SARA 2020 conference

ESG: Debunking the myths and integrating it into executive pay structures

Anelisa Keke

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Agenda

- What is ESG?
- Debunking the myths regarding ESG
- How to approach ESG and executive pay

What is ESG?

What is ESG meant to achieve?

- Long-term sustainability – understanding how environmental, social and governance-related matters will impact the future of the organisation, and planning accordingly
- The 17 United Nations Sustainable Development Goals (UN SDGs) are an urgent call to action by all countries – developed and developing – in a global partnership to achieve the 2030 Agenda
- Understanding ESG requires a more nuanced discussion around how value is created and eroded through the company's short, medium and long-term strategy – this must be supported through (inter alia) life cycle and end-of-life assessments
- Some global sustainability objectives, particularly for the UN SDGs and associated targets, are very broad in scope and can be set at a national or regional level

If you don't know where to start looking:

UN Global Compact: https://www.unglobalcompact.org/

UN SDGs: https://sdgs.un.org/goals

For guidance on how the SDGs can be translated into business targets, consult the UN Global Compact report on "Business Reporting on the SDGs: An Analysis of the Goals and Targets" (2017), available at https://www.unglobalcompact.org/library/5361

What does ESG cover?

Environmental

- Environmental management system
- Carbon emissions
- Water resources
- Waste and pollution
- Biodiversity
- Climate risk management

Social

- Customer relations
- Human capital
- Health and safety
- Human rights
- Communities
- Suppliers
- Labour rights

Governance

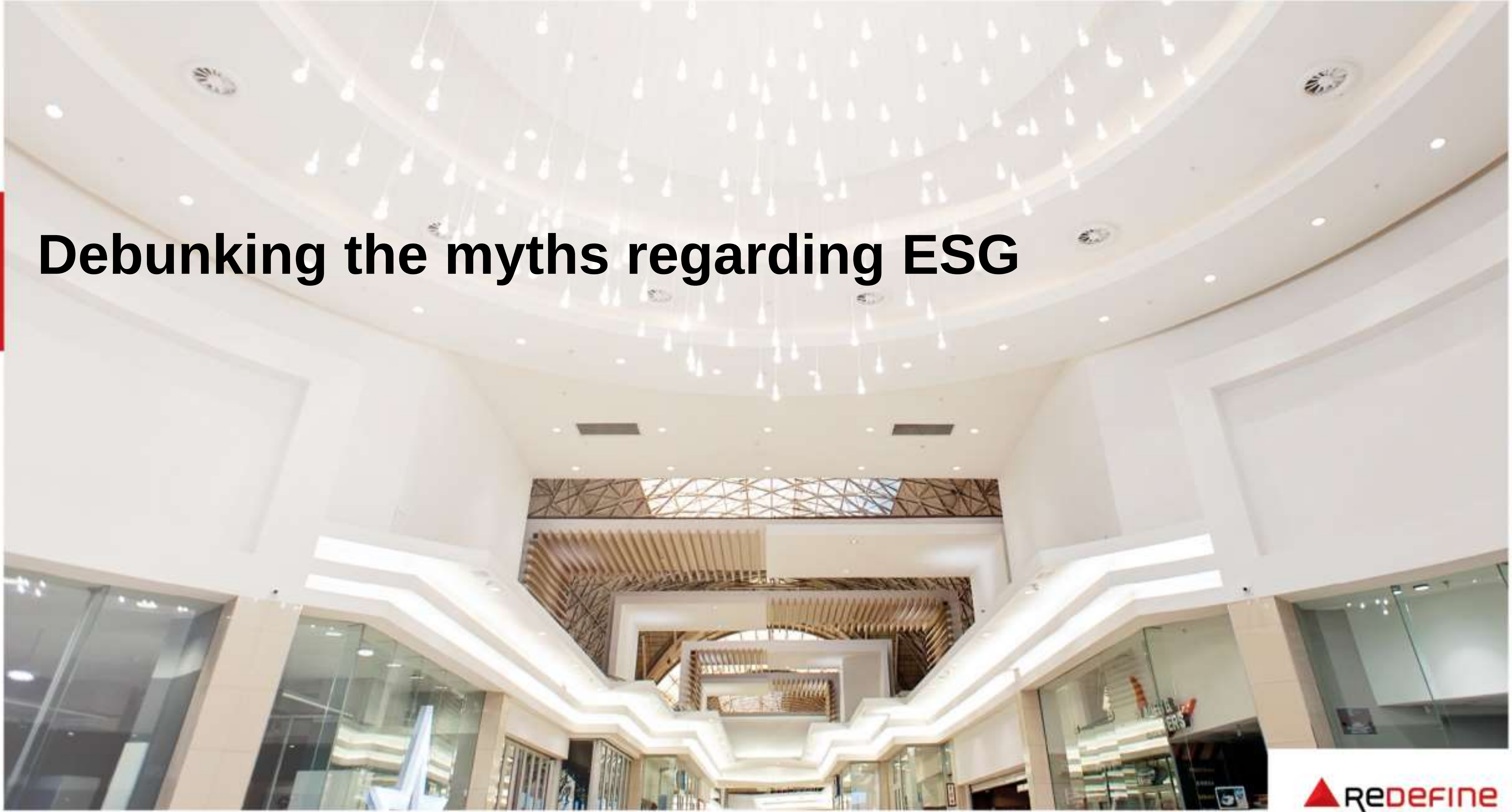
- Anti-bribery and corruption
- Assurance of ESG information
- Internal governance structures
- Compliance and reporting
- Board structure, policies and procedures
- Ethics management
- Risk management

What do all of the ESG-related acronyms mean?

Note that this is not an exhaustive list

Reporting
GRI: Global Reporting Initiative
SASB: Sustainability Accounting Standards Board
Benchmarks
CDP: (formerly) Carbon Disclosure Project
DJSI / CSA: Dow Jones Sustainability Index / SAM Corporate Sustainability Assessment
GRESB: Global Real Estate Sustainability Benchmark
Frameworks
TCFD: Task Force for Climate-related Financial Disclosure
UN GC: United Nations Global Compact
UN PRI: United Nations Principles for Responsible Investment
UNEP FI: United Nations Environment Programme Finance Initiative
IIRC: International Integrated Reporting Framework

Debunking the myths regarding ESG



ESG is focused on environmental matters

False

- ESG covers environmental, social *and* governance-related matters
- Concerns around certain “grey rhino” risk events such as climate change have taken on prominence in the global ESG discussion. This may drive this perception
- No area of ESG can definitively be identified as being more important than all others across all industries – note that respecting human rights, respecting the rule of law and “doing no harm” are the starting point for engagement on the 17 UN SDGs
- In order to prioritise resources, however, a company may need to conduct a materiality assessment to understand which areas of ESG it will impact the most, and which areas of ESG will impact it the most

Is implementing ESG a cost-intensive exercise?

Not necessarily. A company will need to invest in resources (human and financial) to achieve certain objectives but it will also require behavioural change within the workforce and value chain, which is less expensive but in some ways, harder to achieve.

The “Social” aspect focuses on community outreach

False

Community outreach initiatives form part of the social aspect, but it is critical to assess the impact (positive and negative) of your products and services on your customers and the community

Section 43 of the Companies Regulations, 2011 require the Social, Ethics and Transformation Committee to “(a) monitor the company’s activities…with regard to matters relating to- (iii) the environment, health and public safety, including the impact of the company’s activities and of its products or services”

Suppliers	Human capital	Human rights	Customer satisfaction	Communities and social investment	Health and safety

ESG is a specialized discipline

Not always

ESG should not be left to pockets of excellence within your company to implement

Be strategic about the use of external advisors when introducing ESG concepts

Your reliance on external / specialized skills will depend on the maturity of your company's ESG strategy and project-specific needs

Your employees should have a basic understanding of what ESG entails; how they can make ESG come alive; and how ESG will impact their day jobs

Distill complex ESG-related concepts into simple, easy to understand roles for your team; and promote cross-team collaboration

ESG can only be used to develop “non-financial” metrics

False

- ESG-related measures can be quantified – companies must assess and explain how ESG risks and opportunities respectively will impact their financial performance
- Scenario planning plays an important part in this process – assumptions made about future-orientated risks can be difficult to verify until those risks materialise

Example: TCFD

(source: TCFD, 2018)

Table 1

Examples of Climate-Related Risks and Potential Financial Impacts

Type	Climate-Related Risks[32]	Potential Financial Impacts
Transition Risks	**Policy and Legal**	
	– Increased pricing of GHG emissions – Enhanced emissions-reporting obligations – Mandates on and regulation of existing products and services – Exposure to litigation	– Increased operating costs (e.g., higher compliance costs, increased insurance premiums) – Write-offs, asset impairment, and early retirement of existing assets due to policy changes – Increased costs and/or reduced demand for products and services resulting from fines and judgments
	Technology	
	– Substitution of existing products and services with lower emissions options – Unsuccessful investment in new technologies – Costs to transition to lower emissions technology	– Write-offs and early retirement of existing assets – Reduced demand for products and services – Research and development (R&D) expenditures in new and alternative technologies – Capital investments in technology development – Costs to adopt/deploy new practices and processes
	Market	
	– Changing customer behavior – Uncertainty in market signals – Increased cost of raw materials	– Reduced demand for goods and services due to shift in consumer preferences – Increased production costs due to changing input prices (e.g., energy, water) and output requirements (e.g., waste treatment) – Abrupt and unexpected shifts in energy costs – Change in revenue mix and sources, resulting in decreased revenues – Re-pricing of assets (e.g., fossil fuel reserves, land valuations, securities valuations)

ESG means the same thing across all sectors

Not always

Company-specific impacts

- A company or industry's ESG impact can vary based on location, socio-economic circumstances, nature of their core business, supply chain and customer profile

Sector-specific impacts

- Some sectors will have a fundamentally greater impact on certain areas of ESG, while others will have an indirect impact on the same areas of ESG (e.g. biodiversity)

Universal ESG principles

- Some areas of ESG will need to be observed by companies across sectors, e.g. good board governance, labour rights, fair and responsible remuneration

Regulatory framework

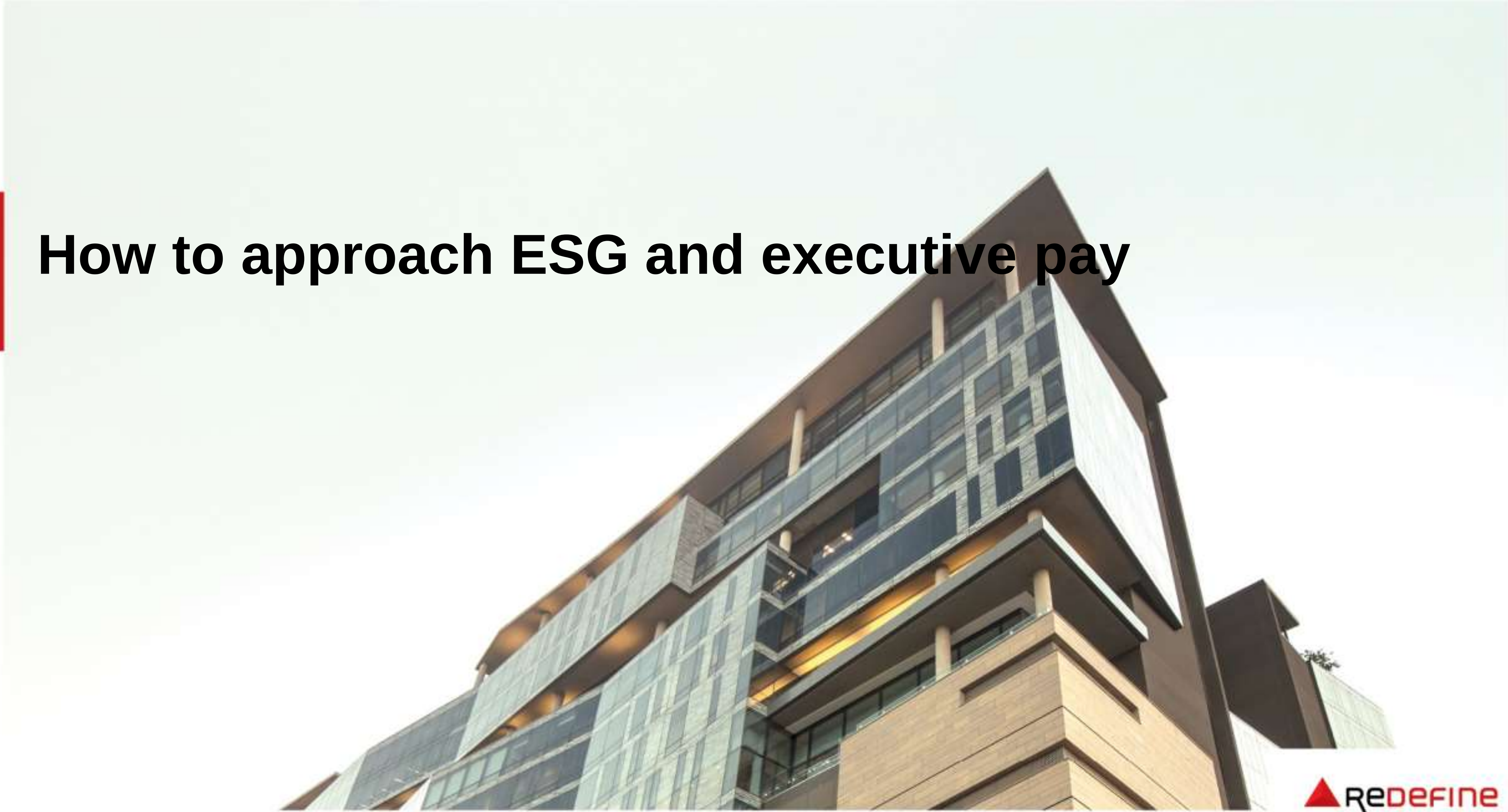
- Regulatory burdens may vary per sector, which may add an additional layer to the company's ESG strategic approach and risk / opportunity framework

ESG does not impact a company’s ability to attract investment

False

- Global credit rating agencies such as Moody’s incorporate ESG into their credit rating methodology
- According to BlackRock data, 88% of sustainable funds in their analysis outperformed their non-sustainable counterparts in the period 1 January to 30 April 2020 (source: UNPRI)
- Sustainable finance products are gaining traction locally and globally, including blue bonds, social bonds, SDG bonds and sustainability bonds; and sustainability-linked loans
- Investors are increasingly incorporating ESG criteria into their investment decisions – impact investment is on the rise
- JSE issued requirements on sustainable debt instruments, confirming (a) independent sustainability advisor with sufficient expertise, (b) use of proceeds and reporting back on impact from eligible projects, (c) compliance with JSE Listings Requirements on sustainability / debt issuances

How to approach ESG and executive pay



How is ESG incorporated into your company’s purpose

ESG and purpose	How does your company’s purpose reflect ESG?
	Demonstrate clear alignment between ESG and the company’s purpose and strategy. If ESG is not meaningfully incorporated into strategic planning and forecasting, any metric associated it will carry little credibility as it effectively lives outside of your strategy
Purpose and remuneration	How does your remuneration structure reflect your company’s purpose?
ESG and remuneration	Consider whether ESG should be incorporated into performance metrics, and if so (i) provide a justification for doing so; and (ii) consider which employees should have ESG metrics incorporated into their balanced scorecards
	Depending on your company’s strategic framework, explain why some ESG metrics have been incorporated into your short-term or long-term incentive respectively and not others

Identify your company’s ESG-related priorities

Conduct an ESG materiality analysis – which areas of ESG does your company impact the most through its core business? And how can the company intensify its impact?

ESG materiality analyses can be conducted at Group level, or for a subsidiary or geographical area. Guidance for materiality analyses at an international level are available for certain industries

Understand how ESG impacts your bottom line, over the short-, medium- and long-term. A lack of future-proofing will be unfavourably viewed by key stakeholders once the ESG-related transition risk materializes

ESG can create value for stakeholders other than, or in addition to, investors. Value creation across your key stakeholder groups must be properly understood and articulated. Consult a wide range of stakeholders to inform your company’s views

Set robust targets

Avoid the “quick win” mentality

Targets

- ESG metrics require targets which must be sufficiently stretching
- Targets linked to specific ESG-related projects must be justifiable
- Consider percentage of operations / employees / suppliers covered

Time horizon

- Outcomes can be measured over a shorter term, but impact is usually measured over a longer period of time
- Some metrics, e.g. transformation, may have short and long-term targets; climate risk management metrics may stretch over 30 years (in line with the time horizons of the Paris Agreement)
- Set milestones for the achievement of more long-term goals

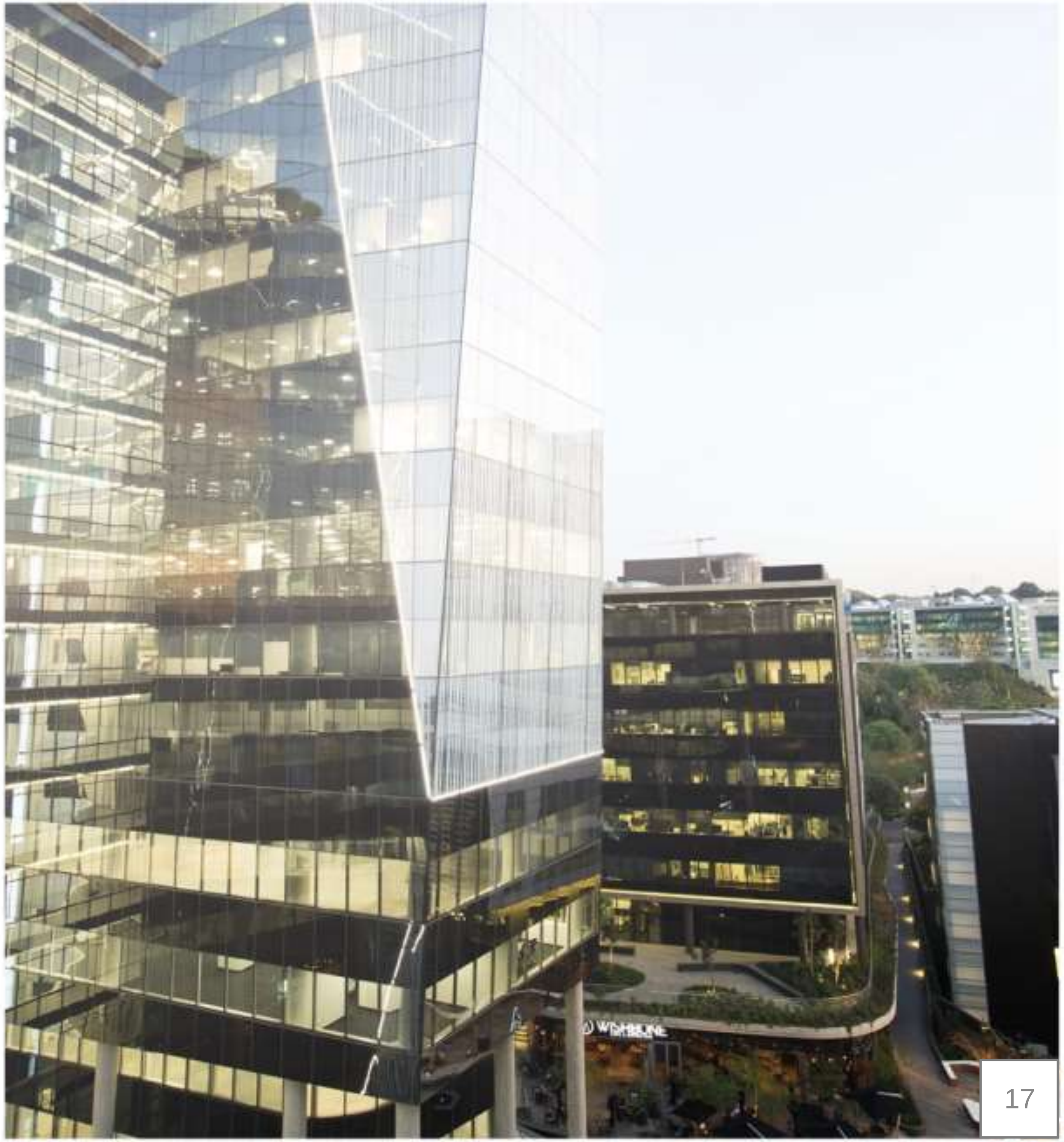
Governance

- Governance must support the monitoring and achievement of the target
- Use of discretion regarding ESG metrics should be very carefully managed
- Cross-collaboration will be needed between board committees in monitoring progress against ESG metrics

Other factors to consider

Be aware of the following -

- Your investors' expectations as they relate to ESG and executive pay
- ESG is not another means of "ratcheting" executive pay – rather, it should compel companies to take a more long-term view of sustainable performance
- Present investor-grade and decision-useful information when demonstrating why the ESG-related target was selected, and how it was met
- The push for ESG assurance is gaining traction



Thank you

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