



DEAD COBRAS AND FABERGÉ EGGS:

UNLOCKING THE POTENTIAL OF ESG DATA



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Preface

On July 19, 2018, the SASB Alliance convened a group of corporate professionals, investors, and other capital markets participants at the offices of Neuberger Berman in New York for a half-day discussion entitled, “Overcoming Challenges—Unlocking the Potential of ESG Data.” The event—a mix of structured conversation and candid commentary—was intended to explore challenges and opportunities related to the disclosure and integration of environmental, social, and governance (ESG) data.

The diverse group of attendees generally agreed there is no clear-cut, near-term solution, but focused instead on ESG reporting and integration as an ongoing journey during which companies, investors, and intermediaries will become more sophisticated over time. Building on this conceptual foundation, participants engaged in a back-and-forth dialogue that surfaced a number of key topics:

- **“Fabergé eggs”:** Every company and every investor is unique—or, at least, believes they are unique—while the market operates at scale. For example, a company may have thousands of shareholders while a large institutional investor must scrutinize thousands of companies. Therefore, the users and providers of financial capital are often challenged to interface effectively without some level of standardization—but when standardization is misapplied or taken too far it can be counterproductive. This dynamic highlights a natural tension between regimented and tailored approaches, making a one-size-fits-all solution unlikely, but a complete lack of standardization is untenable.

- **“The cobra effect”:** In the absence of a thoughtful (and, perhaps, iterative) process to determine the proper metrics for measuring, managing, reporting, and integrating ESG factors, markets may create misaligned incentives and drive unintended consequences.
- **Rating the raters:** Perspectives on ESG ratings and rankings differed greatly, ranging from those who dismissed them because of technical shortcomings to those who viewed them as useful inputs akin to buy/sell recommendations.
- **“The M Word”:** While investors are keenly focused on the importance of financially material ESG factors, companies are loath to apply the word—even when they seemingly agree with the approach—for fear of conversation stalling because of legal and liability concerns.
- **Fostering productive dialogue:** Attendees generally agreed that collaboration is key, so an important next step is overcoming language barriers within companies (e.g., between sustainability and finance), between companies and their investors (e.g., earnings calls, investor relations, etc.), and in markets more broadly (e.g., developing a generally accepted understanding of ESG ratings, much like with credit ratings today).

Although the event was organized and facilitated by The SASB Foundation and the SASB Alliance, the ideas and voices included in this report are those of market participants. It is SASB’s hope that this publication—like the event it documents—will help move the conversation forward to focus less on nagging challenges and more on proactive solutions, thus unlocking the full potential of ESG data.

Overview

Although sustainable investing is a relatively new phenomenon, it is a response to concerns that have long tugged at the conscience of investors. “We’ve been talking about carbon regulation as long as I’ve been in the business,” said one analyst, who started his career in 1991. Another speaker recalled thinking, “What could we have done?” about the governance failures that brought down Enron in 2001. Now, decades later, why has the consideration of environmental, social, and governance (ESG) factors begun to take root as a key pillar in a prudent investment strategy?

Many shareholders view ESG integration as a way to better understand and manage risk—especially those risks related to intangible assets, which now represent more than 80 percent of the market valuation of S&P 500 firms.¹ Many others see ESG integration as a key aspect of their fiduciary responsibility to optimize performance for all beneficiaries, including long-term investors who stand to gain from broad economic growth and an approach to creating value that is both sustained and sustainable.² Still others view ESG integration as an essential consideration for passive strategies—which, one speaker pointed out, now represent approximately half of all managed equity assets in the U.S. For these investors, exiting a position is often off the table, giving way instead to informed engagement.³ Regardless of their motivation, the speaker noted, as investors “we have new priorities, so we need new data.”

Of course, change is difficult, and innovation is often messy. Although ESG integration represents an important modernization of 21st century finance, many specific approaches to date have

been canaries in the coal mine in terms of practical application. Early efforts at socially responsible investment (SRI), which were focused primarily on “negative screening,” have since given way to more robust ESG integration. Many companies have—voluntarily, in most markets—adopted a litany of approaches to reporting on ESG considerations, including the Global Reporting Initiative (GRI), the Sustainability Accounting Standards Board (SASB), the International Integrated Reporting Council (IIRC), the Carbon Disclosure Project (now known as CDP), the Climate Disclosure Standards Board (CDSB), the Task Force on Climate-related Financial Disclosures (TCFD), and others. Meanwhile, as intermediaries in the dialogue between corporations and their investors, seemingly countless ESG data providers have proliferated—and, more recently, consolidated—adding an additional layer of complexity.

“We have new priorities, so we need new data.”

– INVESTMENT PROFESSIONAL

Coupled with the rapid pace of change, this profusion of initiatives—the “alphabet soup,” as several participants called it—has created confusion in the marketplace that has neither benefited from nor facilitated a well-established, commonly accepted set of best practices. The result, attendees noted, has been a communication gap between companies and their investors. As one participant commented, they “are talking past each other.”

¹ Ocean Tomo, “Annual Study of Intangible Asset Market Value” (2015).

² Principles for Responsible Investment (PRI) and UN Environment Programme Finance Initiative, *Fiduciary Duty in the 21st Century* (2015).

³ BlackRock and Ceres, *21st Century Engagement: Investor Strategies for Incorporating ESG Considerations into Corporate Interactions* (May 28, 2015).

On the investor side, an increasing appetite for high-quality ESG information has asset owners and managers pulling data from a variety of different sources—many of which vary dramatically in terms of consistency, comparability, and reliability. “At the end of the day, there’s that noise piece,” said one asset owner, suggesting it’s increasingly challenging to find needles in the haystack. In searching for ESG data that can paint a picture of how a company is managing material risks and opportunities, “investors are overwhelmed by the amount of information,” he said.

“We have to put ourselves in each other’s shoes to co-build a solution that makes sense for both [investors and companies].” – ATTENDEE

Meanwhile, on the corporate side, companies are unsure which information investors value most, where they’re getting it, and what they’re doing with it once they do. As a result, they’re pulled in many directions at once and they don’t know what to prioritize. As one corporate participant noted, the litany of investor surveys and questionnaires “just doesn’t end.” Having recently completed the sustainability reporting cycle using GRI and SASB, her firm moved on to filling out the Dow Jones Sustainability Index (DJSI) questionnaire, then MSCI’s, and was now preparing to respond to CDP. “All the acronyms take a lot of time,” she said.

In the end, neither side seemed especially content with the status quo. The question, then, became how to move forward. As a productive back-and-forth began to reveal key insights, one attendee captured the general consensus: “There has to be a dialogue. We have to put ourselves in each other’s shoes to co-build a solution that makes sense for both sides.”

The Current Landscape

Corporate professionals, investors, and other market participants cited a laundry list of obstacles holding up progress toward unlocking the full potential of ESG data for both corporate and investor decision-makers. At the root of many of these issues was the market's attempt to establish a one-size-fits-all solution to measuring ESG performance. Although most attendees agreed on a need to improve comparability across companies—especially within industries—they agreed there is nevertheless a “natural tension between standardization and bespoke analysis.” This is because no two companies—and no two investors—are exactly alike. As one asset owner summarized: “There is no silver bullet.”

Many companies push back on attempts to assign scores or letter grades to companies' ESG performance using a standardized methodology for each industry because companies view them as potentially reductive, neglecting their unique circumstances—and their unique strategies for dealing with those circumstances. As one asset manager explained, “Each [company] thinks they're a Fabergé egg. ‘We're unique and wonderful!’” Therefore, from the perspective of most companies, important differences in risk exposures and business models aren't captured by standardized assessments, such as composite ESG ratings.

Similarly, each investor has their own unique needs, including their investment goals, time horizon, and risk appetite. To accommodate those needs, each one will employ a unique strategy and take positions in different asset classes with different risk-return profiles. As one participant

noted, the information needs of a large U.S. public asset owner are likely to be very different from those of an SRI fund in Europe or a “hardcore hedge fund” in New York. Like companies, she pointed out, “investors are not a monolith.”

“[ESG ratings agencies] want transparency but they're not transparent themselves!”

– CORPORATE PROFESSIONAL

Thus, to be useful, any prospective solution will have to strike a delicate balance among competing priorities—not just between companies and investors, but among a diverse range within each group. It must, participants generally agreed, provide enough standardization to facilitate efficient analysis across thousands of issuers, while also allowing for their individual nuances to come to light. It is this elusive “middle ground” that attendees attempted to pinpoint, explore, and fertilize.

RATING THE RATERS

The current landscape of ESG ratings and rankings attracted attention for much of the day's discussion. Although attendees' comments revealed a clear dichotomy of opinion on the value of ESG ratings agencies, nearly everyone agreed that their influence is strong and growing.

PARTICIPANT QUESTION *There are lots of discussions about controversies and risks. Are investors looking for positive ESG data or opportunity data, and how is that getting incorporated into an investment thesis or client reporting?*

“Positive” ESG data can be a key set of information for investors, be part of the investment thesis, and can help differentiate between competitors. ESG information ranges; it can provide insight into operational efficiency, into a company's product line that shows understanding of shifting consumer preference, into practices in place to ensure good governance, into the strength or validity of stated company culture, as examples that can lead to business opportunities and give evidence about strategic thinking. If it is truly part of the thesis, it typically makes it into client reporting. -Investment Professional

Comments revealed a broad skepticism about the current quality of offerings and hinted at a simmering concern that market consolidation among ESG raters will reduce competition and potentially slow the pace of innovation and improvement. One asset owner said, “I will use [ESG ratings information], but try not to rely on it too much” because “I’m a bit skeptical in terms of the quality of that information and the consistency.” He added, “I prefer actual company disclosure.” Another investor agreed, saying, “We have a data subscription, but it’s not the kind of thing I’d want to base our strategy on.”

Although many participants found value in the specific ratings or rankings they or their organizations support, most expressed concerns about the following aspects of ratings and rankings:

- **Transparency:** Most sustainability reporting, ratings, and investible products use opaque, “black box” methodologies that are difficult for companies and investors to assess in a meaningful way. As one corporate professional succinctly put it, “They want transparency but they’re not transparent themselves!”
- **Accuracy:** Several participants—including both corporate professionals and investors—said they find the accuracy of ESG ratings to be too frequently dubious. Companies pointed out that they’re often rated based on outdated, inaccurate, or irrelevant information. One corporate professional, whose company had recently been rated poorly on issues that are irrelevant to its industry segment, said, “We still find data errors and outdated data in every single report we get.” Another, whose U.S.-based firm had been rated poorly due to issues specific to Europe, noted that her company can provide feedback, but the ratings agencies “may or may not accept our comments, and there’s no accountability.”
- **Objectivity:** Some ratings agencies charge companies for reporting, raising the specter

“Investors are not a monolith.”

– MARKET INTERMEDIARY

of conflicts of interest. Small- to medium-sized enterprises may not have the resources to pay, while even large companies may elect to forego a specific rating or ranking due to the deluge of requests. As one corporate professional noted, “Last year, we got something like 55 requests for data verification or surveys.” Upon consulting with investors, she found that “96 percent of investors were looking at MSCI, Sustainalytics, and Bloomberg, and it diminished significantly after that.”

- **Focus:** Many ESG ratings are based on dozens or even hundreds of data points,⁴ many of which companies and investors alike may consider immaterial to their objectives. One corporate professional contrasted this scenario with using the SASB standards, which are focused on a minimal set of financially material ESG factors. “We really appreciate that the standards are industry-specific,” because “a B2B company like ours is very different from others in our industry, so many survey questions [from ESG ratings agencies] don’t apply to us.” An investor agreed, saying most ESG ratings “define ESG differently than I would,” suggesting the only relevant data points are those “relating to risks and opportunities that can impact investment.” Another investor echoed those

“Look at ratings for ESG in the same context as buy/sell recommendations...they’re interesting triggers, but not something to screen on or construct a portfolio around.”

– ATTENDEE

⁴ GS Sustain, *The PM’s Guide to the ESG Revolution* (April 2017).

comments, saying, “There’s a complete mismatch between investors who are only looking at material data and [many of] the raters and rankers who are looking at things not relevant to investment.”

- **Consistency:** Several commenters noted that different ESG ratings are often inconsistent with one another, raising questions about their validity. For example, a comparison of MSCI and Sustainalytics ratings for S&P Global 1200 companies reveals a weak correlation.⁵ As one speaker suggested, “When ratings conflict on the same company, obviously something is not working.”

Some participants noted these concerns are especially important given the rise of passive, quantitative strategies. However, others—mostly active investors—largely dismissed such apprehension. Instead of viewing ESG ratings as definitive, they suggested, investors should “look at ratings for ESG in the same context as buy/sell recommendations”: When there’s consensus, that’s a useful signal; when there isn’t, you might want to dig deeper. One such investor said ESG ratings are “interesting triggers, but not something to screen on or construct a portfolio around.”

begun to take more sophisticated approaches to sustainability factors. Participants mentioned developing proprietary methodologies for internal ESG ratings/rankings, taking more standardized and formalized approaches to ESG integration, and looking beyond equities to incorporate ESG factors across asset classes.

Analysts indicated they don’t need to be told which companies are “good” or “bad” by a third-party ratings agency, because such an assessment depends on a range of potentially subjective and interrelated assumptions, including which factors are important and what investment strategy is being employed. As one asset owner noted, “A piece of information reported by a data vendor can be positive for one analyst and negative for another analyst.” A fundamental analyst agreed: “Interpretation is really critical.”

“A piece of information reported by a data vendor can be positive for one analyst and negative for another analyst.”

– ASSET OWNER

MAKING STRIDES

Although many investors indicated their organizations use multiple data providers, they did not gloss over their shortcomings. Looking to dig deeper, many investors also said they have

For this reason, many investors expressed a desire to increase their focus on the raw performance data that underlies most ratings and rankings, preferring to evaluate this information through the lens of their own professional judgment. [See Exhibit 1 for an example of how one company uses

⁵ American Council for Capital Formation, *Ratings That Don’t Rate* (July 2018).

EXHIBIT 1							
<i>Energy Data</i>							
Year ⁽¹⁾	Energy Consumption Data Coverage as % of Floor Area	Total Energy Consumed by Portfolio Area with Data Coverage (MWh) ⁽²⁾	Grid electricity consumption as a % of Energy Consumption	% of Energy Generated From Renewable Resources ⁽³⁾	Like-for-Like Change in Energy Consumption of Portfolio Area with Data Coverage ⁽⁴⁾	MWh per Occupied kW ⁽⁵⁾	MWh per Occupied kW Year over Year % Change
2016	84%	3,699,472	95%	23.4%	2.5%	6.50	(5.8)%
2015	77%	3,252,836	95%	9.5%	n/a	6.90	n/a
<i>Water Data</i>							
Year ⁽¹⁾	Water Consumption Data Coverage as % of Floor Area	Total Water Consumed by Portfolio Area with Data Coverage (kGal) ⁽²⁾	Like-for-Like Change in Water Consumption of Portfolio Area with Data Coverage ⁽³⁾	kGal per Occupied kW ⁽⁴⁾	Gal per Occupied kW Year over Year % Change		
2016	64%	459,127	(2.0)%	0.81	(5.8)%		
2015	60%	403,373	n/a	0.86	n/a		

SASB standards in their annual regulatory filing to provide raw performance data.] Furthermore, they noted that improving the quality of such data would not only strengthen ratings, rankings, and passive strategies, but also enhance active investors' ability to perform their own tailored analysis. An asset manager whose firm employs both active and passive strategies said, "What we've found is that we want data that's high-quality, consistent, comparable, and timely." To get as close as possible to this ideal, his organization currently uses a variety of information sources, including company-reported and third-party data, performance and "sentiment" data, and data that is delivered annually, quarterly, and in real time. Collectively, he said, these sources strengthen investment convictions in a way they can't individually—at least not today.

A mix of investors mentioned they use SASB as "a starting point" in developing internal sector guides and performing fundamental analysis. The volume of ESG information available in the market has increased dramatically and those investors often use the SASB standards to prioritize the information that's most likely to provide insight on business-critical, financially material factors. But there's still work to be done because comparable performance data is still not broadly reported. There's hope for ongoing improvement as a growing number of companies have begun to report SASB metrics in financial filings, sustainability reports, and elsewhere.

Analysts also cited specific examples of how focused ESG analysis that goes "beyond the ratings" has yielded positive results. For example, one mentioned a chemicals company that had been poorly rated by third-party agencies, but which became an attractive investment opportunity upon closer inspection. Because the firm had been spun off from its parent company, its young reporting history didn't fully capture certain ESG strengths, such as an unusually robust approach to employee health and safety. It was "a positive feature in thinking about long-term value creation...but may not be evident in the off-the-shelf data," he said. Another mentioned

a publicly traded energy firm whose ESG profile is often mischaracterized due to preconceptions associated with its industry. Although it sources energy—including from solar and wind—and passes it through to customers, the company doesn't generate electricity. Nevertheless, "a lot of people tag them as a dirty company," he said.

Multiple investor panelists also noted the importance of direct engagement to their ESG platform. They considered engagement especially important with emerging-market issuers and small- to medium-sized enterprises, they said, due to their relative lack of publicly reported ESG performance data and minimal coverage by third-party ESG ratings agencies.

EASIER SAID THAN DONE

Despite the appeal to investors of more rigorous sustainability performance data, companies said they face a variety of challenges in providing such data—most related to measuring, validating, and reporting the information. For example, one corporate professional pointed out that many sustainability issues are inherently intangible and therefore can be difficult to quantify, citing "corporate culture" as an example. Another mentioned measurement and timing challenges related to making air quality disclosures due to inherent conflicts between varying state requirements and the company's own reporting cycles. Put simply, she said, "It's difficult."

"The rigor involved to make sure it's 100 percent accurate we take seriously, but it's very time consuming."

– CORPORATE PROFESSIONAL

Reporting sustainability information that is credible and reliable can also be extremely costly and time-consuming, several corporate professionals said. For example, one noted the verification process involves many subject matter experts across

her company who “have full-time day jobs.” Her company continues to push forward, she said, but not without a cost. “The rigor involved to make sure it’s 100 percent accurate we take seriously,” she said, “but it’s very time consuming.” Another corporate manager described the challenges her company faced in engaging an independent third party to provide assurance over its water data. Because of complexities unique to each of the firm’s approximately 100 plants, the process was lengthy and involved extensive technical expertise. The company pursued it anyway, because “we want our [ESG] data to be as rigorous as more traditional financial data,” she said. Despite the difficulty, she said, the company ultimately found value in going through the process. “It can be mind-numbing, but it’s helpful in terms of establishing more effective protocols and controls.”

Companies are also concerned that increasing transparency around their sustainability performance might affect them negatively—including legally and competitively. For example, several corporate participants mentioned the possibility that additional, voluntary disclosures could heighten their risk of litigation by introducing sustainability issues into the mix of information subject to the securities laws in certain jurisdictions. Others expressed concern that raw, nominal performance data—such as greenhouse gas (GHG) emissions—can look especially bad for a commodity company whose scale naturally drives a larger footprint. However, an investor countered

that this is a strength of underlying performance data, which can be normalized for differences in scale, scope, and business model, versus ratings and rankings, where an opaque methodology may or may not take such differences into account.

CONTEXT IS KEY

Indeed, both companies and investors suggested the ability to make context-specific judgments is critical. As one asset manager said, “Whether it’s active or passive, we’re looking for ESG leadership within an industry or sector.” A fixed income analyst noted that industry context is important because “for some sectors, you can see further out.” In a commodity-based industry, he said, the time horizon for understanding sustainability impacts may be a couple of years, while it can be considerably longer for infrastructure projects. With this in mind, his firm assessed the credit exposure of \$68 trillion in rated debt to identify the sectors most exposed to key environmental risks and found significant variation—for instance, high or very high carbon transition risk was present in 14 of 86 sectors. Notably, this figure may differ for an equity analyst, whose interest extends beyond an issuer’s ability to make timely payments of principal and interest.

Such context is essential, the fixed income analyst said, not only to differentiate among industries, but also to capture important variation within an industry. As a corporate participant said,

PARTICIPANT QUESTION *How can “commodity” companies best articulate carbon/GHG (or other resource-use) performance when greater volumes inherently translates to greater emissions?*

If from the question one presumes “greater volumes” means more of the commodity extracted, this does not necessarily equate to more emissions: A company could implement a more efficient system of extraction or processing and therefore extract a natural resource more efficiently with less GHG emitted. The presumption that “greater volumes inherently translates to greater emissions” in the process of extraction by the commodity company is not always true.

Another aspect to consider and a useful measure of GHG emissions when considering acquisitions and growth, and

comparing across industries, is to not only look at GHG emissions raw data, but also look at GHG emissions as a percentage of revenue—this metric can be used to show a comparable intensity of use of natural resources. Using a GHG/revenue valuation metric takes the expansion or growth of a company into account as it measures emissions vs. revenue. Using the relative measurement provides a way to allow comparability of efficiency of natural-resource-use across time, size, and type of business. -Investment Professional

PARTICIPANT QUESTION *How are NGO reports, protests, or attacks viewed in the risk analysis by IR? Public reporting teams for some companies are not only worried about litigation but NGO actions.*

We consider NGO actions in our comprehensive risk analysis. They are monitored similarly to other traditional risks. Part of our mitigation plan is proactive engagement with NGOs to ensure that communication is open and dialogue is encouraged.
-Corporate Professional

“Comparability [on performance data] across [peer] companies is the right move forward.” For example, although the airlines industry is broadly exposed to significant carbon transition risk, the fixed income analyst said individual companies may face greater challenges (e.g., an airline with primarily international routes or an older, less efficient fleet) or lesser challenges (e.g., a domestic airline with no emissions cap or strong pricing power that enables cost pass-through) depending on their circumstances—in other words, the “Fabergé egg factor.”

Additionally, the analyst pointed out, prudent analysis can’t ignore important cross-sector impacts, such as in the auto industry, where the transition to electric vehicles can have positive effects on electronics or chemicals companies and negative effects on refining and steel firms. It’s also important to note that some industries are more homogeneous—featuring companies with very similar business models (e.g. Airlines)—whereas other industries are more heterogeneous—featuring companies with a variety of products and business models (e.g. Household & Personal Products)—which reinforces the importance of context when comparing companies within an industry.

Given the sheer number of variables to consider, the complexity of key contextual factors, and the important differences between asset classes, many investors agreed that a focus on objective performance data was preferable to subjective ratings. This raised another question: Where should that information be reported?

REPORTING HERE, THERE, AND EVERYWHERE

No clear consensus emerged on where companies should report their sustainability performance. The current reporting practices of corporate participants ran the gamut, with most disclosing ESG information in sustainability reports, others in mainstream financial filings, and still others in annual reports, on websites, or through some combination of channels. Likewise, investors’ opinions were mixed.

Of her firm’s corporate responsibility report, one corporate professional said, “We try to include only the things we’re being asked about, so it’s an encyclopedia or repository for all the questions we’re going to get throughout the year.” Another corporate professional, based on her outreach to investors, said, “we heard sustainability reports are trying to satisfy too many stakeholders.” Her investors told her “they really want reporting that is focused on investment.” In that vein, a few investors in attendance suggested that mainstream financial filings—such as the Form 10-K in the U.S.—are the appropriate place for financially material sustainability information.

However, companies noted that they perceive concerns about increased legal risk from making disclosures in financial filings and seemed reluctant to be the first in their industry to cross that line. Although a corporate participant said her company’s “number one priority is investors,” she also said, “There’s a greater risk of litigation if it’s in the 10-K—why take that risk?” She suggested other channels of communication might be better suited to ESG information, repeating a common refrain among both companies and investors: “The 10-K is long enough as it is.”

At the end of the day, however, most investors generally agreed they don't care where the information is reported as long as it's high-quality. "What we're looking for is how any ESG theme or metric is tied to a company's value proposition," said one asset manager. "Whether the company conveys that in its 10-K or sustainability report—we don't care that much. We're seeing all that, anyway," he said. A corporate professional concurred, having recently consulted with her shareholders on the matter. "A couple [of investors] felt the 10-K would give [ESG data] the imprimatur of accuracy, but others think it's litigation risk and said, 'We don't want to face that,'" she said. "Others don't care one way or the other, as long as it's accurate."

"Materiality is our north star on ESG data."

– FUNDAMENTAL ANALYST

"THE M-WORD"

Much of the debate over where to report sustainability information centered on the concept of materiality. In many jurisdictions, information that is financially material may be required to be disclosed in public filings. Perhaps for that reason, one corporate professional said of her company's standalone sustainability reporting efforts, "We've been told by our legal team to reserve that term for financial filings."

Although many corporate professionals were reluctant to use the word, the general consensus

among investors was that it is beneficial to focus more sharply on a core set of sustainability factors that are relevant to the business. One asset owner said, "Some companies do excessive reporting on ESG," and suggested that investors are "overwhelmed" by the "noise." A fundamental analyst agreed, saying, "Materiality is our north star on ESG data." At his firm, where the typical holding period is well above the industry average, analysts and portfolio managers "all have a common thread of being aligned around materiality," he said. "We're not just focused on ESG data for its own sake, but because it will be material to shareholder value and also good for stakeholders."

Regardless of whether they used "the M-word" or not, such an approach was especially attractive to companies due to the cost-effectiveness of reporting. As one corporate participant noted, when her company implemented the materiality-focused SASB standards, they found they "were already reporting on 80 percent of the issues." A more streamlined approach to sustainability also may hold appeal for companies that expressed uncertainty about whether or not their sustainability reporting efforts are making a difference with investors. As one corporate participant said, "I don't doubt there are specific funds that give it credit...but I don't see it in terms of our valuation multiple." By focusing on material factors with impacts on book value,⁶ market price movements become less of a concern.

CART BEFORE THE HORSE?

Although much of the discussion centered on which sustainability information to report and where, several participants bemoaned what they

⁶ Khan, Mozaffar, George Serafeim, and Aaron Yoon, "Corporate Sustainability: First Evidence on Materiality," *The Accounting Review* (2016).

PARTICIPANT QUESTION *A comment was made that companies may be spending too much time on standardization versus improvement. How do companies and investors feel about that question?*

I do feel that we spend a significant amount of time reporting, which takes time away from the actual "doing." That being said, without the reporting, I don't feel that we would be tracking our "doing" as diligently; it keeps us accountable, both internally and externally. The reporting drives conversations with our stakeholders and helps us benchmark against our peers. -Corporate Professional

saw as an overemphasis on reporting, suggesting it's like the tail wagging the dog. What's more important, they argued, is not improved reporting but improved performance. "We're beginning to lose sight of what the point of the exercise is," one asset manager said. "The end game is not a beautiful sustainability report that sits on the coffee table. The point is to make companies better and stronger," she said. "Let's get back to basics."

Some argued that this focus on reporting has produced organizations—on both sides of the aisle—that seem more concerned with how they're perceived than with creating actual value. For example, asset owners mentioned certain asset managers who "check the box" by subscribing to ratings in an effort to convince owners that they're "integrating" ESG. Managers, for their part, pointed at certain companies that spend significant resources on glossy sustainability reports and on filling out every survey or questionnaire rather than focusing on performance improvements.

Most of these investors acknowledged that transparency plays an important role—as one said, "We want to see that [ESG] is managed with the same rigor as any other business function, not as some bolt-on activity." However, they also noted that not every company is big enough or profitable enough to devote resources to robust sustainability reporting. One asset manager whose firm invests primarily in small- to medium-cap companies said, "They don't have the reporting and disclosure, but they're performing."

Several investors also suggested that a prevailing misconception that reporting is "the end game" is partly to blame for certain shortcomings of ESG ratings, rankings, and investible products, some of which use disclosure as a proxy for performance. Thus, as an asset manager explained, companies are "rewarded and penalized on disclosure rather than on performance."

"We want to see that [ESG] is managed with the same rigor as any other business function, not as some bolt-on activity."

– ASSET MANAGER

An asset owner captured the essence of this dynamic with an anecdote about colonial India. Due to concerns about venomous cobras in Delhi, the British government offered a bounty for every dead snake. "How many dead snakes was the metric," he said. Although the approach was initially successful, opportunists eventually began breeding snakes for income. When the situation became apparent, the program was canceled and the breeders set their newly worthless snakes free, ultimately increasing the population of venomous cobras in Delhi—the exact opposite of the intended outcome.

The moral of the story—that the wrong metric can create perverse incentives and undermine objectives—underscores the need to take a deliberative approach to measuring, managing, reporting, and integrating sustainability factors, the asset owner said. "It needs to be thoughtful," he emphasized, suggesting it's best to take a collaborative, market-based approach to setting metrics that involves both companies and investors.

Looking Ahead

“Reporting is a journey, not a destination. It’s an iterative process.” – MARKET INTERMEDIARY

In surveying the current landscape, participants made a variety of suggestions about how to move the market forward. A central theme was that, as relatively new practices, ESG reporting and integration are—and should be—works in progress. “Reporting is a journey, not a destination,” a market intermediary said. “It’s an iterative process.” Nonetheless, many companies and investors are forging ahead in the face of their own challenges.

Thus, a key takeaway was that Rome wasn’t built in a day—rather it was built day-by-day—and approaches to sustainability reporting shouldn’t

be, either. As one asset manager pointed out, “Financial accounting has been around a lot longer, and they still have problems.” Over time, however, participants suggested that both companies and investors will become more sophisticated and feed off one another’s progress.

Investors noted their approaches are already evolving. One fundamental analyst, whose firm has had a sustainability strategy in place for equities for many years, noted that the philosophy is now being applied across asset classes. Additionally, “our internal [ESG] rating system itself continues to iterate and evolve as both data and regulations change,” he said. Another asset manager noted that his analysts are now incorporating sustainability factors more explicitly in their evaluations and recommendations, with other advances on the way.

Likewise, companies are similarly embracing an iterative process. One corporate participant

PARTICIPANT QUESTION *Our company is shifting away from terms like “sustainability” and “ESG” to a focus on “value creation,” since that is something that everyone can feel more directly connected to and responsible for. Are other companies considering the same sort of shift? How have they communicated about this internally?*

This is consistent with how we think about ESG. To us, ESG is about the risks and opportunities that the company faces that could impact the company’s ability to continue to create shareholder value over time. In other words, it’s about the way a company manages its risks and takes advantage of opportunities that could impact the economic sustainability of the company over the long term. This is how we think about ESG and how our investors think about ESG. The Integrated Reporting framework discusses risks and opportunities as one element of value creation. Because we view what is now termed “ESG” as part of our strategy for value creation, we intend to take an integrated approach to our reporting next year. This should help convey our approach to ESG both internally and to our investors as well as other external stakeholders. -Corporate Professional

We use the term “corporate responsibility” to cover all environmental, social, and governance topics. We have been discussing the concept of “creating shared value,” or using our core business functions and strengths to address social

and environmental issues (as described in the original Porter/ Kramer HBR article from 2011), to help our team understand that corporate responsibility is integrated into the business and not an add-on, but we still use the term “corporate responsibility” and I don’t see us changing that anytime soon. -Corporate Professional*

We have had this discussion numerous times as it seems that the word ‘sustainability’ has come to mean everything and nothing. Unfortunately, ESG may be following the same path. However, for our company, we feel that as long as we clearly define what sustainability means to us and clearly articulate the business strategy, then it is the appropriate term. At this stage ESG is still reserved for investor relations and the associated engagements with ratings and rankings institutions. It is important to identify your audience when using this term and explain clearly the value proposition. I can see how ‘value creation’ might be a useful term when speaking to a broader range of stakeholders. -Corporate Professional

* Michael E. Porter and Mark R. Kramer, “Creating Shared Value,” *Harvard Business Review* (January-February 2011).

discussed how it took time to get over the hump in implementing the SASB standards. Early on, she and her colleagues got hung up asking themselves, “Are these really the most material issues?” However, by going through the process, she said, she developed a deeper appreciation for each ESG factor and its relationship to the company’s business. “It took me to a different level of understanding,” she said.

Companies and investors need to be patient not only with their own progress, but with each other’s. As investors’ sophistication grows, companies will begin to see evidence of ESG impacts on their valuation multiples. “Standardization is a key on the path toward getting due credit,” one corporate professional said. Meanwhile, as companies get more sophisticated, the quality—and comparability—of reporting will improve, thus stimulating a virtuous cycle, some suggested. “We are primarily focused on investors, so we’re looking at our reporting through that lens,” another corporate professional said. “We want to put out reporting that is useful to them,” but it takes time to get it right, she said.

Indeed, participating companies were at very different points along their journey—from those with many years of reporting experience to complete newcomers. However, as one pointed out, being a laggard isn’t necessarily an insurmountable problem. “We’re not saddled with legacy systems and processes,” she said, so her company can build a strategy from the ground up that meets the needs of its key internal and external stakeholders.

OVERCOMING THE LANGUAGE BARRIER

Although building ESG-related capacity and capability takes time, many participants agreed that language barriers have slowed progress—both within companies and in markets more broadly. Different stakeholders often struggle to see eye-to-eye on sustainability matters because they use terminology that is either overly vague or overly specific, loaded with importance on one

side of the dialogue and virtually meaningless on the other. For example, the term “sustainability” itself can be applied to a wide variety of issues related to the environment, society, human capital, innovation, governance, and other broadly defined factors.

“I’ve started to adopt the language of finance. When I go to finance or investor relations now, we’re on the same page.”

– CORPORATE PROFESSIONAL

For example, within a company, several participants agreed that speaking the same language is particularly challenging when sustainability is the domain of a separate department that isn’t today embedded in core business functions such as finance, operations, or risk management. One corporate sustainability manager suggested that establishing strong cross-departmental relationships can foster mutual respect and help bridge the communication gap. For example, she said, implementing the SASB standards helped her company break down walls between the sustainability team and other departments. “I’ve started to adopt the language of finance,” she said. “When I go to finance or investor relations now, we’re on the same page.” Similarly, developing robust and reliable processes for data measurement and collection involved many different internal functions—as well as a lot of time—so a strong culture of collaboration and existing rapport was enormously valuable. “Relationships are the most important thing I have,” said the manager, who regularly interacts with about 40 subject matter experts across her firm.

A common language is important for effective communication between companies and the capital markets, too. A couple of participants suggested that companies and investors often talk past each other on sustainability issues, particularly during earnings calls. As an example, one

PARTICIPANT QUESTION *How do you think corporate boards are performing on the ESG dimension? Is there enough focus?*

It all depends on how one defines ESG. If ESG is a term used to refer to the economic, operational, environmental, social and governance risks and opportunities that could impact the company's ability to create value over time and how the company is managing those risks and availing itself of those opportunities, effective boards are already engaging management in addressing these issues, even if they are not termed "ESG" in board presentations. ESG does not have to be considered by boards as a separate, standalone area—and, in fact, it may be most effective when integrated

into business processes and considered and discussed by the board in the context of the company's strategy for value creation. -Corporate Professional

The focus of corporate boards in general has been historically more on the governance front. Lately, however, we are seeing an expansion of this focus to environmental and social issues. This translates into broader risk management and oversight on E&S issues as they pertain to the overall business. -Investment Professional

analyst pointed out that “commodity companies are subject to cyclical supply and demand, so operational excellence is important.” However, most companies wouldn’t consider that a “sustainability” issue, even though it encompasses employee health and safety. “Illumination around the language of ESG is novel and new to some,” he said, “but when it’s connected to the principle of materiality and you surface the idea that the processes that have been in place have been incorporating ESG for many years, it becomes less of an obstruction.” By speaking the same language, the barriers come down. “Once it’s revealed that it’s been native to the process, it’s seamless,” he said.

Of course, as one corporate professional pointed out, it’s not always companies pushing back on sustainability language—sometimes it’s the other way around. For a conference to sell-side analysts, he was planning to give a sustainability-related presentation and was told, “If you do that, we’re going to think you’re dodging business issues.”

Common language, too, may take time to develop. However, one participant cited credit ratings as an example of how consensus terminology can develop over time. Today, he suggested, “Everyone knows exactly what a Baa means no matter where they are”—a medium-grade bond from an issuer with moderate credit risk and some speculative characteristics. “We want to bring that to the ESG discussion,” he said. Some level of standardization, he suggested, will enable a future in which “we speak with a common voice.”

“Everyone knows exactly what a Baa [rated bond] means no matter where they are. We want to bring that to the ESG discussion.”

– CREDIT ANALYST

Overcoming the language barrier may also pave the way for sustainability to be embedded more strategically into core operations, something that participants generally agreed is important for both companies and investors—especially those currently “checking the box.” As a couple of attendees mentioned, setting the “tone at the top” with buy-in at the board level or among C-suite execs can go a long way toward establishing a culture of embracing key sustainability factors.

MOVING THE CONVERSATION FORWARD

Speaking a common language is important, but ultimately it’s little more than a foundation on which multiple parties can build a productive two-way dialogue. With that in mind, participants suggested, both companies and investors can be more perceptive and responsive to one another’s needs and challenges.

“Who is your shareholder base? Who are you trying to communicate to?”

– MARKET INTERMEDIARY

For companies, speakers suggested they work on developing a better understanding of a key question with respect to their sustainability efforts: “Who is your audience?” Is it shareholders? Or a broader set of stakeholders, including employees, suppliers, the local community, and others? A thoughtful answer to this question, commenters said, can help a firm better determine what it’s trying to accomplish in managing and reporting sustainability factors. This may include which reporting framework is most appropriate—as one corporate participant said, “Investors are our number one primary audience and that’s why we started looking at SASB standards.”

Other speakers warned, however, that even under the broad umbrella of “investors,” there is great diversity and companies should “temper expectations about a grand consensus emerging.” For instance, one asset manager noted, an investor “holding a short-duration investment-grade bond will be looking for a different subset of [ESG] data than one with a long-hold equity strategy.” This can create challenges for companies in trying to

please everyone. Thus, to guide reporting efforts, participants suggested a company should identify its key shareholders, which may be those with the largest stakes, those most aligned with the company’s long-term strategy, or some other criteria. An attendee suggested corporate boards and executives should ask themselves, “Who is your shareholder base? Who are you trying to communicate to?”—and be prepared to develop a deep, detailed understanding.

“Invite me to your [engagement] meetings. We get requests from investor relations and corporate governance for [ESG] information, but rarely to attend.”

– SUSTAINABILITY PROFESSIONAL

Direct engagement can help with this process, said one corporate professional whose company had done targeted outreach to half of its investor base (by shares outstanding) to more effectively tailor its approach to sustainability. As she pointed out, it’s difficult to report useful information when you don’t know how it’s being used. “We don’t have a true understanding of how much they’re

Credit Ratings and ESG Ratings: What’s the Difference?

Credit rating agencies—or “CRAs,” such as Moody’s, S&P, and Fitch—have begun to more explicitly incorporate ESG factors into their credit analyses ratings. CRAs tend to focus on an issuer’s ability to repay its borrowings on time and on schedule. CRAs seek to incorporate a forward-looking view of all issues—including both financial and non-financial factors, such as ESG factors—that could materially impact the credit quality of a given industry, sector, or issuer of debt. Thus, for CRAs, ESG factors represent just one part of a holistic assessment of an issuer’s overall creditworthiness and their ability to make timely payments of a security’s principal and interest.

In comparison, specialized ESG ratings firms, such as MSCI, Sustainalytics, and others, base their analysis on sustainability-related matters relevant to the company but may not directly impact its probability of default. ESG ratings tend to rely on publicly available information, whereas CRAs also incorporate material, non-public information into credit analysis.

One other distinction is that CRAs are registered and regulated in many jurisdictions, and therefore, publish their methodologies and ratings criteria publicly. ESG ratings firms are not generally regulated and also have varying levels of transparency.

weighting MSCI or Sustainalytics versus their own analysis, or ESG information versus financial data,” she said. Some investors acknowledged their heterogeneity “makes it more complicated for investor relations professionals,” and agreed that engagement is a productive path forward.

INVESTORS AS ADVOCATES

Most participants, including corporate professionals, generally agreed that when it comes to moving ESG forward, investors are at the wheel. As providers of financial capital, companies suggested, investors can do better at helping “make the business case” for the sustainability initiatives that are important to them. “It’s important they provide us with that,” one corporate professional said. They can also, corporate representatives pointed out, be more explicit about what information they want and where they want it. “Investors have a really strong role to play,” one participant said. “They need to do everything in their power to get the word out to companies about what they care about and what they don’t find helpful,” another agreed.

One corporate sustainability professional also pointed out that even investors who say they’re keenly focused on sustainability factors as financially material considerations nevertheless leave her department out of the loop when they engage with her company. “Invite me to your [engagement] meetings,” she said. “We get requests from investor relations and corporate governance for [ESG] information, but rarely to attend.”

Participants also suggested investors can continue to press other key levers in the market by engaging not only with companies but also with ratings agencies and data providers. For example, because of investor work through the Principles for Responsible Investment, sustainability is beginning to be more explicitly incorporated into key market infrastructure such as credit ratings. (Although, as a representative from one of the credit rating agencies pointed out, investors’ opinions on the most effective methodology differ, with some wanting ESG incorporated into the overall credit

rating, some preferring a separate ESG score, and others wanting it broken down by sector.) Similarly, some suggested, investors should work with ESG ratings agencies to improve their offerings. “Because investors are paying clients,” one corporate attendee said, “they have it in their power to pressure them to focus on issues that matter. They won’t listen to issuers,” she said. “We’re not their clients.” An asset manager pointed out his firm had recently engaged with a leading ratings agency and the effort had helped push the company toward announcing “a change to a materiality focus more aligned with the SASB approach.”

COLLABORATION IS KEY

Although the day’s discussion covered a wide range of perspectives and opinions, most participants agreed that progress is most likely to come from working together—including the involvement of companies, investors, reporting initiatives, raters and rankers, and other market intermediaries. “We’re all kind of on this learning journey together,” a corporate professional said. “Dialogue is the key piece.” Another participant agreed, saying “The only way to build something that makes sense is co-creation among companies and investors.”

“We’re all kind of on this learning journey together. Dialogue is the key piece.”

– CORPORATE PROFESSIONAL

Although most participants acknowledged that finding common ground isn’t easy, many identified improving the quality of reported performance data as a key area of alignment. As one attendee pointed out, this would not only ease the push-and-pull between companies and investors but also between active and passive investors. Citing the “natural tension between standardized and bespoke analysis,” he observed that, “If you narrow the number of things to standardize and

use those to undertake bespoke analysis, you'd get what [most investors] are looking for." In other words, the market can't standardize everything, but it also can't go deep on every issue at every issuer. Instead, it must find a happy medium where a core set of ESG factors are standardized and used as a launching pad for customized, interpretive assessment. As one attendee said, "There will always be incremental requests from people with specialist needs," but the market can still establish "a foundational level that meets most peoples' needs."

Narrowing the focus not only provides flexibility for different types of investors but may also be more palatable to companies—especially those who see themselves as "Fabergé eggs." As one asset manager pointed out, "We're asking you for hard data on things you want to be unique and lovely," but "we've got 17,000 eggs coming through—how do we choose?" Another attendee agreed, saying, "Using 1,000 data points makes the relevance of each one questionable," but "a methodology that pulls out the relevant pieces and uses those as guideposts" makes more sense. A corporate professional further made the case for a foundational level of standardization, citing the deluge of information requests his company faces. "We get different requests for surveys with different calculations, different formats, and different angles," he said. "It creates a lot of fatigue."

Over the course of the day, the discussion turned a corner from being primarily focused on current problems to emphasizing potential courses of action and progress. As one panelist observed, that evolution mirrored the broader market, which feels in many ways like it is at a turning point. She encouraged "an appreciation of the fact that we're all on a journey" toward a future where sustainability is part of standard—not specialized—practice. "Our jobs didn't exist 5-10 years ago," she said. "I hope they don't exist 10 years from now." Soon, she suggested, "We won't talk about ESG investing. It's just investing."

Appendix A: Participant Questions

Attendees were encouraged to submit questions to guide an open discussion during the “Overcoming Challenges—Unlocking the Potential of ESG Data” event. Due to the volume of questions posed, not every question was addressed directly. Many of those questions are included in the body of this publication along with answers solicited from other event participants with relevant expertise. The remainder are presented here with answers provided by SASB.

Q: As part of its Disclosure Effectiveness initiative, the U.S. Securities and Exchange Commission (SEC) issued a concept release in April 2016 titled “Business and Financial Disclosure Required by Regulation S-K” for which it received public comments. The SEC added this item to its Spring 2018 Regulatory Flexibility rulemaking agenda. I’m wondering what others believe will be the outcome of this and if they believe that the SEC will issue guidance on ESG-related disclosures?

A: The Commission has not indicated what action, if any, it might take in response to the comments received on the Concept Release. However, sustainability issues were a major focus area of commenters—although only four (of 92) pages of the release discussed “public policy and sustainability matters,” the large majority of non-form comment letters submitted to the SEC discussed ESG disclosure, and most of those letters sought more fulsome disclosures. The Commission may well feel obligated at least to address the issue.

SASB’s position, expressed in its comment letter on the release and elsewhere, is that new rulemaking by the SEC, such as new line-item disclosure requirements, are not necessary. This is because existing requirements should lead to better disclosure, particularly now that SASB’s investor-focused, materiality-based framework

will facilitate such disclosure. In particular, Item 303 of Regulation S-K requires that companies describe known trends, events, and uncertainties that are reasonably likely to have material impacts on their financial condition or operating performance in the Management’s Discussion and Analysis of Financial Condition and Results of Operations (MD&A) section of SEC filings.

Moreover, additional rules-based provisions—such as line-item disclosure requirements—may prove unworkable. A given sustainability factor will not be financially material for all companies, and when it is material, it will manifest in unique ways from one industry to the next, thus requiring performance metrics tailored to the specific impact. Thus, requiring generally applicable line-item disclosures might result in additional corporate reporting burden and reporting of a large volume of information that is immaterial to investors.

SASB believes it would be appropriate for the Commission to consider acknowledging the SASB standards—in an interpretive release or similar channel—as an acceptable framework for use by companies in preparing their SEC filings, as the standards facilitate effective disclosure on financially material sustainability factors in a way that is consistent with SEC requirements.

Q: What is SASB’s current position on whether all SASB disclosures should be included in Form 10-K or other SEC filings?

A: There are many ways for companies to communicate with investors. Because SASB standards focus on financially material ESG factors, they can be used to meet disclosure requirements for public regulatory financial filings in some markets. As a result, some companies may choose to use SASB standards in such filings,

including those submitted to the SEC.

However, SASB recognizes that other companies will opt to disclose ESG data in other ways; for example, in a sustainability report, on a website, or in an annual report to shareholders. SASB has learned from the investor community that they are less concerned with where financially material ESG information is disclosed than they are with its quality and utility. However, regardless of where the information is disclosed, SASB believes that the governance processes (including management participation and board oversight) and internal procedures to ensure accuracy for these disclosures should be substantially similar to those used for traditional financial reporting.

Q: How is a company more at risk when discussing material ESG information inside Form 10-K versus outside in a sustainability report—given that all investors are clearly stating they rely on the sustainability reports to inform their decisions?

A: Companies identify, evaluate, and manage the legal risks associated with current and proposed business activities, guided by the recommendations of corporate counsel and/or other trusted advisors. SASB takes no position on what activities may or may not constitute a material legal risk for a specific company.

It is not necessarily the case that companies increase their liability exposure by making SASB-type disclosures in an SEC filing, such as Form 10-K, rather than in a sustainability report. SASB convened a forum at Harvard Law School in June 2017 with many of the top securities law scholars and practitioners in the U.S., and there was no general view that risk would be increased by such SEC disclosures.⁷ As was written in follow-up to that forum.⁸

A company, as well as its officers and directors, can be sued for fraud for any statement, no matter where it might be made. Section 10(b) and Rule 10b-5 of the Securities Exchange Act allow for an SEC or a private lawsuit against persons who make a fraudulent statement, no matter where it is made (although, of course, to succeed in such a lawsuit a private party must show many things, including reliance, causation, materiality, damages, and intent or “scienter”). Thus, it is wrong to conclude that companies can avoid securities fraud liability merely by putting sustainability information in communications (e.g., in corporate sustainability reports, or on websites) rather than in SEC filings.

For example, in the British Petroleum Deepwater Horizon explosion, one of the bases for a securities fraud lawsuit against BP was an allegedly misleading statement about the frequency of BP’s safety inspections made in the company’s sustainability report.⁹ For some companies, such an episode may provide a compelling case for routing sustainability information through the rigor of the traditional financial reporting process, which reduces risk by using accounting standards, effective internal controls, sound data governance, well-established regulatory oversight, and external audits or reviews.

Indeed, one of the nation’s leading securities law scholars, Professor Donald Langevoort of the Georgetown University Law Center (who was a participant at the SASB Legal Forum), published an article addressing this issue in early 2018, and, after reviewing SASB’s work, he concluded that “using a common rubric with other similarly situated issuers reduces the risk that comes from being unique in what is said.” This is particularly true because, as SASB has stated, the standards have been developed to balance investor demand against the costs and risks related to disclosure and, thus, investors should not expect that companies using the standards need to go

⁷ SASB, *Legal Roundtable on Emerging Issues Related to Sustainability Disclosure* (October 2017).

⁸ Tom Riesenber and Elisse Walter, “Sustainability and Liability Risk” *Harvard Law School Forum on Corporate Governance and Financial Regulation* (February 19, 2018).

⁹ See, e.g., *In re BP P.L.C. Sec. Litig.*, 922 F. Supp. 2d 600 (S.D. Tex. 2013).

above and beyond the confines of the standards. Given that, Professor Langevoort concluded that, “Adherence to the letter and spirit of high-quality voluntary sustainability disclosure is more likely to lessen the litigation risk than increase it.”¹⁰

Q: The thing that will keep SASB from becoming another me-too reporting standard is “materiality.” For issuers, materiality seems to be the concept that must not be named, because any acknowledgment of financial materiality for a topic that does not appear in SEC filings can potentially generate liability. SASB itself states that the standards are both financially material and voluntary, but there is no such thing as a financially material, voluntary standard. How does SASB overcome this contradiction, and avoid becoming the “Unsustainable Accounting Standards Board”?

A: This question goes to the heart of what SASB is doing. The SASB standards are designed to surface the industry-specific sustainability factors that are reasonably likely to have material impacts on the financial condition or operating performance of companies in a given industry, but **the determination of materiality and duty to disclose lies with corporations**, in accordance with their national requirements and/or other legal reporting requirements to which they are subject.

Thus, a company might decide that sustainability issues are interesting to a lot of investors, and perhaps important to many investors, but not “material” as that term is defined under applicable law. Materiality in this area is not always easy to determine, in part because sustainability-related metrics are new. Over time, it seems likely that expectations and understanding will become clearer, but in the near future we expect that many companies will view the use of SASB

standards as voluntary and make their own decisions about where to use the standards in investor communications.

Q: What is the best way to introduce new and unknown material sustainability topics to investors that companies will not want to willingly report on?

A: As noted, sustainability accounting is a relatively new practice that involves the measurement, management, and reporting of factors that are often emerging and/or rapidly evolving. To address the dynamic nature of the ESG landscape, SASB has established an ongoing, multi-year process for maintaining the standards. Like SASB’s work thus far, this ongoing due process will involve internal research, external outreach, technical agenda-setting, public comment, and transparent oversight.¹¹

As existing issues evolve and new issues emerge, they are added to SASB’s Research Agenda for further analysis and review. When available evidence indicates a reasonable likelihood for financially material impacts on companies in one or more industries, SASB analysts then subject each issue to a rigorous methodology designed to interrogate the evidence, assess the likelihood and intensity of potential impacts, evaluate investor interest in the issue, and solicit corporate perspectives on whether and how the issue is—or might be—effectively managed.

To ensure regular, high-quality input from the market, SASB has begun to establish and appoint members to 11 standing Advisory Committees—one per Sustainable Industry Classification System® (SICS®) sector—to support SASB and its staff in producing cost-effective standards that yield material, decision-useful information. Committees will be comprised of 10 to 15 members each, including a minimum of at least one member per industry. Members

¹⁰ Donald C. Langevoort, “Disasters and Disclosures” (January 19, 2018).

¹¹ SASB, *Rules of Procedure* (February 2017).

will represent their industry views on emerging topics, implementation of the standards, and raise items for consideration on the Technical or Research agendas.

Q: A presenter mentioned that “governance” and “diversity and inclusion” are universal issues, which I agree with, but if you look at the SASB Materiality Map®, these issues aren’t flagged for all industries. In general, I like SASB and would like to use it, but feel the Materiality Map overlooks a lot of material issues, particularly for our asset class (we are long-term, private equity holders) and style of investing (we frequently take control positions). Regardless of asset class and style of investing, though, aren’t there certain basic issues that are material to all industries, and then others which are material to only some?

A: SASB’s approach to governance builds upon the traditional role of corporate governance by focusing on industry-specific *performance* (e.g., violations, fines and settlements, accidents, certifications, etc.) related to issues that are inherent to the business model or common practice in a company’s industry and that are in potential conflict with the interests of broader stakeholder groups (e.g., government, community, customers, employees), thereby resulting in financial impacts on the corporation.

This approach differs from a more traditional assessment of corporate governance, which tends to focus on board structures and processes and shareholder rights. Because many of these traditional governance topics are addressed by existing SEC regulation, by stock exchange listing requirements, or by industry-based principles and codes (e.g. from the Council of Institutional Investors or the International Corporate Governance Network), SASB instead has chosen to identify metrics that capture performance in specific industries with persistent governance

issues. As such, rather than focusing on the processes, structures, and shareholder rights that constitute effective governance, SASB standards and metrics focus on operational outcomes that serve as indicators of governance quality. To that end, SASB standards are complementary—and a supplement to—traditional corporate governance metrics.

Although corporate governance is relevant across all economic sectors, each sector or industry has its own unique governance profile. For example, the governance issues most likely to have material impacts might involve systemic risks (such as in the Financials sector), operations in highly regulated markets (such as the Infrastructure sector), less competitive markets (such as Telecommunications), or exposure to supply-chain risks (e.g., Consumption, Resource Transformation, and Non-Renewable Resources).

Certain feedback from investors and governance experts has indicated that, by excluding “traditional” corporate governance topics (such as board composition, shareholder rights, and board effectiveness), the SASB standards have created a false market perception that SASB believes such governance does not drive value. To address this misconception and to better align the standards with the recommendations of the Task Force on Climate-related Financial Disclosures (TCFD), and to encourage high quality disclosure, SASB’s codified standards recommend that a company design, implement, and maintain a system of governance around developing and disclosing sustainability information—including management involvement, board oversight, and internal control—that is substantially similar to what it uses for traditional financial reporting.

Q: What are some core “S” (i.e., social) issues within the ESG topics that investors are most sensitive to?

A: In its standard-setting work, SASB explores six key areas related to Social Capital, including:

- Human rights and community relations
- Access and affordability
- Customer welfare
- Data security and customer privacy
- Fair disclosure and labeling
- Fair marketing and advertising

Of these issues, most tend to have highly industry-specific impacts. For example, “access and affordability” may refer to price changes within a pharmaceutical company’s product portfolio, which have received increasing public and regulatory scrutiny. For a water utility, on the other hand, it may refer to the company’s ability to provide reliable access to affordable water, thus strengthening its ability to structure rates to satisfy long-term infrastructure needs.

Even issues that cut across a variety of sectors and industries—such as data security and customer privacy—often manifest differently from one industry to the next. For example, in the Health Care sector, cyber-risk may involve patient privacy and electronic health records, while for technology and communications firms, it can relate to the hardware and firmware vulnerabilities of new and existing products.

Despite these specific impacts, companies typically report on social factors using vague, boilerplate language (which is of limited use to investors) more frequently than they do with environmental, governance, or other sustainability information.¹²

¹² SASB, *The State of Disclosure 2017* (December 2017).

Appendix B: Participants

Organization	Role
AccountAbility North America LLC	Consulting
Affirmative Investment Management	Investment Professional
Ascent Partners Group Limited	Consulting
Bank of America Merrill Lynch	Investment Professional
BlackRock	Investment Professional
Bloomberg	Sustainability Professional
BSR	Consulting
Calvert Research & Management	Investment Professional
CamberView Partners	Consulting
CBRE	Sustainability Professional
Citi	Sustainability Professional
ClearBridge Investments	Investment Professional
Colcomgroup, Inc.	Consulting
Colgate-Palmolive	Sustainability Professional
CPA Canada	Accounting Professional
Danone	Sustainability Professional
Epoch	Market Participant
Eversource Energy	Sustainability Professional
G&S Business Communications	Consulting
G&S Business Communications	Sustainability Professional
G-III/DKNY	Sustainability Professional
Glass Lewis	Investment Professional
Goldman Sachs	Investment Professional
GRI	Market Participant
Heron Foundation	Investment Professional
Illinois State Treasury	Investment Professional
Illinois State Treasury	Investment Professional
Impactvesting LLC	Market Participant
Independent investor	Market Participant
Independent Investor	Market Participant
Inherent Group	Investment Professional
Jarislowky Fraser	Investment Professional
Johnson & Johnson	Sustainability Professional
Kellogg Company	Sustainability Professional
KKR	Sustainability Professional
Lloyd's Register Quality Assurance	Market Participant
Loomstate	Sustainability Professional

Organization	Role
Macquarie Investment Management	Market Participant
Marquette/ Fund Governance Analytics	Academic
Medtronic PLC	Sustainability Professional
Mitsubishi Corporation (Americas)	Sustainability Professional
Moody's	Market Participant
Moody's Investors Service	Market Participant
Morgan Stanley	Investment Professional
Morningstar, Inc.	Investment Professional
Morrow Sodali	Consulting
Nasdaq	Consulting
Neuberger Berman	Investment Professional
Nielsen	Sustainability Professional
NRG Energy	Sustainability Professional
NYU	Academic
Ontario Teachers' Pension Plan	Investment Professional
Pegasus Capital Advisors, LP	Investment Professional
Perella Weinberg Partners	Investment Professional
PwC	Consulting
PwC	Consulting
Quantifire Limited	Investment Professional
Quetzal Strategy - ESG Advisors	Investment Professional
Sage Advisory Service, Ltd. Co.	Investment Professional
Sage Advisory Services, Ltd. Co.	Investment Professional
Schnitzer Steel Industries, Inc.	Sustainability Professional
Schroders	Investment Professional
Schroders	Investment Professional
Scott Energy Technologies LLC	Investment Professional
State of Rhode Island, Treasury	Investment Professional
Sunset Green Home	Market Participant
Sustainable Insight Capital Management	Investment Professional
Travelers	Legal Professional
TruValue Labs	Market Participant
Verizon	Sustainability Professional
Voya Financial	Sustainability Professional
Wafra Inc.	Investment Professional
WEF	Market Participant
Wells Fargo	Investment Professional

Appendix C: Additional Resources

SASB, “[FSA Credential Level I Study Guide](#),” August 2018.

This study guide offers the historical, legal, and investing context for understanding how materiality is understood in the capital markets and why this is relevant for sustainability accounting. It also explores implications of material sustainability information and outlines considerations for using SASB standards for investors, companies, or consultants.

SASB, “[ESG Integration Insights \(Two Volumes\)](#),” December 2016 and December 2017

These volumes are a compilation of case studies from investors highlighting how they are incorporating ESG factors into investment decision-making. The 12 case studies represent major asset classes (equities, fixed income, private equity), developed and emerging markets, and both active and passive investment strategies.

SASB, “[Legal Roundtable—Emerging Issues Related to Sustainability Disclosure](#),” November 2017.

This paper captures the results of a half-day roundtable discussion among law school professors, lawyers, and corporate governance professionals. The roundtable was designed to surface important and relevant legal questions and uncertainties relating to sustainability disclosures and generate ideas about ways to answer the questions and address the uncertainties in the hope of moving the conversation of corporate sustainability disclosures forward.

Brown, Barbara and Mike Wallace, “[The ESG Ecosystem: Understanding the Dynamics of the Sustainability Ratings & Rankings Landscape](#),” BrownFlynn, February 2018.

This report summarizes the findings of a working group established to focus on environmental, social, and governance (ESG) ratings and rankings. The findings include the high-level results of a survey of 60 corporate practitioners who are responsible for responding to ESG questionnaires or surveys.

Dieschbourg, Michael T. and Andrew P. Nussbaum, “[No Place to Hide Thanks to Morningstar, Bloomberg, MSCI, and Multiple Global Data Providers](#),” Investments and Wealth Monitor, November 2017.

This article provides a high-level overview of various ESG research and ratings providers in use by investors, with a comparison of the features and purpose of each provider.