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Governance and Sustainability

ADAPTING TO THE EVOLVING ESG LANDSCAPE

Insights for Business Resiliency

JANUARY 2024

EXCERPT FROM FULL REPORT

Chapter 4

Enhancing Investor ESG Communication and Engagement

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KEY TAKEAWAYS

Over the last 12 months, the surge in ESG politicization had minimal impact on corporate issuers' and investors' approach to the topic. One in 10 investor respondents (21% in Europe) has increased their dollar allocation to ESG funds.

01

ESG disclosure regulations continue to proliferate domestically and internationally, creating an imperative for strong sustainability data collection procedures and controls that can be assured. One in three investors find external assurance of ESG metrics important to their investment decision.

02

Clear communication of ESG's integration into company strategy can shape investor perception of the company's investment thesis, affecting its perceived risk and value.

03

Investors want to see ESG information analogous to traditional financial reporting—quantifiable metrics and targets, their impact on financial performance and company outlook, and a roadmap to achieve long-term targets.

04

INTRODUCTION

As investors and businesses increasingly prioritize ESG issues, a glut of commentary by media, politicians, and activists has followed. In a saturated landscape, it is difficult to discern meaningful trends from unduly amplified voices. To understand and evaluate evolving investor perceptions on ESG, Rivel interviewed 63 investors across North America and Europe for its third annual study. At the same time, Rivel surveyed 158 North American corporate issuer respondents representing a range of market caps and industries on similar topics to identify gaps and areas of alignment and understand how issuers are navigating the changing ESG landscape.

This year's report highlights how ESG information is used by investors to both accurately understand a company's risks and correctly assess its opportunities. Corporate issuers, responding to this demand, are not only disclosing more information, but beginning to assemble robust reporting controls around ESG data. This report examines findings from both investors and issuers on the following topics:

Navigating a polarized ESG landscape

Understanding the regulatory environment

Optimizing ESG strategy and risk management

Enhancing investor ESG communication and engagement

04

Bridging the Communications Gap

Investors crave decision-useful, comparable information about a company's sustainability initiatives and performance. More than two-thirds (71%) of investor respondents note they use ESG information throughout the analytic process. This represents a substantial increase from last year's survey, demonstrating a shift from their historic use as a secondary screen after financial fundamentals. As one North American buy-side analyst explained, *"It's part of the initial idea generation and it's throughout our holding we're looking at a company. It's not behind or separate from financial analysis."*

When ESG is Integrated into Company Evaluation

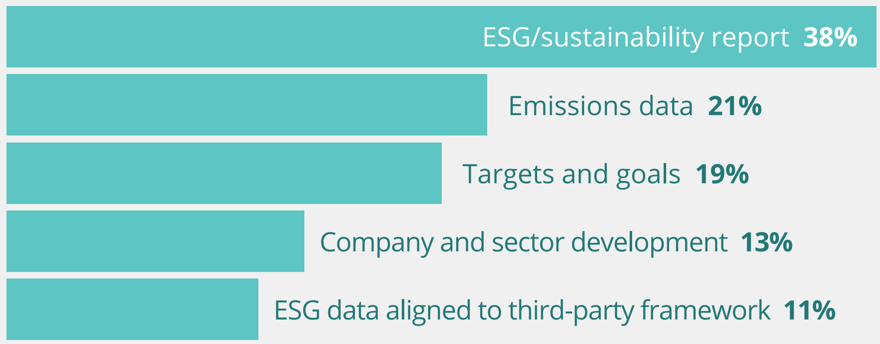
	2023	2022
Throughout the analytic process	71%	57%
During the preliminary company analysis	8%	8%
During the secondary screen after reviewing financial fundamentals	9%	23%

N=63 Investor Respondents, 2022 N=53 Investor Respondents

Investor respondents highlight a company's ESG or sustainability report as the most useful source for evaluating ESG risks and opportunities (38%). Understanding metrics, targets, and goals are also priorities, aligned with sentiment expressed in other areas around strategy and goals. These are important building blocks of a decision-useful narrative for a company's sustainability report.

Inclusion of comparative data, in particular, can support clear communication, as noted by one North American portfolio manager who remarked, *"The ratios, year over year. That's the most effective way for us to track down how they're doing and how they change those metrics. When they present the information on a comparative basis year over year." Another affirmed, "Explainable paths toward decarbonization, beyond just a number. Actual performance to date since targets have been set. Potential impediments to achieving these. More social impact initiatives at the companies."*

Most Useful Company Provided Information to Evaluate ESG Risks and Opportunities (Unaided)

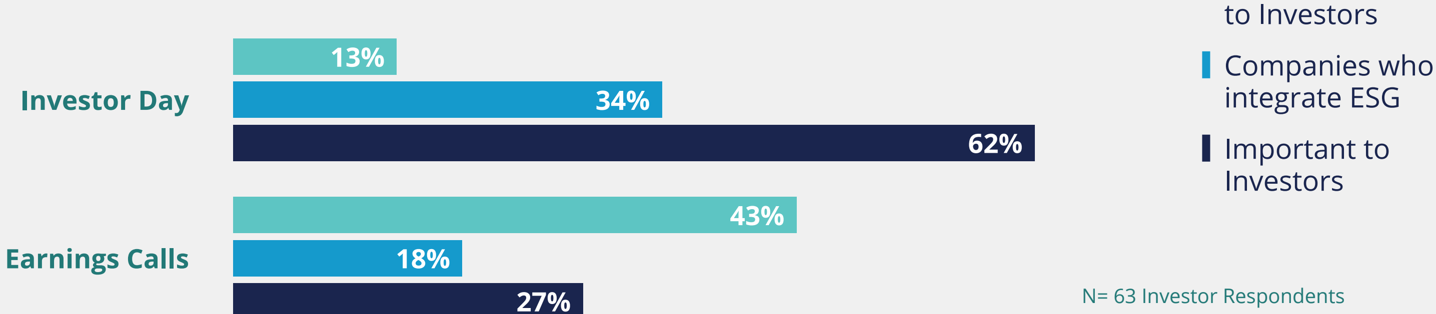


N= 63 Investor Respondents

In addition to insights gathered from an ESG report, a majority of investor respondents (62%) recognize a company's Investor Day as an important opportunity to discuss ESG. In contrast, only 34% of corporate issuer respondents indicated their companies either fully or mostly integrate ESG into Investor Days. Investors want to hear about ESG strategy, goals and metrics in the context of the long-term operational strategy. As companies prepare for upcoming Investor Days, they should consider embedding elements of their ESG story into an authentic storytelling narrative.

"We're looking for their ESG risks and opportunities to be integrated into their corporate strategy, so we're looking at that in terms of the narrative they provide on calls. We're looking at it in how they integrate it into their overall documents. We're obviously also looking at their corporate sustainability report, and we're looking at other voluntary reports that they create, such as disclosures to carbon disclosure project and others." Stewardship Team Member, North America

ESG in Investor Events



N= 63 Investor Respondents
N= 158 Corporate Issuer Respondents

Effectively communicating an ESG story can make an impact on how risky or how valuable an investment thesis is viewed. Sixty-five percent (65%) of investor respondents said they incorporate climate change risks into all models, even non-ESG funds. Yet only 14% of investors said that climate information currently disclosed by companies is useful to their ability to confidently analyze their climate risk and opportunities. Effectively communicating climate risk resiliency can have a real impact on investment decision-making.

> *Adjusted forecasted cash flow. Just to be clear on the cash flow, it [climate risk] is considered into the cost side of their income statement. It's a little bit more explicit.*
>
> –Buy-side analyst, North America

Climate risk is most commonly considered in qualitative analysis, but it also has implications on traditional financial modeling components, such as impacting forecasted cash flows of the company or influencing its growth rate. Effectively communicating how climate risk is embedded in the company's risk management process should be viewed as a tool to link the impact of climate change to financial drivers.

CLIMATE RISK INTEGRATION INTO FINANCIAL MODELING*

88%

Qualitative competitive analysis

51%

Criteria in weighting/portfolio construction

46%

Adjusts forecasted cash flow

44%

Growth rate modifier

34%

Discount rate modifier

32%

Basis for exclusion

*N = 63 Investor Respondents

Communicating ESG Goals

What gets measured matters. Investors want to understand how companies are managing and performing in operationally important non-financial areas. As one North American buy-side analyst said, *"To narrow down the answer [about what is the most useful company-provided information], quantitative data, forward-looking targets, goals, what the company wants to achieve and how it ties into the overall corporate strategy."*

Companies, in turn, are setting quantitative, timebound ESG goals that are relevant for their organizations. Fifty-seven percent (57%) of corporate issuer respondents have ESG goals, while 18% have yet to establish goals but plan to in the future.

Similar to other company goals, ESG goals should be directly tied to the company's corporate strategy and ESG strategy. While it may be tempting to mirror what is seen in headlines, such as setting a net-zero target, companies should fully understand the implications of their ESG goals before making a public commitment. For example, 56% of investor respondents think it is important for a company to adopt GHG emissions reduction targets, but during interviews, many cautioned that this would be heavily dependent on the company's industry. As one North American buy-side analyst opined, *"It's dependent on the company, what sector they're in. A technology company, it's a little bit less important for them to set the carbonization target versus an energy company, a company in food and agriculture, an industrials company, because their footprint is so much less."*

Timebound, Quantitative ESG Goals

50% of issuer respondents have external ESG goals

7% have only internal goals

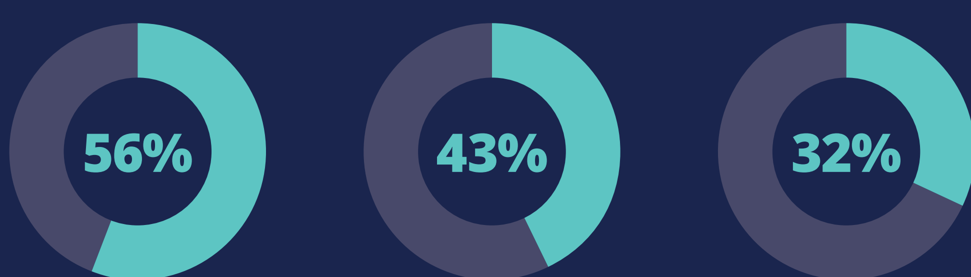
21% of issuer respondents don't have goals or plans to set them

18% don't have goals but plan to set them in the next 6 months

N= 158 Corporate Issuer Respondents

Only 32% of investor respondents believe adopting a net-zero commitment is important for companies to make, further reinforcing the idea that a one-size-fits-most approach does not work for ESG goal setting.

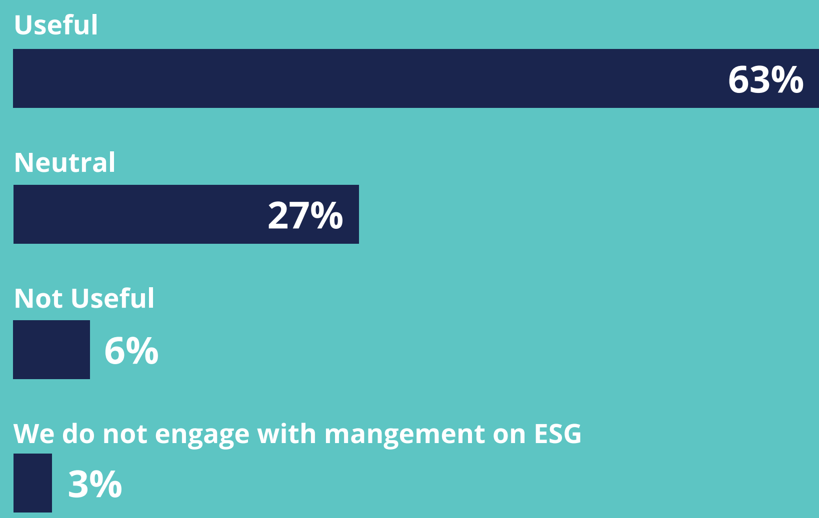
Climate Targets Investors Believe are Important



Adopt greenhouse gas emissions reduction targets | Adopt science-based targets | Net-zero commitment

N= 63 Investor Respondents

Usefulness of Engagements with Management Team to Understand ESG Risks and Opportunities



N= 63 Investor Respondents

Investor Engagement

While direct investor engagement on sustainability topics can feel cumbersome, it is well worth the time. Sixty-three percent (63%) of investor respondents find engagement with the management team useful to help them understand ESG risks and opportunities.

Even though coordinated engagements with the management team can feel daunting, this direct interaction helps investors better understand the company's unique ESG risks and opportunities. Thirty-nine percent (39%) of corporate issuer respondents find a lack of investor knowledge or a focus on immaterial factors to be the biggest pitfall of engagement on ESG on a top-of-mind basis. This was more likely to be cited by mid-caps (52%) then large- (38%) or small-cap (22%) companies. Varying expectations and priorities is another area that issuer respondents view as a common pitfall.

> *The conversations [with management] are almost always more useful than reading the reports. Things aren't always as clear, the presentation of information is fluffier than reality, you can get into some of the more nitty-gritty information in terms of investments that the company is making, things of that nature.*
>
> –Buy-side analyst, North America

BOARD SPOTLIGHT: Directors and ESG Education

Many boards of directors continue to seek ways to enhance their understanding of ESG priorities and their impact on the company's operations. In fact, according to a 2023 National Association of Corporate Directors (NACD) survey, 58% of directors indicated ESG issues have increased in priority with 62% believing ESG programs create long-term value within their organizations.

To keep directors updated on the latest ESG trends and company-relevant areas of risk or opportunity, 62% of corporate issuer respondents say they provide ESG education sessions to the board. Of those, 13% provide sessions to the full board only, while 32% present to the full board and the committee(s) with ESG oversight. The most common committee receiving education sessions is the Nominating and Governance Committee (82%) while the least common board committee is the Compensation Committee (23%). Surprisingly, 30% of issuer respondents providing ESG education sessions to the board provide it to their Audit Committee. This will likely change as audit becomes more involved in ESG regulatory compliance.

Thirty-one percent (31%) of issuer respondents providing ESG education sessions do so at least once per year with the same amount providing them up to three times per year. Only 17% of issuer respondents provide education at each board meeting.

ESG skills among directors have been a topic of focus for many investors as they look to ensure that all relevant risks and opportunities, including those that are non-financial in nature, receive effective board oversight. *"ESG training seems like it would be pretty important. The onus of this falls on the board and I would think that every board member, but especially those that are focused on committees that relate to ESG, would want to go through some type of training just to understand where the industry is at and how it is evolving,"* stated one North American portfolio manager.

SKILLS THAT DEMONSTRATE BOARD MEMBER ESG COMPETENCY TO INVESTORS*

46%
Environmental, Health and Safety experience

46%
sitting on a company board that has an advanced ESG program

35%
ESG board certification or training courses

19%
Educational background

19%
HR experience

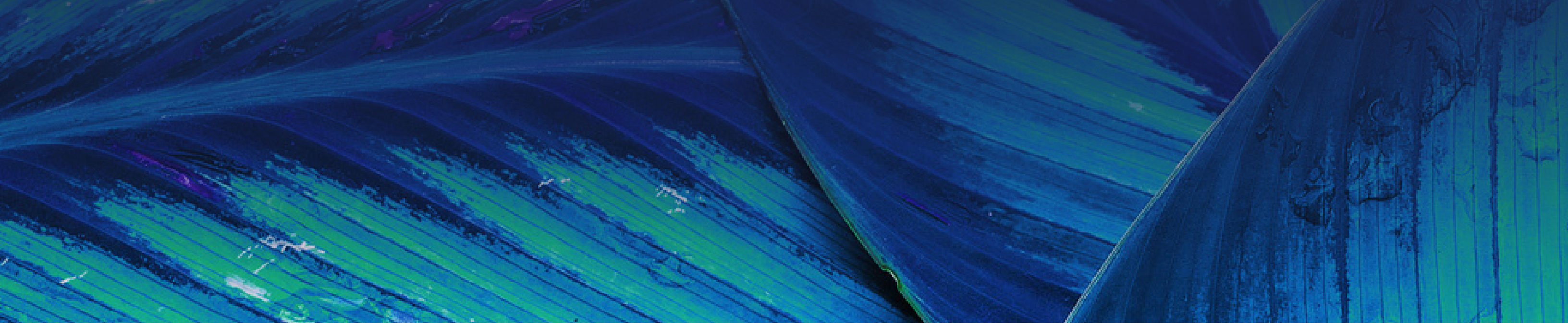
*multiple answers accepted
N=63 Investors

CONCLUSION

Amid persisting uncertainty across the ESG landscape, the pressing need for companies to consider and integrate ESG into their corporate strategy has never been more certain. With disclosure requirements entering into effect and investors—among other key stakeholders—calling for informed action, alignment of sustainability and corporate goals is a business imperative.

While the first companies to be regulated are cautiously navigating the transition, the rest of the business community is watching closely. Regardless of polarized political views, the impact of regulatory changes, or the specific ESG implementation strategies, business resiliency hinges on a company's ability to accurately assess and communicate its climate risks and opportunities.

Rivel's third annual study of investor attitudes and corporate issuer practices highlights actionable perspectives for an informed ESG transition. Insights relating to setting effective goals, leveraging internal audits, and educating management and boards to oversee and confidently discuss ESG issues can guide the strategic allocation of resources right now, as the ESG landscape continues to take shape.



Survey Methodology

This paper integrates survey data from two comprehensive studies completed by Rivel during the latter half of 2023. The studies were designed to provide a comparative framework of ESG attitudes and practices between issuers and institutional investors and deliver research-based insight to help guide corporate strategy in this evolving domain.

The first study was conducted online among a representative, randomly selected sample of 158 North American issuers. It is an exhaustive examination of corporate ESG policy, practice and structure. The second study is highly focused on North American and European institutional investors' ESG investment criteria and expectations. It is predicated on 63 in-depth telephone interviews among a broad, purposive sample of buy-side investment professionals of which 95% are predominantly active managers. Telephone interviewing, conducted by Rivel's elite cadre of executive interviewers, was chosen to ensure accuracy of respondent selection as well as to afford investors the opportunity to expound on their views and evaluations in open-ended discussion.

When examining meaningful differences among corporate issuer participants according to the size of their company, they are segmented into three groups by market capitalization: Large-cap ($10B+), Mid-cap ($2B-$9.9B), and Small-cap (<$2B). Due to questions where multiple responses are acceptable and/or computer rounding of data, percentages may not always add to 100%.

ABOUT RIVEL, INC.

Since 1991, Rivel has been advising management teams and boards on how aligning attitudes and behaviors of key stakeholders can make the difference between success and failure in their business. Rivel works with two-thirds of the S&P 100 and over half of the S&P 500, and companies across six continents.

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Investor presentations and investor day messaging and design

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Investor communications best practices and advisory

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ESG consulting, corporate governance advisory and Board evaluations

CXLign Banking

Research conducted among bank customers and prospects

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- Full suite of design and content copywriting and creation services
- Global regulatory landscape readiness assessment and guidance
- ESG investor perception studies
- TCFD and climate risk mapping

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For more information, please contact the Governance and Sustainability team.