WHITE PAPER | ESG RISKS AND OPPORTUNITIES

ESG Risks and Opportunities: Understanding the ESG Landscape

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Introduction

C-suites and boards are noticing a steadily increasing interest from investors in ESG-related risks and value creation. However, while interest in environmental, social and governance (ESG) concerns is growing, many believe that public companies are not disclosing the information investors want most.

A recent survey of institutional investors coordinated by Donnelley Financial Solutions (DFIN) and SimpleLogic revealed a disconnect between the ESG information public companies are providing in corporate social responsibility reports, annual reports, proxies and other public disclosure documents and what investors seek. Decision-useful information is what investors need to help them assess risk and the information companies need to create and enhance corporate value through a coherent sustainability strategy.

While the importance of ESG is steadily gaining recognition, this topic has traditionally not been central to the financial workings of companies, even within the enterprise risk management function.
All of this is changing.

One sign of a dramatic turnaround is that the world's largest institutional investors, such as BlackRock — a firm with roughly $6 trillion in assets under management — have become vocal about the importance of ESG. In the summer of 2018, BlackRock announced plans to require that *all* of its fund managers consider ESG factors when making investment decisions.

"The truth is that nowadays public companies that disclose ESG data — and even those that don't — are being assessed on this score by investors, many of whom use third-party ESG rating services," said John Truzzolino, director of business development for DFIN. "How well you understand what these rating services do and how thoughtfully you tailor your own disclosures to these services' standards, will be increasingly important in the coming months and years."

"Understanding what the ratings services do is no easy task. Every third-party ratings service uses its own methods of collecting and scoring ESG data, often resulting in ratings that vary widely. The best known services are MSCI ESG Research, RobecoSAM Group, Bloomberg, Thomson Reuters, Sustainalytics and ISS's E&S QualityScore," says Louis Coppola, co-founder and EVP of Governance & Accountability Institute.

In addition, companies are viewing ESG factors differently inside their own organizations. Addressing ESG issues is no longer something that can be done at every fifth board meeting or within a greenwashing report that merely ticks the box for addressing environmental or social issues. Finance executives are finally beginning to see ESG risk as financial risk. "And when financial risk and ESG risk are viewed as two sides of the same coin, then these risks can be managed and monitored more carefully and ESG disclosures can even develop into a source of fresh and untapped opportunities," according to Hank Boemer, chairman, co-founder and chief strategist, Governance & Accountability Institute.

An evolving view of ESG risk

The Committee of Sponsoring Organizations of the Treadway Commission (COSO) argues that ESG is central to a company's conversation about risk. In its applied risk management framework, Enterprise Risk Management — Integrating with Strategy and Performance, COSO stated that such an approach helps "organizations create, preserve, sustain and realize value while improving their approach to managing risk."

COSO has observed growing interest in the link between ESG factors and organizational risk. In a 2018 **report**, COSO quoted the World Economic Forum's Global Risks Report, which surveys businesses, governments, civil society and thought leaders to identify and understand the greatest risks they face in terms of both impact and likelihood. In 2008, only one societal risk — pandemics — was listed among the top five risks in terms of impact. In 2018, four of the top five risks listed in that same category were environmental. These risks included extreme weather events, water crises, natural disasters and failure of climate-change mitigation and adaptation.

With the link between ESG factors and risk increasingly explicit, companies must find ways to bring new functions and leaders into the ESG conversation.

It is also important that risk management experts, general counsel, the corporate secretary, corporate strategists, investor relations professionals and auditors get up to speed on ESG. Only when finance and legal executives from various disciplines are involved in the ESG conversation can there be an enterprise-wide understanding of the environmental, social and governance risks that a company faces and how these risks may be monitored, mitigated and proactively addressed.

Beginning your ESG journey

This white paper lays out four crucial steps in measuring, managing and communicating your ESG risk and long-term business strategy:

1. Navigating ESG issues — performing an ESG materiality assessment
2. Building a map — identifying available information and internal subject owners for developing decision-useful disclosures
3. Following the ESG disclosure path — using company-specific KPIs to articulate ESG strategy
4. Reaching your ESG goals — effectively communicating your ESG risks and long-term business strategy

Step one: Navigating ESG issues — performing an ESG materiality assessment

What is Enterprise Risk Management (ERM)?

ERM is a framework that typically involves identifying events or circumstances that are relevant to organizational objectives and assessing them in terms of likelihood, magnitude and impact, to determine a response and monitoring strategy. The framework includes the methods and processes used to manage risks and seize opportunities related to the achievement of their objectives.

ERM has begun to evolve to address the needs of various stakeholders who want to understand the full spectrum of risks faced by complex organizations and ensure they are appropriately managed now and over time. A well-designed ERM tool will capture emerging and evolving risk factors and enable organizations to respond accordingly. Critically, the effectiveness of any ERM tool or program depends on effective governance and accountability, with ultimate oversight and ownership by senior management and the board.

SOURCE: THE DIRECTORS' E&S GUIDEBOOK, CCGG

ESG materiality is at the heart of any ESG risk management discussion. When looking at materiality, companies might begin with SASB's definition that material financial issues are those issues "that are reasonably likely to impact the financial condition or operating performance of a company and are therefore most important to investors." For more information on how Sustainability Accounting Standards Board (SASB) views materiality, please see **SASB's Approach to Materiality & Standards Development**.

ESG factors can often fit into an existing enterprise risk management framework. Each of the environmental, social and governance spheres has its own distinct risks and business opportunities; once these risks and opportunities have been identified, they can be monitored and addressed.

Truzzolino noted that "companies are now challenged to identify precisely which ESG factors are material to their *own* operations and therefore critical to an enterprise risk management approach."

Who determines ESG materiality?

SASB says that while there is no shortage of publicly disclosed ESG and sustainability information out there, it is often very difficult for a user to identify which information should be considered material.

Currently, many global companies are determining materiality for ESG issues on their own; however, this might change if regulators required disclosure of ESG risk factors. For example, in May 2017, the New Zealand Exchange released its new Corporate Governance Code, which requires issuers to focus on the management and disclosure of non-financial risks and opportunities, especially in the ESG arena.

New Zealand is not alone in requiring ESG disclosures. Beginning in 2017, the European Union (EU), under Directive 2014/95EU, set forth the rule on disclosures of non-financial and diversity information by large companies in the EU. Under this mandate, roughly 6,000 companies were required to disclose information on the way they managed social and environmental challenges.

The Securities and Exchange Commission (SEC) also attempted social disclosure regulation. Dodd-Frank Act Section 1502 — the conflict minerals rule — subjected a handful of U.S. companies to mandatory disclosure of ESG factors. This rule required SEC filers to disclose whether any of their manufactured or contracted products contain so-called “conflict minerals” that originated in the Democratic Republic of Congo.

ESG regulations notwithstanding, most companies are considering the materiality of ESG factors, not because of federal mandates or regulations, but because they recognize the importance of voluntarily understanding and managing ESG risks and opportunities.

Early results from the 2019 proxy season show Environmental and Social Issues are top of mind for investors. This trend started in 2017, and continued in 2018, when environmental and social resolution filings surpassed the number of governance resolution filings for the first time.

Top 10 shareholder resolution types filed 2019 year-to-date

Source: ISS Analytics

“When companies have a better grasp on their risks, they can make better business decisions,” said Peter Bakker, president and chief executive officer of the World Business Council for Sustainable Development (WBCSD). He noted that while stronger regulations will almost certainly come over time, his organization has chosen to work with COSO in strengthening its risk management framework because these types of efforts can have “a massive **impact**.”

How to focus on materiality

COSO draws a distinction between ESG disclosures and risk disclosures, stating: “Despite an increase in ESG disclosures, evidence shows that the issues reported in sustainability reports or ESG disclosures do not always align to the risks reported in an organization’s risk disclosures.”

Here are a few reasons why ESG disclosures and risk disclosures have not historically been in alignment:

- **ESG-related risks have not typically been quantified in terms of dollars and cents.** When there is no attempt to monetize ESG risks, companies may find it challenging to allocate proper resources to addressing these risks. This problem is exacerbated when the risks being considered are long term or when the impacts seem uncertain.

- **Proper KPIs have not been identified for ESG risks** Many companies discuss ESG risks, but have yet to identify the key performance indicators (KPIs) necessary for a successful internal risk review process. Once these KPIs are in place, it is easier to monitor ESG risks over time through an internal dashboard.

- **Silos can hamper communication about ESG issues.** Too often, sustainability practitioners and risk managers are not regularly communicating with one another. The problem is that ESG-related risks are poorly understood by many of the functions that could help monitor or address ESG risks and opportunities.

Once ESG risks are viewed in ways that make them more visible and easily comparable among peers and competitors, companies can identify which ESG risks are material and how these material risks should be managed.

Step two: Building a map – identifying available information and internal subject owners for developing decision-useful disclosures

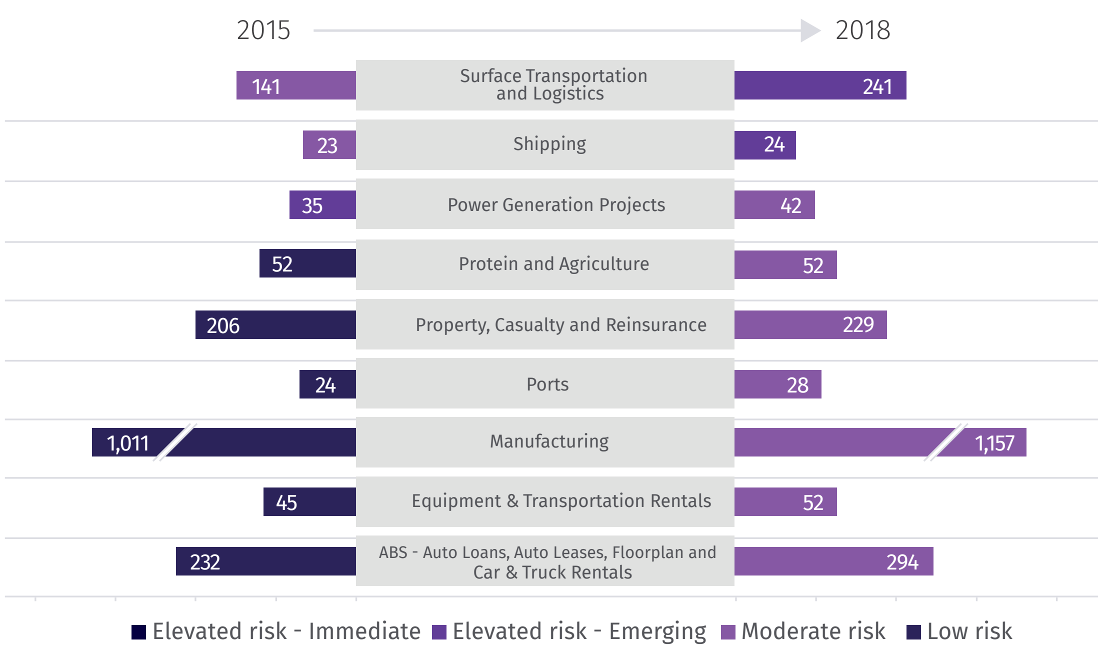
A wide range of tools exists to help companies look at ESG risks in a more systematic way. These tools increasingly include scores from credit rating agencies (CRAs), ESG rating firms and various sustainability and ERM frameworks.

The credit rating agencies

Only recently have major CRAs, such as Moody's Investors Service and Standard & Poor's, begun to fully acknowledge that ESG risk factors are critical to evaluating the financial well-being of a company. CFOs, IROs and auditing teams, along with board governance and sustainability teams, have a stake in assessing the impact that negative ESG rankings can have on the overall credit rating for a company. Moody's stated, "ESG considerations are part of the holistic assessment of credit risk that we undertake for a rated entity. They are an important element in our assessment of an entity's creditworthiness where they represent a material credit **risk**."

In a Sept. 2018 research report, Moody's created a global heat map measuring the environment's impact on credit exposure for 84 industry sectors, representing $74.6 trillion in related debt. Below are areas in which risk has increased over the past three years.

Changes in overall environmental risk scores since 2015
(i.e. rated debt $B)



Source: **Moody's Investors Service**

According to the Principles for Responsible Investment (PRI), Moody's and Standard & Poor's demonstrated "progress in complementing rating analysis with additional research publications on ESG considerations to refine and improve methodologies and transparency."

All is not completely rosy, though, even for the largest CRAs. In a 2017 PRI report titled "Shifting Perceptions — Part 1: The State of Play," the authors noted, "CRAs are integrating many ESG factors into their credit rating analysis, but must communicate this **better**."

While CRAs have long assessed governance, they need to be equally proactive when it comes to assessing social and environmental factors. The writers of the report stated: "CRAs and investors most frequently cite governance as the ESG factor that is likely to directly impact creditworthiness. However, recent research by investors and CRAs suggest their focus is intensifying on environmental and green factors in particular, and less so on social factors, which are less tangible."

Creating a checklist is a fundamental first step toward providing useful ESG company data to ratings firms. The checklist should address the following questions:

- Do we know what ratings our company is receiving from ESG specialists and rating firms, including Moody's and S&P?
- Are we providing the information that ratings firms are looking for when they assign "grades" to public companies for their ESG disclosures?
- Are ESG ratings agencies using information that is accurate and complete?
- Are we providing meaningful ESG disclosures to investors and stakeholders or are we just "checking-the-box"?
- Are we including clear metrics, using company-identified material facts, in our internal and external ESG communications?
- Have we identified which ESG disclosure frameworks can best give our company's investors and other stakeholders the decision-useful information they want and need?

ESG ratings

Whether or not you are actively assessing your organization's ESG performance, there are ratings agencies out there, such as, ISS, Bloomberg and MSCI, that are evaluating ESG activities and comparing your record to that of other companies.

In a **blog post on BlackRock's site**, Martin Small, head of U.S. iShares, wrote that ESG ratings perform "a unique service for investors by revealing data that traditional financial analysis doesn't **capture**."

It is increasingly important to understand your ESG ratings and correct any errors. Here are seven steps to ensure accurate scoring:

1. **Learn about existing ESG ratings frameworks.** There are many ESG ratings services out there and their numbers are growing rapidly. Major ones include MSCI ESG Research, RobecoSAM Group, Bloomberg, Thomson Reuters, Sustainalytics, ISS and Vigeo Eiris. For more information on these services and what they do, read DFIN's white paper "**The Future of ESG and Sustainability Reporting: What Issuers Need to Know Right Now**."

2. **Know your ESG scores.** Make sure your company's ESG ratings accurately reflects the company's current practices by keeping an eye on ratings agencies. Ultimately, a **company's ESG scores may become as important as their credit ratings for investment purposes.**

3. **Compare yourself to your peers.** Your company's ESG rating does not exist in a vacuum. To assess how well you are doing, it is important to know how your peers are doing.

4. **Understand how the various ratings standards compare to one another.** Unfortunately, not all ESG standards yield the same results. In fact, State Street research has shown that there is only a 0.53 correlation between ESG scores from MSCI and **Sustainalytics**.

5. **Attend to the raw data your company provides.** Remember that ESG data providers draw from your public disclosures, as well as the data from your website, blogs, tweets and other social media channels to assess your company. Be sure you are projecting the right image and filling any gaps in information across your channels.

6. **Supply information proactively.** Organizations such as RobecoSAM and CDP, formerly known as the Carbon Disclosure Project, send annual, detailed assessment questionnaires for companies to complete. The information that a company supplies is then used by those agencies to rank and make an assessment according to that agency's own proprietary models and methodologies.

7. **Sharpen your communications.** When taking proactive ESG steps, be sure you are communicating your actions broadly and clearly so investors and other stakeholders take heed.

MSCI ESG key issue hierarchy

To understand the breadth of issues that ESG ratings services are tackling, see MSCI's hierarchy of key issues

3 Pillars	10 Themes	37 ESG Key Issues	
Environment	**Climate Change**	Carbon Emissions Product Carbon Footprint	Financing Environmental Impact Climate Change Vulnerability
	Natural Resources	Water Stress Biodiversity & Land Use	Raw Material Sourcing
	Pollution & Waste	Toxic Emissions & Waste Packaging Material & Waste	Electronic Waste
	Environmental Opportunities	Opportunities in Clean Tech Opportunities in Green Building	Opportunities in Renewable Energy
Social	**Human Capital**	Labor Management Health & Safety	Human Capital Development Supply Chain Labor Standards
	Product Liability	Product Safety & Quality Chemical Safety Financial Product Safety	Privacy & Data Security Responsible Investment Health & Demographic Risk
	Stakeholder Opposition	Controversial Sourcing	
	Social Opportunities	Access to Communications Access to Finance Access to Health Care	Opportunities in Nutrition & Health
Governance	**Corporate Governance***	Board* Pay*	Ownership* Accounting*
	Corporate Behavior	Business Ethics Anti-Competitive Practices Tax Transparency	Corruption & Instability Financial System Instability

* Corporate Governance Theme carries weight in the ESG Rating model for all companies. In 2018, we introduce sub-scores for each of the four underlying issues: Board, Pay, Ownership and Accounting.

Source: **MSCI** (page 4)

Leverage evolving ESG risk management frameworks

Managing ESG risk efficiently doesn't have to be difficult as some initial frameworks have already been established. For example, companies can look to SASB to identify the material ESG factors within one's industry and then assess how relevant these factors are to your company.

Many of the ESG standards point the way to disclosure of the most important ESG risk factors for a company. For instance, the Task Force on Climate-Related Financial Disclosures (TCFD) released its final report in June 2017, giving the world a set of principles-based recommendations for climate risk disclosure. In addition, CDP has devised a global disclosure system that measures environmental impacts for investors, companies, cities, states and regions.

Another important organization is the Canadian Coalition for Good Governance (CCGG), which, in 2018, published a practical **guide** to assist corporate directors in assessing and overseeing environmental and social factors pertinent to business. CCGG approaches E&S issues through a governance lens; its guidebook outlines 29 principles-based E&S recommendations, covering eight key governance areas.

Another important framework for understanding ESG more broadly is the Global Reporting Initiative (GRI). Critical sustainability issues that GRI tackles include climate change, human rights, governance and social well-being.

Although all of these resources are valuable, the following two frameworks are especially useful for efforts to view ESG through the lens of material risk management:

SASB

The Sustainability Accounting Standards Board published 77 industry-specific standards in Nov. 2018, with the overt aim "to assist companies in disclosing financially material, decision-useful sustainability information to **investors**." The SASB standards do not take a one-size-fits-all approach; instead, they tailor criteria by industry sector.

A strength of the SASB standards is the emphasis on materiality. In a Dec. 18, 2018 piece, Matthew Welch, president of SASB, pointed to this very fact, stating, "Because the SASB standards have financial materiality at their core, companies and investors can use these standards to communicate about performance on key ESG issues without the important financial implications getting lost in **translation**."

COSO

In Feb. 2018, COSO and the World Business Council for Sustainable Development released new draft guidance for their ERM framework, the overt mission of which is to apply enterprise risk management to ESG-related risks.

This move did not mark a departure from earlier efforts but instead responded to the increasing prevalence and severity of ESG-related risks, extreme weather events among them. The new guidance includes methods to overcome ESG-related risk challenges, including identifying and assessing the severity of risks with uncertain financial consequences.

Step three: Following the ESG disclosure path – using company-specific KPIs to articulate ESG strategy

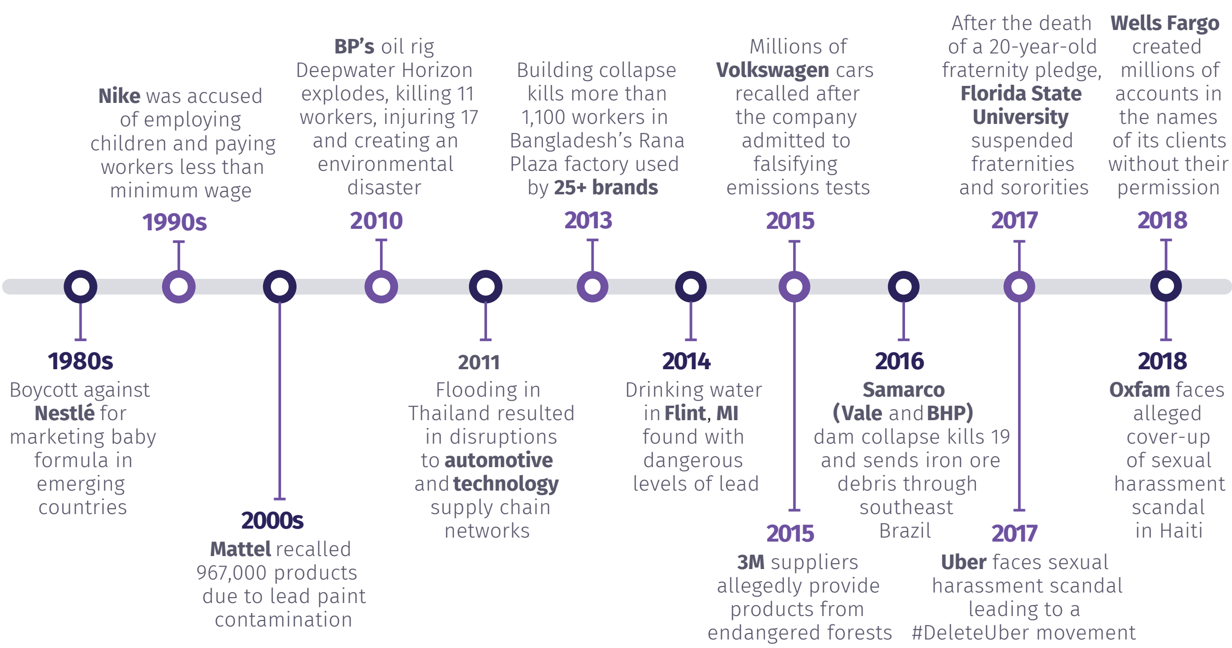
Some experts anticipate that the SEC might outline what ESG disclosures public companies are responsible for, clarifying the approach companies should take.

On Oct. 1, 2018, law professors Cynthia A. Williams of Osgoode Hall Law School and Jill E. Fisch of the University of Pennsylvania Law School asked the SEC for rulemaking on ESG disclosures.

Among the investors who signed on with this effort were California Public Employees' Retirement System, New York State Comptroller Thomas P. DiNapoli and state treasurers for Illinois, Connecticut and Oregon.

Williams and Fisch noted that as of now ESG disclosure in required SEC filings is "inadequate," and they argued that rulemaking by the SEC would "reduce the current burden on public companies and provide a level playing field for the many American companies engaging in voluntary ESG disclosure."

Examples of organizations that have experienced ESG-related impacts



Source: COSO Enterprise Risk Management, page 3

Determining the right framework

There is no one-size-fits-all answer when it comes to understanding your organization's ESG risks, so it is up to each company to find the framework that works best for its own situation. To some degree, settling on a framework may depend on a company's sector. Companies in oil and gas or mining, for instance, have always known that environmental factors are key to their companies' success. For them, the TCFD or CDP may be particularly relevant because of the direct environmental impact of their operations.

Other companies may choose to familiarize themselves with all of the various frameworks before deciding which harmonizes best with their existing risk management process.

Frameworks are not generally designed to operate in isolation; rather, they may be used together to communicate a company's ESG story to a wide-ranging group of stakeholders. For example, where SASB is focused on a fairly narrow view of financial material items, identified within 77 industries, the TCFD guidance is largely based on climate-related financial material risk.

Differences aside, both SASB and TCFD serve the greater universe of stakeholders, including regulators and investors. Meanwhile, GRI, which is the most mature of the standards, takes a holistic approach to cover NGOs, employees, communities and investors.

Once standards have been selected, a company should carefully choose the industry and company-specific KPIs necessary for managing ESG-related risks.

According to Coppola, "many companies are finding that applying one or more of these standards together can enhance the value for end-users of ESG risk data."

Relevant risks can be assessed in a number of ways, including:

- The likelihood of an event occurring
- A company's vulnerability should a particular event occur
- The projected impact of a possible event over time

Savvy companies are flexible and creative when it comes to assessing risk. For instance, reputational risk is an important area to consider, even though assessing reputational risk can be challenging.

Once the ERM framework and KPIs are selected, you can use the associated metrics to drive your company's management analysis and strategy.

The role of the board

The COSO ERM framework explicitly states that the board's role is to "provide oversight of the company's strategy and carry out governance responsibilities to support management in achieving its strategy and business objectives."

COSO also proposes a series of questions that companies should ask themselves vis-à-vis their boards. These questions range from the high level — is the board aware of the ESG-related risks that could impact a company's ability to achieve its strategy and objectives? — to the more specific. Companies should, for instance, consider whether there exists a clear escalation path to ensure that material ESG-related risks are brought to the attention of the board.

While the first step is making sure that the board is aware of ESG risks, there are a number of other concerns as well. Some boards do not possess the information necessary for evaluating various ESG risks. Others are hindered by board members who lack the experience to appreciate the implications of the ESG issues that a company is facing.

Given all this, best practices include making sure that the board charter includes governance of ESG-related risks and dedicating a subcommittee of the board to evaluating the various ESG-related risks out there. In addition, a board should establish mechanisms for receiving regular reports from various corporate functions about unfolding ESG risks.

In Oct. 2018, the COSO ERM framework was updated to include risk-related ESG controls and analysis. As boards are expected to provide oversight of ERM, the COSO framework supplies important considerations for boards in defining and addressing risk oversight responsibilities. The COSO ERM – ESG framework is built on the five pillars of existing ERM reporting.

1. Governance & Culture For ESG-Related Risks
2. Strategy & Objective-Setting For ESG-Related Risks
3. Performance For ESG-Related Risk
    a. Identifies Risk
    b. Assesses & Prioritizes Risks
    c. Implements Risk Responses
4. Review & Revision For ESG-Related Risks
5. Information, Communication & Reporting for ESG-related risks

Source: **COSO Enterprise Risk Management**

Finally, forward-looking boards are appointing one or more directors with ESG-related expertise so that these risks and opportunities can be appropriately assessed. This is becoming increasingly evident in proxies using board skills matrices to highlight ESG expertise.

As an example noted by COSO, in 2017 ExxonMobil added an atmospheric scientist and former president of the Woods Hole Oceanographic Institution to its 13-member board of directors.

Step four: Reaching your ESG goals – effectively communicating your ESG risks and long-term business strategy

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ESG disclosures are becoming a fundamental component of investment analysis, requiring a disciplined approach so that they can be fully integrated into the investment process. In a 2018 study, when the CFA Institute identified the **drivers of ESG integration**, the organization included global demand from institutional investors as a method of evaluating risk, as well as an approach to uncovering investment opportunities. Investors who can spot companies looking to improve their environmental, social and governance profiles in advance of the broader markets may be rewarded.

What's more, when material ESG facts are measured and managed, sustainability, corporate responsibility and ESG disclosures can easily become a platform for your management team to talk about other facets of your company's story.

In fact, it's not uncommon for a company to produce E&S data for internal corporate review, designed to make companies more competitive, while providing management with a clear lens of ESG measures that then may be aligned with long-term business strategy.

In an ideal scenario, organizations will conduct a truly company-specific assessment to identify, report, manage and evaluate E&S data, making sure that the data is useful over an extended time period to provide the most possible value for companies and their investors.

Keys to success

While attention to ESG began primarily as a communication effort, the new owners of this evolving initiative may well be individuals in finance, audit and risk management. While strong communication is still critical, the information being communicated must be broadened to encompass a detailed and user-friendly discussion of both risk and opportunity.

Here are a few keys to success in managing and communicating ESG risks:

- **Engage with investors**. Listening to large investors and those in the socially responsible investing arena is critical because these investors often have distinct ideas about what particular ESG risks pose the greatest threat.

  In the survey of Canadian institutional investors by DFIN and SimpleLogic, it was revealed that investors want companies to establish a clear link between their sustainability initiatives and the company's broader business strategy. Doing so is not easy, but doing so successfully makes engagement far more rewarding.

- **Communicate your ESG progress**. A 2017 IR Magazine study titled “Global IR Practice: ESG Communications” found that when presented with a long list of ESG-focused activities, more than a third of companies said that they have not taken any ESG actions at all. If you are one of the companies that *is* taking action, be sure to say so and get credit for your proactive stance.

- **Consult with outside ESG specialists**. Getting one’s arms around ESG risks is no easy feat. For that reason, companies should avoid “reinventing the wheel” and instead attend ESG conferences to glean the wisdom of specialists or hire consultants who can help shape your ESG risk management strategy.

- **Create an ESG materiality mapping process**. Companies need to identify KPIs that align material ESG risks with business strategy and financial targets. This can be done through ESG materiality mapping, which is made easier by using existing and emerging COSO and SASB guidance. Materiality mapping is also an excellent first step for determining which results are important enough to be communicated to your stakeholders.

- **Tie ESG-risk monitoring to executive compensation**. A company may say ESG matters to its future, but it’s important to bolster this message with the right incentives. Linking executive compensation to monitoring ESG risk will ensure that top managers devote the necessary time and energy to getting this exercise right.

- **Use your proxy as a roadmap for a sophisticated ESG strategy**. The proxy and annual report are terrific opportunities to spell out a company’s commitment to managing ESG risks in specific and measurable ways. When done well, the proxy and annual report can serve as a roadmap for how a company is accomplishing its ESG risk management goals. Remember, annual publications can keep a company honest when it comes to measuring progress over time.

- **Designate owners of ESG risk**. COSO emphasizes that ESG-related risks should not be the sole responsibility of the sustainability team. “All of management,” wrote COSO, “should be able to articulate significant ESG-related risks that impact strategy and decision-**making**.”

Creating value

When ESG is viewed not just as a way to avoid risk, but as a way to gauge and identify future opportunities, ESG becomes an area of heightened importance for institutional investors.

To reap the benefits of linking ESG to opportunity and value creation, a company should first identify and emphasize KPIs that tell the story of that organization's sense of purpose, using quantifiable metrics that are comparable year over year.

A recent report by the Governance & Accountability Institute highlighted that 85 percent of the S&P 500 companies provided sustainability data in their 2017 disclosures. This includes companies posting ESG information on their websites, in corporate social responsibility reports, in annual reports and proxies. It's important to remember that companies' disclosures vary widely, from using clear ESG metrics aligned with reporting standards that provide measurable E&S performance data that is comparable year over year, to providing boilerplate data that is almost useless to investors.

The good news is that a recent report from International Integrated Reporting Council (IIRC) identified clear signs that Fortune 500 companies' ESG reporting is evolving and improving. Moreover, leading companies are using industry materiality assessments, as well as emerging ESG standards and frameworks, to generate decision-useful information.

Additional key findings of the IIRC report include the following:

- 95 percent of sustainability reports include environmental performance metrics (quantified measures that are comparable year over year); what's more, 67 percent of companies set quantified and time-bound environmental goals.

- Nearly all (97 percent of) companies customized sustainability reporting models in style, format and content, rather than closely following any one framework. Just ten percent of sustainability reports closely followed a single reporting framework, typically GRI or another industry-specific model.

- About 40 percent of S&P 500 companies include the concept of sustainability in their annual reports.

- 38 percent of companies include discussions of corporate responsibility or sustainability in their proxies, beyond typical board governance and executive compensation disclosures. Many of those describe company sustainability efforts and goals.

Looking ahead

There is cause for optimism when looking at how far disclosure of ESG factors has come within a relatively short period of time. In a Dec. 18, 2018 piece, Welch wrote, “From rapid population growth and technological innovation to climate change and resource constraints, 21st century economic prosperity faces no shortage of daunting new hurdles. I believe history will show that 2018 was the year capital markets rose to meet these challenges head **on**.”

What’s more, there is growing consensus that companies must provide decision-useful ESG information because this information is central to institutional investors’ assessment models. Along with that consensus comes the belief that an understanding of ESG is critical to how companies run their own businesses. Because a company’s economic performance can be derailed by an extreme weather event or a lawsuit about problematic workplace practices, it is increasingly important that companies examine their myriad risks through an ERM and ESG lens.

While it is imperative to understand the risks posed by ESG, it is equally important to see the opportunities associated with understanding and managing ESG factors successfully.

“While ESG is proving to be a versatile way for gauging the risks a particular company might face, the power of ESG is only just now beginning to be unlocked,” said Truzzolino. He pointed out that ESG reporting is a beneficial way to demonstrate the positive steps your company is taking to create value, whether this value comes from human capital or innovation capital.

“Going forward, companies will use ESG frameworks and rating services as a way to measure their progress against a wide range of unfolding issues,” Truzzolino concluded. “The true power of ESG as a tool for monitoring both risk and opportunity is at long last getting the recognition it deserves.”

About Us

Donnelley Financial Solutions (DFIN)

DFIN is a leading global risk and compliance company. We're here to help you make smarter decisions with insightful technology, industry expertise and data insights at every stage of your business and investment lifecycles. As markets fluctuate, regulations evolve and technology advances, we're there. And through it all, we deliver confidence with the right solutions in moments that matter.

About DFIN's ESG and Sustainability Solutions

DFIN provides a holistic approach, helping corporations identify and deliver decision-useful ESG data and information to all stakeholders at the right time and in the right formats. This is increasingly important as investors and diverse stakeholders – the company's employees, customers, regulators, business partners – now consider a company's ESG performance as a measurement of management quality and overall resilience to long-term risk as well as the ability to seize opportunities.