STATE STREET GLOBAL ADVISORS

What's Your ESG Score?

Board directors often ask our stewardship team: "What's the one question about ESG that I need to ask at the next board meeting?" Our answer is simple: Ask "What is our ESG score?"

While many companies have no idea how to reply to that question, we believe that a company's ESG score will ultimately become as important as their credit ratings for investment purposes.

Why ESG Scores are Important

For a growing number of investors, the risks and opportunities around sustainability and ESG impact have become an integral part of their investment decision-making.

More will follow as millennials increasingly invest not only for returns but also to align with their values. The values investing trend is redefining the investment landscape and driving the growth of ESG investment strategies, which now account for well over $30 trillion in AUM globally.[1]

To create ESG-investable products, portfolio managers rely on ESG scores compiled according to company-reported ESG data. Without that input from companies, ESG data providers such as MSCI, Sustainalytics, ISS-Oekom and Vigeo-Eiris, come up with their own estimates.

And, investible ESG strategies are currently designed in ways that prioritise companies with higher ESG scores, making the ESG score a vital investment parameter.

The Benefits of Knowing

To illustrate the growing power of ESG as an investment differentiator, we often cite the example of a small oil and gas company in the US that recently told us they were surprised by the number of European ESG investors that began investing in their stock after they published their first sustainability report.

Critically, their report provided enough detailed data about the company's carbon emissions that the company's assigned ESG score improved as a result.

Yet, too few board directors take the time to absorb their company's sustainability reports, let alone know what score has been assigned by third-party ESG specialists.

Bringing Focus

This needs to change, because corporate boards are central to overseeing whether management is taking these sustainability issues seriously and changing capital allocation decisions as a result.

State Street Global Advisors has been calling on boards to incorporate material sustainability factors into their long-term strategies for some time.

We also provide a framework to help boards think of the ways environmental, social and governance (ESG) risks might impact their businesses. However, many boards are still struggling to understand how to do this.

But with that one question: "What is our ESG score?" directors can begin to focus board attention on issues such as: What are the material ESG risks to our business? How are these risks being mitigated? How should they be incorporated into strategy? Are we giving investors the information they need to assess the effectiveness of our sustainability practices? How are we communicating the relevance of these factors to our long-term strategy?

[1] 2018 Global Sustainable Investment Review, Global Sustainable Investment Alliance 2018.
[2] A Blueprint for Integrating ESG into Equity Portfolios — Jennifer Bender, Todd Bridges, Chen He, Anna Lester and Xiaole Sun.
[3] Source: "Stewardship 2019", SSGA, data as per year end 2019.

New Frameworks for ESG

What board directors will quickly find is that the methodology driving the company's ESG score is currently opaque and varies by data provider.

Recent research conducted by State Street,[2] for example, found that there was less than a 5% correlation between the MSCI and Sustainalytics ESG scores.

As an industry, we need to do a better job at creating more consistent and higher-quality scoring. The good news is that the Sustainable Accounting Standards Board (SASB) has developed a sophisticated environmental and social reporting framework for companies, which identifies sustainability factors by GICS and sub-GICS sectors that are material for investors.

SASB has developed accounting standards for hundreds of sustainability metrics that will allow companies across an industry to measure and report on material sustainability factors in a systematic and comparable way. Over time, we believe that the SASB reporting framework will increasingly drive the ESG scores of companies. Therefore, companies should begin to report their activities in accordance with SASB's framework.

A Vital Metric for Future Investment

What boards need to recognise is that ESG is no longer an ancillary topic that shows up once a year in the company's corporate responsibility report. On the contrary, a company's ESG score will increasingly determine if trillions in global institutional and retail capital will flow toward them or away from them. It is past time for boards to take notice.

Making Asset Stewardship Work

At SSGA, we believe that our stewardship role extends beyond proxy voting and engagement with issuer companies.

It also includes promoting investor protection for minority shareholders in global markets through partnerships with local investors and regulators, and working with investee companies to encourage adoption and disclosure of environmental, social and governance practices.

As near-perpetual holders of the constituents of the world's primary indices, we use our voice and vote to influence companies on long-term governance and sustainability issues. Our approach to stewardship is designed to have an impact. We use a risk-based approach to identify thematic and company issues that are important to our clients.

By prioritising our engagements and thematic areas of interests, we engage with more than 45% of the assets under management in equity.[3] This has resulted in State Street Global Advisors being the largest asset manager at the forefront of countless issues such as board tenure, climate risk and diversity.

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