firm would ask investee companies to disclose against SASB's standards by year-end. SASB's critics argue that the standards miss out on critical issues that defy precise financial measurement.

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The ratings agencies

Most IROs experience ESG through ratings-agency surveys – Sustainalytics research showed a five-fold increase in surveys to around 600 last year. It's no wonder that amongst our clients, 'survey fatigue' was one of the most talked about ESG issues in 2019. We look at some of the largest agencies below:

MSCI

Among the most well-known ESG ratings, the firm ranks more than 7,500 companies and 46 of the 50 largest global asset managers pay for those rankings. MSCI's methodology is powered by AI, tracking key issues and pulling from datasets that include company disclosures and media coverage. A large proportion of its review is on media sentiment to the company, which makes engagement with their ESG research teams even more critical.

Sustainalytics

The firm measures and rates more than 11,000 companies, broadly looking at how exposed they are to ESG issues and how they're managing them. Its process relies heavily on controversy tracking and reporting which stays on the company's file over the long term. Companies view a draft report, to which they can respond before it is made available to Sustainalytics' clients, which include the world's leading pension funds and asset managers.

RobecoSAM

The investment specialist's stated focus is linking sustainability to financial materiality. RobecoSAM invites the world's largest 2,500 publicly traded companies to participate in their annual Corporate Sustainability Assessment (CSA) by completing a questionnaire. Companies are ranked on a total score from 0–100, and these scores then inform the Dow Jones Sustainability Indices.

To make matters more confusing, there is overlap and cross-pollination (and even competition) between the standards, frameworks and rating agencies. PRI is integrating TCFD into its requirements for signatories, for example, while FTSE4Good's ratings are aligned with the UN's SDGs. Earlier this year, the World Economic Forum's International Business Council (or WEF's IBC, for the acronym-inclined) announced a new initiative to harmonise ESG reporting. The IBC's plan is to draw upon the work of GRI, SASB, TCFD, and CDSB (Climate Disclosure Standards Board). Alphabet soup indeed. ■