# Navigating the new ESG agenda

LEADERSHIP NAVIGATION

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# 1. Welcome to a new normal for ESG

Sustainability is no longer optional for global companies, innovative SMEs and brands. This new zeitgeist is significantly reinforced by ESG-related financial imperatives pushed by the international investment community. For example, more than 500 investors with over US $47 trillion dollars in assets under management are demanding that greenhouse gas emitters present and action business strategies to achieve net-zero emissions in line with the Financial Stability Board's Task Force on Climate Related Financial Disclosures (TCFD).

The COVID-19 crisis revealed the weaknesses of the current socio-economic systems world-wide. Stakeholder demands were one of the major factors that accelerated the change of corporate strategies and culture towards more sustainable business practices. The demands from Millennials and younger generations cannot to be underestimated. The 2019 edition of the Morgan Stanley Institute for Sustainable Investing survey of high-net-worth investors found that 95% of Millennials were interested in sustainable investing. According to Nielsen's research, 93% of Millennials want investments to reflect environmental and social values and 80% of Generation Z, as well as Millennials, believe that companies should implement ESG policies.

Regulatory frameworks are moving in the same direction. With an urgent need for regulation concerning climate, investments and social issues, the EU has set in motion an ambitious plan to regulate ESG related issues and ensure compliance.

Subsequently, ESG right now represents a huge opportunity and – at the same time – is the greatest risk for companies, trade associations and organizations. There is no magic solution or a single recommendation for individual actors, be it companies or associations. However, a systemic approach based on organizational learning appears to be the most relevant to design, manage, evaluate and communicate defined ESG approaches. The company's position on ESG is heavily impacted by the industry it operates in. Therefore, trade associations can play a vital role in becoming brokers of holistic industry contributions as they are able to speak with a unified collective voice on behalf of their members. This opportunity is rarely harnessed to the extent of its potential, often because it has become more and more difficult to stand out in a crowded international discourse with often-moving long-term sustainability targets and a plethora of declarations and commitments.

## 2. New agenda in the EU and beyond

The European Union has become a global powerhouse of regulation in the broad scope of sustainability regulatory frameworks. The EU's ambitions – as formulated by the European Commission – for a new framework that would ensure sustainable growth and environmental protection took shape in 2020 when the European Parliament approved the EU Green Deal.

The EU Green Deals requires EU-Member States to:

- Reach zero net GHG emissions by 2050
- Decouple economic growth from resource use
- Leave no person and no place behind[1]

The new sustainable finance agenda has been in the spotlight since 2020, when the EU introduced the Green Taxonomy. The Taxonomy is one of the cornerstones of the EU's strategy and puts a spotlight onto an ESG-focused approach within the business community.

Its future implementation will have an overarching impact on all business-related regulatory domains including international trade. EU becomes a powerhouse of ESG related legislation and many of its initiatives are taken forward as blueprint in other jurisdictions.

ESG-focused regulatory action is also increasing under the Biden/Harris administration in the USA at several levels:

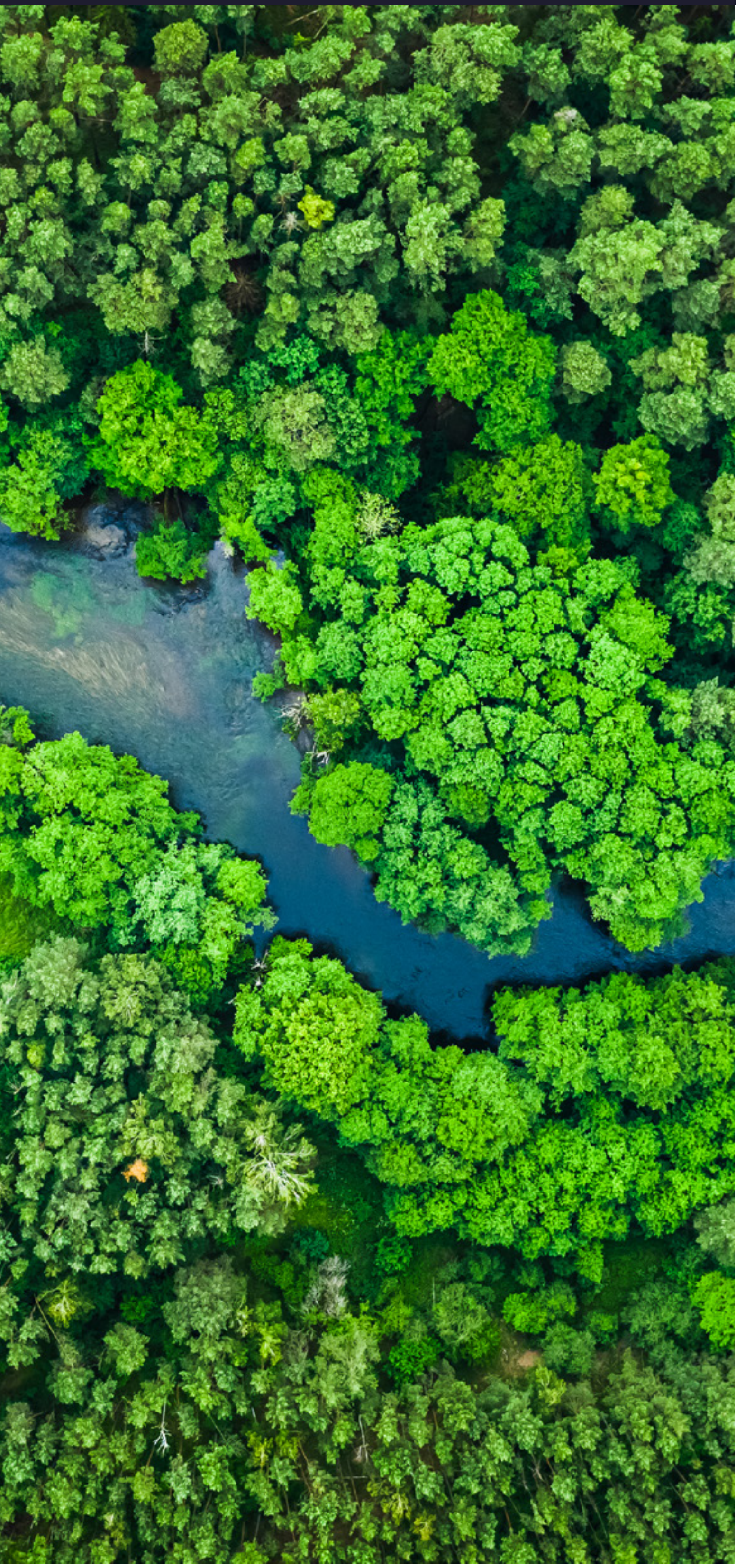
- Re-joining the Paris Agreement,
- Net-zero emissions by 2050,
- ESG declaration for public companies[2],
- The U.S. Federal Reserve is addressing climate risk and has joined the network for greening the Financial System[3]

Decoupling these developments unveils an interconnectivity of the regulatory agenda between all ESG components.

[1] The European Green Deal 2019: eur-lex.europa.eu/resource.html?uri=cellar:b828d165-1c22-11ea-8c1f01aa75ed71a1.0002.02/DOC_1&format=PDF

[2] President Biden's Climate Plan, 27 Jan 2021

[3] Board of Governors of the Federal Reserve System, "Federal Reserve Board announces it has formally joined the NGFS as a member" Press release. 15 December 2020.



## ENVIRONMENTAL (E)

The environmental aspect of the EU's ESG agenda can be simplified into the three main initiatives:

- **The Fit for 55 package**
- **EU Taxonomy**
- **EU Green bonds**

### The Fit for 55 package

At its core, this vast package contains the EU's ambition to achieve its target of cutting emissions to at least 55% below 1990 levels by 2030 and achieve climate neutrality by 2050. Although the proposed reforms touch on many issues and industries, a key element of the package is the revision and strengthening of the EU Emissions Trading Scheme (ETS). A separate ETS exists for buildings and road transport, together with an expansion of the current ETS to include certain maritime emissions.

### EU Taxonomy

The EU taxonomy is a classification system, establishing a list of environmentally sustainable economic activities.[4] It was designed to aid businesses in identifying truly environmentally friendly activities and directing their investments towards sustainable projects on the way to meeting the objectives of the EU Green Deal.

In August 2021, the Platform on Sustainable Finance released a draft report on the criteria for the remaining environmental objectives, i.e. water, circular economy, pollution prevention and control and biodiversity and ecosystems.[5] The final report will be presented to the Commission in November 2021, with an expected adoption of the formal delegated act in the first half of 2022.

Separately, the Commission is also consulting on a draft for "Brown Taxonomy" and a "Social Taxonomy". It again presents a view on the interconnectivity between the different issues.

[4] EU taxonomy for sustainable activities ec.europa.eu/info/business-economy-euro/banking-and-finance/sustainable-finance/eu-taxonomy-sustainable-activities_en

[5] "Draft report by the Platform on Sustainable Finance on preliminary recommendations for technical screening criteria for the EU taxonomy" European Commission (2021) ec.europa.eu/info/sites/default/files/business_economy_euro/banking_and_finance/documents/210803-sustainable-finance-platform-report-technical-screening-criteria-taxonomy_en.pdf

**EU Green Bonds**

Another initiative supported by the EU Taxonomy is the plan to create the European Green Bond Standard ( EUGBS) which will channel monies raised from bond issuance into projects assessed in accordance with the EU Taxonomy. Its principal aim is to "set a gold standard for how companies and public authorities can use green bonds to raise funds on capital markets to finance such ambitious large-scale investments, while meeting tough sustainability requirements and protecting investors".[6] The legislative proposal for a Regulation implementing the standard was published by the Commission in early July 2021.[7]

## SOCIAL (S)

The "S" element of the ESG strategies, although as indispensable as the others, has traditionally received less attention than its sibling concepts. Some reasons could be the traditionally limited direct impact on investments and a lesser need to develop new scientifically founded frameworks or methodologies to support its realisation. However, the focus has begun to shift, with more and more stakeholders looking at social investment as an opportunity rather than a burden.

In line with new stakeholder demands and expectations, businesses must factor in the social element and show respect towards human rights, labour laws, diversity and equal opportunities - to name a few - in order to create value and manage risks.

For instance, the elevation of the "S" issues In the ESG framework is evidenced by attributing greater attention and importance to the workforce which has often been characterized by inappropriate employment contracts, specifically in areas such as social care or sick pay provisions.

During the EU Social Summit in Porto this year, the President of the European Commission, the President of the European Parliament, the Portuguese Prime Minister, the European social partners as well as civil society organizations committed to:

- At least 78% of people aged 20 to 64 being in employment.
- At least 60% of all adults participating in training every year.
- Reducing the number of people at risk of poverty or social exclusion by at least 15 million, including at least 5 million children.[8]

Another sign of the growing importance of the "S" element is the previously mentioned draft report on a social taxonomy[9] which keeps its focus on sustainable corporate governance, value chains and sustainable product policy. According to the draft, it is crucial to identify economic activities that contribute to advancing social justice objectives, considering a large number of factors including the COVID-19 pandemic, social questions around sustainable transition, perpetual human rights abuses, and the rising costs of housing. As there is currently no one single definition or evaluation framework for social sustainability in the context of investments, the social taxonomy would aim to provide exactly that, while building on international frameworks such as the UN Global Compact, UN Sustainable Development Goals (SDGs)[10] and the UN Guiding Principles for Businesses and Human Rights[11].

[6] Strategy for financing the transition to a sustainable economy European Commission (2021) ec.europa.eu/info/publications/210706-sustainable-finance-strategy_en

[7] Proposal for a REGULATION OF THE EUROPEAN PARLIAMENT AND OF THE COUNCIL on European green bonds COM/2021/391 final eur-lex.europa.eu/legal-content/EN/TXT/?uri=CELEX:52021PC0391

[8] Porto Social Summit: all partners commit to 2030 social targets European Commission (2021) ec.europa.eu/social/main.jsp?langId=en&catId=89&newsId=10004&furtherNews=yes

[9] Draft Report by Subgroup 4: Social Taxonomy (July 2021) ec.europa.eu/info/sites/default/files/business_economy_euro/banking_and_finance/documents/sf-draft-report-social-taxonomy-july2021_en.pdf

[10] The 17 Goals UN sdgs.un.org/goals

[11] Guiding Principles on Business and Human Rights UN/OHCHR (2011) ohchr.org/Documents/Publications/GuidingPrinciplesBusinessHR_EN.pdf

## GOVERNANCE (G)

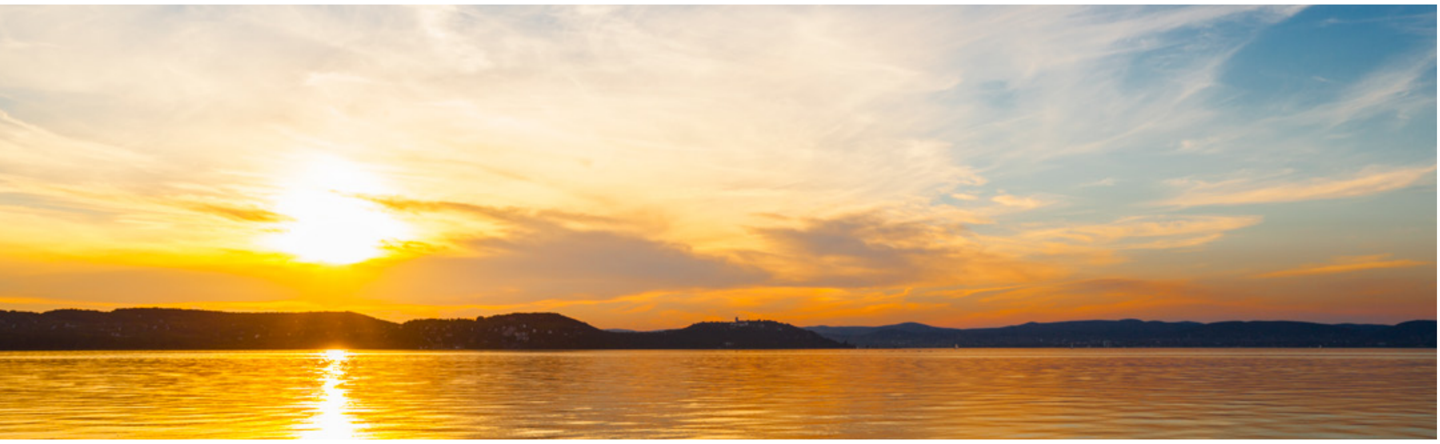
The EU Sustainable Finance Disclosure Regulation on ESG for certain financial services sector firms adopted in spring 2019 and applied as of 10 March 2021 is the main legislative piece in this area.[12] It requires financial institutions, asset managers and financial advisors that claim their activities have environmental benefits, to disclose internal data to justify those claims and produce annual reports, citing up to 50 indicators defined by the EU regulators. The Non-Financial Regulation Directive (NFRD) now includes all the companies with more than 500 employees which means that the number of affected did grow significantly.

Apart from the purely EU framework, there is an increasing number of private sector initiatives and voluntary frameworks created with a thought of committing to net-zero transition plans. For instance, in July 2021, the Institutional Investors Group on Climate Change, which represents $14trn in assets, called on companies to produce net-zero transition plans, ensure director accountability and subject the plans to regular shareholder votes. The Net-Zero Banking Alliance, convened by the UN, led by the industry and co-launched by the Prince of Wales' Sustainable Markets Initiative Financial Services Taskforce[13], brings together 58 banks representing almost a quarter of global banking assets and commits to aligning their lending and investment portfolios with net-zero emissions by 2050.[14]

Voluntary frameworks like the Science-Based Targets initiative (SBTi) fill a gap left by policy. The same can be said about the proliferation of ESG standard-setters, reporting frameworks and standards boards, of which there are 614 and counting. While the sheer number can be overwhelming, together they create a policy framework for governments to pick approaches that suit them best.

## MAKING SENSE OF REGULATORY LANDSCAPE

It is apparent that the ESG regulatory framework moves from a soft law domain towards hard laws. However, not all aspects are treated the same. For instance, the environmental regulation and legislation is the most advanced with a variety of legislative initiatives in place. Social aspects, however, are far more governed by soft laws and compliance with labor laws and other national legislations, while governance still is the most regulated part in the corporate equation. Interestingly, there is currently little regulatory push to align the initiatives under one sustainability governance roof. Finally, it is visible that the regulations impact a wider range of companies of all sizes.



[12] Regulation (EU) 2019/2088 of the European Parliament and of the Council of 27 November 2019 on sustainability-related disclosures in the financial services sector OJ L 317, p1

[13] sustainable-markets.org/taskforces/financial-services-taskforce

[14] Net-Zero Banking Alliance UNEPFI unepfi.org/net-zero-banking

## 3. Conclusions

The evolution of the thematic focus within the discourse around sustainability showcases a tendency to move from compliance to utilizing voluntarily the competitive advantage by proactively tackling increased regulatory measures that may impact the bottom line and overall performance.

The reporting and industry standards originally designed as soft laws are now replaced by an increasingly stringent and binding regulatory framework. As a result, ESG is central to business strategies.

While the EU can be considered as the leading powerhouse of regulation on ESG matters, other jurisdictions such as United States are following closely. Regulatory developments are coupled with increasing pressure from consumers and stakeholders, demanding the integration of sustainability communication into all external activities of corporations.

Yet, many companies and industries operate in organizational silos, especially when it comes to external relations and stakeholder engagement disciplines. Becoming "fit for ESG" requires a re-think and re-set of corporate activities organizationally, strategically and at a tactical engagement level.

It starts with understanding where the organization is and how it can progress through a strategic approach, The maturity index provides a dual support: identification where the company is at its ESG journey and what are the next organizational, strategic and tactical steps it might take to progress its objectives. Finally, it supports benchmarking within the industry and between the industries.

The pathway starts with defining an organizational North Star and aspiration, taking a holistic view of ESG engagements and activities:

1. Develop a landscape analysis at both regulatory and consumer levels to identify key areas of influence and influence gaps according to industry sectors and business areas.
2. Define the level of impact and desired outcomes from an integrated sustainability programme.
3. Align ESG approach with organizational purpose, vision and mission while ensuring they are integrated with the values of the company.

It requires strong alignment, both at systemic and strategic level, to ensure organizations can carry the implementation of its ambitions:

4. Build a strong sustainability management system connected with sustainability reporting standard selected by the organization.
5. Rethink organizational structure and ensure cross-disciplinary alignment between functions working on ESG matters.
6. Create a strong narrative to unify the understanding of the ESG programme across the organization.
7. Develop a measurement and evaluation scheme with precise KPIs.

Finally, it demands genuine engagement with all relevant stakeholders to move the needle.

8. Identify stakeholders and influence brokers to leverage network of networks for an enhanced engagement programme.
9. Write one engagement strategy combining all the engagement disciplines to drive impact across all the channels and communication means.
10. Be bold and creative to stand out in a saturated sustainability landscape.
11. Monitor and benchmark engagement outcomes and adjust strategies if necessary.

## 4. Fit for ESG (maturity index)

The companies need to navigate this increasingly complex landscape and find their strategic and tactical approach towards ESG governance. The index presented on the right of this page and below, aims at identifying behavioral patterns by the companies and provide a compass in development/integration of sustainability strategies. Based on the current activities and profiles of the companies, it advises on beneficial next steps in their strategic development. The index itself has a dynamic character and it will be evolving over time to accompany evolution of the ESG field. The best practice of today will not necessarily be the best practice of tomorrow.

While strategizing the ESG approach, it is important to see the development in both horizontal and vertical manner. Therefore, the company profiles allow to identify gaps and discrepancies between the strategies and tactical implementation. These gaps can, in turn can lead to reputational risks – gaps between declarations and implementation, or lack of tactical support to the ambitious plans.

Starting from organizational and strategic considerations and ending on tactical implementation, it is without a doubt the companies are presented with a great opportunity to harness the developments of regulatory landscape and build their approaches.

The index itself allows to:

1. Benchmark where the company is compared with the organizational profiles and best practices.

2. Identify the gaps and discrepancies between strategic objectives, declarations and operationalization.

3. Define next steps in strategic development.

4. Finally, it provides a checklist of consideration in the ESG strategic development.

## FIT FOR ESG MATURITY MODEL

### North Star – organizational vision and purpose

| BEGINNING | CONSERVATIVE | MODERATE | PROGRESSIVE | LEADING |
|---|---|---|---|---|
| Lack of articulated company vision. Values might be mentioned but not aligned with the strategic framework. | Vision and mission developed in top-down manner. Focus on financial performance and companies' inward view. | Vision and mission integrating ESG aspects implicitly. Vision includes societal aspects and contributions. | Explicit integration of ESG aspects in company North Star. North Star integrated throughout the corporate business strategy. | Purpose-driven company. North Star and vision as the drivers of business decisions, structures and operational processes. |

### Strategic prioritization and goal setting

| BEGINNING | CONSERVATIVE | MODERATE | PROGRESSIVE | LEADING |
|---|---|---|---|---|
| Lack of explicit sustainability aspects, priority areas and goals. Some sustainability messaging might be included in overall financial performance goals. | Sustainability goals prioritized based on regulatory compliance. Articulation of goals in line with CSR compliance standards. | Clearly articulated long term ESG strategy with set goals and contributions. Integrated sustainability strategy. | Short and mid-term sustainability goals defined and developed. ESG aspects as one of the key drivers for business development, new ventures and overall activities. | Business strategy driven by ESG considerations. Permanent evaluation of ESG priorities and needs. |

### Organizational structure

| BEGINNING | CONSERVATIVE | MODERATE | PROGRESSIVE | LEADING |
|---|---|---|---|---|
| No formal sustainability structure. | Sustainability as part of departmental responsibility: HR/HESQ/ procurement... No reporting lines and lack of empowerment to set the company agenda. | Sustainability function established. Might be represented by mid-senior level executive or limited team. Function focused on coordination and alignment. | Formal sustainability structure (sustainability unit/ department). Sustainability lead/or appointed representative as part of management team. | Matrix organization including functional and geographical integration of ESG. Management board level function for sustainability lead. |

### Materiality analysis

| BEGINNING | CONSERVATIVE | MODERATE | PROGRESSIVE | LEADING |
|---|---|---|---|---|
| Limited knowledge of ESG issues impact on business and bottom line. | Materiality analysis performed from a regulatory risk and public affairs perspective. | Knowledge and prioritization of material issues from a sustainability perspective. | Regular update and monitoring of the material issues and broader landscape developments. | Dynamic approach to materiality with on-going re-evaluation of the materiality and importance of the issues. Competitive and landscape tracking. |

## FIT FOR ESG MATURITY MODEL (CONTINUED)

### Alignment with global frameworks and standards

| BEGINNING | CONSERVATIVE | MODERATE | PROGRESSIVE | LEADING |
|---|---|---|---|---|
| Lack of alignment with the international frameworks and standards. | Initial identification of SBTI/SDG priorities.<br>The frameworks might be vaguely referred to in the sustainability reporting/ communications material. | "Pick and choose" approach focusing on the SDG framework at a high goal level.<br>Possible alignment and membership in the Global Compact and other (local) organization or initiatives. | Mapping of sustainability and business activities according to SDG framework.<br>Commitments to the SDG framework based on concrete targets. | Driving of business decisions according to the SDG framework.<br>Holistic understanding of the business from SDG perspective at a target level. |

### Reporting and evaluation

| BEGINNING | CONSERVATIVE | MODERATE | PROGRESSIVE | LEADING |
|---|---|---|---|---|
| ESG activities not reported.<br>Data not collected. | Internal and external reporting based on arbitrary selected indicators.<br>No verification of the statements. | Selected reporting standards and established annual sustainability report. | Integrated reporting of sustainability and ESG activities in line with corporate reporting.<br>ESG measured and reported also at business line/ divisional level. | Internal culture of ESG reporting and goal setting beyond requirements of the standard.<br>External third-party evaluation and verification. |

### External partnerships

| BEGINNING | CONSERVATIVE | MODERATE | PROGRESSIVE | LEADING |
|---|---|---|---|---|
| No partnerships with regards to ESG and sustainability. | Some partnerships established based on philanthropic financial contributions. | Selected "flagship" partnerships in some areas of sustainability. | Dynamic approach to partnerships combining established corporate partnerships with ad-hoc ones. | Ecosystem of partners and engagements in all areas of ESG. |

### Engagement and relationship building / management

| BEGINNING | CONSERVATIVE | MODERATE | PROGRESSIVE | LEADING |
|---|---|---|---|---|
| No external engagement in sustainability. | Driven by an existing function: public affairs, communications, external relations... | Driven by sustainability function/unit. | External stakeholder relationships with multiple touchpoints across the organization.<br>C-level responsibility. | Relationships based on an ecosystem across all the functions.<br>CEO as key driver of sustainability. |

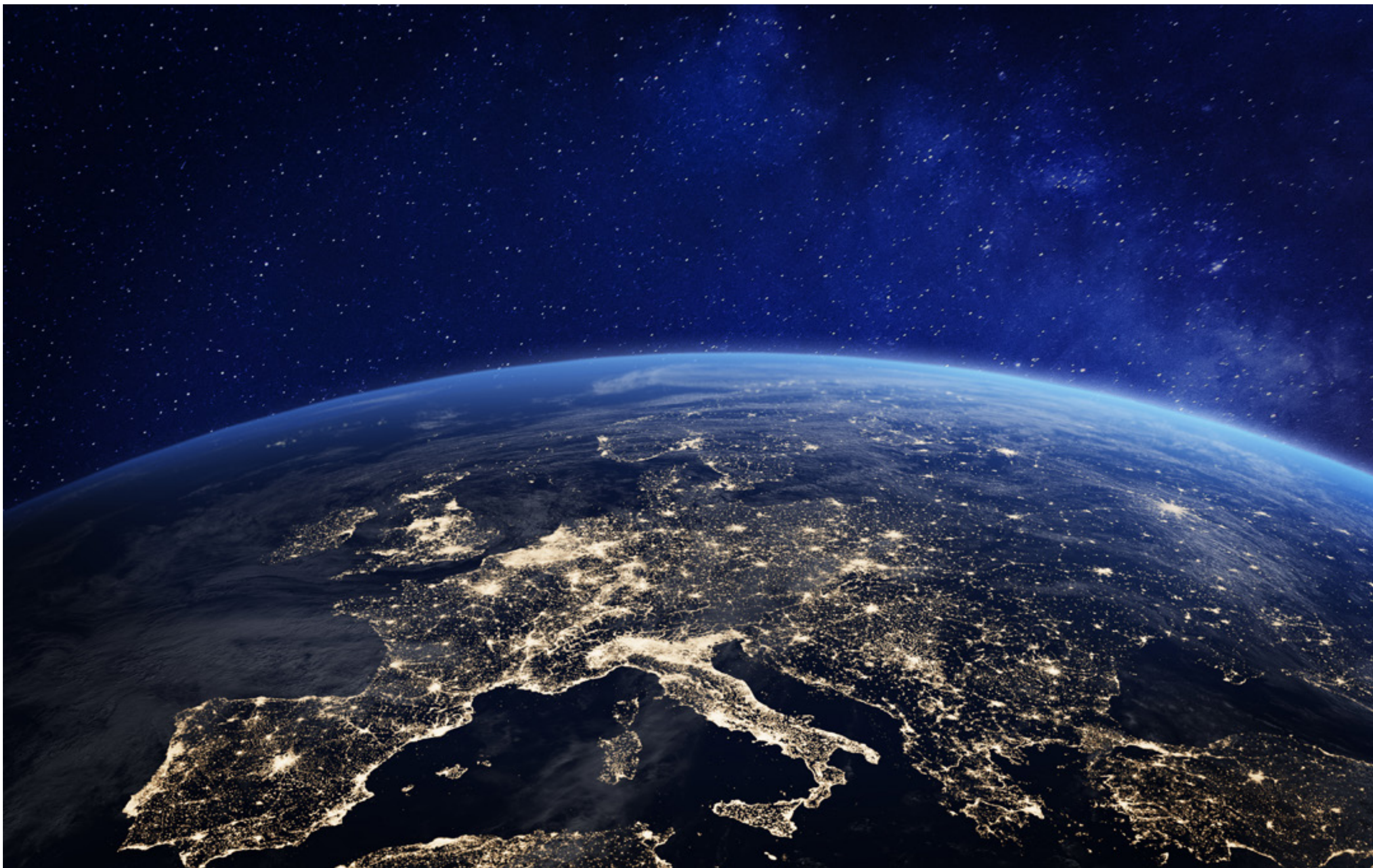
## FIT FOR ESG MATURITY MODEL (CONTINUED)

### Cross-channel integration

| BEGINNING | CONSERVATIVE | MODERATE | PROGRESSIVE | LEADING |
|---|---|---|---|---|
| Limited or no communications about ESG.<br>Might present some sustainability claims in external communication. | Sustainability as part of marketing communications and product communications.<br>High level messaging about sustainability and ESG in corporate material (ex. Dedicated website page). | Stakeholder and consumer/customer communication about sustainability.<br>ESG subjects as part of internal and external communication campaigns. | Established ESG and sustainability narrative with proof points.<br>Sustainability as part of all externally developed messages.<br>Assets related to sustainability shared on all external communications channels. | Sustainability and ESG messaging integrated in all external communications materials.<br>Omni-channel campaigns focusing on sustainability and ESG. |

### Company culture

| BEGINNING | CONSERVATIVE | MODERATE | PROGRESSIVE | LEADING |
|---|---|---|---|---|
| Lack of internal awareness of sustainability and ESG. | Some ESG / sustainability initiatives driven by HR function. | On-going engagement with employees through internal awareness programmes and initiatives (ex. Volunteering project). | Sustainability and ESG integrated into corporate culture journey.<br>Change management projects in place. Cross-functional integration. | Sustainability as the core of company culture. Combination of "soft approaches" with formal training and inclusion into the individual KPIs. |



## About Leidar

Headquartered in Geneva with offices in London, Brussels, Oslo, and Dubai, we mainly work with businesses and organisations that operate on a global scale. We understand how to develop and deliver their messages to a wide internal and external stakeholder audience and how to leverage business opportunities in a rapidly changing political landscapes.

Our clients include companies, both publicly listed and private, industry groups as well as international organisations and NGOs, across all sectors.

If you are interested in learning more about what we can do for you and your organisation please contact **Lukasz Bochenek** at **+41 79 746 18 73** or at **Lukasz.Bochenek@leidar.com**

**Leidar SA**
**Rue Ami-Lévrier 15**
**1201 Geneva (CH)**

Rue Ami-Lévrier 15
1201 Geneva
Switzerland

Avenue Louise 120
1050 Brussels
Belgium

2 Kingdom Street
London W2 6BD
United Kingdom

Grev Wedels
Plass 4, 0151 Oslo
Norway

JAFZA One, Tower A
PO Box 35608, Dubai
United Arab Emirates