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The New ESG Communications Mandate

Overview

The popularity of environmental, social and governance (ESG) integration into the investment process of traditional institutional investors is ramping as active buy-siders look to mitigate risk while meeting changing client demands. ESG integration, which focuses on the "value" it provides to the investment process, emphasizes the analysis of environmental, social and governance risks and opportunities that impact financial performance. It is quite different from socially responsible investing (SRI), which aligns with an investor's "values" and focuses more on social and environmental "good" to bring about change. For example, a pure SRI investor may not hold liquor or firearms stocks, but an ESG investor might, depending on how well the company addresses ESG-related issues.

ESG has increasingly become part of investor relations professionals' vernacular as more investors are using ESG screens in their decision-making process. This growing wave of interest is underscored by a study that reported ESG-related investing accounted for $22.9 trillion, or 26.0% of professionally managed assets in Asia, Australia, New Zealand, Canada, Europe and the U.S. at the start of 2016, as compared with 21.5% in 2012[i].

Clermont Partners, a strategic communications firms, recently conducted a survey to explore how active investors view this topic[ii]. Below, we highlight the findings and recommendations that are most relevant to IROs.

Highlights from the Study

- ESG integration is gaining momentum and becoming more mainstream:
  - Of the 47% of survey respondents who use ESG screens when evaluating potential stock investments, 75% said ESG has become more important to their firm's decision-making process in the past two years.
- Two main camps have emerged as the key drivers of ESG integration:
  - First, as an additional metric to identify and evaluate risk, and
  - Second, in response to changing client demand and preferences.
- In particular, respondents want to hear more about:
  - Corporate governance practices
  - Cybersecurity preparedness
  - Environmental sustainability efforts
- While annual reports are the top source of ESG information, respondents said topics could be better communicated by integrating messages in the investor presentation, as well as providing a report dedicated to ESG topics.
- Corporate sustainability reports alone do not appear to be highly valued by respondents, since nearly two-thirds said they do not spend much time reviewing these reports.

Recommendations: View ESG Communications as Required, not Optional

- Given the evolving nature of ESG integration, plus the rising number of ESG scoring firms and indexes vying for attention, companies need to proactively communicate their ESG "assets" or metrics.
- To do this, build a cross-functional team represented by the investor relations, communications, legal, operations and sustainability departments. Educate the team on which ESG metrics are most important to your investor audience, especially within your industry.
- Determine your company's ESG agenda and goals, and assess your most material 4 to 7 assets, such as carbon emissions, workforce turnover, data security or Board diversity. Based on investor preferences, decide how best to provide the information and how often to report progress.
- Consider merging the annual report and sustainability report to increase readership and interest for both. Make sure the document is on your website.
- Develop an ESG "talk track" for investor meetings and calls.
- Take charge of knowing how your company is being portrayed by ESG and corporate governance rating agencies. Expect disparity among these many ESG rating sources based on their customized analyses. Ultimately, provide information that makes sense for your company, but don't leave these third parties to erroneously tell your story.

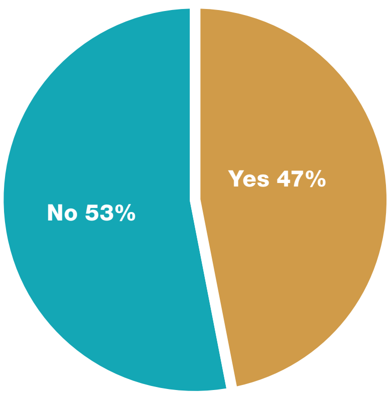
[i] Amy Whyte, 'McKinsey: ESG No Longer Niche as Assets Soar Globally,' *Institutional Investor,* October 27, 2017. Data according to the Global Sustainable Investment Alliance.

[ii] Survey methodology: This survey explored how investment professionals view ESG factors in their investment decision-making process. The electronic survey gathered data between March 27, 2018 through April 18, 2018. A total of 189 investment professionals who were invited to participate responded.

Almost Half of Respondents Focus on ESG Factors

Forty-seven percent of respondents consider ESG factors when making an investment decision. For our discussion, we will refer to those who replied 'Yes' as "ESG Evaluators."

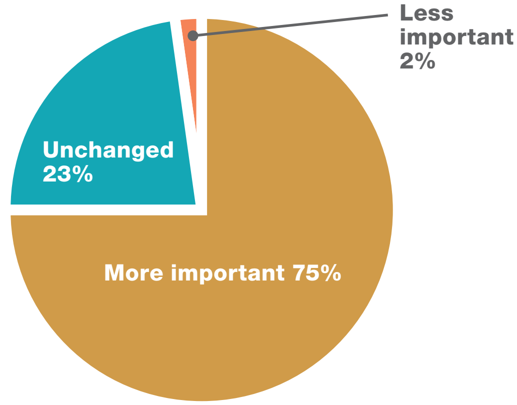
Are ESG factors considered when making an investment decision?



ESG Has Become More Important

In the past two years, 75% of ESG Evaluators view ESG factors as 'more important' to their firm's decision-making process. The emphasis is 'unchanged' for 23% and only 2% say it's 'less important.'

In the past two years, how has the importance of ESG changed in terms of your decision-making process?



Risk Mitigation and Client Demand are Driving ESG Integration

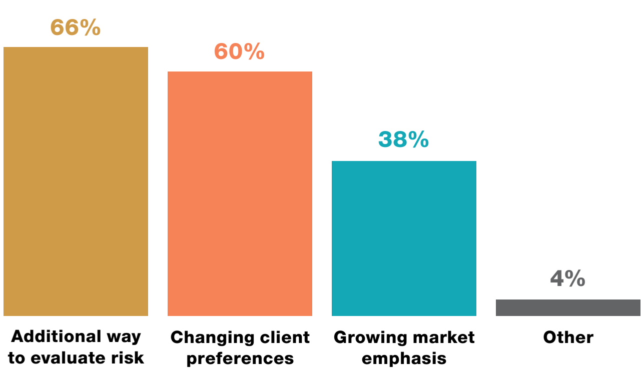
There are two key reasons why ESG Evaluators consider ESG factors:

- Risk mitigation (66%)
- Client demand and changing preferences (60%)

Other reasons include:

- Growing emphasis on ESG in the financial markets (38%)
- Investment Committee directives (mentioned in "other")

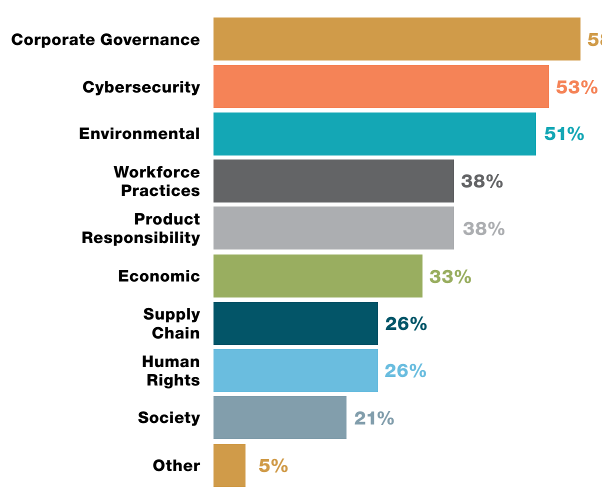
What are key drivers for the increased performance of ESG factors in your investment strategy? Check all that apply.



Respondents Want to Hear More

Companies could provide more disclosure on several topics, according to respondents. Corporate governance leads the pack (58%), followed by cybersecurity (53%) and environmental (51%).

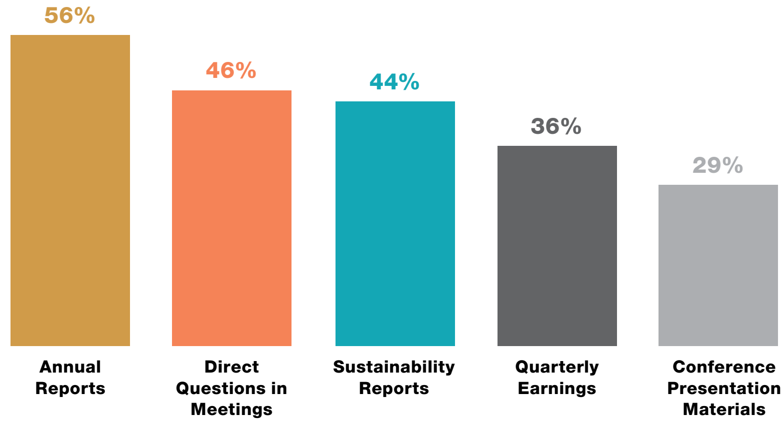
What ESG topics would you like to recieve more disclosure on from companies? Check all that apply.



Annual Reports are the #1 Source for ESG Information

Respondents gain the most helpful ESG information from companies through annual reports (56%), followed by direct questions to the company (46%), and then sustainability reports (44%).

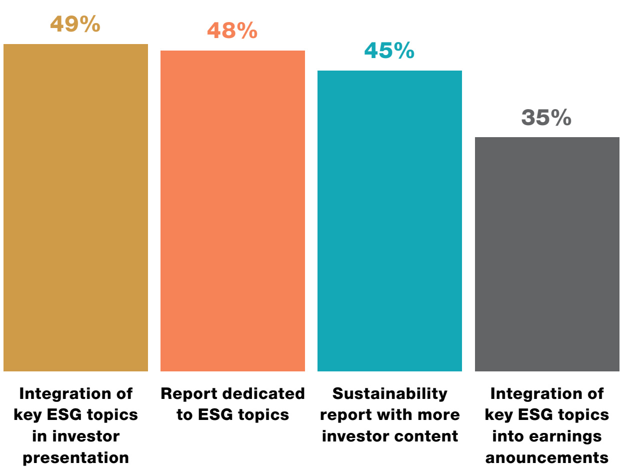
How do you get the most helpful information on your ESG screening? Check all that apply.



Companies Could Better Integrate ESG Messages

Nearly half of respondents said ESG topics could be better communicated by integrating messages in the investor presentation (49%), and providing a dedicated ESG report (48%). Forty-five percent recommended including more investor-focused content in sustainability reports, and 35% said important ESG information could be included in quarterly earnings reports.

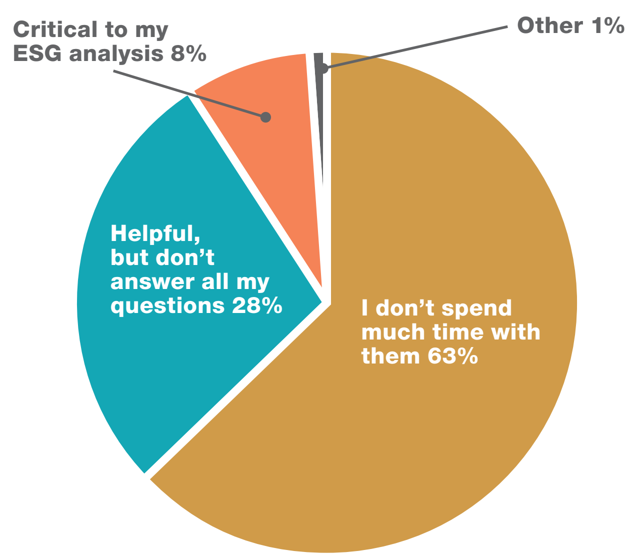
What investor communications could be improved with ESG topics? Check all that apply.



Low Value Placed on Sustainability Reports

While respondents look to corporate sustainability reports for ESG information, 63% said they don't spend much time with these reports, while 28% found them helpful, but didn't answer all their questions. Only 8% said these reports are critical to their ESG analysis.

How do you view Corporate Sustainability Reports?



RESPONDENT COMMENTS

- "ESG factors are a contingent liability - one that could become very real if not handled right from the outset."
- "It (ESG) is attracting increased interest from clients."
- "Corporate governance is becoming more of an issue. Ethical standards as well."
- "Our firm has ESG workshops as well as ongoing ESG dialogue."
- "We have looked at and employed a new ESG strategy."
- "We opened a new portfolio that screens for ESG. Then (we) add our value overlay."
- "Environmental, social, and governance issues can be relevant depending on the industry, and as such, are subject to individual analyst discretion in evaluating risk."
- "ESG concepts may apply - but we don't have an ESG checklist that we run an investment idea through. We are very active with our management teams - but are focused on their fundamental execution and not whether they fulfill an ESG mandate. This may change over time."
- "We focus on downside protection and ESG is another risk mitigation tool. Our formal ESG effort was spurred by client demand."
- "We find social investing to be overly subjective."
- "ESG is becoming an increased focus, but doesn't drive my investment decisions."
- "In the past I've used ESG reports from MSCI, my complaint is that there's way too much fluff vs. actual details, and this limits how much confidence myself/others feel about the reports."
- "Need more standardization of reporting for ESG metrics."
- "Please adopt SASB (Sustainability Accounting Standards Board)."
- "More research on ESG rankings by industry and companies would be helpful."
- "Need an index of stocks that meet an agreed upon standard to benchmark ourselves against."
- "Topic still feels like it is in the early innings."

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Clermont Partners empowers companies to make the most of strategic communication opportunities that impact equity valuation. By blending our decades of capital markets experience and relentless focus on research, we help clients cut through the noise and better navigate change that impacts stakeholder narratives and investor engagement.

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