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Governance and Sustainability

ADAPTING TO THE EVOLVING ESG LANDSCAPE

Insights for Business Resiliency

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EXCERPT FROM FULL REPORT

Chapter 3

Optimizing ESG Strategy and Risk Management

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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

03

Optimizing ESG Strategy and Risk Management

Taken at face value, sustainability considerations, such as developing an engaged workforce, reducing energy use, and upholding strong ethics and governance practices, build efficiencies, reduce costs, enhance productivity, and conserve resources—all of which directly impact traditional financial and operational drivers. Despite this connection to business fundamentals, many corporate issuers struggle to meaningfully link their ESG strategy to their broader company strategy. Not surprisingly, investors appear to be in a similar quandary.

Thirty percent (30%) of corporate respondents believe their company effectively integrates ESG into their long-term strategy while a mere 11% of investors shared the same sentiment.

> *"I believe our ESG Report is strong, but [we] could do a better job within normal communications on how ESG correlates with our strategy."*
>
> –Sustainability Manager, Mid-cap

Effectiveness at Integrating ESG into Long-term Strategy

	EFFECTIVE	NEUTRAL	INEFFECTIVE
Corporate Respondent View	30%	50%	17%
Investor View	11%	71%	16%

N=158 Corporate Respondents Uncertain not shown, N=63 Investor Respondents

This uncertainty between corporate and investor views is likely due to the lack of comparable and comprehensive ESG disclosures—an area that regulators and standard setters aim to address. Similar to traditional information used by capital markets, when it comes to ESG, investors want to see quantifiable metrics and targets, their impact on financial performance and company outlook, and a roadmap to achieve long-term targets.

Areas Companies Fail to Communicate about ESG Practices

Quantifiable metrics and targets	19%
Human capital	16%
Impact to financial performance/outlook	11%
Roadmap to achieve long-term targets	10%
Carbon emissions	8%

N=63 Investor Respondents

Despite the old adage, "what's measured gets managed," measuring ESG metrics without an accompanying strategy deprives companies of the opportunity to demonstrate how ESG drives resiliency and fosters long-term financial performance.

Materiality assessments can be an effective tool to pressure test the external understanding and effectiveness of a company's ESG strategy and to help ensure that a strategy is attuned to stakeholder expectations. Investors recognize the importance of assessing ESG strategy with almost one in two (48%) agreeing that conducting a materiality assessment is important.

48%

of investor respondents say it is important for companies to conduct a materiality assessment.

The majority of ESG strategies that I see are generally very big, broad statements and include mission statements and all that sort of stuff. In reality, there's often very little discussion about how it works on a practical basis and how it's actually woven in the workplace.

–Portfolio Manager, Europe

Quantitative measurements. A lot of ESG reports have a lot of fluff stuff and while it's good that they're putting stuff out there, in order for us to judge how well they're doing, it would be helpful to have more qualitative measurements.

–Buy-side analyst, North America

The Evolution of ESG and ERM

As ESG is further ingrained in organizations, it is becoming standard practice to incorporate ESG risks much like other enterprise risks. In fact, 72% of issuer respondents note that ESG risks are considered in their companies' enterprise risk management (ERM) framework. The majority of issuer respondents integrate ESG into risks that are already managed through their routine ERM process. This could take the form of weather-related impacts in assessing operational resiliency or turnover rate when discussing strategic risks. The approach enables companies to clearly connect ESG to business risk, translating ESG risks into strategic initiatives and resiliency.

While ESG's integration into ERM is becoming the norm, there is a lack of consensus around how the ERM team effectively collects this information. Almost one-third of issuer respondents noted they use internal committees or cross-functional collaboration to identify and collect ESG risks, while even fewer used internal stakeholder surveys or interviews. Nearly one in five relied on their sustainability or ESG team to identify risks. Regardless of the method used, companies should ensure ESG is considered within their ERM framework.

HOW ESG IS INTEGRATED INTO A COMPANY'S ERM PROGRAM

43%

Considered as a driver of various individual risks that are managed throughout the organization

17%

Each component of ESG is considered as a standalone risk (e.g., a risk for E, S & G)

9%

ESG is categorized as a standalone risk

13%

We don't have a formal ERM process

N= 158 Corporate Issuer Respondents

> *Each enterprise risk has a risk owner who has oversight of the areas of the company impacted by that specific risk. The ERM team collects updated information on these risks from each risk owner and levels of risk are assessed by a corporate risk committee.*
>
> –Vice President, Investor Relations and Communications, Large-cap

> *The ESG team is considered an independent risk owner team in the ERM process, and the ESG team also collaborates with other risk owner teams across the business to integrate ESG manifestations and mitigations into other teams' risks.*
>
> –Senior Associate General Counsel, Mega-cap

The Rise and Impact of Audit on ESG Disclosure

Regulatory statutes reinforce the need for companies to develop sound procedures and controls for non-financial reporting. Just under half of issuer respondents (48%) admitted to managing their ESG data internally—likely by Excel spreadsheet—while only 25% use an external platform.

As companies establish more sophisticated controls around ESG metrics, many are turning to internal audit to help improve data accuracy and increase reporting confidence. Almost 50% of issuer respondents confirmed internal auditing of their publicly disclosed ESG metrics, with large-cap companies three times more likely to have internal audit involved than small-cap companies.

Internal Audit of ESG Metrics

15%	Yes, all ESG metrics
31%	Yes, some ESG metrics
22%	No, but we plan to in the next 1-2 years
21%	No

N=158 Corporate Issuer Respondents

HOW COMPANIES MANAGE ESG DATA

48%
Internally manage (e.g., Excel)

25%
Use an external platform

13%
Internally built, non-Excel management tool

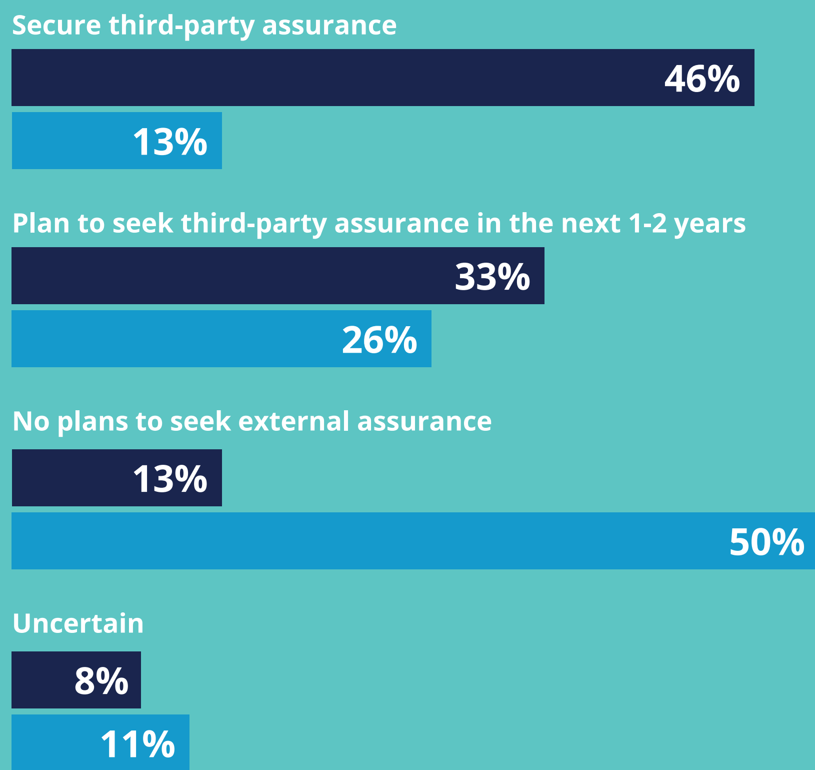
N=158 Corporate Issuer Respondents

The involvement of internal audit varies, with 42% of issuer respondents that involve internal audit stating their team verifies calculations. Even fewer respondents noted that their audit teams evaluate data sources, with others reviewing the data collection process, and some merely spot-checking data. The inclusion of these core components of a financial audit are critical as companies prepare for external assurance, which many impending global regulations require.

Among companies indicated as disclosing ESG metrics that have been internally audited, additional third-party assurance is secured far more often for environmental (46%) than social (13%) metrics such as human capital and turnover. Large-cap companies are three times as likely to have their environmental metrics assured than mid- or small-cap companies.

How Companies Approach Third-Party ESG Metric Assurance

Environmental Metrics
Social Metrics



N= 72 Corporate Issuer Respondents

While external assurance is and will continue to be important from a regulatory perspective, one in three (33%) investor respondents state that external assurance of ESG metrics is important to their investment decisions. European investors (50%) are almost twice as likely to find external assurance important to their investment decisions than their North American (29%) counterparts.

> *It's meaningful. It's not the most important thing, but it is always very useful in the sense that it sets context.*
>
> –Buy-side analyst, North America

One in three investors find external assurance of ESG metrics important to their investment decision.

THIRD-PARTY ESG INFORMATION REQUESTS

85%
Rating agencies (e.g., MSCI, ISS)

54%
Investor-specific surveys (e.g., surveys from individual investors)

46%
ESG indices

20%
Investor coalitions (e.g., Workforce Disclosure Initiative, etc.)

16%
Data providers (e.g., ESG Book)

N=158 Issuer Respondents

Allocating Resources to ESG Data Requests

In 2023, an increased investment focus on ESG factors led to a proliferation of ESG data requests. These requests come to issuers in all formats, from large Excel spreadsheets to long third-party questionnaires.

While ESG rating agencies are the most common request received by issuer respondents, over half (54%) note they dedicate time to completing individual investor surveys. Small-cap company respondents (30%) were half as likely to respond to ESG indices and investor coalitions as large-cap survey participants' companies (57%).

Data requests also come from customers, with 11% of issuer respondents receiving requests to participate in ESG supplier surveys such as Ecovadis. While this number may be low in 2023, companies should anticipate increased customer demand for ESG information as global regulations go into effect.

> *We determine which ESG data requests to respond to based on how impactful they are with our investors and prospective investors. Our decision is also based on the complexity of the request and the impact on available resources required to respond.*
>
> –Vice President, Investor Relations and Communications, Large-cap

Given the limited corporate resources dedicated to ESG, issuers need to be prudent about which inquiries they respond to and which they decline. Issuers already think strategically about when and how to respond: Most often, they evaluate the impact and relevance of the data request before responding, with many also noting that the source and time commitment influences their decision to participate.

One mid-cap Senior Board Liaison and Subsidiary Compliance Officer acknowledged their company, *"determine[s] if there is a benefit to us, our shareholders, or our customers by participating."* While another mid-cap Sustainability Manager evaluates, *"It's visibility, which stakeholders are requesting, if our peers are also participating."*

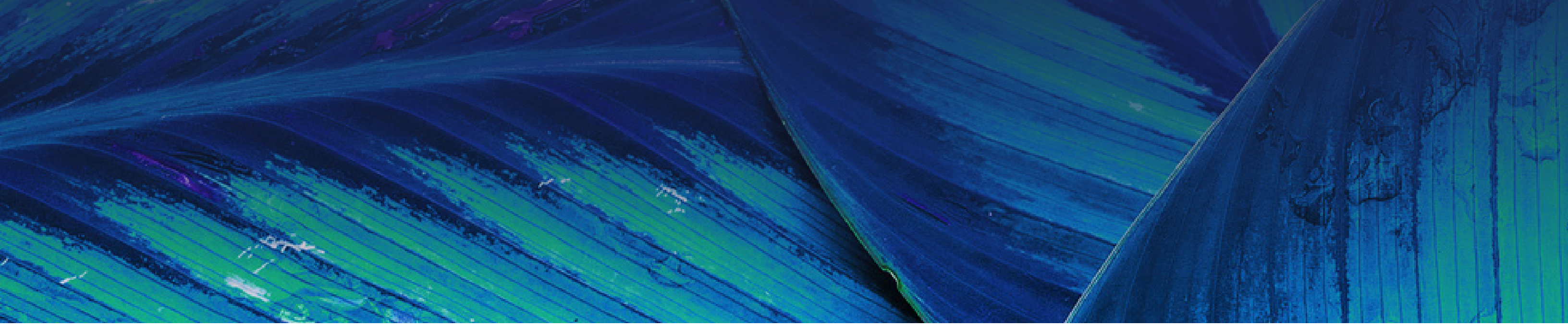
For companies seeking a strategic approach, they should consider developing a hierarchy of responses or employing a classic decision tree to identify which surveys are opportunities for clarity and which are more effort than they are worth.

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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