Meeting Minutes for the APPG on Environmental, Social, and Governance

Topic: Standardising and regulating ESG performance and assessment in the UK
Date: Wednesday, 27 October, 10.30am (Hybrid)

Chair
Alexander Stafford MP (APPG on ESG Chairman) (AS)

Parliamentary Attendees
Baroness Northover (Member of the APPG on ESG)

Attendees
Tanisha Aggarwal, Policy and Public Affairs Manager at Nationwide, Simon Aldrich, Senior Environmental Consultant at Hatch, Bridget Beals, Partner (Co-Head of Climate Risk and Decarbonisation Strategy) at KPMG, Steve Cracknell, CEO of insig AI, Ciaran Hamill, ESG specialist at Severn Trent, Nick Henderson, Director of Learning and Content at VinciWorks, Xanthe Kueppers, Head of Investor Relations at EDF Energy, Maria Long, Research and Content Director at the Standards Board for Alternative Investments, Diana Rose, ESG Director at insig AI, Nicola Stopps, CEO of Simple Sustainable, Clare Turgoose, Investor Liaisons Analyst at EDF Energy, Caroline Turnball-Hall, Director of Corporate Affairs, Regulation and Legal Issues at PwC, Helena Watson, Director (Accounting Advisory Service) at KPMG.

The meeting starts at 10:30 am.

AS welcomed everyone to the meeting.

ESG is a key consideration for businesses - especially with COP26 next week. All businesses want to talk about ESG, so discussion of the topic is important. However, we have seen multiple framework performance systems arise. We therefore need more clarity. So I would like to ask some questions:

- What are the key indicators of ESG performance?
- What ESG metrics are relevant?
- Which frameworks of performance assessments do you find more useful?
- Do you rely more on in-house ESG analysis or work that is assessed externally?
- What are the outcomes of this meeting?

The Government is keen to hear our ideas and opinions and act on them. So this APPG is truly important.

Discussion begins

Contribution: From an investor's perspective, ESG disclosures can be incorporated into our company decision making. It will enable us to have better investment conversations regarding sustainable business models. It is vital that we have the granularity of information from investment companies so we can report meaningfully to our clients, otherwise we risk misleading them and mistakenly reallocating capital. In terms of specific metrics, it is important that we consider financial material. This is an important stepping stone. We want to see companies improve their reporting in line with TCFD and the ISFB.

Contribution: ESG is not a new phenomenon. We have been working on the topic of corporate sustainability for 11 years and we think of it through the lens of pre-financial reporting. All our clients ask for standardisation in regards to ESG metrics and it is a fair assumption that the solution is standardisation - but this depends on what each company is aiming for. A cohesive, transparent way to assess financial risk may benefit from standardisation, but this is not a sustainable approach for many businesses. A well-crafted ESG strategy is important for a business and can drive disclosures, and compliment KPIs. Broadly speaking, a sector-based guide created by sector experts could create a sector-based standard - we have seen this in hospitality and aviation.

Contribution: I agree there is a divide between the two, but I find clients are more open when they can measure themselves against an existing comparison, especially TCFD. Different people and companies have different standards. The metrics are important. Greenhouse gases are being calculated by people using an array of different metrics, thereby complicating their involvement with financial institutions. I would say that standardisation is necessary, but you must consider both.

Contribution: I can understand why there are different ratings as they offer different ways to assess ESG risk. The FCA refuses to accept that its models of risk aren't perfect. It can improve based on tailoring its approach to sectors.

Contribution: The equality of assessment can be poor sometimes. Clients ask what they should be doing well, but oftentimes, overly powerful rating agencies are mixing up their assessments with other companies and sending misrepresentative reports - essentially there is disorganisation across this area.

Contribution: We must tackle this challenge from the bottom up and centralise company data - this will help validate data. The NSCR can play a part in scoring, but it is out of date. How can we proceed with an investment when the scores are so outdated? From here it quickly becomes complex. The pain we see from clients comes from obstacles to their genuine desire to do good and perform well. They simply do not know who is telling the truth. Companies have taken to setting their own ESG metrics, which from a UK perspective is good, but when a business goes global it can cause problems. Companies are wary of third party judgement and are justly fearful of their well-intentioned reports attracting penalisation and criticism.

Contribution: This is an important point, that investors will provide this information, combining this with the direct engagement of a company to understand their statistics which are driving company turnover. One thing rating agencies may find easier is the E in ESG, but the S and G can be more qualitative-based and subject to judgement calls. They are becoming increasingly important to the investment process, but are largely unregulated. Of course, we need innovation in the market, but there ought to be space for regulation too.

Contribution: Regulation raters are an issue, but the quality of data from business is too. This is a driver of problems. Greenhouse gas emissions are simple, but industries and businesses are failing to report the various nuances associated with them. The ISFB will be massively important in ensuring data is viable for investors. This does not negate the space to have the more company-specific multi-stakeholder type disclosures. Essentially, we do need that core of information.

AS: Who is responsible for collecting all this data and who decides?

Contribution: Our metrics are inherently ESG metrics that are agreed with a regulator and standardised. We then consult on these with a view to best-serving investors.

Contribution: One thing we are seeing from an investment perspective is tracking goods and services throughout the supply chain. From start to end, collecting data can be tough - especially when all too often the start of the chain can be China. Having some standardisation and accessibility to corporate information is key in enabling investors to make comparisons and then make informed choices.

AS: Of course, the UK cannot go at this alone, but we all have interests outside the country. How do we ensure that ratings and measurements are consistent across the board?

Contribution: At the G20, we saw a commitment to support the work of the International Sustainability Standards Board and their drive towards a Climate First Standard. One important thing to note is that they are moving from climate standards to broader issues - this is promising and enables us to consider the S and G in ESG in relation to the E too. It is a cohesive approach that has been endorsed by IOSCO. This builds credibility and creates and sustains momentum.

Contribution: My concern is what will happen with the EU and USA. The two use different metrics and we cannot proceed with a three-pronged approach. The EU stated it has a double materiality perspective and attempting to combine our standards on this is tough. The US position is less clear but they still support the ISFB. Having three truths is not a good approach. Taxonomy is worse and companies are struggling to understand the concept. We need comparability internationally.

AS: How are TCFD and SFDR working for you?

Contribution: SFDR is constantly dominating conversations with clients as no one can really define themselves. They struggle with whether they are an Article 8 or Article 9 company, or whether they will get accused of greenwashing. Asset managers are now making three different calculations to broaden their reporting scope.

Contribution: The SFDR approach challenges include a lack of sequencing and a lack of asset managers not truly understanding the data. We must also consider what companies want to happen when they enable change. We have seen through TCFD and Mark Carney that climate change is a real financial risk to businesses. This approach can be replicated to governance and social issues too. If you think about it through a pre-financial lens (so they will become financially material in the future), then it can yield greater success. Issues such as board-level diversity and gender pay gap reporting are increasingly being framed through TCFD disclosures.

Contribution: Transition is important, as some countries, especially in Africa, are still shifting from reliance on fossil fuels and find themselves hamstrung.

Contribution: Any real impact will be made through engagement with any standardisation part of a broader discussion. ESG is large and we often focus too much on the E as the metrics are more comparable. So, if you want standardisation, imagine each company reporting on the E, S, and G. We need a sense of what is material for each sector, firm, and set them proportional goals.

AS: It is easy to measure E well and it is topical of course. When it comes to ratings, how do you measure the S and G? Can you measure these?

Contribution: It must be about impact over metrics, which in turn refers us back to a company's capacity to report and act.

Contribution: I think it ultimately comes down to what benefit to society your business has. This must be your material social issue - this can include upskilling people on digital skills and giving them access to resources to enhance their skills. You must consider what benefit to society your business contributes - this must be the material measurement.

Contribution: I would also note that cultural differences can be a caveat. 10% of women at a UK board level is poor, but in Japan would be impressive! So there are cross-border cultural sensitivities to consider. For example, in both Japan and Sweden it is illegal to ask about the diversity of a board.

Contribution: We must not miss the granularity of social issues. Gender is not just about how many women there are on the board, but the pipeline of talent. Financial reports are audited and the disorganisation of the sector means data is scattered across many reports making trust an issue. There is a lack of best practice in disclosing social or governance reports. Perhaps we could have a TCFD, but for these areas of ESG?

AS: Is there increased governance-washing or social-washing? We speak a lot on what they are reporting, but not on what they aren't.

Contribution: Modern slavery is an example of this, where companies will shy away from reputational damage. The conversation needs to shift and companies need to find where slavery may be occurring. This is a challenging area and if you look at the quality of reporting on this there is definitely under-reporting. We need supplementary indicators to assess risk and this could focus on your workforce and location in the world. The E can help solve problems for S and G, so I would welcome an integrated approach.

Contribution: There needs to be less greenwashing shaming. If the narrative is on punishing greenwashers, then reporting will never be transparent.

Contribution: It will always be about what risk you want to take and what info to put out or not. Modern slavery is guaranteed to be in a supply chain and no business leader would admit to that. I always think we need to keep an eye on how ESG isn't really considering how businesses are supporting democracy. This is an interesting angle when thinking about certain countries. Another issue is the irony that some responsible businesses have good strategies but in reality, suppliers aren't getting paid and this isn't getting reported.

AS: Does the Government need to get involved?

Contribution: It could solve the issue. There is a case for this. In regards to greenwashing, you can't get a real sense of the company until speaking to workers individually.

Contribution: There are some elements in 'social' that can be standardised. We ought to tackle a top-down company culture where so many categories are bucketed up and undefined leaving the opportunity to standardise missed.

Contribution: I agree. There must be an agreed international minimum supplemented by jurisdictional pressures.

Contribution: If a company discloses modern slavery, it could ask the Government for an amnesty period between reporting it and changing it. Penalisation can be harsh and if the Government recognised this, then more companies would be transparent.

AS: This is a good idea - one which levels the playing field and ensures the company won't get hit, rather the sector may. In fact, what should and should not be reported?

Questions
AS: With the forthcoming standardisation from the IFRS Foundation - with the aim to develop standards that bring transparency, accountability and efficiency to financial markets around the world - how can we keep materiality relevant for Sustainability?

Contribution: By being clear about the purpose of reporting, we must be clear about what we mean about the materiality behind various financial statuses.

Contribution: Agreed, we need a clear structure process that is audited externally. Dual materiality is important from a climate change view.

AS: How can we encourage TCFD focused reporting throughout the investment chain?

Contribution: There is a huge amount of reporting occurring, but we just aren't seeing inter-capital management and companies recognising the Paris Climate Agreement and how they can accommodate their business for a 1.5-degree world.

Contribution: Fundamentally, businesses need to look at their business model. When working with boards, upskilling is required so those making the decisions have enough education and knowledge to proceed.

Contribution: Increasingly, businesses are adding ESG to their KPIs which all too often can feel like a marketing exercise. They must explain why ESG is fundamental to their strategy.

Contribution: Businesses are attempting to improve diversity without offering any methods on how and why it is good for the company. This can descend into tokenism. We need cognitive and physical diversity.

Contribution: I think if you have women on boards it serves to inspire talent from below.

Contribution: Women can too often be the lone voice in the room.

Contribution: I think it will be hard to drive behavioural change when there is a lack of scope and clarity on ESG metrics.

AS: Change does come from the top. But how can the Government help boards understand this?

Contribution: The EU rushed its strategy and there was panic to clarify assets. Is there a place to stand back in the UK and think it through more carefully? Quick fixes are not the answer to a long-term challenge, but need debate and thought. There must be ownership from the top down to the metrics and there should be no shortcut for this.

AS: I agree, the UK should not be looking like it is dragging its feet, but must also assert itself as an ESG leader.

Contribution: I think there is a real chance to establish the UK as an S and G leader.

Contribution: What is the Foreign Office's view on this?

AS: Well, we don't wish to antagonise countries we are seeking trade deals with. But the majority of the Government think that the UK can use its ESG soft power to press countries with questionable human rights records, with whom we are also seeking trade deals.

Contribution: I feel we have let our soft power slide. We need to re-establish what British businesses stand for!

Contribution: Obviously, there is a new emphasis on the E in ESG, S has been around for a while and G for longer. Are we seeking to work out how the interrelation of G within E and S is reported? If you have a company ESG committee, it should look at the governance of the whole company, but so should other committees. How can we ensure treading on toes doesn't occur whilst ensuring proper integration?

AS: I believe if you have clearly defined industry expectations, you can find a way.

Contribution: You can expose this by showing whether the disclosure has changed or the materiality of it has changed by comparing your most recent ESG commitment to last year's.

Contribution: An ESG committee is a sense checker so it will either serve to drive and provide knowledge or sense check commitments.

AS thanked everyone for attending, noting that the next meeting will be on the 24th of November.

The meeting ends at 12:00 pm