Investor perspectives on sustainability:
How can companies better engage investors on ESG performance?
Welcome to the webinar

Speakers

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BlackRock

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MSCI

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Corporate Citizenship

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ASSOCIATE DIRECTOR
Corporate Citizenship

How can companies better engage investors on their ESG performance? | 2017
Webinar objectives

1. Better understanding of how investors use ESG information

2. What can companies do about it

3. Evolving investor expectations around ESG disclosure and performance
A few definitions

Socially Responsible Investment (SRI)

ESG

Mainstream Investors

Long-term Value Creation
Verity Chegar
Vice President, ESG Strategist

“The long-term, environmental, social and governance (ESG) issues – ranging from climate change to diversity to board effectiveness – have real and quantifiable financial impacts.

At companies where ESG issues are handled well, they are often a signal of operational excellence.

BlackRock has been undertaking a multi-year effort to integrate ESG considerations into our investment processes, and we expect companies to have strategies to manage these issues.”

Larry Fink, BlackRock CEO Governance Letter to S&P 500 CEOs, February 2016
“It’s challenging to wade through ESG information because much of what is disclosed is not financially relevant. It’s also hard for investors to know what any piece of ESG data means without industry context or rigorous peer benchmarking. That is why we see a great deal of uptake among institutional investors for using ESG ratings in their investment analysis.”

Linda-Eling Lee, Global Head of Research, MSCI’s ESG Research group, Forbes, June 2015
ESG as a Risk Factor

UNDERSTAND EXPOSURE TO LONG-TERM RISK

SYSTEMATIC RISK

WEATHER PATTERNS
WATER SCARCITY
DATA SECURITY
DEMOGRAPHIC SHIFTS

ASSESS MANAGEMENT QUALITY & LIMIT SURPRISES AND EVENT RISKS

ACCIDENTS
SHUTDOWNS
FRAUD
STRIKES

CORPORATE GOVERNANCE: FOUNDATION OF RISK MANAGEMENT

BOARD
PAY
OWNERSHIP & CONTROL
ACCOUNTING

Recent Examples:

Volkswagen
Prior to emissions cheating scandal, flagged on Governance and accounting concerns

Valeant
Downgraded in May '15 on “Very Aggressive” accounting, drug pricing, & product safety concerns

Wells Fargo
Bottom ratings predating the customer account scandal were driven by major governance concerns, complaint data, and product oversight lapses.
### MSCI ESG Rating Model

#### Key Issues

<table>
<thead>
<tr>
<th>ENVIRONMENT PILLAR</th>
<th>SOCIAL PILLAR</th>
<th>GOVERNANCE PILLAR</th>
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<tbody>
<tr>
<td>Climate Change</td>
<td>Human Capital</td>
<td>Corporate Governance</td>
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<td>Natural Capital</td>
<td>Product Liability</td>
<td>Business Ethics</td>
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<td>Pollution &amp; Waste</td>
<td>Product Safety &amp; Quality</td>
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<td>Env. Opportunities</td>
<td>Controversial Sourcing</td>
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<td>Clean Tech</td>
<td>Access to Communication</td>
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<tr>
<td>Toxic Emissions</td>
<td>Board</td>
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<tr>
<td>&amp; Waste</td>
<td>Pay</td>
<td></td>
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<tr>
<td>Clean Tech</td>
<td>Access to Finance</td>
<td>Anti-Competitive Practices</td>
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<td>Packaging Material</td>
<td>Health &amp; Safety</td>
<td>Ownership</td>
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<tr>
<td>&amp; Waste</td>
<td>Chemical Safety</td>
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<td>Green Building</td>
<td>Financial Product Safety</td>
<td>Corruption &amp; Instability</td>
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<td>Renewable Energy</td>
<td>Human Capital Development</td>
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<tr>
<td>Electronic Waste</td>
<td>Financial Product Safety</td>
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<tr>
<td>Renewable Energy</td>
<td>Supply Chain Labor Standards</td>
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<td>Renewable Energy</td>
<td>Privacy &amp; Data Security</td>
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<td>Renewable Energy</td>
<td>Responsible Investment</td>
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<td>Climate Change</td>
<td>Insuring Health &amp; Demographic Risk</td>
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<td>Vulnerability</td>
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#### Three-Step Process

1. Identify Key Issues By Industry
2. Measure Risk Exposure
3. Measure Risk Management

**NEW:**
- Tax Transparency
How does MSCI assign materiality to ESG topics on a sector by sector basis?
# How to Choose?

Which ESG Issues are significant?

<table>
<thead>
<tr>
<th>Category</th>
<th>CARBON EMISSIONS (t CO2e / $M)</th>
<th>WATER STRESS (m³ / $M)</th>
<th>HEALTH &amp; SAFETY (fatalities per 1m workers)</th>
<th>BRIBERY &amp; ETHICS (# of active controversies)</th>
</tr>
</thead>
<tbody>
<tr>
<td>Utilities</td>
<td>1853</td>
<td>79</td>
<td>0.29</td>
<td>53</td>
</tr>
<tr>
<td>Energy</td>
<td>550</td>
<td>26</td>
<td>0.09</td>
<td>42</td>
</tr>
<tr>
<td>Materials</td>
<td>1270</td>
<td>44</td>
<td>0.09</td>
<td>46</td>
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<tr>
<td>Cons. Staples</td>
<td></td>
<td>25</td>
<td>0.09</td>
<td>96</td>
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<tr>
<td>Industrials</td>
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<td>19</td>
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<td>Telecom</td>
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<td>Health Care</td>
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<td>Cons. Disc.</td>
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<td>Info Tech</td>
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<tr>
<td>Financials</td>
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Which Issues Are the Most Significant to the Industry?

**ESG Key Issue Weights Are Based On:**
- Industry’s contribution to externality vs. other industries
- Time horizon of risk factor for that industry

**Weights Set by GICS Sub-Industry**

<table>
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<tr>
<th>Short Term</th>
<th>Medium Term</th>
<th>Long Term</th>
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<tbody>
<tr>
<td><strong>Lowest Weight</strong></td>
<td>Low Contribution to Externality</td>
<td>Moderate Contribution to Externality</td>
</tr>
<tr>
<td><strong>Highest Weight</strong></td>
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Sources: MSCI ESG Research, As of October 2016
What process does MSCI use to rate company ESG performance?
Measuring ESG Risk Exposure

- Type of operations
- Location of operations
- Size of operation, etc

Level of Exposure
- Management Capacity
  - Policies & commitments
  - Programs & initiatives
  - Performance indicators
  - Controversies

EVALUATE MANAGEMENT STRATEGY IN THE CONTEXT OF RISK EXPOSURE
Assessing Risk Management

POLICIES AND OVERSIGHT
ex: Highest Level of Water Oversight

TARGETS AND PROGRAMS
ex: Water Reduction Targets

PERFORMANCE METRICS
ex: Water Withdrawal Intensity

Management data points inform risk mitigation

Company data as of May 2016. Source: MSCI ESG Research
How does MSCI work with companies throughout the year?
**ESG Ratings Data Review process**

- **Quarterly Alert for Pending Update**: all companies whose industry is scheduled for an update in the upcoming quarter are alerted and invited to provide MSCI ESG Research with data updates.

- **Industry Update Engagement Period**: all companies are invited to engage with MSCI ESG Research while analysts are actively updating management assessments for the industry.

- **Data Review Report Available**: a completed data review report (containing all relevant data collected by analysts) is sent to all companies after the industry update period ends, and companies are invited to review and engage with MSCI ESG Research at their convenience.

- **Post-Industry Update Engagement**: all companies are invited to engage with MSCI ESG Research at any time during the year to update data.
Audience Poll
**Poll 1:** Have you incorporated investor views in your company’s materiality assessment process?

- a) Yet to undertake a thorough materiality assessment
- b) Conducted materiality review, without direct investor input
- c) Specifically asked investors/owners as part of the process

**Poll 2:** How would you describe your organization’s engagement with investors on ESG issues?

- a) Only responding to ESG research and rating providers
- b) Also, some engagement, mainly to answer queries
- c) Also, some dialogue, but mostly with specialist SRIs
- d) Proactive engagement with both SRI and mainstream investors
- e) We don’t currently engage with investors on ESG issues
### “Investors don’t care about ESG and long-term”

<table>
<thead>
<tr>
<th>ESG integration among asset managers</th>
<th>Policy instruments related to fiduciary duty</th>
<th>Significant growth in AUM incorporating ESG</th>
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<tbody>
<tr>
<td>Managers’ perceptions of investors’ views on ESG materiality are out of date</td>
<td>Stock exchanges as the conduits between issuers and investors</td>
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- 75% of investment firms agree that good sustainability performance is materially important when making investment decisions.
- Only 60% of managers believe that good sustainability performance is materially important to investors’ investment decisions.
- In the largest 50 economies in the world, PRI identified nearly 300 policy instruments which support investors to consider long-term value drivers, including ESG factors. Over half of these were created between 2013 and 2016.
- Two-thirds of asset managers indicate that they pursue sustainable investing, with 64% believing its adoption will continue to grow.
- US Forum for Sustainable and Responsible Investment, Nov 2016
- Morgan Stanley Institute for Sustainable Investing and Bloomberg, Nov 2016
- PRI, Jan 2017
- Exchanges currently incorporate reporting on ESG information into their listing rules and 16 provide formal guidance to issuers, including the London Stock Exchange. 22 additional stock exchanges have committed to introducing new ESG reporting guidance for their listed companies. Sustainable Stock Exchanges (SEE) Initiative, Report on Progress, Sep 2016
- “Investors don’t care about ESG and long-term”
How can companies better engage investors on their ESG performance?
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Contact us

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