Global ESG Regulatory Trends and Materiality Assessments—What Does This Mean for You?

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Presented by:

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Our Evolution

In Operation for Nearly 100 Years

STORIED BRAND
1932-2004

- Duff & Phelps founded as investment research firm

NEW FIRM, EXPANDING CAPABILITIES
2005-2020

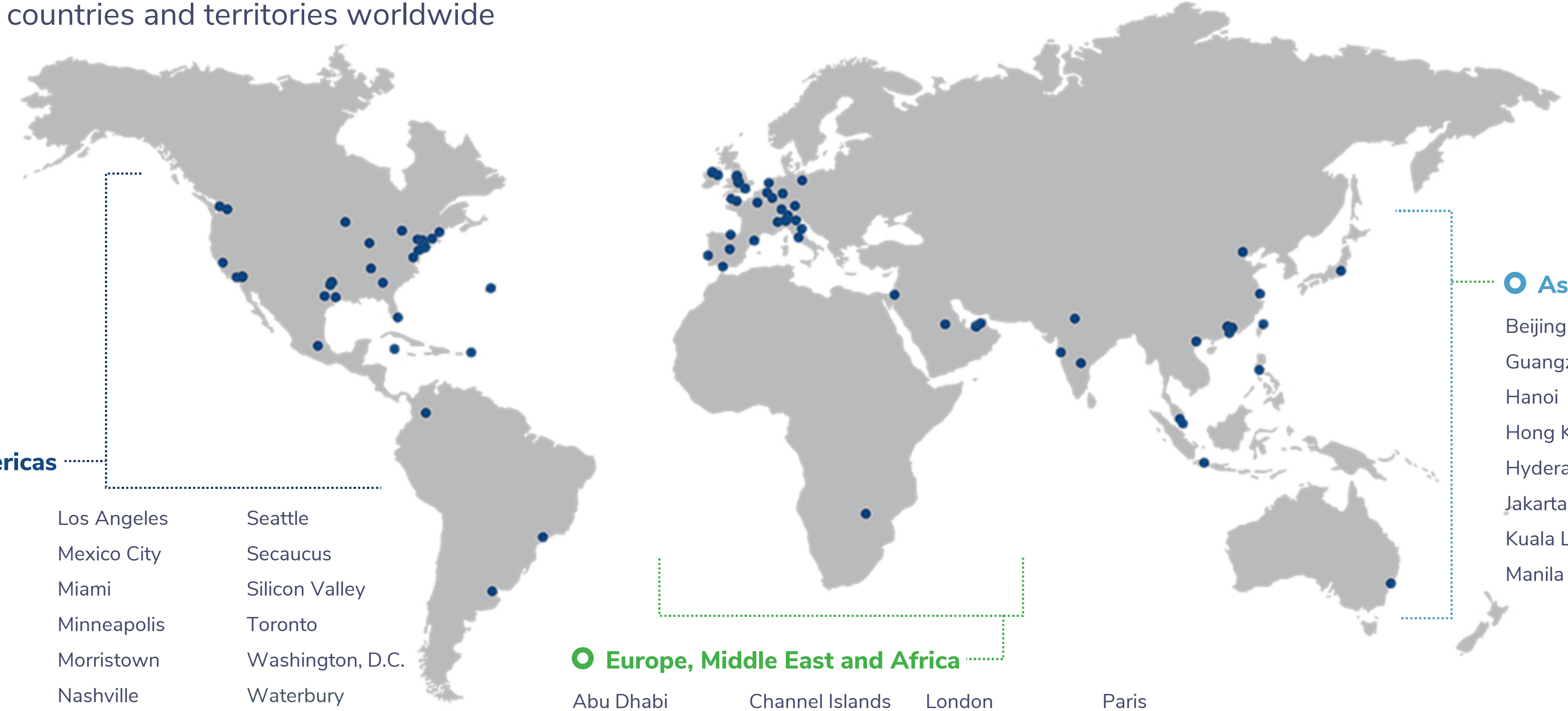
- Started as valuation and corporate finance advisor
- Rapid growth into other governance, risk, compliance and complementary solutions
- Acquired 30+ businesses, including Kroll

ONE TEAM, ONE KROLL
2021-present

- Duff & Phelps rebrands as Kroll and completes brand unification
- Full business life cycle capabilities across risk, governance and growth
- Serving clients in 140 markets across nearly every industry and sector
- Acquired Crisp and Resolver risk companies
- Acquires AVC Ltd. to create dedicated energy team within FAAS practice

Our locations

Across 32 countries and territories worldwide



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Julianne Recine

Managing Director – ESG Advisory

Qualifications:

- MBA in Finance from Iona University
- Bachelors of Business Administration in International Business from Iona University

Location: US (Miami)
Languages: English and Italian

Background

- Julianne Recine is a Managing Director in the ESG Advisory practice, based in New York. She has more than 29 years of financial and investment management experience.
- Julianne is responsible for providing support to endowments, foundations, public and private pensions, sovereign wealth funds and family offices seeking to build out, upgrade or optimize their operational due diligence process for various types of firms. These include hedge funds, fund of funds, managed accounts private equity funds, real estate and real asset fund investments. Julianne has extensive experience in building operational due diligence frameworks and operational platforms.

Relevant Experience

- She has worked with ESG platforms, investment vehicles and has managed account and seeding platforms. Additionally, she has provided consulting and oversight to early stage and emerging managers and has a great deal of experience with strategic acquisitions and implementing regulatory oversight programs.
- Prior to joining Duff & Phelps, Julianne was an executive director at JP Morgan Chase where she established the Americas Control Manager organization for the Securities Services business within the Corporate Investment Bank. She was also involved with establishing governance frameworks to insure compliance with various banking regulations. Prior to joining JP Morgan, she was COO and Director of Operational Due Diligence at Sciens Investment Management where she was responsible for overseeing the due diligence, operations and marketing of Sciens' liquid and real assets businesses. She joined Sciens from PineBridge Investments (formerly AIG Investments) where she was Head of Operational Due Diligence and responsible for building out the Operational Due Diligence infrastructure. Prior to joining PineBridge, she was Vice President of Investor Services at EnTrust Capital Inc. Julianne's previous roles also include her stints at Goldman Sachs and Brown Brothers Harriman.
- She holds an MBA and bachelor's degree in business administration with a focus on international business from Iona College Hagan School of Business. Julianne is a member of 100 Women in Finance, The New York Hedge Fund Roundtable and the Women's Association of Venture & Equity. She is also a board member of Belmont Community Day Care Center and a regional member of the National Organization of Italian American Women.

Chris DeSa

Managing Director – ESG Advisory

Qualifications:

- M.Phil (Economics/Politics) with distinction from the University of Oxford
- J.D. with honors from the University of Texas at Austin
- B.A. from UCLA
- Fundamentals of Sustainability Accounting (FSA) Credential (Levels 1 & 2)
- Certificate in Sustainable Capitalism & ESG from UC Berkeley School of Law
- Certificate of proficiency in Organizational GHG Accounting

Location: US (Los Angeles)

Languages: English and Portuguese

Background

Chris is a Managing Director in the Environmental, Social and Governance (ESG) Advisory practice, based in Los Angeles. Chris serves as a trusted advisor to clients on ESG and sustainability-related matters, including with climate-related risks and opportunities, ESG materiality assessments and benchmarking, KPI selection, sustainability accounting and reporting, and internal controls.

Relevant Experience

Chris offers particular expertise helping clients to ensure the integrity, consistency and transparency of their ESG data and climate-related disclosures under evolving U.S. and international ESG regulations and norms. He has significant experience on energy transition issues, environmental standards and GHG emissions reporting, having assisted NYSE-listed public companies preparing for attestation and assurance on their ESG disclosures, including around their GHG emissions inventories and disclosures (Scopes 1, 2 and 3) and the related internal controls and systems.

He also assists private equity funds and companies with pre-acquisition ESG screening, due diligence and risk assessments as well as post-acquisition remediation plans.

Prior to Kroll, Chris was a managing director in the Risks & Investigations practice at FTI Consulting, where he assisted clients with identifying, investigating and managing complex environmental, political, social, labor and compliance risks. Chris also assisted external counsel with expert witness and advisory services on complex securities class actions and enforcement actions by the Securities and Exchange Commission (SEC) and Department of Justice (DOJ).

Chris also previously served as an associate director at Control Risks, where he advised multinational clients on matters related to regulatory compliance, reputational risks and corporate intelligence. He began his career as an associate in the São Paulo office of White & Case, where he advised clients as a U.S. securities and capital markets lawyer.

Chris received a Master of Philosophy in Latin American Studies (Economics & Politics) with distinction from the University of Oxford, a J.D. with honors from the University of Texas at Austin (where he was a member of the Texas Law Review) and a Bachelor of Arts from UCLA. In addition to the Fundamentals of Sustainability Accounting (FSA) credential, he also holds proficiency certificates in Organizational GHG Accounting from the Greenhouse Gas Management Institute and Sustainable Capitalism & ESG from UC Berkeley School of Law.

Chris is fluent in Portuguese, having lived and worked extensively throughout Brazil.

Carla S. Nunes, CFA, ABV

Managing Director

Philadelphia, PA

Carla.Nunes@kroll.com

Carla S. Nunes is a Managing Director in the Office of Professional Practice of Kroll (previously Duff & Phelps). She has over 25 years of experience. In that role, Carla provides firm-wide technical guidance on a variety of valuation, financial reporting and tax issues. She also co-authors Kroll's annual U.S. and European Goodwill Impairment Studies. In addition, Carla is the Global Leader of Kroll's Valuation Digital Solutions group, which produces cost of capital thought leadership content and data housed in the Cost of Capital Navigator.

- In 2011, Carla completed a one-year rotation in Kroll's London office, where she promoted the firm's IFRS education efforts and marketing initiatives, as well dealing with IFRS implementation issues.
- Prior to this role, Carla was part of the Valuation Advisory Services business unit, performing engagements primarily for financial reporting and tax purposes at Kroll's predecessor firms, PricewaterhouseCoopers, Standard & Poor's, and Duff & Phelps.
- Carla has conducted numerous business and asset valuations for a variety of purposes, including purchase price allocations, goodwill impairment testing, M&A, corporate tax restructuring and debt analysis. She has been involved in multiple valuation assignments for a wide range of industries, including pharma & biotech, healthcare, vitamin retail, specialty chemicals, industrial manufacturing and gaming & hospitality. Carla has substantial experience with cross-border valuations, working with multinational corporations to address complex tax, international cost of capital and foreign exchange issues.
- Carla is one of Kroll's experts addressing valuation issues related to cost of capital. She is a co-author of the "Valuation Handbook" series and is a co-creator of the Kroll Cost of Capital Navigator. Carla is a frequent speaker in webinars and conferences on the topics of cost of capital, goodwill impairment and valuation in general.
- Carla is a member of the Education Committee of the International Institute of Business Valuers (iiBV) and a former Practitioner Director in the Board of the Financial Management Association (FMA) International. She was a Fellow of the defunct Kroll Institute.
- Carla received her M.B.A. in finance from the University of Rochester's Simon School, an honors degree is business administration from Lisbon's School of Economics and Management (ISEG Lisbon) and completed coursework for a Masters of Taxation from Villanova University School of Law. Additionally, she holds a Chartered Financial Analyst (CFA) designation, an Accredited in Business Valuation (ABV) credential, and has passed the exam and fulfilled all the requirements for the Certified in Entity and Intangibles Valuations (CEIV) credential (now-discontinued). Carla also holds a certification awarded by the Wharton ESG Executive Certificate for Financial Professionals Program.
- Carla was a co-author of the Kroll's "ESG and Global Investor Returns Study" (2023) which examined the relationship between historical returns of over 13,000 publicly traded companies across a variety of geographies and industries and their ESG ratings to determine the correlation of ESG ratings to company performance.

Zoe Koskinas

VP, Head of ESG

- B.A. from University of Western Sydney
- Institute of Sustainability Leadership at Cambridge

Location: US (Orange County)

Background

Zoe Koskinas is Vice President and Head of ESG at (NYSE: CODI), a publicly-traded holding company that provides shareholders with unique access to niche middle-market businesses. She is responsible for the firm's ESG strategy and works closely with the portfolio companies to integrate the firm's environmental, social and governance outcomes across the business.

Relevant Experience

Zoe is a seasoned sustainability professional who drives sustainable business initiatives and fosters positive impact. She excels in engaging closely with company management teams, ensuring the timely execution of initiatives that mitigate risks and contribute to value creation, resulting in win-win scenarios. She is recognized for her ability to build and execute initiatives in key ESG areas such as health and safety, inclusion and diversity, climate change, and employee engagement. She has a proven track record in identifying, tracking, and reporting on ESG data management and key performance indicators and developing systematic processes to ensure consistency. With her experience working across Australia and the UK and a commitment to making a difference, Zoe continues to be a driving force in the financial services industry, shaping the future of ESG practices

Prior to joining CODI in 2021, Zoe was in the Global Sustainability Team at Lendlease Group and held various roles across Australia and the UK.

Zoe is a graduate of the University of Western Sydney, and the Institute of Sustainability Leadership at Cambridge.

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Recent ESG/Sustainability Disclosure and Regulatory Developments

ESG & Sustainability Disclosure Standards

Background

- Many questions have arisen on what qualifies an initiative or an investment to be labeled as climate-, ESG-, or sustainability-focused. Accusations of **greenwashing** have risen significantly.
- **Lack of consistency and standardization** about what these terms mean contribute to ESG.
- The **voluntary** nature of much of the reporting means that many companies and funds selectively disclose information that portrays them more favorably. According to the **Carrots & Sticks** project (analysis by Kroll):
  - In 2020 there were over 600 sustainability reporting provisions globally, with almost 60% being mandatory and with the balance being voluntary.
  - In 2023 database expanded to cover 130 countries. In May 2023, the number of sustainability reporting provisions had increased to over 2,400, with 55% being voluntary in nature.
- This has led to a greater effort by international standard setters and regulators to propose and, in some cases, adopt mandatory disclosure rules.

ESG: The Land of Confusion

Ratings Agencies

SUSTAINALYTICS · S&P Global · MORNINGSTAR · ROBECOSAM We are Sustainability Investing. · TRUCOST · ISS · Dow Jones Sustainability Indexes · MSCI · vigeoeiris · FTSE Russell · REFINITIV

Governing Principles

UN GLOBAL COMPACT · SUSTAINABLE DEVELOPMENT GOALS · PRI Principles for Responsible Investment · WORLD ECONOMIC FORUM

Investor Resources

RepRisk · CSRHUB® · MIOTECH · OWL analytics · TruValue Labs · Util · Climate Action 100+ · arabesque s-ray · covalence ESG ratings · IMPACT LENS · S-Factor · MARKLABS

Reporting Frameworks

CDSB Climate Disclosure Standards Board · GRI Empowering Sustainable Decisions · SASB Sustainability Accounting Standards Board · IFC International Finance Corporation WORLD BANK GROUP *Creating Markets, Creating Opportunities* · CDP · ICGN · TCFD TASK FORCE ON CLIMATE-RELATED FINANCIAL DISCLOSURES · IR

Data Aggregators

Reporting

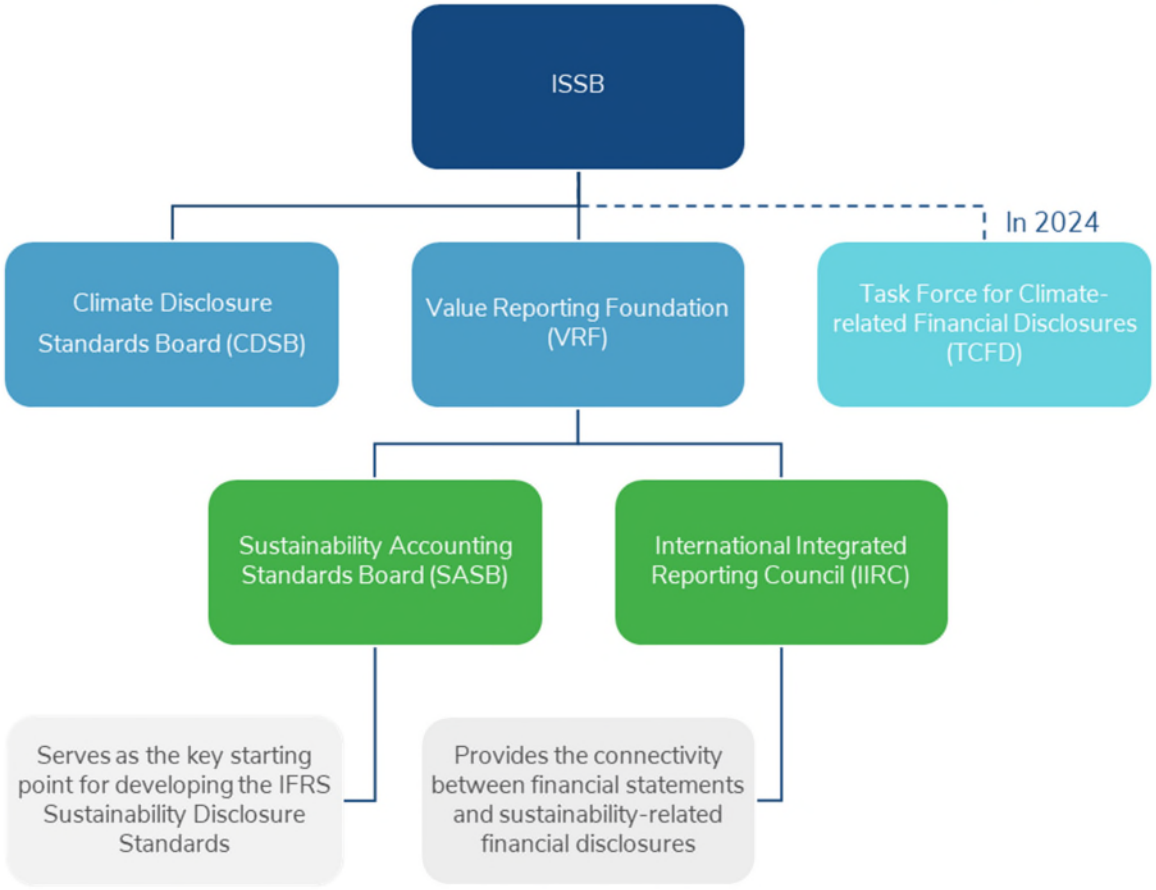
NOSSA DATA · IMPACT MANAGEMENT PROJECT · OneReport · GRI Certified Software & Tools Program · The Reporting Exchange · scope 5 · CSRware · Certified B Corporation · METRIO · measurabl

Metric Specific Monitoring

ecovadis · materiality.sasb.org · SINAI · Datamaran® · TCS · normative · ecoact · Turnkey Group · Emitwise · wbcsd

International Sustainability Standards Board (ISSB)

- Created in November 2021, following widespread support during the United Nations Climate Conference (COP26) in Glasgow.
- The IFRS Foundation now oversees two global standard setting boards:
  - (1) the IASB, responsible for international financial reporting standard (IFRS) and
  - (2) the ISSB, tasked with setting IFRS Sustainability Disclosure Standards.
- **In 2022, the IFRS Foundation integrated other independent organizations that had been previously producing voluntary climate, or more broadly ESG and sustainability disclosure standards. In 2024, the TCFD will be transferred to ISSB's supervision.**
- **ISSB's Objective:** Deliver a comprehensive global baseline of sustainability-related (climate and other ESG) disclosure standards that provide investors and other capital market participants with information about companies' sustainability-related risks and opportunities, thereby allowing more informed investment decisions.



Source: Kroll ESG and Global Investment Returns Study, Exhibit 3

Important Corporate Reporting Initiatives with Potential Global Reach

International Sustainability Standards Board (ISSB)

- *IFRS S1 General Requirements for Disclosure of Sustainability-related Financial Information*
- *IFRS S2 Climate-related Disclosures*

European Union (EU)

- Corporate Sustainability Reporting Directive (CSRD)
- *European Sustainability Reporting Standards (ESRS) developed by EFRAG*

United Kingdom (UK) Department for Business and Trade (DBT)

- UK Sustainability Disclosure Standards (SDS)
- *Corporate disclosures on sustainability-related risks and opportunities will be in line with ISSB (IFRS S1 and IFRS S2), with any diversion only if strictly necessary*

United States Securities and Exchange Commission (SEC)

- 2022 Proposal "The Enhancement and Standardization of Climate-Related Disclosures for Investors"

State of California

- Climate Corporate Data Accountability Act (CCDAA) (CA SB 253)
- Climate-Related Financial Risk Act (CRFRA) (CA SB 261)

This is by no means an exhaustive list. ESG and/or sustainability-related regulation has also been recently adopted or proposed by national and subnational governments and regulators across the global.

Fund Reporting Initiatives with Potential Global Reach

European Union (EU)

Sustainable Finance Disclosure Regulation (SFDR):
- Article 6
- Article 8
- Article 9

United Kingdom Financial Conduct Authority (FCA)

UK Sustainability Disclosure Requirements (SDR)

Applies to issuers of bonds and shares listed on a UK regulated market and UK-based investment managers. Focus is to provide greater transparency and consistency in the market for sustainable investment products

United States Securities and Exchange Commission (SEC)

Amendments to the Fund "Names Rule"

Proposed ESG Disclosures for Investment Advisers and Investment Companies

State of California

California Fair Investment Practices by Investment Advisers (SB 54)

Mandates that investment advisers managing venture capital or certain other private funds to report information about their portfolio companies, which includes information on the diversity of the founders they are backing

What does this all mean for you?

Given the broad jurisdictional reach and low financial thresholds, many public and private business and funds will be caught off guard by these regulations.

Illustrative examples of financial thresholds and timing

Regulation	Minimum Revenue Threshold	Public/private	Earliest Potential Timing
EU CSRD	EU €40 million*	Both	For certain issuers, annual reporting begins as early as 2025 for 2024 data. Dates vary depending on organizational characteristics.
CA SB 253	US $1 billion	Both	Annual reporting begins in 2026 for 2025 data (2027 for Scope 3 GHG reporting).
CA SB 261	US $500 million	Both	Biannual reporting begins in 2026.

Organizations need to determine now whether new regulations may be applicable and begin preparing for the significant policy, procedural and data-related improvements needed to ensure proper management and disclosure of material sustainability information.

* Subject to change. An increase of the threshold to €50 million has been proposed in 2023.

How to Prepare?
The Critical Role of Materiality Assessment

Where to begin?

Organizations should prepare for evolving voluntary and mandatory requirements by taking a sober look at their current situation and mapping out an implementation strategy in line with reporting requirements. This typically involves a combination of the following:

- **Take a deep, introspective look ("gap analysis") at your current situation**. Gaps and weaknesses should be identified.
- **Establish high-level sustainability-related strategic goals and objectives** at the board and executive-level based on preliminary assessment and needs. They should reflect the enterprise's strategic competitive positioning on material sustainability factors and fundamental commitments.
- **Build a roadmap with key tangible milestones** to adopt and implement specific policy and procedural enhancements over the short-, medium- and long-term to align your sustainability program with timing requirements (i.e., governance, strategy, risk management and metrics/targets).

Assessing the Materiality of Sustainability Information

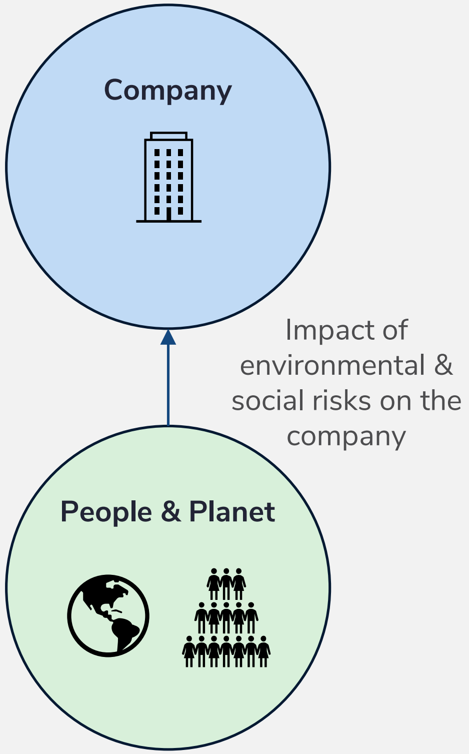
Materiality Assessment is a process designed to identify priority ESG and/or sustainability issues or topics for a specific entity. The process is informed by internal & external stakeholder interviews and surveys, as well as research and analysis of industry and entity specific background and ESG and/or sustainability-related information.

1	Informing Strategic Decision-Making
	Identifying strategic areas of focus in relation to ESG/sustainability, including important **areas of value creation & preservation**
2	**Informing ESG/Sustainability Reporting**
	Identifying priority ESG/sustainability topics to focus on for reporting & external communications based on **key stakeholders' expectations**
3	**Identifying Emerging Risks & Opportunities**
	Identifying areas to monitor on an ongoing basis to inform risk management and to **anticipate regulatory and stakeholder demands**

Different Definitions of Materiality

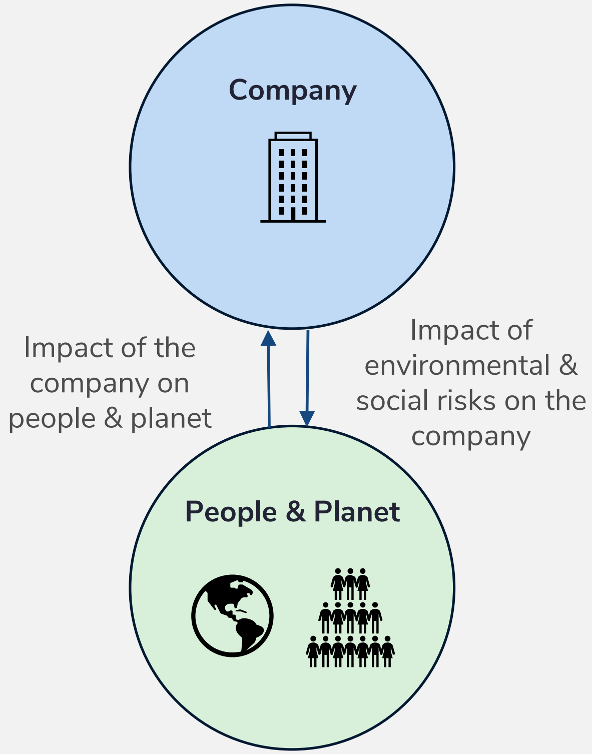
The definition of what is material in the world of sustainability varies significantly across different reporting standards & regulations and may be different from definitions of traditional materiality as defined in financial reporting.

Financial (Single) Materiality



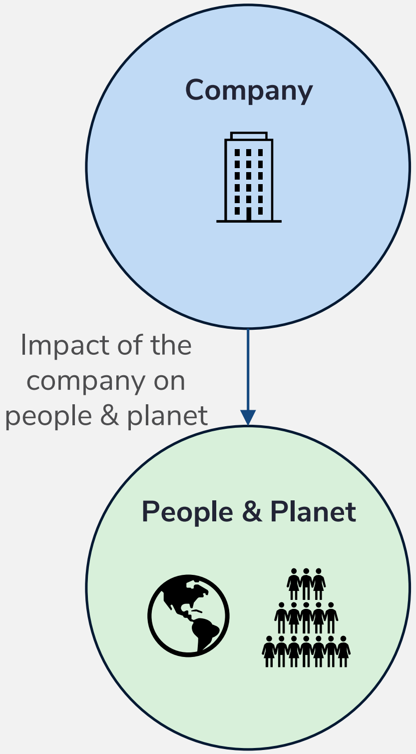
Example: SEC proposal, ISSB/SASB

Double Materiality



Example: EU CSRD
(Corporate Sustainability Reporting Directive)

Impact Materiality



Example: GRI (Global Reporting Initiative)

Conducting the Assessment

There are four basic steps for designing and customizing a materiality assessment to align with the needs of a given organization, including specific reporting requirements.

STEP 1: DEFINE APPROACH & OBJECTIVES

To design the right approach for the organization we provide guidance to define the following:

- **Assessment Objective(s)**
- **Reporting Requirements** (Voluntary or Mandatory)
- **Materiality Definition** (Financial, or Double Materiality)
- **Assessment Output**

STEP 2: UNIVERSE OF POTENTIAL MATERIAL TOPICS

Creation of a list of topics to be assessed based on step 1, and peer disclosures. Research of **reference frameworks/ standards** could include the following:

- EU CSRD
- GRI
- IFRS S1/2/SASB

STEP 3: ASSESSMENT

Assessment of the importance of each topic from an impact and/or financial materiality perspective. We use a mixture of methods to carry out the assessment:

Survey internal/external stakeholders	Interview internal/external stakeholders	Expert & In-Depth Research - Litigation/Media - Industry Trends - Regulatory Trends - Peer Analysis Etc.
Basic Assessment *		
Full Assessment		

STEP 4: RESULTS

Aggregating the results and defining thresholds through discussion with management, in order to **finalize the list of material topics** (e.g. 1 - topics that of strategic importance, 2 - topics to be reported, 3 - topics to monitor..)

Subject to Assurance under CSRD

* Basic Assessment can include light touch industry research.

Kroll ESG and Global Investor Returns Study

Kroll ESG and Global Investment Returns Study

Executive Summary

- **Released in September 2023**
- Universe of over **13,000+** publicly-traded companies across a variety of geographies and industries around the globe.
- Investigated the relationship between a company’s total stock returns (dividends plus capital appreciation) and its MSCI ESG rating over the **2013-2021 period**.
- Examined **four geographic regions** (World, North America, Western Europe, and Asia Pacific) and **12 countries/markets** (Australia, Brazil, Canada, China, France, Germany, Hong Kong SAR, India, Japan, South Korea, United Kingdom, and United States).
- Within some of these geographies, we further scrutinized the results for **11 industries** (as defined by the GICS): Energy, Materials, Industrials, Consumer Discretionary, Consumer Staples, Health Care, Financials, Information Technology, Communications Services, Utilities and Real Estate.
- Interactive ESG Dashboard available here: https://www.kroll.com/en/insights/publications/cost-of-capital/esg-global-investor-returns-study

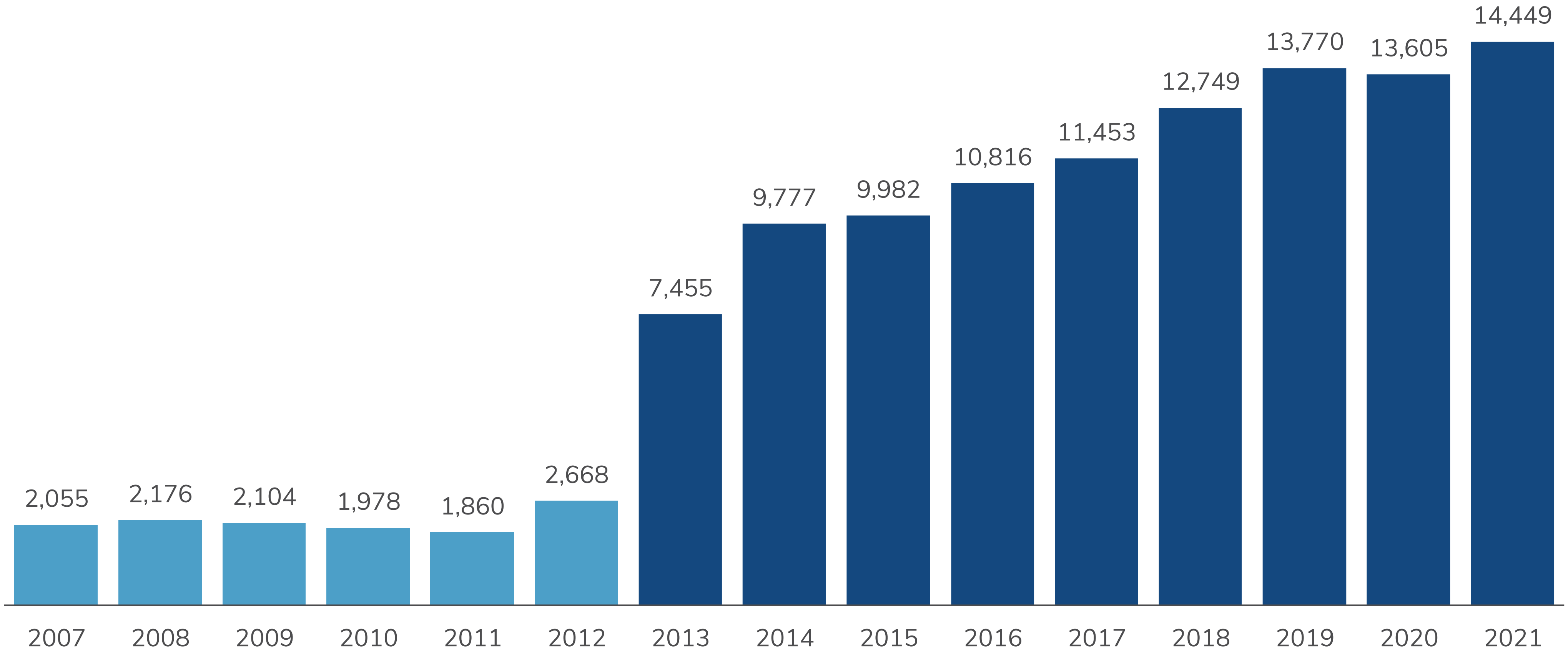
Why MSCI?

Rationale for selecting MSCI as the source of ESG ratings for the Kroll Study

In early 2021, Kroll conducted an analysis of main providers of corporate ESG ratings to decide on which source to use for our analysis. We interviewed researchers at some of these providers to better understand their rating methodology. Ultimately, our decision tried to balance some of the following key elements:

- Coverage period
- Coverage depth
- Frequency of re-rating
- Composite ESG ratings availability
- Rating methodology

Monthly Average Number of Issuers Included in the MSCI ESG Ratings Time Series



MSCI ESG Ratings System

Not the same as Credit Ratings

AAA AA

Leader
A company leading its industry in managing the most significant ESG risks and opportunities.

A BBB BB

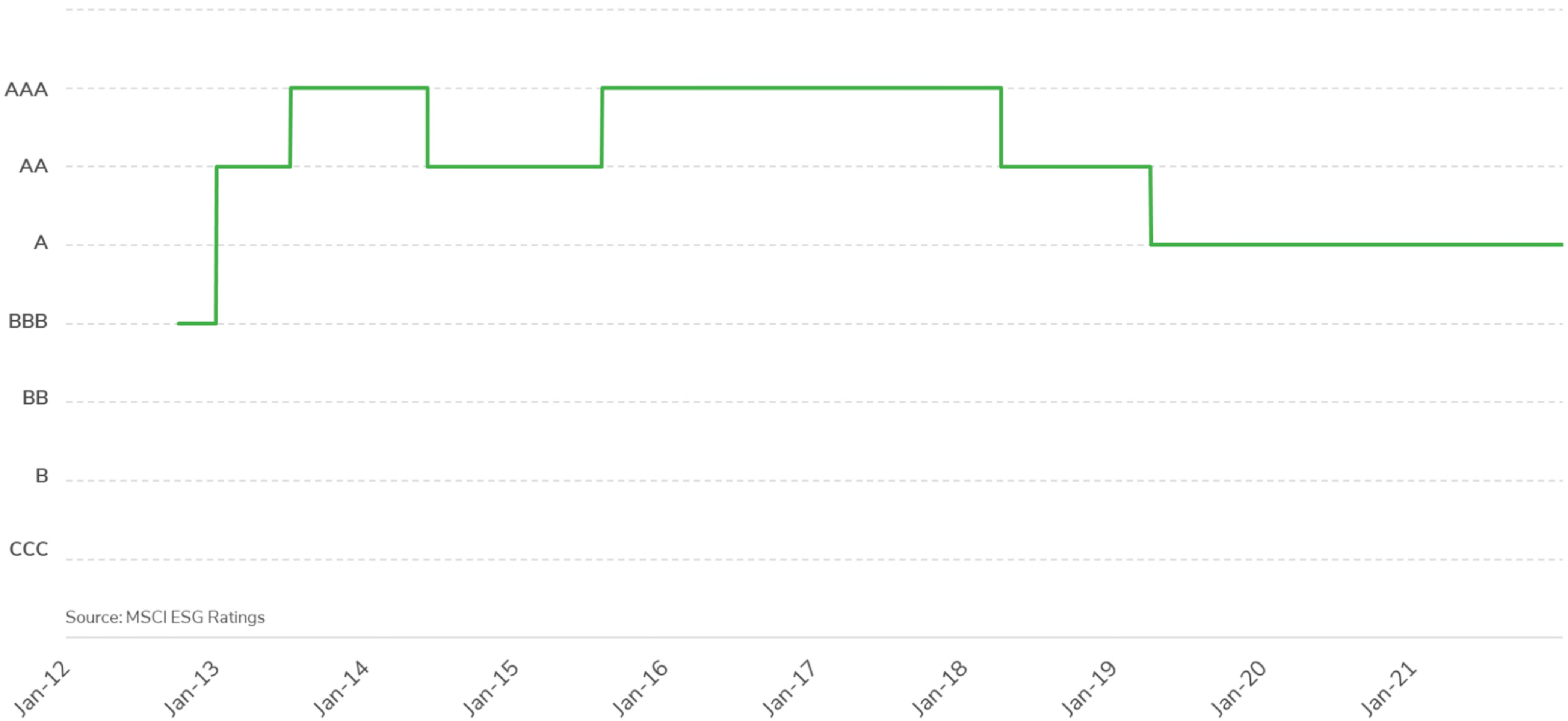
Average
A company with a mixed or unexceptional track record of managing the most significant ESG risks and opportunities relative to industry peers.

B CCC

Laggard
A company lagging its industry based on its high exposure and failure to manage significant ESG risks.

MSCI ESG Ratings Over Time

Example: Tesla



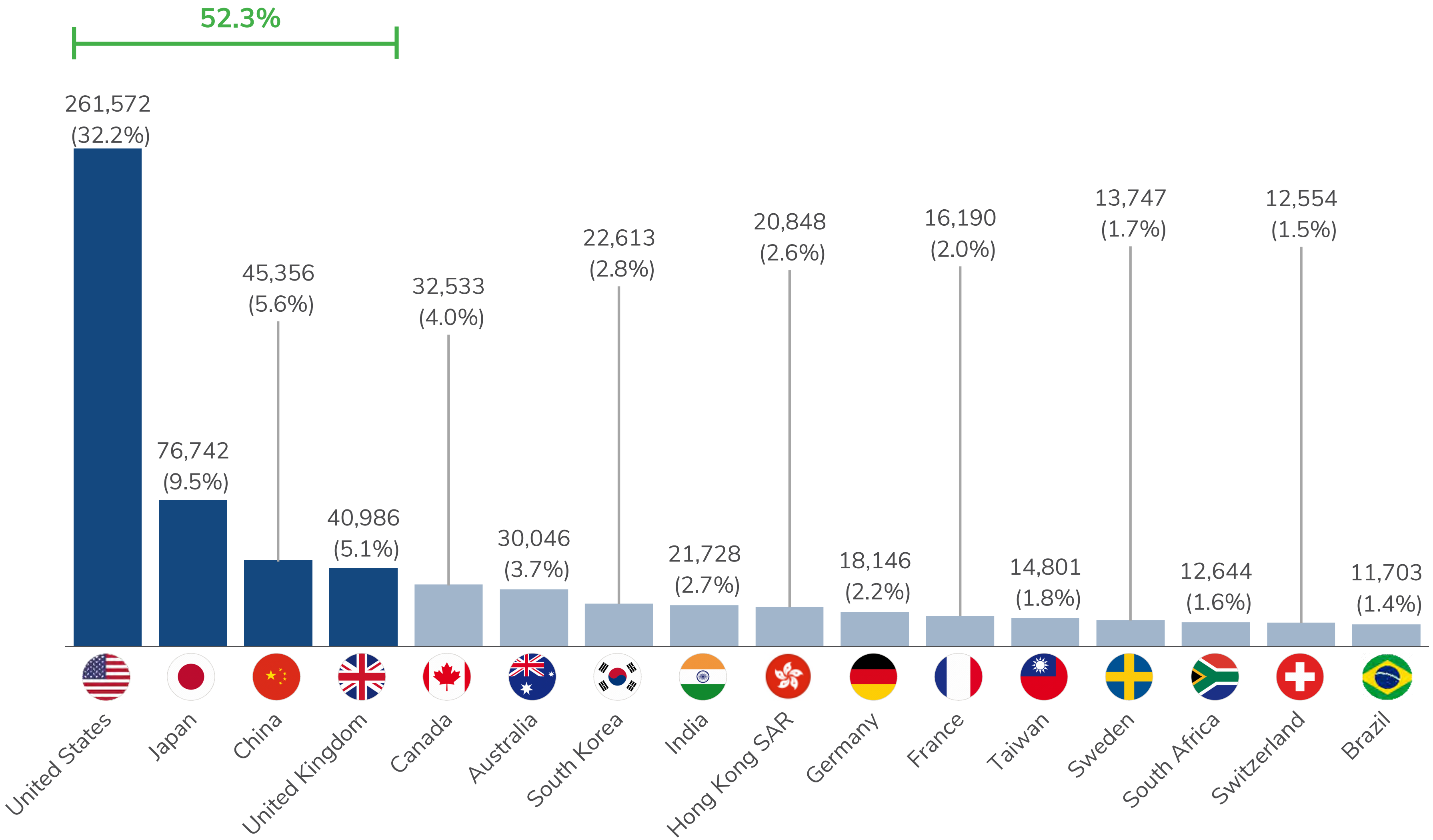
Kroll ESG and Global Investment Returns Study

Methodology Summary

- Created portfolios (or indexes) comprised of companies rated in each of MSCI's ESG rating categories and rebalanced them each month over the study period.
- Computed total returns (= dividend + capital appreciation) on a monthly basis for each index:
  - Calculated what the cumulative return was for each index since January 2013 through December 2021 (i.e., what would $1 invested in December 2012 would grow to be at the end of December 2021).
  - Annualized the cumulative returns for easy comparison of one rating category relative to another.
- Index returns are market-cap weighted based on the individual companies' total returns in each rating category.
- Returns are denominated in USD to allow for comparison across geographies.

Top 16 Countries/Markets Included in the World Indexes

Number of Firm-Month Observations (January 2013–December 2021)

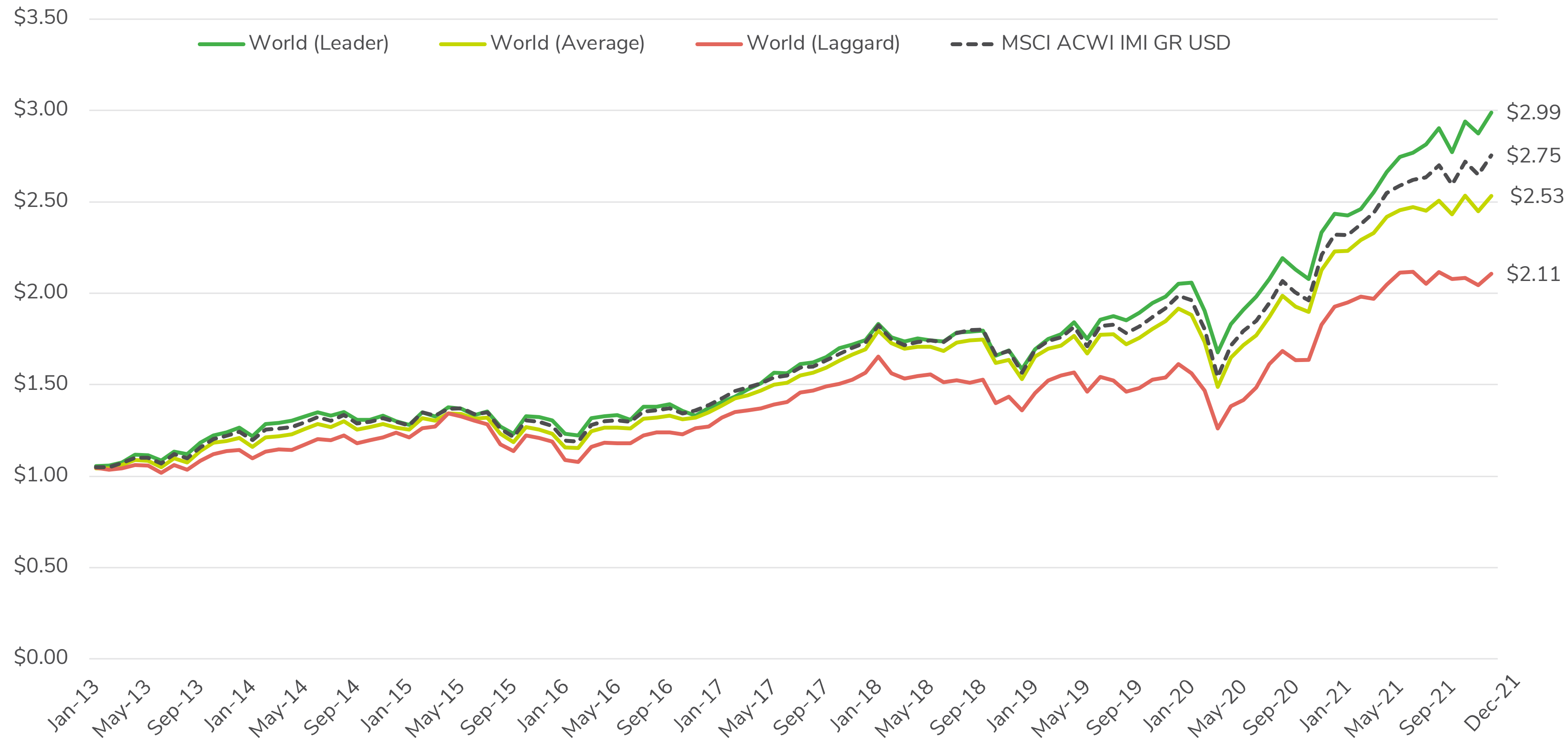


Kroll Study

Aggregate MSCI Ratings (Leader, Average, Laggard) vs. MSCI ACWI IMI Index Cumulative Return

(USD 1 Invested in December 2012)

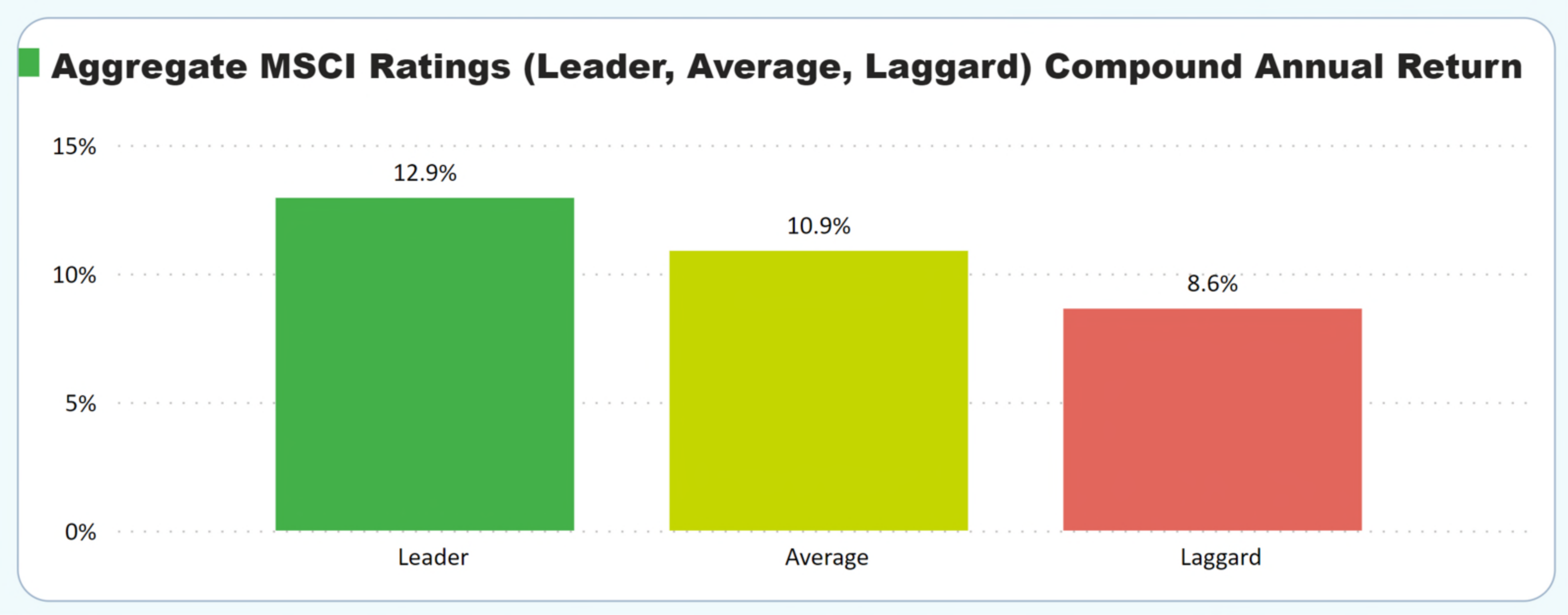
January 2013–December 2021



Source: Kroll ESG and Global Investment Returns Study

Kroll Study

High Level Results – World Portfolio



Source: Kroll ESG and Global Investment Returns Study

Filtered by Rating (is Leader, Average, Laggard, or Overall), Industry (is Overall), Region (is World)

Kroll Study

High Level Results – World Portfolio

Company Count by MSCI Rating (Leader, Average, Laggard)

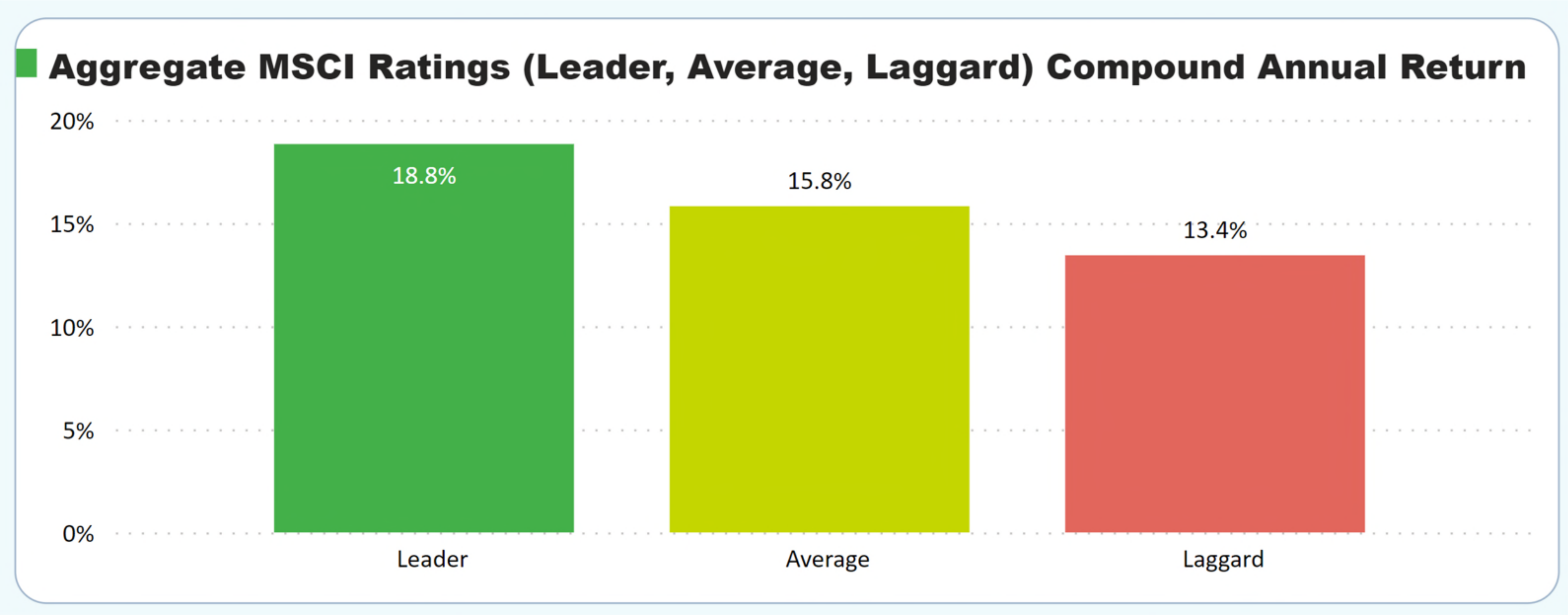
Rating	Company Count (Mo. Avg. 2013–2021)	Company Count (Dec 2021)	
Leader	941	1,486	13%
Average	4,780	6,621	64%
Laggard	1,791	2,563	24%

Source: Kroll ESG and Global Investment Returns Study

Filtered by Rating (is Leader, Average, Laggard, or Overall), Industry (is Overall), Region (is World)

Kroll Study

High Level Results – North America



Source: Kroll ESG and Global Investment Returns Study

Filtered by Rating (is Leader, Average, Laggard, or Overall), Industry (is Overall), Region (is North America)

Kroll Study

High Level Results – North America

Company Count by MSCI Rating (Leader, Average, Laggard)

Rating	Company Count (Mo. Avg. 2013–2021)	Company Count (Dec 2021)	
Leader	181	312	10%*
Average	1,904	2,198	72%*
Laggard	639	523	17%*

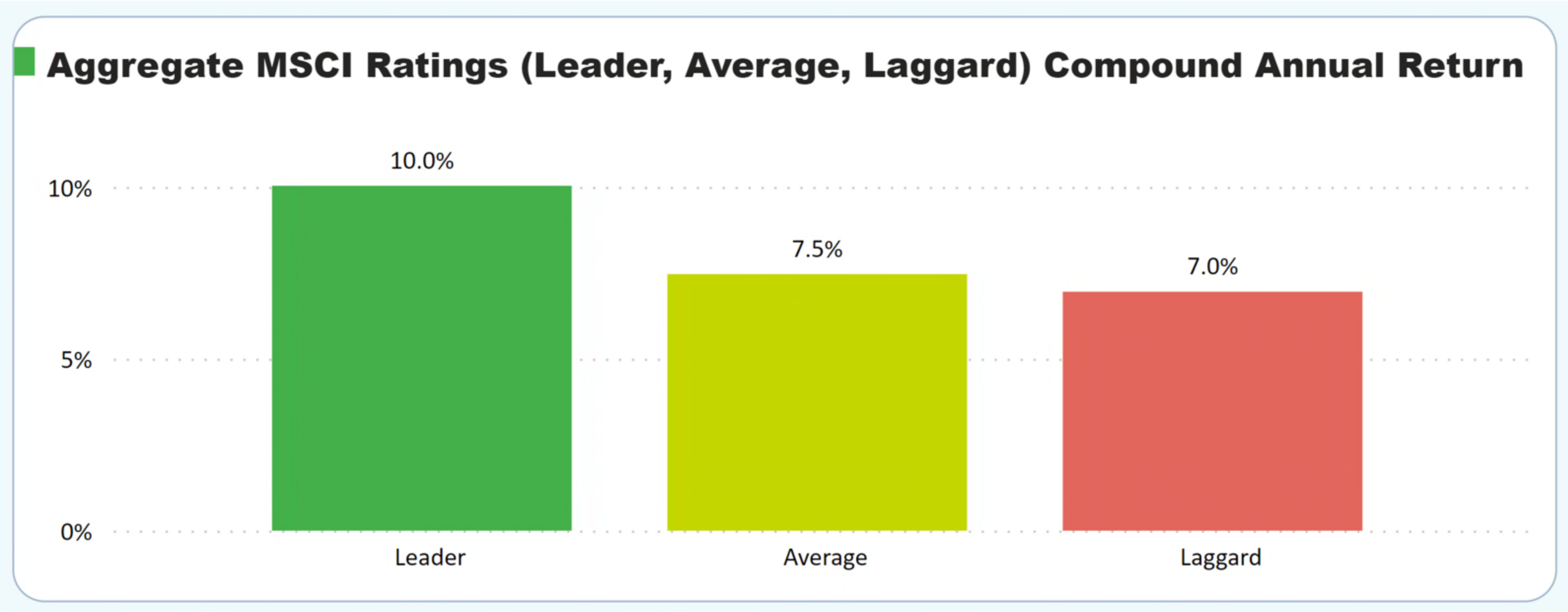
* Differences due to rounding

Source: Kroll ESG and Global Investment Returns Study

Filtered by Rating (is Leader, Average, Laggard, or Overall), Industry (is Overall), Region (is North America)

Kroll Study

High Level Results – Western Europe



Source: Kroll ESG and Global Investment Returns Study

Filtered by Rating (is Leader, Average, Laggard, or Overall), Industry (is Overall), Region (is Western Europe)

Kroll Study

High Level Results – Western Europe

Company Count by MSCI Rating (Leader, Average, Laggard)

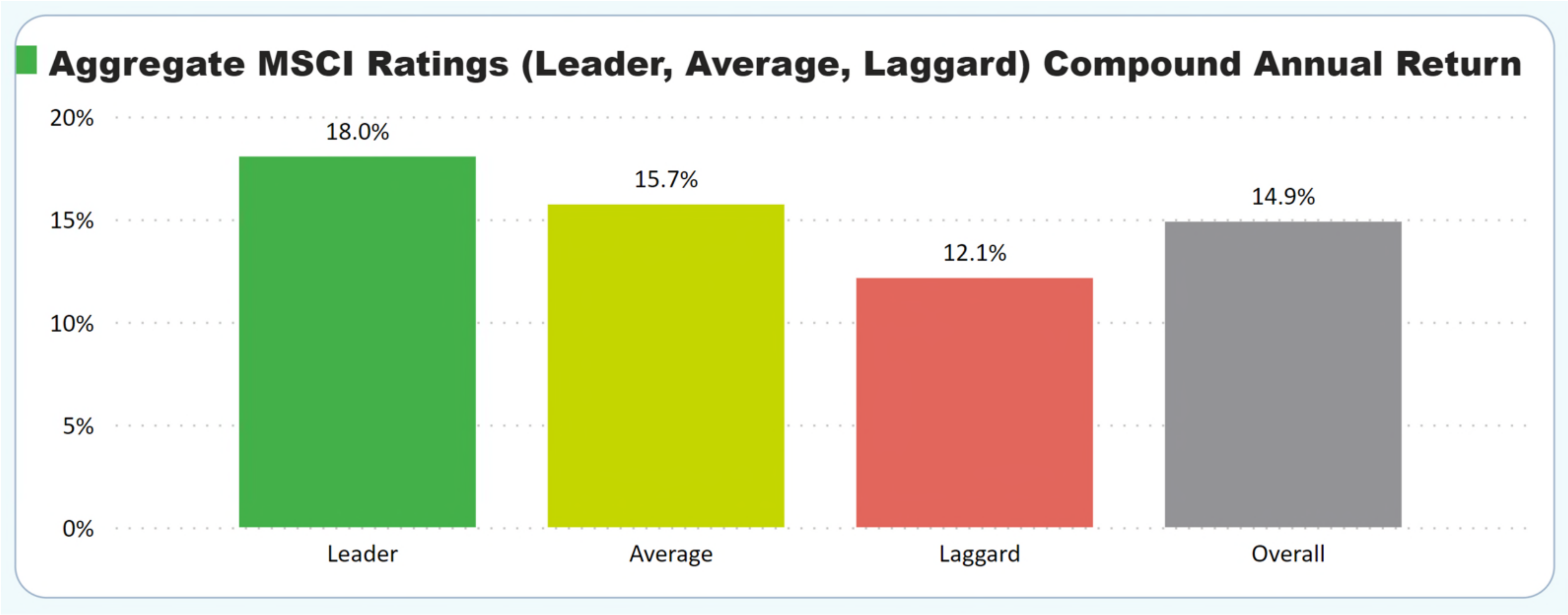
Rating	Company Count (Mo. Avg. 2013–2021)	Company Count (Dec 2021)	
Leader	409	655	34%
Average	897	1,152	60%
Laggard	126	122	6%

Source: Kroll ESG and Global Investment Returns Study

Filtered by Rating (is Leader, Average, Laggard, or Overall), Industry (is Overall), Region (is Western Europe)

Kroll Study

High Level Results – U.S. Industry Example: Financials

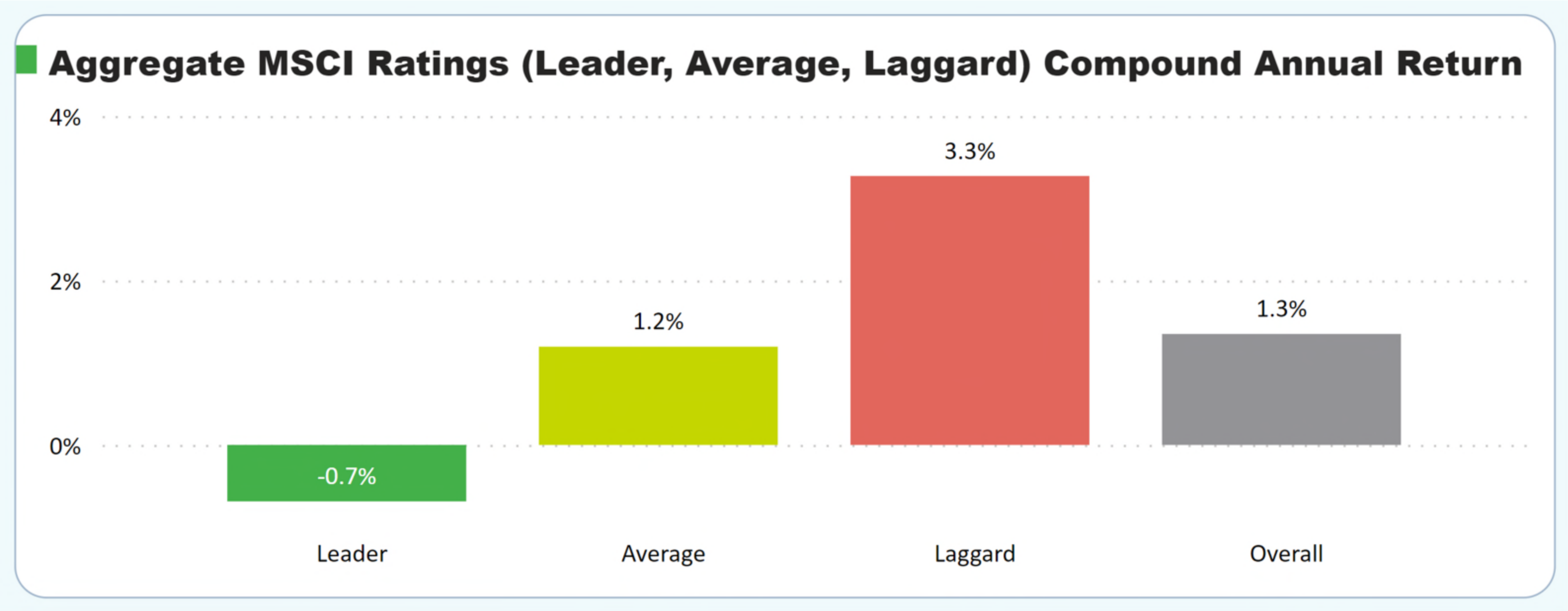


Source: Kroll ESG and Global Investment Returns Study

Filtered by **Rating** (is Leader, Average, Laggard, or Overall), **Industry** (is Financials), **Region** (is United States)

Kroll Study

High Level Results – U.S. Industry Example: Energy

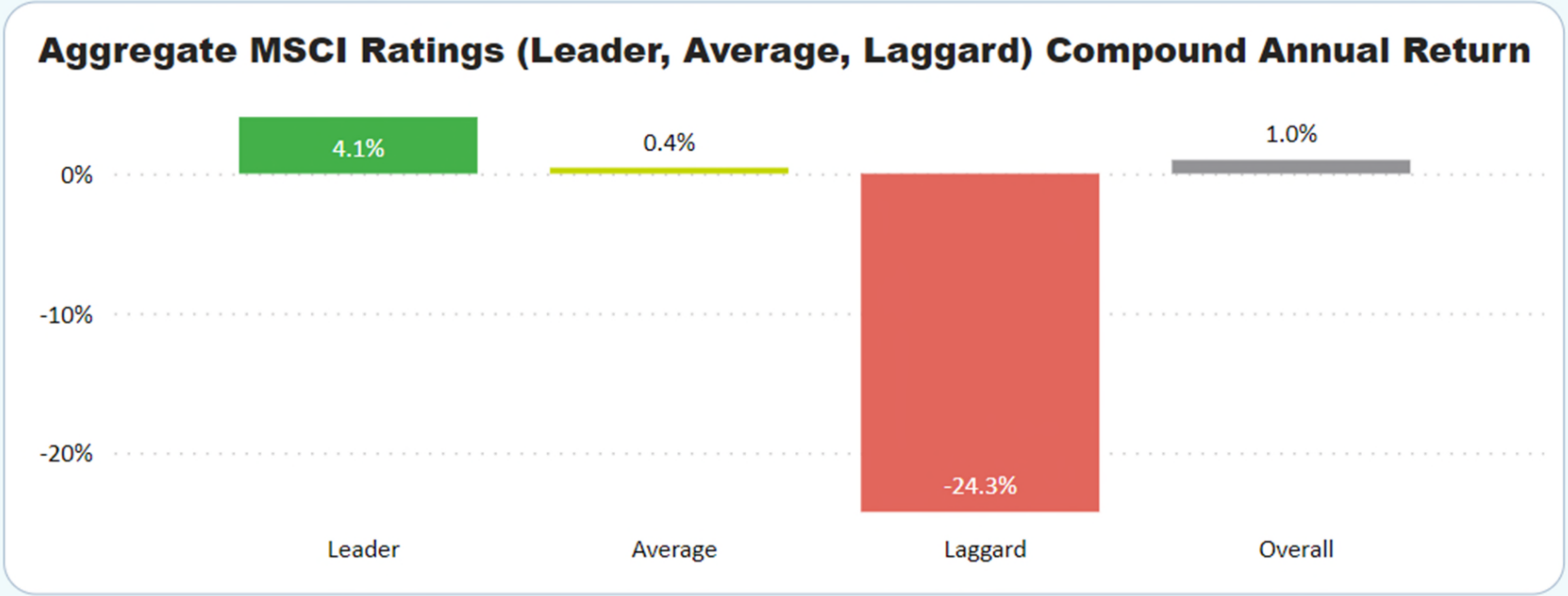


Source: Kroll ESG and Global Investment Returns Study

Filtered by **Rating** (is Leader, Average, Laggard, or Overall), **Industry** (is Energy), **Region** (is United States)

Kroll Study

High Level Results – Western Europe Industry Example: Energy



Source: Kroll ESG and Global Investment Returns Study

Filtered by **Rating** (is Leader, Average, Laggard, or Overall), **Industry** (is Energy), **Region** (is Western Europe)

Kroll ESG and Global Investment Returns Study

Main Takeaways

- The idea behind ESG investing is that if significant capital is flowing to companies that are considered “good” ESG citizens, they should be able to raise capital at a lower cost (when compared to “bad” ESG citizens).
- From an investor perspective, a lower cost of capital means that investors should expect lower returns from companies with better ESG credentials. However, the Kroll study reveals that companies with better ESG ratings generally outperformed those with lower ratings over the 2013-2021 period, the opposite that theory would predict.
- This relationship holds generally for all the major geographic regions and for most countries in the study. While we have not shared the graphs in this presentation, there are two notable exceptions: Brazil and Germany.
- Focusing on U.S. industries, the best ESG rated companies do not always come out on top. ESG Leaders outperformed Average and Laggard-rated companies in only five out of the 11 industries examined. Leaders still outperformed Laggards in all but three industries: Energy, Healthcare and Communications Services. Outperformance is not limited to the Tech sector, contrary to popular perception.
- **Bottom line:** making an adjustment to Cost of Capital (discount rates) for ESG is not a straightforward exercise – it could vary by industry and country as well as over time.

Kroll ESG and Global Investment Returns Study

Caveats

- As more scrutiny is placed on what constitutes an ESG-focused investment, capital allocations may change the relationship observed in our study.
- Because there are fewer companies with an ESG rating in some countries/industries, the results may not be as meaningful as for broader geographic regions. This is also the case with the more granular results for the seven individual ESG rating categories (i.e., AAA, AA, A, BBB, BB, B, and CCC).
- The study only covers companies that had an ESG rating assigned by MSCI and therefore does not cover the entire universe of publicly traded companies around the world.

Where Could We see the Impact of ESG in Business Valuations?

Now: in Projected Cash Flows?

- Revenue initiatives
- Brand reputation
- Employee attrition / hiring costs /productivity
- Property losses / Insurance protection
- Stranded assets
- CapEx
- Long-term growth
- Other

Where Could We see the Impact of ESG in Business Valuations?

In the Future?

- Discount rates?
- Trading multiples?
- Acquisition/Transaction multiples?

Q&A

Extra Resources

ISSB – Corporate Disclosures

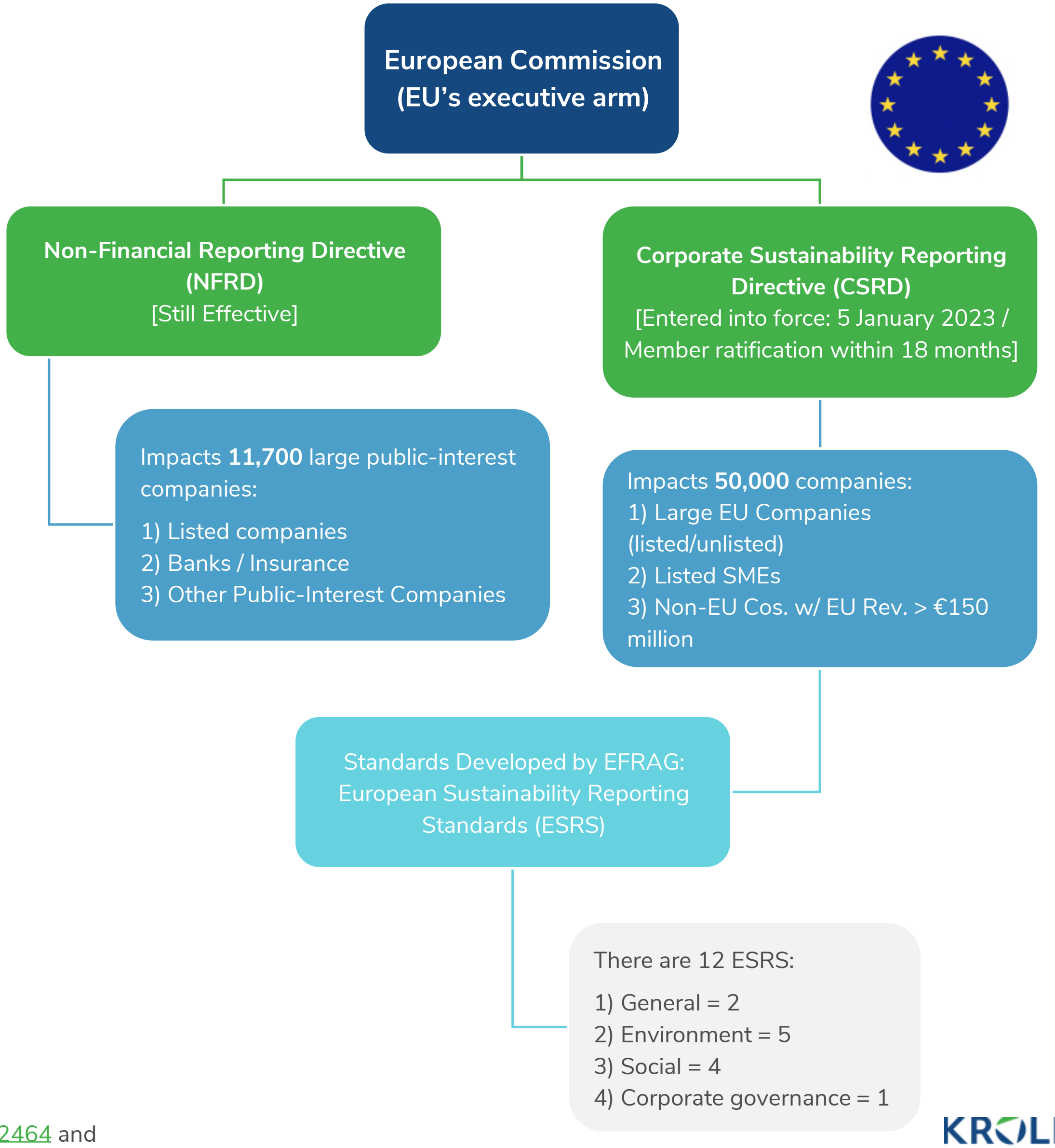
- Finalized standards in **June 2023:**
  - IFRS S1: General Requirements for Disclosure of Sustainability-related Financial Information
  - IFRS S2: Climate-related Disclosures
- Both standards will become effective starting on **1 January 2024**. This means that an entity would report its first sustainability-related disclosures in **2025**, if under scope. Some transition relief is available in first year of application (e.g., limited climate-related disclosures).
- Early adoption allowed, but only if an entity applies both IFRS S1 and IFRS S2 at the same time.
- IFRS S1 and IFRS S2 are built on and consolidate the TCFD recommendations, SASB Standards, CDSB Framework, Integrated Reporting Framework and World Economic Forum metrics. Requirements are interoperable with Global Reporting Initiative (GRI) standards.
- Disclosures should be as part of a company's general purpose financial reports that include its financial statements.
- Additional industry-specific disclosure standards to follow.

- The ISSB is working with a number of jurisdictions to ensure the IFRS Sustainability Disclosure Standards can be adopted and applied effectively around the world.
- The application of the standards, either voluntary or mandatory, will be predicated on individual jurisdictions' willingness to incorporate them into national laws. Several African, Asian and Latin American countries have expressed interest in adopting.
- Even if the U.S. or the EU do not adopt these standards domestically, U.S. and EU companies with operations abroad will still have to deal with disclosure requirements in jurisdictions where the standards become mandatory.
- The European Commission, EFRAG and ISSB confirmed a high degree of climate-disclosure alignment and will continue to work jointly to optimize the interoperability of their respective standards.

European Union – Corporate Disclosures

CSRD/EFRAG's ESRS

- The rules introduced by the NFRD remain in force until companies have to apply the new rules of the CSRD. Under the NFRD, large companies have to publish information related to environmental matters, social matters and treatment of employees, respect for human rights, anti-corruption and bribery, and board diversity. CSRD introduces more detailed reporting requirements on companies' impact on the environment, human rights and social standards.
- The EC adopted the European Sustainability Reporting Standards (ESRS) in **July 2023.** Sector-specific standards to follow. Currently considering some relief by phasing in requirements.
- Disclosures subject to limited assurance. **Double materiality applies** ('financial' and 'impact').
- The rules will start applying between 2024 and 2028:*
  - From 1 January 2024 for large public-interest entities (listed companies, banks, and insurance), with over 500 employees - already subject to NFRD. Reports due in 2025.
  - From 1 January 2025 for large companies (including non-listed) not currently subject to NFRD (large undertakings meet at least two of the following criteria: >250 employees and/or >€40 million in revenue and/or >€20 million in total assets). Reports due in 2026.
  - From 1 January 2026 for listed SMEs and other undertakings, with reports due in 2027. SMEs can opt-out until 2028.
  - From 1 January 2028 for non-EU parent companies with EU revenues >€150 million and have (1) a large or a listed EU subsidiary, or (2) large EU branch. Reports due in 2029.



Some exceptions apply. Sources: https://eur-lex.europa.eu/legal-content/EN/TXT/?uri=CELEX:32022L2464 and https://eur-lex.europa.eu/legal-content/EN/TXT/?uri=celex%3A32013L0034. Revenue and total assets thresholds subject to change.

United States – Corporate Disclosures

Securities and Exchange Commission (SEC)

- In 2022, the SEC proposed for public comment, "The Enhancement and Standardization of Climate-Related Disclosures for Investors," amending rules that would require registrants to provide certain climate-related information in their registration statements (e.g., S-1, S-4) and annual reports (e.g.,10-K, 20-F).
- The SEC indicated plans for further rulemaking on human capital management disclosures, with a proposal originally expected in 2023.
- By the end of the climate proposal's comment period, the SEC had received more than 11,000 comment letters—a significantly higher volume than it typically receives—from a broad range of constituents, both in favor and against various aspects of the proposal.
- In April 2023, the SEC signaled it could issue the final climate rules in the fall of 2023, but that seems to have been delayed to April 2024.
- The proposed rules would be phased in for all companies, with the compliance date dependent upon the status of the company (e.g., large accelerated filer) and the content of the item of disclosure. As originally proposed, the earliest impact of the new rules would begin to be felt and seen in 2023-2024. However, given that the final rulemaking has been pushed out significantly, the timeline for compliance would likely also be extended.
- Some attestation would be required.

Example: Assessing Climate Impacts and Risks

- Much of the existing and upcoming regulation requires formal assessment and management of climate risk, which includes:

(1) Establishing adequate processes for identifying and assessing climate risk (this can be part of the materiality assessment process)

(2) Establishing adequate processes for managing climate risk

(3) Integrating climate risk into broader enterprise risk management systems

- Given the anticipated prevalence and practical import of the ISSB S2, most organizations would benefit from expressly adopting that framework, which are fully aligned with this approach.

Examples of Climate-Related Risks (Non-Exhaustive)

Physical Risks	**Acute** • Increased severity of extreme weather events such as cyclones and floods
	Chronic • Changing weather patterns and rising mean temperature and sea levels
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
	Technology • Substitution of existing products and services with lower emissions options • Unsuccessful investment in new technologies • Costs to transition to lower emissions technology
	Market • Changing customer behavior • Uncertainty in market signals • Increased cost of raw materials
	Reputation • Shifts in consumer preferences • Stigmatization of sector • Increased stakeholder concern or negative stakeholder feedback

Source: TCFD
Available at: https://assets.bbhub.io/company/sites/60/2021/10/FINAL-2017-TCFD-Report.pdf

Scenario Analyses and the Taskforce on Climate-Related Financial Disclosures (TCFD)

- All of the three major disclosure initiatives based their proposed standards in part on the TCFD recommendations.
- An essential recommendation of TCFD is to undertake climate-related scenario analyses to assess companies' resilience to climate change
- Both the CSRD and the ISSB will require companies to use scenario analysis in some form to assess their climate resilience.
- Unclear if the SEC will make it mandatory in some circumstances.
- To the extent a company is subject to either the CSRD or the ISSB, it would have to develop a system to conduct climate-related scenario analyses to meet the associated disclosure requirements.

16%

of Companies disclosed the use of climate-related scenario analyses in **2021**

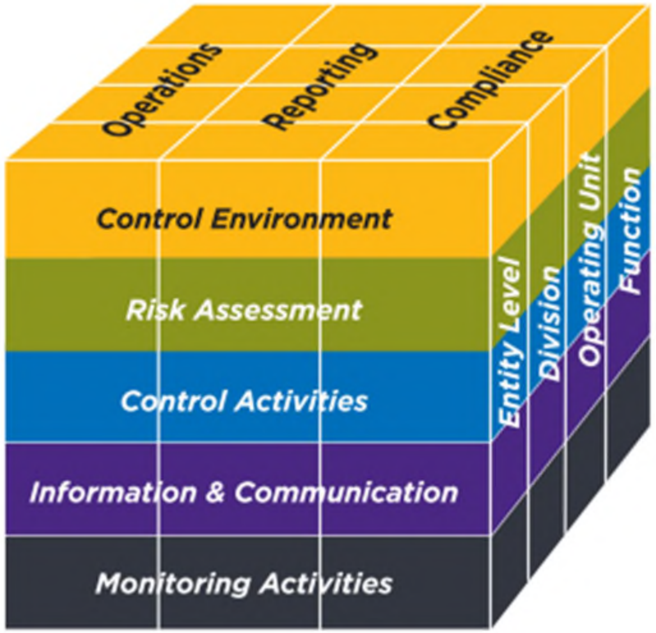
6%

of Companies disclosed the use of climate-related scenario analyses in **2019**

Based on an AI (artificial intelligence) review of reports from over 1,400 public companies from five geographic regions over a three-year period (fiscal years 2019, 2020 and 2021). Source: "2022 Status Report: Task Force on Climate-related Financial Disclosures", Financial Stability Board, 13 October 2022.

Preparing for Evolving Assurance Requirements

Regulators are increasingly requiring limited or reasonable assurance over sustainability information, necessitating adequate and effective internal controls with same methodological rigor involved in financial reporting.



Source: COSO Internal Control—Integrated Framework

1. **Control Environment**
   – Commitment to integrity and ethical values
   – Independent board of directors' oversight
   – Structures, reporting lines, authorities, responsibilities
   – Attract, develop, and retain competent people
   – People held accountable for internal control
2. **Risk Assessment**
   – Clear objectives specified
   – Risks identified to achievement of objectives
   – Potential for fraud considered
   – Significant changes identified and assessed
3. **Control Activities**
   – Control activities selected and developed
   – General IT controls selected and developed
   – Controls deployed through policies and procedures
4. **Information & Communication**
   – Quality information obtained, generated, and used
   – Internal control information internally communicated
   – Internal control information externally communicated
5. **Monitoring Activities**
   – Ongoing and/or separate evaluations conducted
   – Internal control deficiencies evaluated and communicated