ESG Disclosure: what effects?

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Reporting 3.0 Conference

June 17, 2019

COMMONWEALTH Climate and Law Initiative

Overview

What do we expect from disclosure?

- Standard financial disclosure
- Sustainability disclosure

What do investors say about sustainability disclosure: Petition to the SEC for an ESG rule-making

What does academic research show?

One example: TCFD and why it might be powerful?

Lingering questions

What do we expect from disclosure?

Standard theory: promote market efficiency and allocational efficiency

What about sustainability disclosure?

---Explicit goal: To inform a broader group of investors, including SRI investors and now Bloomberg, BlackRock ($6.7 trillion assets under management), Vanguard, State Street, and the “Bloomberg” and “BlackRocks” of the world

---Implicit, underlying goal: Affect the way the company is being run: “We manage what we measure.”

What do mainstream investors say today? Petition to the SEC in the U.S.

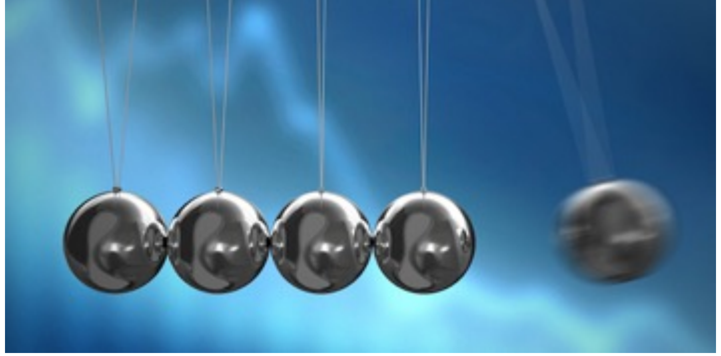
1. June, 2017, Bank of America Merrill Lynch study: Sustainability factors to be “strong indicators of future volatility, earnings risk, price declines, and bankruptcies.” Bank of American Merrill Lynch, *Equity Strategy Focus Point—ESG Part II: A Deeper Dive* (June 15, 2017).

2. June, 2017: Allianz Global Investors concluded that the heightened transparency of ESG disclosure lowered companies’ cost of capital by reducing the “investment risk premium” that sophisticated investors would require. Allianz Global Investors, *ESG matters, Part 2: Added value or a mere marketing tool? What does ESG mean for investments?,* (June 2017).

3. April, 2018: Goldman Sachs concluded that “integrating ESG factors allows for greater insight into intangible factors such as culture, operational excellence and risk that can improve investment outcomes.” Goldman Sachs Equity Research, *GS Sustain ESG Series: A Revolution Rising-From Low Chatter to Loud Roar [Redacted]*, 23 April 2018. GS concluded that “the ESG Revolution is just beginning, as the logical, empirical and anecdotal evidence for its importance continue to mount.”

4. In 2018, more than half of global asset owners are evaluating ESG considerations in their investment strategy. Pension funds & other asset owners are increasingly demanding sustainable investing strategies from their asset managers.

Momentum regarding ESG governance



Photo, creative commons

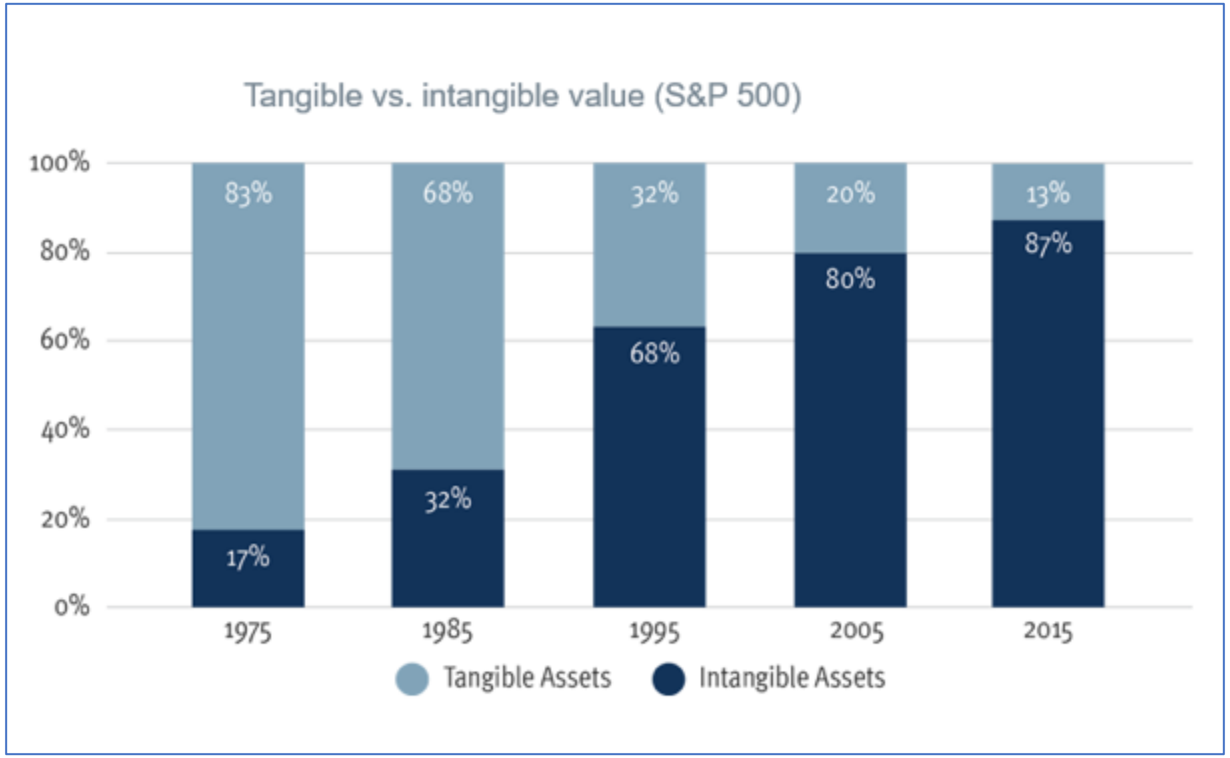
Growing evidence that appropriate consideration of material ESG factors can lead to better investment decisions and superior risk-adjusted returns, particularly over a longer-term horizon.

2018 Morgan Stanley survey of 118 global asset owners: 84% are actively integrating ESG factors in their investment processes. In 2017, investments guided by ESG criteria were $12 trillion in US, and $23 trillion globally.

2019 Mercer: Long-term investors typically have multidecade time horizons, with exposure across the global economy; thus, essential to address in short term both potential impacts of a low carbon transition and physical damages associated with climate change to better prepare portfolios for the future.

What is driving institutional investor focus on ESG?

The link to performance



Source: http://www.oceantomo.com/blog/2015/03-05-ocean-tomo-2015-intangible-asset-market-value/

Some academic insights

1. Deutsch Asset & Wealth Management, in conjunction with researchers from the University of Hamburg, analyzed 2,250 individual studies of the relationship between ESG data and corporate financial performance. From this analysis, the researchers concluded that improvements in ESG performance generally lead to improvements in financial performance. Deutsche Asset & Wealth Management, *ESG and Corporate Financial Performance: Mapping the Global Landscape*, December, 2015, *available at* https://institutional.deutscheam.com/content/_media/K15090_Academic_Insights_UK_EMEA_RZ_Online_151201_Final_(2).pdf.

2. Gordon Clark et al: Analysis of empirical studies found that 90% of studies show that sound sustainability standards lower firms' cost of capital; 80% of studies show that companies' stock price performance is positively influenced by good sustainability practices; and 88% of studies show that better E, S, or G practices result in better operational performance. *See* Gordon L. Clark, Andreas Feiner & Michael Viehs, *From the Stockholder to the Stakeholder: How Sustainability Can Drive Financial Outperformance* (2015), *available at* http://papers.ssrn.com/sol3/papers.cfm?abstract_id=2508281.

Cautionary academic research

Which way does causation go?

"We manage what we measure" IF:

(1) Disclosure is mandatory AND

(2) There are clear users of the information feeding back to the issuers

Archon Fung, Mary Graham & David Weil, *Full Disclosure: The Perils and Promise of Transparency*

Can investors as users of ESG information provide enough strong feedback to overcome voluntary status of many disclosure regimes?

One example: TCFD and why might it be a powerful example

Core Elements of Recommended Climate-Related Financial Disclosures

Governance
The organization's governance around climate-related risks and opportunities

Strategy
The actual and potential impacts of climate-related risks and opportunities on the organization's businesses, strategy, and financial planning

Risk Management
The processes used by the organization to identify, assess, and manage climate-related risks

Metrics and Targets
The metrics and targets used to assess and manage relevant climate-related risks and opportunities

Lingering questions

Can "sustainable finance" actually solve social and environmental problems caused in significant part by companies responding to the financial imperatives of impatient investors?

Maybe when backed up by government initiatives, such as the EU's High-Level Expert Group on Sustainable Finance. But without government backing?

Does disclosure according to voluntary standards provide the same impetus for management attention as mandatory, financial disclosure? What if the sustainability report is the province of HR? Or the CSR team, i.e., siloed?

Can "responsibilization of the market" (Rohnen Shamir) overcome political impasse and polarization?

Reporting 3.0 is going in the right direction by incorporating standards of what is good performance by which to evaluate disclosure: how to amplify?