ESG and Sustainability

What it means

Contents

What is ESG?

Definition

Sustainability is defined as – 'Meets the needs of the present without compromising the ability of future generations to meet their own needs.' ESG is a part of Sustainability.

ESG stands for: Environmental, Social and Governance. This refers to a company's behaviour with regards to the 3 pillars and ESG data produced reflects the externalities an organisation is producing with regards to them. Investors are increasingly applying these factors as part of their analysis to identify business risks and opportunities, and they are relevant to all stakeholders in the value chain. Complying with ESG is more than trying to recycle or cutting your waste. However, currently there are lots of frameworks to report under, with no globally approved standards, meaning comparing disclosures can be confusing. Still an evolving term.

Environmental	Social	Governance
• Greenhouse gas (GHG) emissions • Climate change • Loss of biodiversity • Waste management • Deforestation • Loss of habitat • Net zero transition – 2050	• Fair wages and rewards • Human rights • Forced labour/modern slavery • Employee relations and labour standards • Workplace culture • Gender and race pay gaps • D&I • Workplace training and skills development	• Business resilience • Appropriate governance and approval structures • Executive pay • Board composition and independence, and diversity of skills and experience • Tax compliance

Why does it matter?

Overview

ESG can be seen as either a risk management tool or a market opportunity. Either way, the incorporation of the ideas are vital to the long-term health of all businesses.

Environmental	Social/Governance
All stakeholders across the value chain will be interested in a firm's ESG data, this is a brief overview: • **Investors:** ESG data allows the investor to understand the risks and opportunities the company faces into the future. Nowadays, ESG data is one the most, if not most, important factor when deciding upon investment opportunities. JFSC research states in 2021, 100 percent of investors as well as 61 percent of managers and their advisers noted that ESG criteria will play an increasing role in fund domiciliation. • **Lenders:** Providers of finance want to be sure the borrower is aware of its risks and has a transition plan. Those that are, will have access to cheaper rates and better terms. • **Insurers:** Those that have identified external events and plans to insulate themselves will gain better premium terms. • **Employees:** Data shows employees are more motivated working for an ESG conscious employer. Likewise, it is a tool to attract future talent. • **Policymakers/Regulators:** As the global push towards a sustainable economy continues, those companies leading the push will be looked upon favourably. • IASB and IAASB have stated auditors need to consider material climate risks on companies.	• There are many benefits to incorporating sustainable practices and a long-term vision internally. • Sustainability services have been mooted as the biggest growth area for professional services in a generation. • Clients are coming under increasing pressure to ensure their service providers meet certain sustainability standards. • Financial savings. • Ensuring a resilient business model into the future. • Marketing and branding opportunities to win reputational influence.

Business services

Overview

There is a multitude of service offerings in this space. As standards are increasing in prominence and are expected to become mandatory, complying with them will take time and effort. Research states 81% of CFOs said ESG information is considered important in their organisations' decision making, but two thirds believe their organisation lacks the full suite of reliable tools and techniques to make this happen.

Environmental	Social	Governance
• Education and training around emissions reduction and impacts. Climate change is a strategic and financial risk, and the related event driven consequences (such as floods) need to be taken seriously by the Board and integrated into business models. • Limited assurance over reporting. • Reporting under CSRD (EU), ISSB (International), SEC (US) and TCFD. • Reporting GHG emissions under scope 1, 2 and 3. • Development and update of transition plans. • Net zero transition plans. • SFDR – Mandatory to all asset managers based in, or marketing products, in the EU.	• This will be a big issue on the Channel Islands, given the wealth disparity. Issues such as fair wages are acutely important on the Islands given the cost of living, and employers should be seen to be helping to alleviate the problem. • Ensuring executive pay awards are transparent and aligned to performance. • Workplace culture assessment and advice. • Setting metrics for performance and rewards. • Producing modern slavery reports. • Calculating gender and race pay gaps.	• Producing business resilience statements. • Advising on governance structures. • Advising on make-up of Boards. • Ensuring tax compliance.

Business services

TCFD

The international Financial Stability Board (FSB) created TCFD in 2015, the goal is to identify the types of information companies should disclose to give investors, lenders and other stakeholders an accurate handle on the climate-related risks that might affect a business's value.

With the Task Force on Climate-related Disclosures (TCFD) already mandatory in some jurisdictions, and increasingly adopted as environmental risk management by large businesses, acting now will empower mid-market companies to secure their value chains, boost credibility with stakeholders, and ensure future access to vital funding and investment. ISSB standards are based on TCFD.

Advantages	Challenges	How to get started
• Adoption is growing rapidly, across 99 countries and counting and firms with market cap of over $26tn. • Relevant to all sectors of the economy. • Secure your supply chain, clients are increasingly enforcing compliance with TCFD reporting. • Likewise to secure your value chain. • Boost credibility with stakeholders. • Access funding and investment.	• Difficulty in understanding which disclosures to make, there are 11 recommended. • Lack of experience in reporting. • Getting access to relevant data. • Whether to scenario plan or not.	• Understand the complexity and timeframe (if mandatory reporting will occur). • Build a roadmap/plan to reporting. • Create an internal reporting framework. • Define KPIs and track performance. • Understand the challenges to disclosure. • Put the appropriate governance structures in place.

Business services

CSRD

The Corporate Sustainability Reporting Directive (CSRD) was approved on 28 Nov 2022 by the European Council. Once CSRD enters into force, EU member states have 18 months to implement and adopt the framework. This is especially important/pertinent as the scope of CSRD is large, and will affect a huge number of EU companies as well as non-EU companies who promote their services into the EU (i.e. funds in the CI).

Also, companies in scope of CSRD will need to produce European Sustainability Reporting Standards (ESRS) disclosures. The main point of the framework is that companies will have to report double materiality. Double materiality means companies first report how sustainability factors affect the company (single materiality) as well as how the company affects the environment through its operations (double materiality).

What does it mean?	What do firms need to do?	Timeline
• Disclose info on the way companies operate and manage social and environmental change. • CSRD will expand and standardise existing rules on Non-Financial Reporting Directive (NFRD). Aim is to make it easier to compare data. • Double materiality will have to be reported upon. • Scope of reporting will include: all large companies, listed SMEs incorporated in the EU, non-EU companies promoting services into the EU or who have over EUR150m turnover and a subsidiary in the EU. • Reporting will need to be assured. • Overall aim is to bring sustainability reporting to the same level as financial reporting.	• This will have a significant impact on reporting requirements. Companies need to determine which entities are in scope as well as effective reporting dates. • Non-EU companies can be affected in multiple ways and need to assess this. • Companies need to embed sustainable values into their business model to meet CSRD requirements. This is a risk management exercise as well as market opportunity. • CSRD reporting requires significant data. Companies need to understand what they need and whether existing reporting processes can handle this.	• First companies in scope will start to apply CSRD in 2024, reporting in 2025. • Companies already subject to NFRD, apply in 2024 to report in 2025. • Large companies not already subject to NFRD, apply in 2025 to report in 2026. • Listed SMEs. Small credit unions and captive insurers, apply in 2026 to report in 2027. • Non-EU companies subject to regulation, apply in 2028 to report in 2029.

TNFD – It's not just about climate

Overview

The Taskforce on Nature-Related Financial Disclosures (TNFD) is a developing framework that is working to deliver a risk management and disclosure framework for organisations to report and act on nature-related risks.

Mission – To develop and deliver a framework as described above that will support a shift in financial flows away from nature-negative towards positive outcomes.

Who – The taskforce consists of 40 members, representing finance, corporates and market service providers, over $20tn in assets. This is a framework being developed by the market, for the market, to make clear to companies as to what they want from them to guide investment decisions.

Challenge – Nature loss poses risks and opportunities, now and in the future. More than half of the worlds economic output, $44tn, is dependant on nature. Currently, financial institutions do not have the info they need to understand how nature impacts the organisations immediate financial performance, or longer-term risks.

What happens next?

The work of the TNFD is quickly gaining prominence, and nature-related discussions are going further up the Board agenda as disclosure frameworks edge closer. COP 15 was held this year, with a historic deal reached, the 30 by 30 pledge promises to:

- Delegate countries have promised to protect and restore 30% of land and water by 2030.

Just like the Paris climate agreement, countries will push these obligations down to companies, who will be expected to lead the agenda by all stakeholders.

What next?

Overview

Hopefully this document will give you an overview of what sustainability services and ESG are. As more reporting becomes mandatory, TCFD is already mandatory for all listed UK companies and will be mandatory for all registered businesses by 2025, businesses will have to be switched on to meet these obligations.

Businesses, such as funds, based in the CI but marketing into the UK and EU will already be subject to these regulations.

More mandatory regulation is expected to follow, locally and internationally.

What you can do

- Stress to your colleagues that this is not only a risk management exercise to be done when mandatory disclosures are enforced, but a market opportunity to get ahead of your rivals and gain competitive advantage. Some opportunities are listed in slide 4.
- If you do see this as a risk management exercise, preparation is vital, and data needed for disclosures cannot be easily gained and reported by 'flicking a switch.' Firms need to identify what data they require, then get it. If not, the market will punish poor disclosure.
- Live the values and spread the message.
- If you or your network are interested in knowing more, I am always open to talk. If there's anything I don't know, I will find the answer.

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Dipak qualified as an ACA from KPMG in London, working in the FS Audit practice, primarily at large multi-national banks.

From then he moved to work for ICAEW, and looked at Sustainability issues for their technical arm, producing guidance and technical updates for those looking to increase their sustainability offerings internally and to clients.

Dipak joined Grant Thornton Limited in 2022 leading their Sustainability activities.

Glossary

Overview

Brief definitions of some of the terms mentioned.

Term	Meaning
ESG	Environmental, Social, Governance
GHG	Greenhouse emissions. Gases released that absorbs and emits energy, trapping heat in the atmosphere, causing warming
CSRD	Corporate Sustainability Reporting Directive. The EUs version of sustainability disclosure, mandated into law
ISSB	International Sustainability Standards Board, part of the IFRS foundation. It's remit is to deliver a global baseline of sustainability disclosures. Seen as the foremost standard setter globally
SASB	Sustainability Accounting Standards Board. Develop and disseminate sustainability standards, now recognised by the IFRS
TCFD	Taskforce for Climate Related Disclosures, established by the Financial Stability Board (FSB). TCFD is seen as the primary method to report impacts of climate related information. UK registered businesses have to report against TCFD for periods beginning after 06/04/2022. Disclosure will be mandatory across the UK economy by 2025, and nevertheless will be needed even if not mandatory due to stakeholder demands
Scope 1	Direct emissions from a company, e.g., fuel used in vehicles making delivery
Scope 2	Indirect emissions from a company, e.g., electricity purchased to power the company workplace
Scope 3	Everything else. E.g., business travel, employee commute to the workplace, emissions recorded from customers using your products. The hardest scope to calculate. All scopes expected to be mandatory to disclose by May 2023 under ISSB
Scope X	An emerging term that could be a market differentiator for firms that understand and can apply the concept. It concentrates on what a firm is doing to take emissions out of the system, to restore and regenerate. The idea is to use the resource of business to change the system
SFDR	Sustainable Finance Disclosure Regulation – applicable to funds in, or marketing into, the EU
CDSB	Climate Disclosure Standards Board. Created by World Economic Forum, absorbed by ISSB
SBTi	Science-Based Targets initiative. Used to show decarbonisation pathways
IPCC	International Panel on Climate Change: United Nations body that provides research and suggestions on tackling climate change
GFANZ	Glasgow Finance Alliance for Net Zero: Coalition of major FIs committed to accelerating a carbon-free economy. Created in the run-up to the 2021 COP26 climate summit in Glasgow, Scotland

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