# ESG 101

2022

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# Agenda



# What is ESG

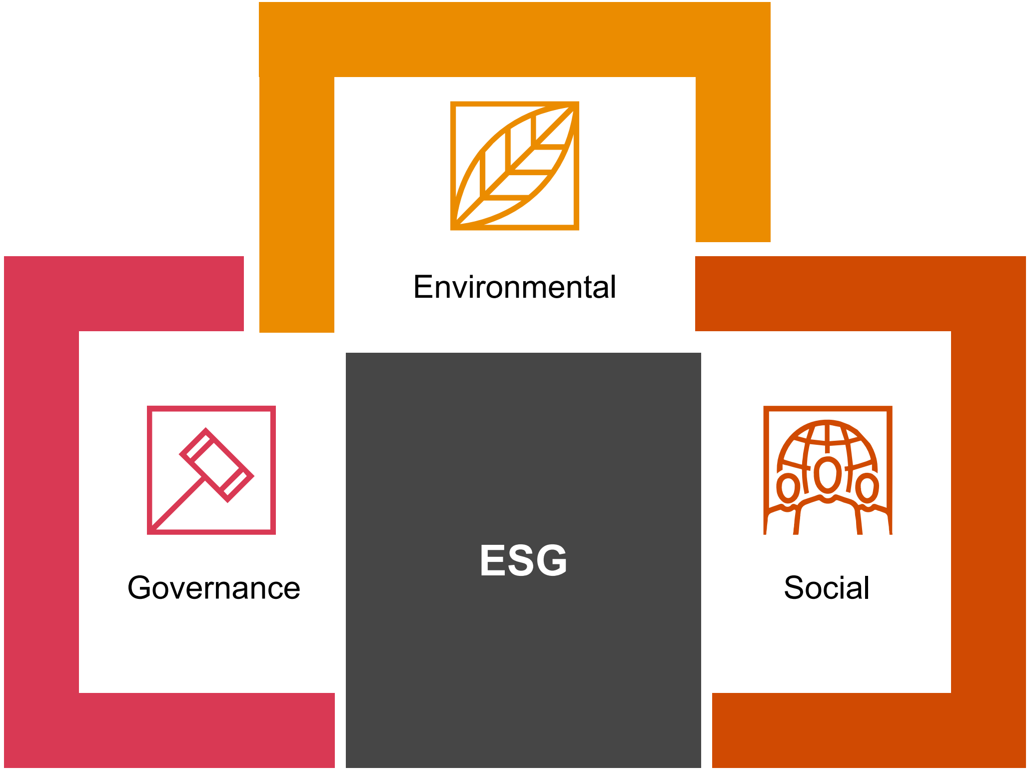
# What is ESG?

**ESG** stands for Environmental, Social, and Governance.

It refers to non-financial factors that investors are increasingly incorporating into their investment decision making.

**ESG investing** has been around since the 1960s, when it was known as socially responsible and/or sustainable investing.

In recent years, sustainability has evolved as **ESG** to include values alignment to the risks (climate, human capital biodiversity, etc.) and opportunities that could impact a company's ability to create long-term value.



# Why is ESG important

# The move from voluntary to mandatory reporting is driving controllership action on ESG - which is a driver of business value.


**Wes Bricker, PwC Vice Chair, US Trust Solutions Co-Leader**
***FEI, Financial Executives International***

## Market Leadership

**83%**

of consumers think companies should be actively shaping ESG best practices

Source: PwC ESG Consumer Intelligence Series, 2021

## Retention

**88%**

of employees will stay at a company longer because of their values

## Competitive Advantage

**92%**

of business leaders believe ESG provides competitive advantage

# Five key challenges our clients are navigating

| Standards chaos | SOX-lite | Climate ready | Deliver Growth | Moving to equity |
|---|---|---|---|---|
| Investors are pushing for enhanced ESG disclosures, but there is a range of frameworks | Our clients are taking a hard look at whether their disclosures are "investment grade“ | Building a comprehensive view of climate risk and a resilience strategy | Integration of ESG into business strategy - from supply through vehicle end of life | Meeting the challenge of creating a diverse, equitable and inclusive business |
| **Alignment on ESG strategic framework** | **Disclosure Committee reviews** | **Cross-functional teams** | **ESG risks & opportunities inform business strategy** | **Workforce projections & predictive simulations** |
| **Investor & rater engagement** | **Accounting policies for KPIs** | **Prioritize climate risk dimensions** | **Extend ESG across the value chain** | **Managing brand perception & transparency expectations** |
| **Managing competing frameworks** | **Process documentation and controls design** | **Scenario analysis to quantify risks** | **Invest in capabilities across functional areas** | **Listening capabilities through focus groups & scalable tools** |
| **Focus on sector based material topics and reporting trends** | **Technology investment** | **Program and operating model to achieve long term goals** | **Formalized governance, high level Board and Leadership engagement** | **Data-informed business interventions to accelerate performance** |

# Questions to consider about your sustainability program

Once the responsibility of a single department, sustainability now touches every part of the business

| CMO | CRO | COO | CFO/IR | Boardroom | CEO |
|---|---|---|---|---|---|
| "How can social and environmental trends help us **differentiate our products** and increase our market share?" | "How do we build **resilience to business disruptions** caused by climate change and resource scarcity?" | "How can we operate our **business more efficiently,** realizing efficiencies across all the inputs to our operations from electricity use to travel?" | "How can a sustainability strategy help enhance our reputation with **customers, employees, investors and analysts and deliver value?"** | "How does the Board drive commitment to **long-term vision**, and **purpose** and take faster strides in areas that matter the most to our **stakeholders**?" | "How can we evolve our our business and institute an **operating model** to drive action and deliver **positive** environmental and social change?" |

**Identifying sources of value to the business is the foundation of the business case**

**Value to society pays back to the business in the medium- to long-term**

**← Value to the business →**

# There are currently many competing ESG reporting frameworks and rating agencies

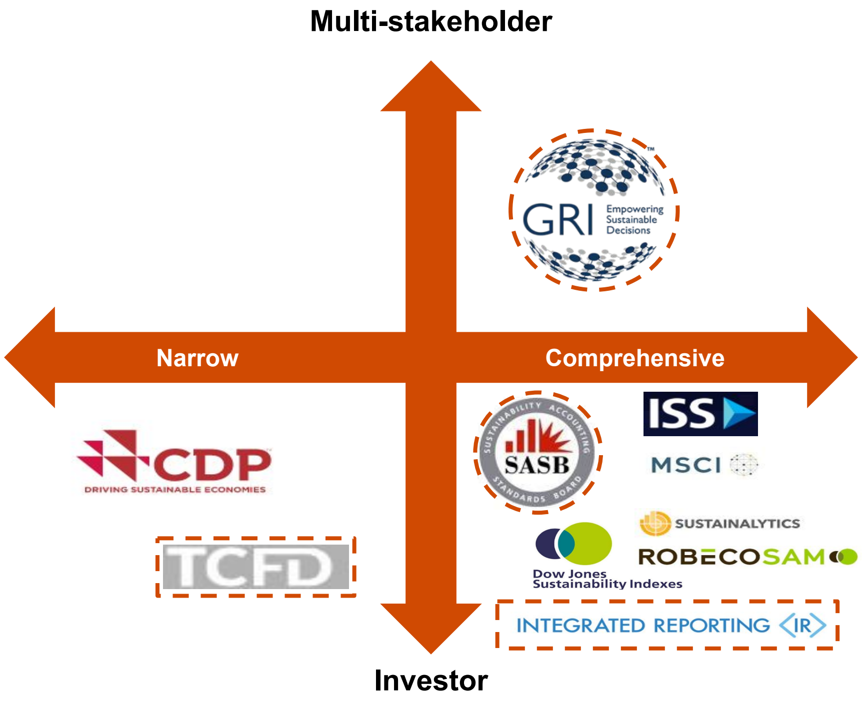
## ESG reporting frameworks

- SASB – Sustainability Accounting Standards Board
- TCFD – Task Force for Climate-related Financial Disclosures
- GRI – Global Reporting Initiative
- WEF IBC – World Economic Forum International Business Council
- SDGs – Sustainable Development Goals

## ESG raters

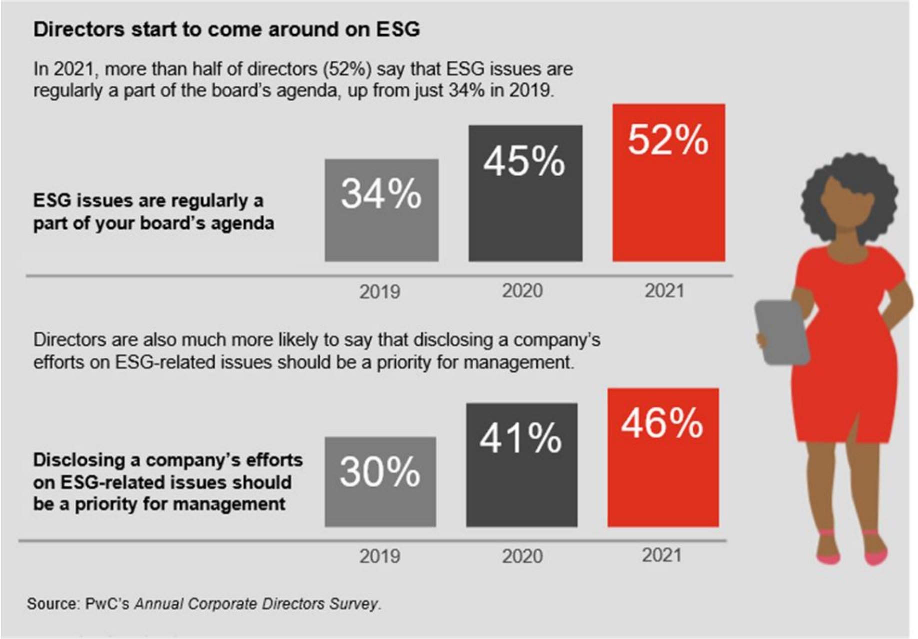
- MSCI – Reviews public disclosures on E,S and G
- ISS – Previously G rater, now expanded to E and S
- Sustainalytics – ESG rater, provides score in Yahoo Finance
- CDP – rates on E based on voluntary reporting by the company
- DJSI – tracks stock performance in terms of ESG

At COP26, the IFRS Foundation announced the creation of the International Sustainability Standards Board (ISSB) to develop a comprehensive global baseline of high quality disclosure standards




**Disclosure frameworks that lay out standards for disclosure** (others are ESG **ratings**)

# ESG is rapidly gaining momentum in the boardroom




## Board oversight and investors' expectations

Investors are continuing to expect more and more transparency from boards in how they oversee particular topics. ESG oversight is no exception. Boards can find a number of ways to provide shareholders with the information they seek. For example:

- Robust disclosure in the proxy statement describing the board's oversight efforts
- Updates to board committee charters to address committee oversight responsibilities related to ESG
- Additional information about directors' skills that enhance their contribution to ESG oversight efforts

Source: ESG Oversight - The Corporate Director's Guide

# Focus on the E

# Climate reporting – a stepped approach to TCFD reporting

Identifying the key climate risks and opportunities for your business and embedding TCFD recommendations across the business

**Governance**

- What climate governance structure do you have in place and is it fit for purpose?
- How does the governance structure compare to WEF Climate Governance principles?
- To what extent are the TCFD recommendations embedded throughout the organization?

**Strategy**

- How is the company understanding what scenarios and narratives are appropriate given the exposures in your business?
- How does your current strategy address key risks and opportunities?
- How does current strategy consider flood and storm risk, diversification of global supply base, opportunities related to its role in enabling the low carbon transition?

**Risk Management**

- Are your data and information systems able to support board discussions on climate related risks and opportunities?
- How does the company report and account for the resulting financial impact, where material?
- Is climate scenario analysis work integrated into your ongoing existing risk management processes?

**Metrics and Targets**

- Do you incorporate climate-related metrics into remuneration policies?
- Have you identified the appropriate metrics for any key physical risks ?
- Do your financial targets integrate climate risk?

TCFD TASK FORCE ON CLIMATE-RELATED FINANCIAL DISCLOSURES


**Governance**

The organization's governance around climate-related risks and opportunities

**Strategy**

The actual and potential impacts of climate-related risks and opportunities on the organization's businesses, strategy, and financial planning

**Risk Management**

The processes used by the organization to identify, assess, and manage climate-related risks

**Metrics and Targets**

The metrics and targets used to assess and manage relevant climate-related risks and opportunities

# What are climate risks and opportunities?

The TCFD asks companies to stress test the business against relevant risks and opportunities:

## Transition risks as a result of transition to a low carbon economy

### Policy and legal
- Increased carbon policy/pricing of GHG emissions
- Enhanced emissions-reporting obligations
- Mandates on and regulation of existing products and services
- Exposure to litigation

### Technology
- Substitution of existing products and services with lower emissions options
- Unsuccessful investment in new technologies
- Costs to transition to lower emissions technology

### Market
- Changing customer behavior
- Uncertainty in market signals
- Increased cost of raw materials

### Reputation
- Shifts in consumer preferences
- Stigmatization of sector
- Increased stakeholder concern or negative stakeholder feedback

## Physical risks resulting from changes in the climate

### Acute
- Increased severity of extreme weather events, e.g.,
  - Floods
  - Wind storm
  - Storms and cyclones
  - Wildfire
  - Storm surge
  - Hail

### Chronic
- Changes in precipitation patterns
- Changes in extreme variability in weather patterns
- Rising mean temperatures
- Rising sea levels

## Opportunities

### Resource efficiency
- More efficient resource use
- Move to more efficient buildings and modes of transport

### Energy source
- Use of lower emission energy sources
- Use of supportive policy structures
- Use of new technologies
- Participation in carbon markets

### Products and services
- Development/expansion of low emission goods and services
- Climate adaptation and insurance risk services

### Markets
- Access to new markets
- Use of public sector incentives

### Resilience
- Resource substitution/diversification
- Renewable energy programs, efficiency initiatives

# TCFD is now the leading climate disclosure standard

While the guidelines are still new, TCFD has quickly become the industry standard for how companies should orient around climate risk, and how they should disclose on it publicly

Nearly 2,600 organizations have announced support for the guidelines, including global financial firms responsible for assets in excess of $194 trillion

The Task Force on Climate-related Financial Disclosures (TCFD) issued guidance for climate risk disclosure for all sectors, and specific recommendations for certain sectors

| | |
|---|---|
| **01 Insufficient disclosure** | The TCFD is an advisory body set up by the G20 to address concerns around insufficient disclosure of climate-related risks and opportunities for businesses. |
| **02 Led by industry leaders** | The TCFD is chaired by Michael Bloomberg and consists of 31 industry leaders, including representatives from Blackrock and Unilever |
| **03 Informed investment decisions** | The TCFD recommendations aim to enable better understanding of exposures to climate risks and opportunities. |
| **04 Progress** | The Task Force will released a monitoring report this year highlighting the progress made in companies’ climate risk disclosure over the past year. |

# Focus on the S – Human capital

# The SEC's human capital disclosure requirement

The SEC amended its rules regarding disclosures of business, legal proceedings, and risk factors under Reg S-K. These rules require SEC registrants to make certain Human Capital disclosures on Form 10-K and registration statements (S-1) -- effective November 9, 2020.

**What's in the final rules**

The final rules require registrants to disclose certain aspects of their human capital resources within the overall framework of principles-based disclosures. Specifically, the following disclosures are required to the extent they are material to the understanding of the registrant's business as a whole:

1. A description of the registrant's human capital resources, including the number of persons employed by the registrant, and
2. Any human capital measures or objectives that the registrant focuses on in managing the business, potentially including measures or objectives that address the development, attraction and retention of personnel

**If information disclosed is material to a particular segment of the business, the registrant should additionally identify that segment.**

**What is next...?**

The SEC is expected to propose a rule requiring that public companies disclose a range of workforce data.

Believe that could include the following:

- Employee demographics
- Costs
- Health and safety
- Skills and development training
- Workforce stability or turnover
- Workforce diversity across levels of seniority

# Focus on the S – D&I

# Pressure for D&I transparency

| | | |
|---|---|---|
| Social & Political unrest | Regulatory & Disclosure requirements | Aspirations and Commitments |
| Employee demands | Accountability framework | Reputational risk |

## Common challenges

| | | |
|---|---|---|
| Inconsistent employee engagement and experience | Realizing impact & outcomes of people strategy | Unclear D&I vision and lack of buy-In |
| Challenges exist with current reporting | Growing internal, external and regulatory pressures | Realize return on inclusion |

# D&I – What does good look like?

**Focuses on**

**Measures**
That evaluate our collective behaviors and link to the business impact of a diverse, equitable and inclusive workforce

**Describes**

**Inclusive behaviors**
That are repeatable and recognizable to shift mindsets and create authentic formal and informal leaders

**Outlines**

**Clear actions**
For both Individuals and Organizations to demonstrate alignment towards a shared outcome

**Includes**

**Learning paths**
That provides participants the ability to increase awareness, guides self-reflection, promotes inquiry and encourages a growth mindset

**Prioritizes**

**Internal & external purpose**
At the center of your DEI strategy - ensuring that it is manifested in day-to-day operations and positively impacting the experience of all of your employees

**Relies on**

**Current state assessment**
To make sense of the stories in your data. In order to realize a full Return on Inclusion (ROIn) you must first uncover any gaps in experiences by reviewing the programs, policies and procedures that might be barriers to full inclusion in your organization.

**Starts with**

**An inclusive architecture**
That focuses on designing and linking efforts to your workforce and business strategy

# SEC Climate Disclosure Update

# SEC climate disclosure rule proposal

## ? What happened

On March 21, the SEC proposed new rules for climate change disclosures. While they are not yet final and are open for public comments, the SEC is likely to advance rules that require disclosure of:

- Prospective risks and material impacts on the business, strategy and outlook caused by climate change, generally in compliance with the Task Force on Climate-Related Financial Disclosures (TCFD) disclosures
- Scope 1 and 2 greenhouse gas emissions
- Scope 3 emissions if material or if the registrant has set a GHG emissions reduction target that includes Scope 3 emissions (e.g., a science-based GHG reduction target)
- Additional qualitative and quantitative climate risk information as they pertain to risks and opportunities
- Financial impacts of cost of climate change

Companies across the industry spectrum should start focusing now on the potential implications of the proposal to accelerate their climate change reporting strategies, processes and controls.

# Proposed disclosure highlights

## Requirements impacting the financial statements

**New financial statement footnote disclosure**

- Climate-related financial statement metrics intended to be derived from financial statement line items:
  - Financial impact metrics*
  - Expenditure metrics*
  - Financial estimates and assumptions
- Materiality - 1% threshold by financial statement line item, with the sum of absolute impacts
- Subject to financial statement and ICFR audit

*Disclosure would include financial impact of and expenditures to mitigate risks related to severe weather events and other natural conditions; as well as impacts of and expenditures related to transition activities.

## Requirements impacting the 10-K

**New qualitative disclosures**

- Details on climate-related governance activities, including the board's oversight of risk and management's role in assessing and managing those risks
- Impact of climate change on strategy, business model, and outlook, including how a company assesses resilience (e.g., through scenario analysis)
- GHG emissions metrics, including an attestation requirement on Scope 1 and Scope 2 for large accelerated and accelerated filers
- Climate-related targets and goals, including transition plans
- Subject to "other information" audit procedures

iXBRL tagging required for both narrative and quantitative disclosures

# What’s next

- The proposal is open for public comment until June 17.
- Companies should carefully review the requirements under the proposal and submit comments on any areas where expectations are not clear or may not fully address idiosyncrasies of your business model.
- If the rules are finalized within the 2022 calendar year, applicability is as follows for calendar year end companies:

## Table 1 – Disclosures

| Registrant type | Disclosure compliance date | |
|---|---|---|
| | All proposed disclosures, including GHG emissions metrics: Scope 1, Scope 2, and associated intensity metric, but excluding Scope 3 | GHG emissions metrics: Scope 3 and associated intensity metric |
| **Large accelerated** | Fiscal year 2023 (filed in 2024) | Fiscal year 2024 (filed in 2025) |
| **Accelerated and non-accelerated** | Fiscal year 2024 (filed in 2025) | Fiscal year 2025 (filed in 2026) |
| **Smaller reporting company** | Fiscal year 2025 (filed in 2026) | Exempted |

## Table 2 – Assurance

| Registrant type | Scope 1 and Scope 2 disclosure compliance date | Limited assurance | Reasonable assurance |
|---|---|---|---|
| **Large accelerated** | Fiscal year 2023 (filed in 2024) | Fiscal year 2024 (filed in 2025) | Fiscal year 2026 (filed in 2027) |
| **Accelerated** | Fiscal year 2024 (filed in 2025) | Fiscal year 2025 (filed in 2026) | Fiscal year 2027 (filed in 2028) |

Check out these PwC resources:

- First look at the SEC's climate disclosure proposal
- SEC Climate risk disclosures landing page

# Some practical actions to consider

The proposed disclosures are broadly aligned with existing frameworks, such as TCFD and the GHG Protocols. Public companies should evaluate their climate change reporting while assessing the processes and controls that support it. All businesses are at different points in their ESG journey, but here are five things every company may want to consider.

1. **Assemble a cross-functional team to create accountability for ESG performance:** The finance function has the experience to oversee accounting, controls and reliability of ESG information while sustainability teams have the deep subject matter experience and context. Companies should address any knowledge gaps through upskilling or hiring to make sure they have the right team in place.
2. **Make sure you have the data that regulators will expect**. It's critical to clearly define ESG metrics, their scope and boundaries, what systems the information comes from, and who the owners are inside the company. To do so, companies should gather baseline data to compare current performance against future goals and milestones.
3. **Set an overarching strategic approach to ESG.** This is not an exercise merely to tick a regulatory box, but to create sustainable advantage and value. Companies should connect ESG strategies, milestones and reporting to the overall business strategy.
4. **Upskill corporate directors.** Boards—especially audit committee members—need to better understand how ESG fits into the overall business strategy to appropriately manage governance oversight responsibilities.
5. **Prepare for independent assurance.** The SEC proposed independent, third-party assurance for Scope 1 and Scope 2 emissions to bolster confidence in climate change information (for accelerated or large accelerated filers).

# Thank you

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