HOW GREEN ARE YOUR DISCLOSURES?

Companies are facing increasing demands from investors, advocacy groups, and research firms for sustainability data.

By Ted Allen

While many large-cap companies have been producing sustainability reports over the past decade, the conventional wisdom within IR circles is that most U.S. mainstream investors don't care much about environmental and social issues.

While sustainability traditionally has ranked low in investor surveys, it appears that these views are slowly changing, in part because of the growth of sustainability-focused funds in Europe and increasing information demands by socially responsible investors, non-governmental organizations (NGOs), and research firms. In addition, some companies are discovering that gathering and disclosing this data can help them better understand risks and appeal to longer-term investors.

"It should be very interesting to an IRO because sustainability sits at the heart of corporate reputation, which affects valuation," notes Jane Okun Bomba, senior vice president and chief sustainability, investor relations, and corporate communications officer at IHS, a Colorado-based provider of economic and market data. "It's a very ripe area for IROs to expand their spheres of influence – it's all about how a company is run and includes strategy, structure, and culture."

As Bomba alludes to, sustainability is not just a company's greenhouse gas emissions, energy consumption, or water use. The term also encompasses a wide range of social concerns, including worker safety, human rights, board diversity, and corporate citizenship issues (such as political contributions and tax avoidance strategies).

Sustainability often is used interchangeably with terms like SRI (socially responsible investing), ESG (environmental, social, and governance), and CSR (corporate social responsibility). While the disclosure of executive compensation and other governance information already is mandated in the United States and Europe, there is growing pressure for companies to provide more environmental and social information.

In April, the European Parliament adopted a mandate to require "large" companies (i.e., those with more than 500 employees) to disclose more information on "environmental matters, social and employee-related aspects, respect for human rights, anti-corruption and bribery issues, and diversity on boards of directors."

Pressure From Activists

In the United States, shareholder activists have been urging the Securities and Exchange Commission to require more disclosure on climate change. The SEC's Corporation Finance Division staff is reviewing its Regulation S-K rules, and activists are hopeful that the SEC will take an expanded view of "materiality," which is the legal trigger for whether disclosure is required in a company's filings.

In February, Ceres, a sustainability advocacy group, criticized the SEC for not following through on commitments outlined in the Commission's 2010 guidance on climate change disclosure. Ceres' Investor Network on Climate Risk, which represents institutions with $8 trillion in assets under management, argues that climate change has become a major concern of the "reasonable investor," and thus should be considered material.

However, SEC observers doubt that the agency will adopt new mandates in the near future, given the Commission's unfinished Dodd-Frank rulemaking and Chair Mary Jo White's publicly stated concerns about using disclosure rules to advance social causes.

"I don't think this is a topic the SEC staff will attempt to address through guidance, and I haven't seen any indications yet that new rules in this area would garner the required support of the commissioners and Chair White," says Brian V. Breheny, a partner with Skadden Arps, who previously worked as deputy director of the Corporation Finance Division.

Nevertheless, ESG activists likely will continue to pressure the SEC, which could respond by holding a roundtable or issuing a concept release. In addition, Ceres is lobbying U.S. and international stock exchanges to revise their listing standards to require more disclosure. At Hong Kong's exchange, ESG reporting already is a recommended best practice.

Sustainability also is getting more attention at annual meetings. During the spring 2014 U.S. proxy season, investors filed a record number (417) of proposals on a wide range of environmental and social issues, according to a report by As You Sow, an activist foundation. While many proposals related to political spending and lobbying, a Ceres-led coalition of investors submitted 142 resolutions on climate change and other environmental issues this year. Among the 35 institutions involved in this effort are the California State Teachers' Retirement System, pension funds from New York State and Connecticut, and Walden Asset Management.

As in past proxy seasons, shareholders withdrew dozens of resolutions this year after issuers agreed to provide more disclosure. However, these settlements won't prevent investors from returning next year.

"I have seen some companies consider, prepare, and issue the most thoughtful and responsive disclosures in their industry and still they receive proposals seeking more information," says Breheny.

Do Investors Care About Sustainability?

Many IROs see a mixed picture when trying to assess investor interest in sustainability. Despite all the noise from SRI activists, the perception remains that most U.S. institutional investors don't really care about sustainability.

However, ESG investors, NGOs, and consultants point to the growing number of institutions around the world that say they look at sustainability issues when making investment decisions or engaging with a company. Almost 1,100 asset owners and investment managers, with more than $32 trillion in total assets under management, have signed the United Nations Principles for Responsible Investment (PRI).

While not all signatories closely follow these principles or allocate a significant portion of their assets to SRI-oriented funds, it appears that they want more information on these issues. In May, PwC, which provides consulting on sustainability issues, reported that 82 percent of investors said they considered climate change or resource scarcity in making investment decisions with the past 12 months. While European issuers received positive marks, 61 percent of investors expressed dissatisfaction with the disclosures by U.S. companies, according to the PwC report, "Sustainability Goes Mainstream: Insights Into Investor Views," which was based on responses from 40 institutions. (To view a copy of the report, visit www.niri.org/sustainability.)

Julie Kegley, director of investor relations at Tyson Foods, says investor interest has definitely increased since her company's first sustainability report in 2005. "It's not a primary focus, but is on their radar screens," she says.

Tyson, which used to produce sustainability reports every two years, has switched to annual reporting and now provides more current content on its website. The meat products company's most recent sustainability report was written in a "more conversational style," accompanied by video clips on the company's website, and promoted by social media, notes Leigh Ann Johnston, Tyson's director of sustainability.

Greater Interest in Europe

Shareholder views on sustainability differ significantly by region. In Europe, interest has increased over the past decade as fund managers have hired ESG analysts and started new SRI funds to compete for "green" investments from pension plan managers, recalls Anne Guimard, president of FINEO Investor Relations, a London- and Paris-based IR consultancy.

Another factor has been the growing list of ESG disclosure mandates by European Union nations. She cites a 2012 HSBC Global Research report, which found that "broad" SRI assets (where fund managers do simple screening) in Europe had grown from almost zero in 2005 to $8 trillion, while "core" SRI assets, which reflect screening for best-in-class companies, had increased to $1.7 trillion.

"If you want to have a European shareholder base, it's become increasingly important," says Alexandra Deignan, vice president for IR at Schnitzer Steel Industries, an Oregon-based metals recycling company. Deignan expects that U.S. investor interest will increase "gradually."

She says her company, which used to produce sustainability reports every few years, has shifted its attention to providing more current and tailored sustainability information on its website.

Guimard believes companies should provide some ESG metrics to their investors, even if they aren't asking for that information. "In 99 percent of road shows, there won't be any questions on ESG issues, but that doesn't mean that you can't proactively put forth metrics that tell your story to investors," says Guimard, noting that global steel company ArcelorMittal starts off its quarterly earnings calls by providing workplace safety data.

Barbara Brown, co-founder of BrownFlynn, a Cleveland-based corporate responsibility and sustainability consulting firm, expresses a similar view. "It absolutely is mainstream; our clients view it as a differentiator," says Brown, who has worked with companies that have been noticed by new investors after increasing their sustainability disclosures.

In addition, a growing number of institutions, such as public pension plans and sovereign wealth funds, are increasingly seeking ESG information, which is creating new ESG research activities and programs at mainstream asset management firms, like BlackRock and Goldman Sachs, notes Brown, adding that an increasing number of private equity firms are also reviewing their own holdings for ESG risks and opportunities.

"While it's still not top-of-mind for many IROs, we see this sort of disclosure as a leading indicator of good corporate governance, which investors and the markets are monitoring more closely," says Brown. "We don't see it as a 'nice' thing to do. We see it as a real reflection of the quality of management."

Bomba expects that more investors will become interested as they realize that sustainability reporting can help them better understand how a company manages a broad range of potential risks. In the PwC survey, 73 percent of investors said they consider sustainability "primarily because they believe doing so will reduce risk."

"It's an educational process," observes Bomba. "I often say to investors, 'If you care about a company's performance over a long period, it's something you may want to look at.' It's all about providing transparency about the issues that investors care about."

An Array of Voluntary Reporting Standards

One challenge for IR professionals is the alphabet-soup array of NGOs that are urging issuers to provide more standardized data that would enable better comparisons among companies. The Amsterdam-based Global Reporting Initiative (GRI) oversees the most widely followed standards; 78 percent of the companies worldwide that report on sustainability or corporate responsibility make reference to GRI guidelines, according to KPMG.

In May 2013, GRI released an updated "G4" set of guidelines that includes additional guidance on "material" issues that should be included in reports. An affiliated organization, the International Integrated Reporting Council, released its own set of guidelines in December 2013. "Integrated" reporting is intended for investors and other providers of capital; sustainability reporting has a broader audience that includes other stakeholders.

In the United States, the Sustainability Accounting Standards Board (SASB) was launched in 2011, but its efforts didn't receive much public attention until this year. The group is analyzing industry-specific sustainability risks that companies would discuss in their Form 10-K filings. SASB, which plans to develop minimum standards for 88 industries, has released guidelines for the financial services, health care, and technology-communication sectors.

SASB has attracted high-profile support, as former New York Mayor Michael Bloomberg and ex-SEC chair Mary Schapiro joined its board earlier this year. In May, SASB launched a pilot program to help companies incorporate sustainability into regulatory filings; Nasdaq OMX was the first company to join this effort.

GRI and SASB have invited companies to participate in the development of guidelines. For instance, Tyson Foods participated in the GRI standards process for food producing companies. Kegley says companies should try to have "a seat at the table" to ensure that they can comply with the guidelines. As she points out, "It's going to happen; do you want to be part of the conversation, or not?"

However, the efforts of SASB and other organizations have sparked concern from SEC Commissioner Daniel Gallagher. "While companies are free to make whatever disclosures they choose on their own time, so to speak, it is important to remember that groups like SASB have no role in the establishment of mandated disclosure requirements," Gallagher said in a speech in March.

In response, SASB Executive Director Jean Rogers emphasized that its standards are voluntary and that it uses the same definition of materiality as the SEC. Noting that 75 percent of sustainability data provided by companies is not material, SASB said it seeks to help issuers identify the other 25 percent of information that is material, and to encourage reporting that is "comparable and easily accessible" to investors," Rogers wrote in a letter to Gallagher.

In a speech in June, Gallagher continued to express alarm about "special interest" groups and their requests for more sustainability information. "I worry that it is only a matter of time before the not-too-subtle 'voluntary' push for such disclosures morphs into an express effort to mandate these disclosures by embedding them as new requirements in our rulebook," he said. "The majority of these disclosures are simply not material to a reasonable investor."

Deluge of Questionnaires

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One of the best-known questionnaires is that of the CDP, which was founded as the Carbon Disclosure Project in 2000. London-based CDP produces annual reports on climate change and supply chains based on information submitted from the S&P 500, FTSE 350, and other companies.

In addition, there are numerous advocacy groups and research firms that ask companies for data. Many surveys are very similar, but most companies don't have the resources to respond to all of them, notes Laura Gagnon, vice president for IR at The Mosaic Co., the world's largest producer of phosphate and potash. "Try to find a survey that's broad enough and has a big enough audience and then direct investors to your response where they can find the information they need," she advises.

"Our sustainability report has allowed us to limit the time we spend responding to questionnaires," Kegley says, noting that Tyson often directs information seekers to specific pages in its sustainability report or regulatory filings. Johnston said Tyson sometimes will generate additional data, but doesn't always provide data in the format requested. "We may not give them information exactly as they asked for it, but we try to be responsive," she says. "The biggest thing is not to ignore the request."

Guimard says companies should be careful about the non-public information they provide, given the risk that it could be used by competitors. "You don't have to answer all these questionnaires, except for the most reputable ones," she points out. "You should ask, 'Do your investors care whether you are rated by a specific ESG or sustainability index?' "

IROs also should monitor the sustainability information about their company published by research firms and ESG advocates, advises Johnston. Sometimes, these reports cite information that is no longer current, or rank a company poorly on certain metrics because of an absence of disclosure.

"You have to read everything to see if there are any egregious errors that would merit a response," Deignan says. A company also should be prepared to answer investors' questions about why it didn't answer a particular survey. "The biggest mistake you can make is to ignore it," she notes.

WHILE LARGE-CAP ISSUERS RECEIVE THE MOST REQUESTS FOR INFORMATION, BROWN SAYS THESE REQUESTS ARE "TRICKLING DOWN" TO SMALLER FIRMS, SUCH AS THOSE IN THE HEALTH CARE, IT, OR AUTOMOTIVE SECTORS, WHICH HAVE LARGE AND COMPLEX SUPPLY CHAINS.

Value to Other Stakeholders

Many of the companies that produce sustainability reports do so for audiences beyond investors. Tyson receives the most requests for sustainability data from its customers, followed by NGOs and activists.

Likewise, Gagnon says Mosaic produces annual sustainability reports for a "broad array of constituents" that include state regulators, local communities, and NGOs.

"Sustainability is one of our major corporate values; it's important to us internally and externally," she says, noting that the company has used its reports to highlight its environmental reclamation efforts in Florida, where a top golf resort has been built on former mining land.

While large-cap issuers receive the most requests for information, Brown says these requests are "trickling down" to smaller firms, such as those in the health care, IT, or automotive sectors, which have large and complex supply chains. Brown points out that many companies have ambitious environmental goals and are looking to their suppliers to help them achieve some of these improvements. "A well-managed company has to look at this," says Brown. "If your customers care, your investors will care."

Guimard observes that companies can benefit from producing sustainability data because they have to quantify their impact on the environment and local communities. "The beauty of ESG reporting is that you have to put up numbers and get measured every year," she says. "It's helping companies become more mature and better present their business models through a holistic and comprehensive approach."

IHS recently completed a 150-page sustainability assessment as part of its application for membership in the Dow Jones Sustainability Indices, which include 333 global companies. This assessment, which was prepared by a broad-based team that included human resources, health and wellness, and supply chain management, is viewed by the company's CEO as "required reading" for senior management, says Bomba.

"If an IRO wants a seat at the table and wants to be considered a company leader," notes Bomba, "you have to take a broader view than just the shareholder community." IRU

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