Perspectives on Environmental, Social, and Governance

What Boards and Management Should Know about ESG

Presentation to Central Pennsylvania FEI
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KPMG Board Leadership Center
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Stephen L. Brown

— Globally recognized thought leader and trusted adviser to corporate boards and C-suites
— Advises on high-stakes Environmental, Social, and Governance (ESG) and bespoke corporate governance matters
— Extensive experience as a corporate securities lawyer, corporate governance stewardship leader of a major institutional investor, CEO of a distinguished corporate governance association, and investment banker
— Adjunct professor at McDonough School of Business at Georgetown, Yale, and in the Skadden, Arps Honors Program in Legal Studies, and Colin Powell School for Civic and Global Leadership at City College of New York
— BA, Yale University; JD, Columbia Law School
“The thing about ESG is that it can be subjective, it’s forward-looking, involves considerable judgment… and it impacts everything.”
Agenda

- Defining ESG and how to think about it
- Current ESG landscape
- Framework for ESG oversight
- Q & A
Defining ESG and how to think about it
ESG: What’s in a name?

— Variety of definitions
— Range of ESG “IQ’s”
— Regulation uncertainty in the U.S., but growing consensus globally
— Deep stakeholder interests and “private ordering”
— Reporting “requirements” and demands are vast and expansive
— Some fatigue over the “Alphabet Soup” of reporting frameworks
CPE knowledge check-in #1

1) “ESG” stands for what?

   a) Energy, Science, Governance
   b) Environment, Social, Governance
   c) Environment, Science, Government
Focus on ESG has been accelerated

Laws & Regulation

Market

Culture & Current Events

Intense focus on ESG
The “Alphabet Soup” of reporting standards/frameworks

- **IIRC**
  - International Integrated Reporting Council, a global coalition of regulators, investors, companies, standard setters, the accounting profession, and NGOs.
  - Its mission is to establish integrated reporting and thinking within mainstream business practices.

- **CDSB**
  - Climate Disclosure Standards Board; seeks to standardize environmental information reporting through collaboration and by coalescing around the most widely shared and tested reporting approaches that are emerging around the world. The framework adopts relevant principles from existing standards and practices with which the business is already familiar.

- **SASB**
  - Sustainability Accounting Standards Board; standards cover 77 different industries.
  - Independent standards board that has developed a set of globally applicable sustainability accounting standards.

- **TCFD**
  - Task Force on Climate-related Financial Disclosures; TCFD framework focuses on governance, strategy, risk management, metrics, and targets.
  - Financial Stability Board’s recommendations for voluntary and consistent climate-related financial risk disclosures to investors and stakeholders.

- **GRI**
  - Global Reporting Initiative; first global standard for sustainability reporting.
  - A leading practice for reporting on a range of economic, environmental, and social impact.
ESG: Three considerations to thrive as a going concern

- **Profit**
- **Externalities**
- **Social license**
Current ESG landscape
Breadth of ESG

Environmental

- Climate change risks
- Energy efficiency strategy and carbon management
- Emission to air, land, and water
- Energy consumption
- Water use
- Use of raw materials
- Use of scarce resources
- Sourcing practices such as the use of responsibly sourced materials
- Management of waste and recycling
- Impacts on ecosystems and biodiversity
- Exposure to extreme weather
- Readiness to respond to changing regulations on environmental performance

Social

- Diversity, equity and inclusion
- Employee demographics
- Employee attraction/retention records
- Human rights risks
- Supply chain risks
- Product safety records
- Labor relationships
- Worker safety
- Mental health
- Artificial intelligence ethics
- Protection of customers’ data and compliance with privacy laws

Governance

- Shareholder rights and voting structure
- Capital structure issues (share repurchases, dividends)
- Political contributions, lobby efforts, expenditures
- Board succession planning
- Executive remuneration and demographics
- Board demographics
- Pay equity issues
- Anti-competitive behavior
- Bribery, corruption, and responsible tax record
ESG is increasing in priority for institutional investors

As we recover from COVID-19:

Of U.S. investors expect their firm to increase prioritization of ESG as an investment criteria
96%
91% of 6-Market Global Average

&

Of U.S. investors expect the companies they invest in to increase their prioritization of ESG initiatives
93%
88% of 6-Market Global Average

Source: Edelman Trust Barometer Special Report: Institutional Investors
Many institutional investors have already embraced ESG

<table>
<thead>
<tr>
<th>Percentage</th>
<th>Description</th>
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<tbody>
<tr>
<td>86%</td>
<td>of EMEA respondents have stated that sustainable investing is already—or will become—central to their investment strategies</td>
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<tr>
<td>x2</td>
<td>Respondents plan to double their sustainable assets under management in the next five years</td>
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<tr>
<td>53%</td>
<td>cited the poor quality or availability of ESG data and analytics as the biggest barrier to deeper or broader implementation of sustainable investing</td>
</tr>
<tr>
<td>88%</td>
<td>ranked environment as the highest priority</td>
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<tr>
<td>75%</td>
<td>are currently or considering integrating ESG into their investment decisions</td>
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Sustainable fixed income and alternative asset classes set to grow

Source: BlackRock 2020 Global Client Sustainable Investing Survey
Investors expect board engagement on ESG issues

Which leaders are being engaged on ESG by investors

<table>
<thead>
<tr>
<th>Leader</th>
<th>Percentage of U.S. investors surveyed</th>
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<tbody>
<tr>
<td>Board of directors</td>
<td>52%</td>
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<tr>
<td>Investor relations officer</td>
<td>42%</td>
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<tr>
<td>Head of ESG/sustainability</td>
<td>41%</td>
</tr>
<tr>
<td>C-suite/company management</td>
<td>37%</td>
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<tr>
<td>General counsel/corporate secretary</td>
<td>36%</td>
</tr>
<tr>
<td>Legal officer/counsel</td>
<td>33%</td>
</tr>
<tr>
<td>Communications officer</td>
<td>32%</td>
</tr>
<tr>
<td>I do not engage with companies on ESG issues</td>
<td>3%</td>
</tr>
</tbody>
</table>

99% of investors expect the board of directors to oversee at least one ESG topic.

Source: Edelman Trust Barometer Special Report: Institutional Investors
Boards are expected to oversee climate risk

Investors expect the board to oversee at least one environmental issue (72%)

Source: Edelman Trust Barometer Special Report: Institutional Investors
The challenge: Directors are perceived as having weak ESG credentials.

Source: NYU Stern Center for Sustainable Business, survey of credentials of 1,188 board members of Fortune 100 companies
CPE knowledge check-in #2

2) Which one is a private sector ESG standard setter/governance standard setting body?
   a) SEC
   b) PCAOB
   c) SASB
   d) ESPN
Framework for board oversight
Framework for board oversight of ESG

**Level setting**
Agree on definition of ESG and its importance to the company.

**Assessment**
Determine which ESG risks and opportunities are of strategic significance to the company.

**Board oversight**
Ensure that the board has the right composition, structure, and processes to oversee ESG in the context of strategy and long-term value creation.

**Stakeholder communications**
Shape the company’s key ESG messages to investors and other stakeholders in the context of strategy and long-term value creation.

**Integration**
Encourage integration of strategically significant ESG issues into the business.

Framework developed by the KPMG Board Leadership Center in collaboration with Professor George Serafeim of Harvard Business School.
3 areas involving ESG impact on your operations
ESG: Three considerations to thrive as a going concern

Considerations
- Profit
- Externalities
- Social license

Parallel Paths
- Long-term shareholder value creation
- CSR
Additional insights

**ESG, strategy and the long view**

**The ESG journey: Lessons from the boardroom and C-suite**
CPE knowledge check-in #3

3) True or false: ESG is being pushed only by regulators?

a) True

b) False

c) Don’t Know
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