Climate Change in the Crosshairs

Strategic, Pragmatic and Effective Advice for Complex Times

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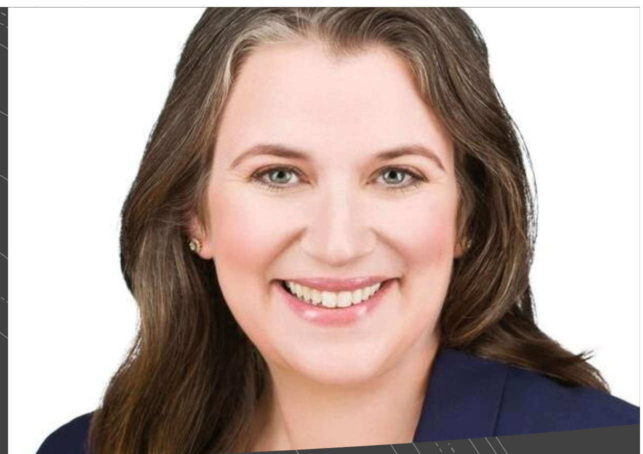

Introducing

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Agenda

- Environmental Issues in Focus
- Who are the Players?
- The new SEC Climate Proposal
- Compliance and Ethics Issues with ESG
- Greenwashing and other Frauds

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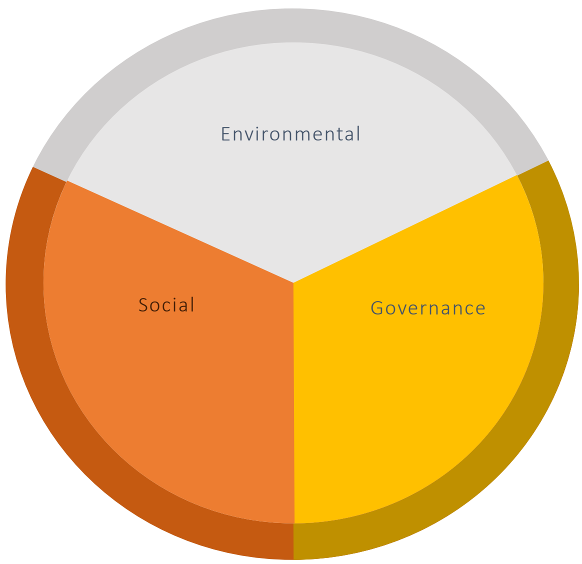
ESG:
Environmental
Social
Governance



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Climate in the Crosshairs

- The **2021 EY Global Institutional Investor Survey (pdf)** explores the perspectives of more than 320 senior decision-makers at buy-side institutions around the world and identifies three important themes:
  - While the COVID-19 pandemic has been a powerful ESG catalyst, more should be done by both corporates and investors to assess ESG risk effectively and meet the increasing stakeholder emphasis on social issues.
  - There is a growing focus on the transition to a net zero economy, and climate change is increasingly central to investment decision-making. But both investors and corporates should improve their approach to climate scenario analysis and drive the post-COVID-19 pandemic green recovery and energy transition.
  - Better-quality nonfinancial disclosures and a clearer regulatory landscape are likely to be important to realizing the potential of ESG performance, alongside more sophisticated data analytics capabilities.

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Standards and Ratings Agencies

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Current State of Climate Disclosure by US Companies

4 Primary Sustainability Reporting Frameworks Have Emerged:

1. CDP – f/k/a the Carbon Disclosure Project
   - Actually online questionnaires that create a global disclosure system for companies, cities, states and regions to report out their environmental impact to their stakeholders
2. GRI (or the Global Reporting Initiative)
   - Set of reporting standards, currently broken down by Universal, Sector and Topic standards
3. SASB (or the Sustainability Accounting Standards Boards)
   - Set of reporting standards for 77 industries in 11 sectors around 5 dimensions (**environment**, social capital, human capital, business model & innovation, and leadership & governance)
   - Now merged with the IFRS Foundation, but still building on SASB's "industry-based" approach
4. TCFD (or the Task Foard on Climate-related Financial Disclosures)
   - Set of 11 detailed recommendations around 4 pillars: Governance, Strategy, Risk Management and Metrics & Targets)
   - Goal: Report out climate-related issues, which can overlap with other sustainability reporting frameworks
   - Strong support from capital market participants, including the G20 Finance Ministers and Central Bank Governors

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4 Frameworks Have 3 Fundamental Differences

Framework (year effective)	Audience	Materiality Definition	Format for Disclosure
CDP (2000)	Stakeholders	Not explicit, but implicitly includes what its "investor members" have requested as "material" to them	• Questionnaire based on company's "environmental impacts" • Separate "supplier" questionnaire that may be requested by investors and/or customers • Up to company whether to make disclosures public
GRI (2000)	Stakeholders	Each company determines which of its own activities may have a "material impact" on the larger world	• Generally in CSR reports with GRI Index • Data goes into data base, generally free to public
SASB (2018)	Investors/other financial market participants	"Financial" materiality to investors, particularly over the long term	• Standalone SASB report; or SASB Index in CSR reports • "Financially material" disclosures should end up in SEC-filed documents
TCFD (2017)	Investors/other financial market participants	"Financial" materiality to investors, particularly over the long term	• Often in CSR reports with Index, sometimes a standalone report • May have enough overlap with other frameworks to have a TCFD Index to cover TCFD recommendations in another framework-based report

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Additional Framework Reporting/Support requested by Customers

IMPORTANT REMINDER: These additional ones can be relevant to you *if*:

- You are a private company with stakeholders who care; OR
- You are a public company whose stakeholders request this information as a condition of doing business with them.

There are also a number of groups you can choose to join or whose standards you can deploy such as:

- Ecovadis
- SBTI (Science based targets)
- Global Compact
- IIRC (International Integrated Reporting Council)
- UN SDG (Sustainable Development Goals
- CDSB (Climate Disclosure Standards Board)

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What to Know About the SEC's Proposed Climate-Related Rule

- **TCFD seems to have won**
  - Explicit support for broadly accepted notion that "climate-related risks" can have actual or likely "financially material" impacts on companies' businesses, strategies and outlooks.
  - Delay of final rule likely until 2023, when new Congress or Legal Challenges could gut or void it.
  - How much will that matter?
    - Investors are already getting some of the disclosure included in the proposed rule; and they can be expected to continue to push companies to provide this disclosure.
    - Companies are already reading the writing on the wall.
      - Notwithstanding company complaints, companies know that much of this disclosure is what their sophisticated investors/customers want and expect due to the "financial materiality" of these issues and their importance to our capital markets system in the US and globally.
    - Uniform and explicit rules are generally considered best for investors + our capital markets.
    - Even with Congressional and/or Judicial action, both sides will likely continue to look at the draft or final SEC rule for guidance in their engagements with each other regarding company disclosures.

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6 Biggest Compliance and Ethics Issues with ESG Management

The following are a few of the most common misconceptions and problematic practices among companies when dealing with the management of ESG issues:

- **Focusing only on Ratings**: A focus on "checking boxes" instead of developing a strategy that is tailored runs the risk of being ineffective risk management.
- **Talking the Talk But Not Walking the Walk**: Communications can help the company amplify its messaging, but fraud is still fraud and misstating or misrepresenting reality is still a problem.
- **Tone At the Top**: The company's ESG management strategy should part of the company's vision and values. If senior leaders aren't supportive, these efforts will not have impact.
- **Compliance-Only Approach**: An approach to ESG management focused exclusively on compliance with rules and regulations may meet requirements, but going above and beyond minimum requirements is where ethics comes in.
- **Inconsistencies:** Lack of a company-wide strategy and coordination often leaves significant gaps in the company's ESG programs, with potential exposures to risk.
- **Lack of Assessment and Monitoring**: Lack of effective monitoring of ESG performance impedes the company's ability to make progress and receive full credit for its ongoing initiatives through reporting. There may also be issues with validating claims if monitoring is not implemented to identify emerging concerns.

What to Know About Compliance + Legal Concerns Related to Climate Disclosure

In September 2022 *Merriam-Webster* added "greenwash" to its dictionary:

- "to make (something, such as a product, policy, or practice) appear to be more environmentally friendly or less environmentally damaging than it really is."

Examples of "greenwashing" that raise compliance concerns:

- The Netherlands regulators put regulatory pressure on fashion company H&M and sporting goods company Decathlon for sustainability labeling of their products that sounded green (*e.g.*, "conscious choice" and "Ecodesign") without providing enough support for what sustainability benefits the products were providing. Both had to remove the questionable claims from their products and make donations to sustainable causes.
- Similar examples with:
  - Financial firms claiming their funds promote "sustainability", but may have questionable investments.
  - Firms that use ESG/climate metrics in their executive & employee compensation goals, but the goals may not be easily verifiable, *e.g.*, some Scope 2 and 3 emission reductions that are based on assumptions and cannot be measured directly.

How to Avoid Greenwashing- Fraud by Another Name

Know

Know your company's climate/ESG messaging and ensure consistency

- Importance of governance practices and policies for ESG communications across departments, including marketing, financial reporting, legal, and others.
- Know who your audience is

Differentiate

Differentiate clearly between:

- Where you are – must include data to back up
- Where you want to be – aspirational

Distinguish

Distinguish between different types of company data:

- Fact-based back-up data
- Data based on underlying assumptions and modeling that may not reflect reality

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