ESG in B.C.

An Opportunity for a Sustainable Economy

Business Council of British Columbia
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ESG AND ESG REPORTING: A PRIMER

PREAMBLE

Welcome to BCBC's series ***ESG in B.C.: An opportunity for a Sustainable Economy***.

The accompanying paper was written by Denise Mullen, BCBC's Director of Environment, Sustainability, and Indigenous Relations, to provide an overview of the ongoing ESG evolution and its emerging impact on today's business landscape.

Over the course of the five-part series, global, national, provincial, and local leaders from industry, government, Indigenous Peoples, academia, and policy development will examine risks, evaluate opportunities, and define a path forward towards a sustainable economy in the context of ESG; and we'll do it together.

When thinking about creating and delivering a sustainable economy, B.C. has many naturally ingrained ESG strengths, but we cannot expect the world to instinctively come to us. It is our responsibility to leverage the advantages we have and reach out to capture the world's attention.

What does the world want to know? What do they need to hear? Where is the rest of the world moving with respect to ESG? How do we stand out as a province, a sector, or an individual firm?

Like all capital, ESG focussed capital demands a return on investment. ESG does not mean we ignore the need for creating a strong, robust, and healthy investment climate where the private sector can generate jobs and create wealth. It means we look at different activities, we seek to understand communities, we identify more impacts and mitigate for more risks.

Will there be trade-offs? What trade-offs are we willing to make? What are the implications for our business, employees, and customers? How can we be best positioned for success?

BCBC is not the purveyor of the answers, but we are pleased to be the convenors for the discussion. If there is one thing that I am certain of, it is that change is constant. As we look to economic recovery and resiliency, one thing is clear: the world is not going to wait for British Columbia, and we must be ready to leverage every opportunity in front of us.

The goal of this series is to move B.C. forward in our ESG journey. To achieve this, we encourage you to think critically about where we are as a province, an economy or as individuals firms and where we need to go . This is an opportunity to explore the possibilities openly and with optimism, because the ESG conversation is not new, and it is not going away. Lastly, this is a forum for forthright and the genuine sharing of perspectives on both the opportunities and the challenges we face to become a differentiated destination for ESG investment and leadership.

I look forward to our discussions.

Greg D'Avignon

President & CEO, Business Council of British Columbia

WHAT IS ESG?

ESG is the latest evolution of corporate responsibility divided into three focus areas — environmental, social, and governance. Whether it is referred to as ESG, sustainability, sustainable investing, or socially responsible investing, it amounts to the same thing — the consideration, measurement, and reporting of environmental, social and governance factors alongside financial aspects in the investment and/or business decision-making process.

Environment: Stewardship of natural resources and a firm's environmental footprint is the focus of E. This includes reducing impacts on and maximizing the benefits from land and resources with a usual focus on, but not limited to, energy and water use, greenhouse gases, natural resource conservation, materials, packaging, and waste.

Social: Relationships and communities is the focus of S. It covers everything from a company's approach to diversity and inclusion, working conditions including health and safety of its employees and child labour and slavery, philanthropic investments, partnerships with contractors and suppliers, and commitments to investors. Importantly, S also includes I — Indigenous rights and responsibilities. In fact, S has the biggest portfolio of components in the ESG equation.

Governance: G is the foundation. Good governance is essential for success. Positive outcomes on E and S are not possible without a strong governance framework. Governance is a system and a process for decision-making, accountability, control, and behaviour. It influences how an organization's objectives and commitments are set and achieved, how risk is monitored and addressed, and how performance is optimized. Done well, good governance cultivates a culture of integrity, strengthens stakeholder confidence, enables a nimble response to a changing external environment, and creates value for all stakeholders.

ESG is most often associated with the outcome — a sustainability report. But this is the final step. Arriving here requires both an internal and external process that reconciles the specific meaning of ESG to a company, its culture, and its stakeholders. In its detail, ESG means different things to different companies based on many considerations including the industry, location, services, and products, to mention a few. No two companies will have the same ESG metrics or strategies.

WHY IS ESG IMPORTANT?

On one level, it is simply an enhanced risk management tool and attempts to make abstract and often hard to measure issues, tangible and real. Integrating ESG into business strategies using a structured and deliberate evaluation process against "standards" that reflect minimum performance expectations can have benefits. It can help reveal opportunities and avoid issues and negative consequences from poorly conceived or implemented business strategies. In a reporting sense, accurate ESG data, meaningful measures to manage impact and authentic storytelling can strengthen internal and external communication, enhance a firm's reputation as both a place to work for employees (current and future), be a trusted partner for clients, attract new investors and build loyal customers for products and services. Ultimately, embedding sustainability into the business model of a company provides a transparent line of sight on a company's contribution to and impact on its immediate community and society more broadly.

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WHERE DID ESG COME FROM?

ESG is not a new concept. In fact, it was part of Roman law both in terms of the definition of a "corporation" and the obligations to society.

> *"… "corporation" derives from the Latin term "corpus" which means "body of the people," although these organizations under Roman law were known by other names, including "collegium" and "universitas." These organizations had close ties to society, and they even included municipalities and the Roman state itself."*[1]

Over time the ideas and practices behind the concept of a social "contract" between business and society has changed. In recent history, heightened interest about

[1] Chafee, Eric C., The Origins of Corporate Social Responsibility, University of Cincinnati Law Review. April 24, 2017. Vol. 85.

the meaning of corporate social responsibility and its implementation began in the 1970s. This coincided with an increasing attention on the environmental impacts from a quickly expanding global population[2] and the related development needed to fill human material needs as well as other issues including human rights, labour, and diversity. By the late 1980's and through the 1990's companies began to grapple with the practical and expanding requirements of annual sustainability assessment and performance reporting. Then with the adoption of the Millennium Development Goals, which eventually became the current United Nations Sustainable Development Goals, and the signing of the Paris Agreement in 2015, global momentum reached an economy of scale. Today's conversation is not fundamentally different from the past twenty or so years, although on some fronts more urgent (e.g., greenhouse gas emissions), and topics covered are now grouped within a three-part rubric of environment, social, and governance.

By the end of 2020,[3] eighty percent of the top 100 global companies by revenue had integrated ESG into their business practices. The same report concludes that North and South America, combined, have the highest ESG participation rate among public companies. In fact, 92% of Canadian public organizations having an ESG framework and report annually on their performance, despite the absence of a regulatory obligation to do so. And while the ESG focus has been on public companies, more and more, private companies are following suit in part because increasingly "companies face legal penalties, increasing litigation risk, and meaningful public relations fallout if they fail to address [broader sustainability] requirements."[4]

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THE "STANDARDS" — EVERYONE AND NO ONE

Standards are important. They provide requirements, specifications, guidelines, or characteristics that can be used consistently to ensure that materials, products, processes, and services are fit for their purpose. They are tools for measurement.

There is no single global "standards" entity and no single standardized set of ESG standards. There are many who claim to be the definitive "standards" organization (see box). It can be confusing. However, it is true that the Global Reporting Initiative (GRI)[5] is the dominant comprehensive reference framework for companies, followed by Sustainable Accounting Standards Board (SASB)[6] who recently joined forces with the International Integrated Reporting Council (IIRC),[7] and then the International Standards Organization (ISO).[8] Other commonly referenced "standards" include the Climate Disclosure Standards Board Framework (CDSB)[9] and Task Force on Climate-Related Financial Disclosure (TCFD).[10] The latter was a joint effort with SASB and is used largely by asset management funds and is specific to greenhouse gases. There are several others that are industry specific, for example for labour the International Labour Organization and sizable number for mining such as the International Council on Mining and Metals.

It should be noted that while indigenous interests are a key factor in ESG practices in Canada, and other parts of the world, there is currently no tool by which the Indigenous perspective can be measured or evaluated. Indigenous partnerships and full or part ownership in companies and projects are often used as a proxy for understanding impact on indigenous communities, however more work is underway in British Columbia on this issue.

[2] In 1971 the global population was ~3.6 billion with population growth peaking at 2.11% per year. By 2020, the earth was/is supporting almost 8 billion people.
[3] https://assets.kpmg/content/dam/kpmg/xx/pdf/2020/11/the-time-has-come.pdf.
[4] The Lawyer's Corporate Social Responsibility Deskbook, Practical Guidance for Corporate Counsel and Law Firms, American Bar Association, 2019.
[5] https://www.globalreporting.org/.
[6] https://www.sasb.org/.
[7] https://integratedreporting.org/the-iirc-2/.
[8] https://assets.kpmg/content/dam/kpmg/xx/pdf/2020/11/the-time-has-come.pdf.
[9] https://www.cdsb.net/.
[10] https://www.cdsb.net/tcfd-good-practice-handbook.

"STANDARDS" AND REPORTING

Standards are most often associated with reporting. Stock markets are beginning to require sustainability reporting, which by extension requires the integration of ESG into business practices. For example, Singapore requires every listed issuer to prepare an annual sustainability report, which must describe the issuer's sustainability practices with reference to the primary components set out listing rules.[11] Hong Kong has proposed mandatory reporting metrics and a comply or explain process.[12] In August 2020, the US Securities and Exchange Commission (SEC) approved amendments affecting both domestic registrants and foreign private issuers that file registration statements, periodic reports, proxy statements, and other documents.[13] These filings now require disclosure related to general development of a business and human capital, legal proceedings that may be underway including those related to the environment, and material risk factors. In March 2021, the SEC is invited public comment on climate change disclosure requirements until June 2021.[14]

With the preponderance of multiple ESG measurement, reporting frameworks, and guidelines, the World Economic Forum published a white paper in the fall of 2020.[15] It proposes a common set of 21 core and 34 sub-elements metrics, and an approach trying to reconcile the various "standards." This work was completed in collaboration

Global Reporting Initiative: A multi-stakeholder focus and developed via engagement from a broad set of stakeholders. Can be used by for- and not-for profit organizations. Used by ~ 76% of the world's largest corporations. It is flexible and can be applied comprehensively for all major- and sub-components or more narrowly to fit the unique materiality of issues specific company operations. It is a membership-based organization. Fees are based on annual gross revenues. There are 4 broad headings for reporting:

- 101 Foundation, 102 General disclosures and 103 Management Approach
- 201 Economic with 6 sub-components
- 301 Environmental with 8 sub-components
- 401 Social with 19 sub-components

Sustainable Accounting Standards Board: SASB is meant for financial stakeholders and was codified in 2018. There are standards for 77 industries, all downloadable. SASB has 5 broad headings for reporting:

- Environment with 6 sub-components
- Social Capital with 7 sub-components
- Human Capital with 3 sub-components
- Business Model and Innovation with 5 sub-components
- Leadership and Governance with 5 sub-components

Task Force on Climate Disclosure: These are climate-centric standards (i.e., risks and opportunities for a company's business operations.) The focus is for lenders and insurance underwriters. The framework was created jointly with SASB. The handbook identifies good practices for governance, strategy development, risk management, and metrics and targets ALL related to greenhouse gas management.

Climate Disclosure Standards Board Framework: CDSB is an international consortium of business and environmental NGOs for reporting on environmental and natural capital. The framework is aligned with the EU directive 2004/95/EU, United Kingdom mandatory greenhouse gas reporting requirements, and the UN SDGs specifically 12.6: "encourage companies, especially large and trans-national companies, to adopt sustainable practices and to integrate sustainability information into their reporting cycle." CDSB also work with stock exchanges in development of listing criteria and reporting requirements. CDSB has an advisory role and can work directly with companies in development of reporting practices (for a fee)

[11] http://rulebook.sgx.com/rulebook/practice-note-76-sustainability-reporting-guide.
[12] https://en-rules.hkex.com.hk/.
[13] https://www.sec.gov/rules/proposed/2019/33-10668.pdf.
[14] https://www.sec.gov/news/public-statement/lee-climate-change-disclosures.
[15] http://www3.weforum.org/docs/WEF_IBC_ESG_Metrics_Discussion_Paper.pdf.

with the world's four largest accounting firms. The pillars of the proposed approach align with the UN Sustainable Development Goals (SDGs).[16] Since many companies also incorporate stories related to their SDG contributions, in theory the WEF method may make this an easier process.

Importantly, the non-financial components of business reporting are not mandated by governments. The European Commission (EC) is an exception. Sustainability reporting is mandatory for public companies (i.e., EU directive 2004/95/EU).[17] Then April 2021, the EC adopted a proposal for a Corporate Sustainability Reporting Directive, which amends existing reporting requirements in the following ways:

- extending the scope pf reporting to all large companies and all companies listed on regulated markets (except listed micro-enterprises).
- requiring the audit (assurance) of reported information ('limited' assurance).
- introducing more detailed reporting requirements, and a requirement to report according to mandatory EU sustainability reporting standards.
- requiring companies to digitally 'tag' the reported information, so it is machine readable and feeds into the European single access point envisaged in the capital markets union action plan.

The proposal also "foresees the adoption of EU sustainability reporting standards to simplify the reporting process for companies that are currently under pressure to use different standards and frameworks."[18]

And even if the EU leads the way, there will always be challenges. These include:

- Finding common ground with stakeholders.
- Building internal capacity and systems to manage sustainability assessment and reporting over the long-term including data integrity, transparency, and accessibility.
- Dealing with uncertainty created by the lack of specificity on the boundaries for assessment and reporting.
- Reconciling difference requirements among jurisdictions.
- Emerging and evolving understanding about the nature of obligations to and expectations of shareholders and stakeholders.
- Conflicts between providing enough information on a subject versus materiality.
- Establishing clear, realistic, and measurable and material targets (against what).
- Ensuring timely, accurate and sufficient disclosures on material risks.
- Choosing a reporting "standard" and framework suited to a company's business model and sector.

THE OUTCOME — A SUSTAINABILITY REPORT

And finally, as the outcome of the ESG process, the sustainability report is the story of performance. And while these will be unique by company, there are 10 essential elements to any story. These are:

1. A **CEO** statement that is a genuine and authentic personal commitment to improve performance in all three areas of sustainability: environment, social, and governance.
2. A completed assessment of the most **material issues/risks** faced by a company.

[16] https://sdgs.un.org/goals.
[17] https://ec.europa.eu/info/business-economy-euro/company-reporting-and-auditing/company-reporting/non-financial-reporting_en, https://eur-lex.europa.eu/legal-content/EN/TXT/?uri=CELEX%3A32014L0095.
[18] https://www.sustainability-reports.com/european-commission-adopts-proposal-for-a-corporate-sustainability-reporting-directive-csrd/.

3. A **clear expression of** a company's vision or **ambition for sustainability** situated within the context of global trends and challenges in all three components of the ESG equation.
4. A **clear sustainability policy and strategy** demonstrating how sustainability is integrated into the overall business strategy, accompanied by a statement from the Chief Sustainability officer (or equivalent).
5. A description of **governance structures and processes**. Governance is the foundation of sustainability. It signals to all stakeholders that sustainability matters.
6. Identification of **clear goals and targets** in each of the material issue areas.
7. A **summary of performance (positive and negative)** against key metrics including analysis and a narrative explanation of results, how these have changed over time, and new risks that may arise.
8. **Stories written in plain language** that clearly show progress on "what is important." These can be linked to the SDGs thus creating a link to the world.
9. **Quotes from real people** both internal and external stakeholders reflecting the conversations had, learning from listening, relationships built, and demonstrating tangible progress.
10. An **assurance statement** from a recognized, independent provider to lend credibility to the report.

CONCLUSION

The history of ESG in its various forms has been around for as long as humans have traded goods and services. Today, it is an evolving and expanding field of study and practice. ESG considerations are increasingly important for both investors and businesses. Investors want to see ESG factors incorporated explicitly and transparently into the investment process alongside traditional financial analysis. Businesses are using ESG to differentiate their products and services to attract investors, maintain customer loyalty, and establish more long-lasting connections to their employees and communities. The expectation is for ESG to continue to grow in importance. The Business Council of B.C.'s "ESG in B.C.: An opportunity for a sustainable economy" is a starting point for joint and continuous learning.

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