NationSwell Trend Report
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The state of play: ESG in 2022

NATION SWELL

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> ESG can retain the attention it has garnered over the past two years if companies and investors better match their public commitments with operational rigor. Skeptics will undoubtedly remain, but ESG can become a powerful force for change if stakeholders make it so.

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Definitions

Clarifying our terms

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ENVIRONMENTAL, SOCIAL, AND GOVERNANCE (ESG)

ESG describes an array of non-financial factors that investors, regulators, and other stakeholders use to evaluate the performance of companies. The growing popularity of ESG-motivated investing is contributing to more transparent and rigorous corporate reporting practices as well as operational changes aligned with improved social and environmental impact. ESG factors are increasingly understood as interconnected with–rather than distinct from–the financial performance and value of a company.

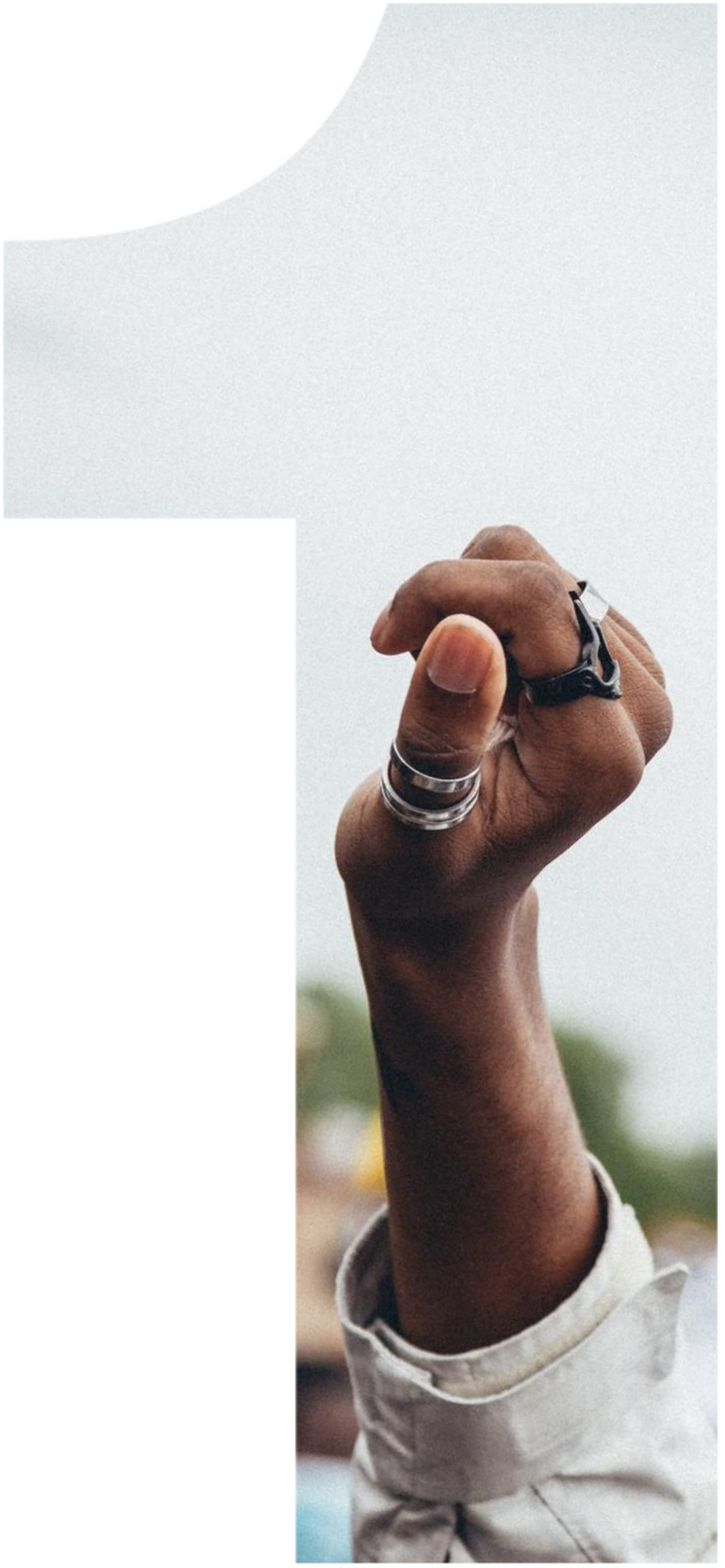
Trends and pulse checks

Understanding where the market is heading and diagnosing your preparedness

TREND ONE

Social issues are at once more fragmented and more important to the general public than climate concerns.

As companies concentrate their climate commitments around carbon neutrality and net zero, the public is likely to become even less forgiving of those that perform poorly on social factors.



Growing yet fragmented pressure points on social factors

Public interest focused heavily on workers over environment

- In a 2021 opinion survey of the general public, 5 of the top 10 issues Americans say corporations should focus on relate to workforce issues, while just one relates to the environment (JUST Capital)
- Just 2% of Americans identify climate change as the most important issue facing America today, fewer than those who identify racism (5%), immigration (5%), and inflation (17%) among other social and economic issues (Gallup)
- Unionization drives at companies like Starbucks, REI, Amazon, and Apple point toward a growing trend particularly in the retail sector (Business Insider)

Mounting concern over social risks of climate action

- Current economic conditions–including inflation and higher energy costs– will sharpen the focus on the economic impacts of governmental and corporate climate action (S&P Global)
- Companies will specifically be called to balance actions taken on the "E" with the "S" when implementing climate transition plans to account for impacts on developing nations and vulnerable domestic populations (S&P Global)
- Particular concerns include access to affordable critical services and the availability of good paying jobs (S&P Global)

Political environment creates social challenges for companies

- 87% of Government Relations executives and corporate PAC managers anticipate the overall environment for corporate political activity to be at least as challenging in 2022 as it was in 2021 (The Conference Board)
- The frequent emergence of new social/political issues on which companies face pressure to take a stance is likely to persist as a key challenge for corporations in 2022 and beyond (The Conference Board)

How we're doing: Social factors

	YES	NO, BUT WE HAVE A PLAN	NO
We have deep conversation with stakeholders at all levels of the organization about designing a future workplace that helps our employees thrive			
We take an interdisciplinary approach to understanding the relationship between environmental and social factors			
Our organization has a strategy for advancing and upholding democratic principles during the next election cycle			

TREND TWO

Dozens of ESG reporting frameworks and regulatory standards exist in jurisdictions around the globe.

Efforts are underway to consolidate and simplify those frameworks for the sake of consistent and universal reporting requirements.

Cautious optimism for progress on ESG reporting

ISSB starts its work, but big questions loom about adoption in the U.S.

- The IFRS Foundation announced the formation of the International Sustainability Standards Board (ISSB) on November 3, 2021 at COP26 in Glasgow, with the intention of building on the work of existing investor-focused reporting initiatives to become the global standard-setter for sustainability disclosures for the financial markets (IFRS)
- The IFRS Foundation's ambition is for the ISSB's disclosure standards on sustainability to be adopted by most countries over the next few years (CFO)
- Even if the U.S. does not follow other jurisdictions in adopting ISSB standards, U.S. companies that do significant business in Europe or Asia will likely have to comply with the sustainability disclosure standards of the countries in those regions (CFO)

New efforts emerge to standardize reporting in private markets, too

- Formed in September 2021, the ESG Data Convergence Project is one of several efforts designed to simplify data collection and reporting standards in private markets (ILPA)
- Their stated objective is "to streamline the private investment industry's historically fragmented approach to collecting and reporting ESG data in order to create a critical mass of meaningful, performance-based, comparable ESG data from private companies" (ILPA)
- The Project's participating LPs and GPs have initially agreed to report on a core set of ESG metrics across six categories and drawn from existing frameworks (ILPA)
- The six categories of metrics include greenhouse gas emissions, renewable energy, board diversity, work-related injuries, net new hires, and employee engagement (ILPA)
- The group plans to meet annually to assess the prior year's data, and to refine and build on the initial metrics, prioritizing materiality (ILPA)

PULSE CHECK

How we're doing: ESG reporting

	YES	NO, BUT WE HAVE A PLAN	NO
We have processes and systems for gathering data that anticipate emergent international reporting standards in relevant jurisdictions			
We participate in relevant industry work groups designed to simplify and standardize ESG data reporting			
We hold ourselves accountable to accurate and credible public reporting on our ESG performance, even when we're falling short of our targets			

TREND THREE

Investors and companies are seeking deeper expertise and greater accountability related to ESG on their management teams, staff, and boards.

The marketplace for that talent is not yet well established. Soon, that will change.

THE DATA

An uneven race to secure ESG expertise

Investment firms hiring expensive ESG expertise

- Top ESG experts are in high demand, a market driven largely by private equity firms (Bloomberg)
- A head of ESG can now command $1.3 million in annual pay, with the lowest salaries at around $475,000 (Bloomberg)
- More top ESG roles are sharing in profits, in addition to hefty salaries and bonuses (Bloomberg)
- Pay levels for top ESG positions are up 50% to 100% since late 2020 (Bloomberg)
- Experts report 25% to 30% growth a year in responsible investing positions (Bloomberg)

U.S. companies increasingly tying executive compensation to ESG performance

- In 2021, 60% of S&P 500 companies had at least one ESG metric in their executive compensation plans, up 8% over the prior year (Willis Towers Watson)
- 12% of S&P 500 companies intend to introduce, expand, or modify ESG metrics in incentive plans (Willis Towers Watson)
- 52% of corporate directors support tying executive pay to DEIB goals, up from 39% in 2020 (PwC)
- 69% of investors want executive compensation linked to ESG, up 17% over 2020 (Edelman)

Corporate boards slow to reflect ESG's importance

- Even though 64% of corporate directors say ESG is linked to their company strategy, only 29% of directors say their boards understand ESG risks very well (PwC)
- While 29% of Fortune 100 directors have some relevant ESG credentials, the large majority of those (21%) were related to social factors and only 6% of directors have relevant credentials related to environment or governance (NYU Stern)

How we’re doing: ESG expertise

	YES	NO, BUT WE HAVE A PLAN	NO
Our company’s management includes substantial and relevant expertise related to all ESG factors			
Our company’s management has financial incentives aligned with ESG performance			
Our board of directors includes substantial and relevant expertise related to all ESG factors			

TREND FOUR

More retail investors, small funds, and large institutional investors are embracing an activist posture related to ESG and expressing growing skepticism that companies will make good on their commitments.

The efficacy of ESG-motivated investor activism is on the rise, too.

THE DATA

Growth of ESG-motivated investor activism

ESG-motivated investor activism is on the rise, as is investor skepticism

- 95% of U.S. investors say they are “more interested in taking an activist approach to investing” (Edelman)
- 81% of U.S. investors are likely to actively engage in activism in regards to corporate board structure, while 79% are likely to engage around the eco-efficiency of company’s operations (Edelman)
- 91% of U.S. investors say they are specifically looking for instances when companies fail to deliver on their ESG commitments, and 94% anticipate an uptick in ESG-related litigation activity (Edelman)

Activism efficacy is on the rise, too

- In 2021, nearly 20% of the social and political proposals voted on received majority shareholder support, more than double the rate from 2020 and 2019 (Harvard Law School)
- Of the environmental proposals that were voted on in 2021, around 38% received majority shareholder support, up from 21% in 2020 and 0% in 2019 (Harvard Law School)
- 2020 saw 3x more negative credit actions taken as a result of shareholder activism compared to 2017 (S&P Global)
- An investor with 0.02% ownership of ExxonMobil successfully claimed three board seats in mid-2021 with a goal of improving the company’s carbon footprint (S&P Global)

How we're doing: Investor activism

	YES	NO, BUT WE HAVE A PLAN	NO
We understand what our investors and shareholders prioritize as far as our ESG performance and can anticipate investor action on ESG-related issues			
We have mechanisms in place to appropriately measure the risk of social backlash to our products and services			
We are transparent with investors about our targets and plans for operationalizing our ESG-related commitments			

TREND FIVE

Until recently, private markets have taken a back seat to public markets in ESG investing.

Now, private equity investors are playing a major role in the next chapter of the ESG story.

THE DATA

Private equity is maturing its approach to ESG

ESG factors are getting a closer look before investment decisions are made, and they're derailing deals

- A large majority of private equity (PE) investors (72%) always screen target companies for ESG risks and opportunities prior to making an acquisition (PwC)
- Limited Partners (LPs) evaluate General Partners (GPs) on their ESG frameworks during due diligence, with 57% of LPs saying they do so currently and an additional 24% planning to do so in the future (Pitchbook)
- 56% of PE investors have either refused to enter an agreement with a GP or turned down an investment opportunity on ESG grounds (PwC)
- Industry onlookers report private equity firms are pulling bids due to ESG concerns and IPOs of companies backed by PE being postponed due to ESG issues (Linklaters)

Private equity firms increasingly manage portfolio companies with ESG at the fore

- 66% of private equity firms identify "value creation" as a top 3 driver of responsible investing or ESG strategy, while a significantly smaller share (40%) identify risk management as a top 3 driver, signaling a shift toward an upside-orientation (PwC)
- More than 7 of 10 PE investors integrate ESG risks and opportunities into their transformation plans for portfolio companies (PwC)
- Private equity investors increasingly expect that portfolio companies and their management take steps toward ESG policy development and implementation early on in an investment (Linklaters)

In 2021, 56% of PE firms said ESG was featured on the board agenda more than once a year, up from 35% in 2019 (PwC)

How we're doing: Private equity

	YES	NO, BUT WE HAVE A PLAN	NO
Our firm has a strategy for evaluating ESG opportunities and risks with target companies pre-acquisition			
Our firm has a playbook for improving ESG performance of portfolio companies in advance of our exit			
Our firm has specific funds and regular investment opportunities for LPs focused on social impact			

Policy and regulatory movement

The rules that matter

SEC proposes new rule on climate disclosure

SEC seeks greater disclosure standardization between issuers and investors

On March 21, 2022, the SEC proposed a rule requiring public companies to disclose the following in their 10-K:

- Disaggregated climate-related financial metrics, including impact of climate related events on current and consolidated financials
- Scope 1 and Scope 2 greenhouse gas (GHG) emissions
- Scope 3 emissions if they are material or if the company has made a commitment referencing Scope 3 emissions
- Plans to reach any climate targets, achieve transition plans, and/or price carbon if and only if those targets and plans exists

We may see new requirements begin in 2023

- Rule may become effective by December 2022, but requirements will be phased in depending on the type of disclosure and registrant's filer status
- Disclosures, including for Scope 1 and Scope 2 GHG emissions, will begin:
  - In FY 2023 for large accelerated filers
  - In FY 2024 for accelerated filers and non-accelerated filers
  - In FY 2025 for smaller reporting company filers
- Liability safe harbor built in for Scope 3 GHG disclosures, aimed to balance the need for disclosure against the cost

733

In 2021, 733 investors with $52T in assets called for mandatory climate disclosure (The Investor Agenda)

Practitioner spotlight

One organization helping to set the pace

Microsoft

Microsoft

ENVIRONMENTAL

Committed to becoming carbon negative by 2030, and to removing all carbon from the world by 2050 that the company has emitted directly or indirectly since 1975 (Microsoft)

Setting climate goals in alignment with Science Based Target of a 1.5 degree celsius warming scenario (JUST Capital)

Deploying $1 billion of its own capital in a Climate Innovation Fund to accelerate the development of carbon reduction and removal technologies that will help Microsoft and the world become carbon negative (Microsoft)

SOCIAL

Offers 15 days of paid vacation, 20 weeks of paid leave for birthing mothers, and 12 weeks of paid time off for all other parents (JUST Capital)

Investing in supportive and inclusive economic opportunities through programs like TechSpark, which promotes digital skills and employability, increases broadband access, and helps local organizations leverage technology to thrive (Microsoft)

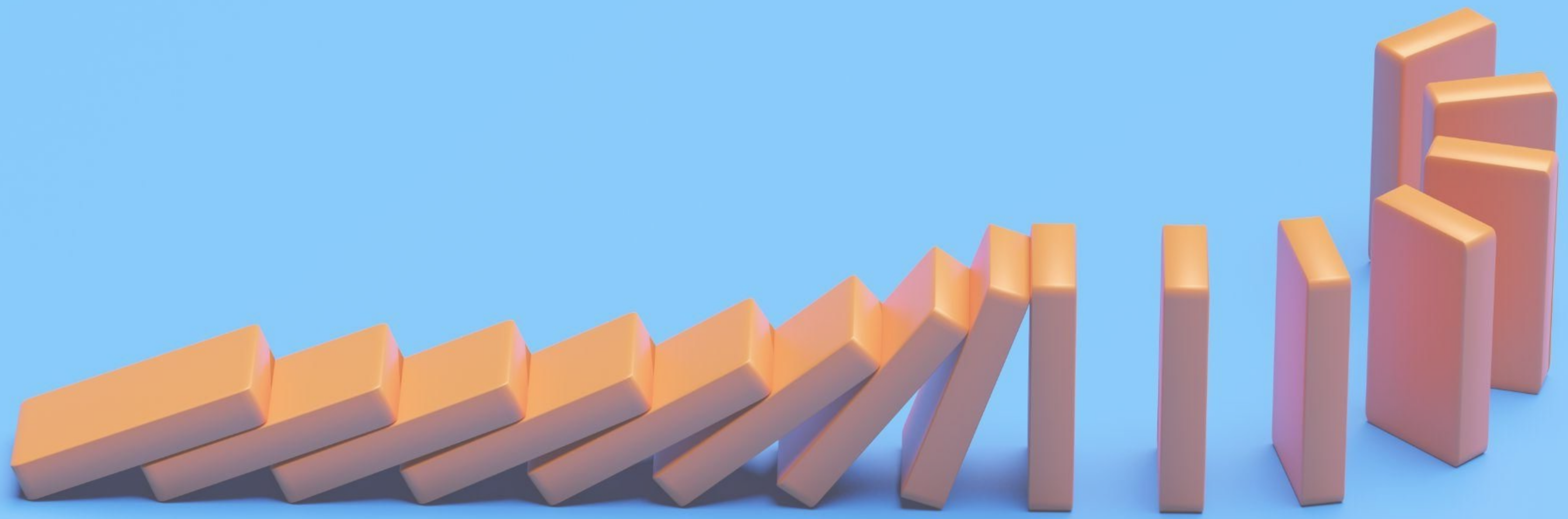
GOVERNANCE

As of September 2021, all racial and ethnic minority employees in the US combined earn $1.006 for every $1.000 earned by their white counterparts, and women in the US earn $1.002 for every $1.000 earned by their counterparts in the US who are men (Microsoft)

Aiming to double the number of Black and African American people managers, senior individual contributors, and senior leaders in the U.S. by 2025 (Microsoft)

Further reading

From our library to yours



Suggested reading

1. NationSwell Insights Briefing: Actionable Practices for 2022 | NationSwell
2. Survey Analysis: In Great Resignation, Americans Are United in Wanting Action on Wages and Jobs, and Accountability from Corporate America | JUST Capital
3. Key trends that will drive the ESG agenda in 2022 | S&P Global
4. PwC's Annual 2021 Corporate Directors Survey | PwC
5. 2021 Edelman Trust Barometer | Edelman
6. Recent Shareholder Activism Trends | Shearman & Sterling LLP
7. Private equity's ESG journey: From compliance to value creation | PwC

For questions, feedback, or more information about this NationSwell Trend Report, please contact Nick Cericola at nickcericola@nationswell.com

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Putting your company’s purpose at the foundation of your relationships with your stakeholders is critical to long-term success. Employees need to understand and connect with your purpose; and when they do, they can be your staunchest advocates. Customers want to see and hear what you stand for as they increasingly look to do business with companies that share their values. And shareholders need to understand the guiding principle driving your vision and mission. They will be more likely to support you in difficult moments if they have a clear understanding of your strategy and what is behind it.

LARRY FINK

Chairman and CEO
BlackRock
2022 Letter to CEOs