LISTEN Through the NOISE

THE TITLE OF THIS PANEL DISCUSSION OF SUSTAINABLE FINANCE EXPERTS SAYS IT ALL: THE FUTURE OF ESG.

ESG IS GROWING MORE CONNECTED TO BUSINESS performance, against a backdrop of challenge and polarization. That's the consensus of a panel of experts that convened in January by BritishAmerican Business, a trade association incorporating the British Chamber of Commerce in America and American Chamber of Commerce in the UK. The panelists, assembling by Zoom, included Brunswick Partner Jordan Bickerton. What follows is an edited transcript of their conversation.

DUNCAN EDWARDS: I'm the CEO of British-American Business, and it's a real pleasure to welcome you to this event today, the latest in our ongoing corporate citizenship and sustainability series.

ILLUSTRATION: LINCOLN AGNEW

Today, we're going to be talking about the future of ESG and if, and how, companies are evolving their approach to this issue. By way of context, we've been holding events in this citizenship and sustainability series broadly looking at ESG issues for a number of years.

We've done events where we've tried to look at the issue from the perspective of the corporation, from the perspective of regulators, of financial sponsors and of shareholders of course.

Over the last four years, it seems to me that the direction of travel has been broadly going in one direction. But over the last year, that has changed.

In the US, a number of states have pushed back against anti-fossil fuel initiatives particularly, impacting asset managers that have taken anti-fossil fuel positions. In 2023, the number of funds that are dedicated to ESG or impact investing for the first time declined, and the amount of cash being invested through those funds also declined.

The Supreme Court's decision back in June to end Affirmative Action in college admissions has led to some reevaluation by companies of corporate DEI initiatives. And there have been a number of high-profile missteps in the social category, the S of ESG, which in some cases have led to loss of sales, loss of reputation, even the loss of the job of the CEO.

Open up financial newspapers and you'll see headlines like, "ROI is more important than DEI." And yet much of the world is still fully committed—in some cases, legally committed—to a greener future with dramatically lower carbon emissions. It feels that the journey is only going in one direction ultimately. And good companies want to do the right thing. They want to do the right thing for their employees, their customers and the communities within which they operate, as well as the right thing for their shareholders. It's a tricky environment to navigate.

To help us to do that, we have this fantastic panel: Jordan Bickerton, a Partner in ESG and Sustainable Business at the consultancy Brunswick; Amy Franzen, Co-Head of US Originations—Sustainable Finance at HSBC; Ulysses Smith, ESG Senior Advisor at Debevoise; and Kal Trinkner, a Senior Manager in the Climate Change and Sustainability practice at EY.

PORTRAIT ILLUSTRATIONS: THOMAS FUCHS

From your own experience and expertise in the ESG space in the US and UK, where do we stand now? Ulysses?

ULYSSES SMITH: Thanks for having me back for what has been a great series.

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DUNCAN EDWARDS
CEO, BritishAmerican Business

"The direction of travel is clearly towards treating ESG reporting & disclosure with the same level of rigor as you would financial information."

ULYSSES SMITH
ESG Senior Advisor, Debevoise

The direction of travel is clearly towards treating ESG reporting and disclosure—the information about your ESG commitments and performance that you're putting out in the world—with the same level of rigor as you would treat financial information.

To date, one of the main areas of focus for SEC enforcement action related to ESG matters is consistency between what's in your formal disclosure to the SEC versus what's in your sustainability reports or what's on the ESG page of your website.

If your sustainability report is grandiose or exaggerated as compared to what you've included in your SEC disclosures, that's greenwashing, right? The SEC has a dedicated task force investigating these cases; it's regularly sending out comment letters requesting information from corporates questioning such inconsistencies.

In Europe, you see major new regulatory developments that are ambitious and robust.

This year, 2024, we'll see the first year of implementation of the EU's Corporate Sustainability Reporting Directive, the CSRD. This is a milestone piece of regulation that will be implemented over the next few years in phases.

The first phase is playing out this year where essentially large-listed filers in Europe and groups above a 500-employee threshold will in 2025 have to include in their annual reports detailed and extensive sustainability reporting for the year 2024.

Meanwhile, we're awaiting the final text of the CSDDD, the Corporate Sustainability Due Diligence Directive. It will have a longer timeline in terms of implementation. But it will be a significant and transformative new regulation of not just European companies, but major companies around the world that have significant operations in Europe. CSDDD will require real governance transformations. It will require the implementation of due diligence policies and procedures, and reporting on social and environmental harm.

That's a real milestone.

In the US, there's the SEC's proposed Climate Rule, which has been a bit like the film "Groundhog Day," trying to decide whether, and in what form, it will appear or not. We've been expecting it for quite a long time. Meanwhile, California has a host of new climate-related disclosure laws and, elsewhere around the world, Singapore has new disclosure regulations, Hong Kong is working on disclosure regulation and the list goes on.

It's quite a vigorous environment—and this is just the legal and the regulatory side. We're also seeing this year new biodiversity disclosures. The Taskforce on Nature-related Financial Disclosures (TNFD) just announced last week the first round of biodiversity disclosures. Something like 100 financial institutions, among others, will be disclosing under TNFD this year.

But at the same time, primarily in the US but not only in the US, you're starting to see a significant amount of pushback. It comes in the form of state-level regulations and laws in the so-called anti-ESG realm.

Those come in different forms, with some prohibiting asset managers from "boycotting" certain industries, placing restrictions around pension funds and other fiduciaries from considering ESG factors in their investment decision-making, and so on.

You're seeing investigations, subpoenas and Congressional involvement, all of which, I think, is likely to be amplified this year by the election cycle and the increased polarization we see.

DUNCAN EDWARDS: Kal, with legal obligations snowballing, how prepared are companies to fulfill the increased reporting requirements?

KAL TRINKNER: Hello, everyone, it's a pleasure to be here.

There is an ongoing debate at every company that I work with of, "Who should own regulatory ESG reporting?"

Is it the sustainability team who's been doing this for five, 10, 15-plus years in a voluntary capacity and they know the subject matter? Or is it finance, who, though overburdened, has spent the same number of years, if not more, establishing reporting processes in a regulated space?

Companies are figuring out that it's about getting the two groups in a room, identifying the skill sets that each group brings to the table, then defining a path forward.

We're also seeing the rise of a new position within companies: the ESG controller. Companies are stepping up hiring for this position, establishing an in-house resource who can speak sustainability, finance and regulated reporting.

Another common question facing sustainability teams today is, how do we leverage our existing IT systems to semi-automate or automate data collection? There are so many different vendors who are trying to solve ESG reporting that it's overwhelming. Ideally, this question gets the IT group as involved as finance in working to solve the new ESG reporting challenge.

"Stay the course on doing the work that's going to make your business more valuable by virtue of it being more sustainable."

JORDAN BICKERTON
Partner, ESG & Sustainable Business, Brunswick Group

DUNCAN EDWARDS: Jordan, you're an ESG advisor to corporations at a moment when a small mistake can blow up into a value-destroying debacle. How are you advising clients to own the challenge?

JORDAN BICKERTON: Wonderful to be with you this morning.

The most prominent missteps have come from inconsistency, where they said one thing and either didn't follow it through or subsequently were proven to be doing another thing. Or a decision was made that wasn't based on what was right for the business.

No matter what though, you're not going to please everyone. The extremes on both sides of this debate are so noisy, so passionate, so polarized, so motivated—you have to have a fairly thick skin. And when you've made a decision, you have to stay the course and recognize that you're not going to please everyone.

If it was the right move for your business, then it was the right thing to do. Our advice: Listen through the noise. It's important not to get distracted or brow-beaten.

Stay the course on doing the work that's going to make your business more valuable by virtue of it being more sustainable, more inclusive, more responsive to the changing world around you.

DUNCAN EDWARDS: What is your advice to companies on risk avoidance?

JORDAN BICKERTON: At Brunswick, we've advised management teams for many years on exactly these issues—risk mitigation and opportunity, reputation building and backlash. Basically, how do you navigate ESG?

I'd like to touch on four big shifts. The first is from focusing on ESG as a broad category, which was very in vogue over the past couple of years. You saw all kinds of financial products being labeled as ESG. You heard companies talking a good game about their commitment to this agenda.

What's changed in the last year is a focus on the specifics, finding the points where each of those letters—environmental, social, governance—intersects with business value.

We think a good way to de-risk is to focus not on the broad category, but on the point where these issues affect your business. In many cases, major asset managers have stepped back from using ESG publicly in their communications and in their engagement. But do they have transition investing units, which are putting significant capital to work in the energy transition? Yes.

If the first trend is the shift from the category to the specifics, the second is from stakeholder-led ESG to strategy-led ESG. The reason that's happening is that stakeholder expectations have diverged. California will soon mandate Scope 3 disclosure while Montana prohibits the consideration of climate factors in major energy projects.

At a moment when the stakeholder landscape is so fragmented, the only possible answer is, "Does this work for the business? What's the commercial argument for doing these things?"

We worked recently with a bank being called out by activists for financing fossil fuels while facing serious domestic pressure to finance more fossil fuels. How on Earth do you decide?

What the bank wound up doing was defining its expectations of fossil fuel clients, defining what their commitment to the transition should look like, and why and how that benefits the bank. In that way their approach shifted from stakeholder led to strategy led.

The third shift is from claims to credible action. We saw a lot of big, long-term claims about 2050 and making the world a better place. Those claims are hard to stand up as legal risk grows and reporting requirements get stricter.

As the reputation risks become greater, the question is, "What are you doing, and how do you prove it?" We're seeing lots of companies move from talking about 10, 15 years from now, to talking about the next year and leaning into the tangible progress they've made on a given issue.

The fourth shift is from a mass broadcast of one's ESG strategy to a more targeted approach. This is a result of greenhushing. Greenhushing is a trend wherein companies have been discouraged from talking about what they're doing on climate, and they've become reticent.

As this backlash ramps up, it's starting to occur in DEI as well. In the last earnings cycle, Q4 2023, we saw a 30% reduction in people using the term ESG on earnings calls compared to the past year. It doesn't mean that they're winding back from the action. Executives are becoming a lot more targeted in their engagement.

DUNCAN EDWARDS: Is it an option for companies to say, "We're going to obey the law and keep quiet about everything else"?

JORDAN BICKERTON: Absolutely. It's a choice that many companies do make. But it can be a real pity to look at it only from a risk mitigation perspective, because there is opportunity.

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KAL TRINKNER
Senior Manager, Climate Change and Sustainability, EY

"We are committed to helping our clients and prospects as they move along this transition to net zero."

AMY FRANZEN
Co-Head of US Originations—Sustainable Finance, HSBC

There are two areas where the opportunity is great. The first is in the war for talent. We hear a lot about younger employees wanting to work somewhere purposeful and holding their employers accountable and wanting to know, "What are they doing on climate? What are they doing on inequality and access?"

The second opportunity involves corporate innovation in products and services, particularly in the energy transition. Lots of our clients are working toward a place where in the next five years they can unlock real growth by being more sustainable, by being more inclusive.

DUNCAN EDWARDS: A question for Amy, as a bank that does business with companies engaged in the transition to new energy sources, how does HSBC see the landscape at the moment—either the opportunities or the challenges?

AMY FRANZEN: Thanks, Duncan. Great to be here and see everyone today.

At HSBC, we are committed to helping our clients and prospects as they move along this transition to net zero.

With our corporate clients, we're helping them learn about best practices, what others are doing in the industry, keeping up with regulations and what reporting requirements will be, and then helping them fund that transition.

I think some of the biggest trends we're seeing are in the renewable energy space. Specific financing structures that we're helping companies with are sustainability-linked loans, green loans and social loans. Also, in the public markets, our clients are looking at green bonds, social bonds and sustainability-linked bonds.

Then the other side of that is the emerging companies, the startups to which we've committed $1 billion in climate tech funding.

We're helping those startup companies all the way up to the large global companies that are multinational. HSBC operates in more than 60 markets, so we can help companies all over the world.

Also, as our global clients look into their Scope 3 emissions or their supply chains, we're helping them with financing solutions, such as sustainable supply chain finance programs. And that is encouraging their suppliers, either from an environmental or social standpoint, to continue to improve.

DUNCAN EDWARDS: Thank you all for your time and contribution to this discussion. ◆