

# A guide to ESG transparency



Various stakeholders such as investors, our asset owner clients, employees, NGOs, and the wider public all expect better environmental, social and governance (ESG) disclosures and accountability from companies. Regulators across the world are also stepping up. The pressure is growing and LGIM<sup>1</sup> acknowledges it can be difficult for companies to manage these different expectations.

In this guide, we set out our expectations as a long-term investor regarding what ESG information our investee-listed companies should report on, and how to communicate this information effectively to stakeholders.



1. Unless otherwise stated, references herein to "LGIM", "we" and "us" are meant to capture the global conglomerate that includes Legal & General Investment Management Ltd. (a U.K. FCA authorized adviser), Legal & General Investment Management International Limited (a U.S. SEC registered investment adviser and U.K. FCA authorized adviser), Legal & General Investment Management America, Inc. (a U.S. SEC registered investment adviser) and Legal & General Investment Management Asia Limited (a Hong Kong SFC registered adviser). Each LGIM entity acts within its authorized jurisdictions only.

# LGIM's responsibility for ESG transparency

As a long-term investor with a universal owner approach, we have a responsibility to advocate for markets to accurately price in material ESG information, so the appropriate level of risks and opportunities can be attributed to the company's activities.

Access to what is considered 'non-financial' and ESG information has been traditionally overlooked, mostly because such information was rarely included in the annual reports or seen by the auditors. Given the growing consensus on the financial materiality of ESG factors, many investors like LGIM are increasingly seeking to integrate them within their investment processes.

In order to accurately understand risks and opportunities, investors need access to relevant, comparable, consistent, and verifiable ESG data across markets regardless of size, geography or asset class. And we have only just begun that journey. We believe ESG 'laggard' companies will increasingly be penalised by the markets, encouraging the (re-)allocation of capital towards more sustainable companies.

**Investors need access to relevant, comparable, consistent, and verifiable ESG data across markets regardless of size, geography or asset class**



## How we currently act on our responsibility:

- Use of company engagement and voting power:** LGIM already holds boards accountable for ensuring the good performance of their ESG credentials. We expect boards to integrate relevant and material ESG considerations within their strategies and we therefore place sanction on those which do not meet our minimum ESG expectations, including minimum disclosures, as per our voting policies.
- Public policy engagement:** LGIM is working closely with policymakers across the world to ensure disclosure regulation and standards are robust and consistent across markets.
- Allocation of capital – 'financial consequence':** as more widespread access to ESG data gradually enables markets to better price in that information, we believe this will empower the investment community to use capital allocation as an engagement tool. This will also be an incentive for boards to seek to achieve better ESG performance. This is something LGIM is already doing, for example with its proprietary ESG score that combines an assessment on a company's ESG performance with adjustments made for a company's overall transparency levels on related issues ('T score'). We utilise the LGIM ESG scores in the Future World fund range, whose index funds are 'tilted' towards companies with stronger scores and away from those that score poorly. The scores can also be used as a data input into the active investment process, combined with further detailed ESG analysis and fundamental research.
- Transparent approach:** the methodology for our ESG score, along with the scores we allocate to various companies, available on our website. In addition, LGIM publishes thought pieces, voting policies and a Task Force on Climate-Related Financial Disclosures (TCFD) report.

# The responsibility of boards for transparency

We believe boards have a responsibility to ensure their company's ESG credentials can be appropriately used by markets to efficiently price in this information. Their role is not limited to disclosure of ESG information; it also encompasses improving transparency, using the steps we set out below:

## Achieving better transparency

Materiality > Standardisation > Disclosure > Verification > ESG performance ✓

## Market impact: more efficient allocation of capital

### 1. What to disclose: materiality and standardisation

Defining 'material ESG information' is a difficult task as the concept is constantly evolving and incorporates an element of subjectivity. It is our view that the company should focus on what is material to their business, both now and in the future, including their various stakeholders. Different stakeholders will also have different views on what company disclosures are material for them.

To facilitate this process, LGIM encourages as a minimum that all investee companies disclose their ESG credentials in accordance with the existing guidance set out by the Sustainable Accounting Standards Board (SASB). This guidance encourages disclosure of material ESG factors where they are 'reasonably likely to affect the financial condition or operating performance of a company'. This framework adopts a financial and sector-based approach to the definition of materiality.

However, boards need to bear in mind that an ESG data point that is not considered financially material at one point in time may become financially material in the future. It is therefore important that boards do not limit their focus to ESG information defined as financially material at only one point in time. They should be forward-looking in their approach, and therefore disclose and focus on a broader range of ESG data points which could become financially material at a later point in time. This is why, in addition to SASB, LGIM also encourages all investee companies to disclose their ESG performance in accordance with the GRI Standards set out by the Global Reporting Initiative (GRI). These standards encourage disclosure by corporates of their impact on critical sustainability issues such as climate change, human rights, governance and social wellbeing. This framework adopts a stakeholder approach to the definition of materiality.



## LGIM expects companies to explain their process for assessing 'materiality' in their annual disclosures

LGIM expects companies to explain their process for assessing 'materiality' in their annual disclosures, i.e. how they have defined and selected what is material to the company and to society. We expect this process to be embedded into the company's governance as it is the responsibility of the board to ensure that the company has a full view of material risks and opportunities, along with appropriate processes to ensure informed decision-making and risk management.

### Standardising data for greater comparability

As companies increasingly disclose their ESG activity, the risk of inconsistent data also increases. It is important for investors to be able to compare data in order to efficiently price in ESG information across markets. LGIM believes that the consistent use by all companies globally of well-established reporting frameworks will help stakeholders access data that is relevant and comparable across all markets.

In addition to SASB and GRI, there are specific disclosure requirements in certain sectors for particular themes where internationally recognised standard reporting has been developed, for example climate change. We encourage disclosure in relation to the Taskforce on Climate-related Financial Disclosures (TCFD), the Climate Disclosure Standards Board (CDSB) and the CDP (Carbon Disclosure Project) on this topic

## 2. Efficient disclosure

Disclosure of ESG information can be made in the company's annual report, in a separate sustainability document, or in an integrated report. LGIM does not prescribe that companies adopt one form of reporting over another. Instead, we encourage companies to weigh the pros and cons of each form of reporting, bearing in mind the following key considerations:

- reporting should allow boards to evidence the integration of ESG within their corporate vision and strategy, including the consideration of ESG risks and opportunities
- boards should make sure that the ESG data presented in the reporting is accessible so that it can be easily extracted and used by the wide range of stakeholders who increasingly rely on it.

The annual and standalone sustainability reports allow for extensive disclosure of ESG data points. However, we find that these reports do not always adequately evidence the integration by the board of ESG issues, and can result in separate and disengaged financial and ESG sections or documents.



**We support the idea that material ESG information be audited with the same degree of rigour as traditional financial information**

In order to evidence the integration of ESG into the board's thinking, companies may find it beneficial to go a step further in their reporting and, in addition to annual and sustainability reports, follow the guiding principles of the International <IR> Framework developed by the International Integrated Reporting Council (IIRC). This calls for 'financial and other' information to be presented in an integrated manner within corporate reporting. This helps companies adopt an 'integrated thinking' approach between ESG and their financial and strategic information, with the perspective of value creation over time.

Whilst the International <IR> Framework does not reference existing international reporting frameworks that LGIM supports such as SASB or GRI, it can be a useful complement for boards who may wish to further demonstrate integrated thinking between ESG, financial and strategic information. It can also help boards in their determination of materiality (discussed above).

### **3. Verification of data**

Given the importance of ESG data for our investment decisions, we are supportive of the idea that material ESG information be audited with the same degree of rigour as traditional financial information. This is essential to ensuring that companies' ESG disclosures are reliable for investment decisions.

However, LGIM recognises that this is early days, and that a discussion at market level is required. We encourage our investee companies to be proactive and undertake where possible the verification of their ESG data externally by an independent assurance specialist, based on recognised standards. This can be evidenced by making the assurance statement public. This verification exercise should provide comfort to stakeholders, including investors, around the ESG data disclosed, and should strengthen the credibility of companies' ESG data.

#### 4. ESG performance: the importance of third-party scoring

Boards' responsibility regarding ESG disclosures goes beyond the company's own reporting. The financial community and various stakeholders increasingly rely on ESG data provided by third party providers. It is fundamental that boards of today seek to position their company as an ESG leader as investor sanctions will be imposed not only through voting, but also and increasingly at the capital allocation level. Inaccurate ESG information held by a third-party provider and used by the investment community might result in markets inaccurately pricing company stock and/or bonds. ESG laggards are likely to be penalised by the markets and it is therefore important that boards step up on this issue and make sure the information third-party providers have on their companies is accurate and that investors can use it.

Please note the difference between ESG data and ESG ratings:

- ESG data are the underlying metrics, usually reported by a company or modelled in a transparent calculation, that are gradually becoming standardised across the market. We strongly encourage the continued progress towards consistency of these metrics
- ESG ratings (or scores) are an aggregation of a series of ESG data points produced by e.g. a ratings provider or an asset manager. These aggregations are usually designed to assess the overall performance of a company across a range of ESG fields and may or may not become standardised over time. The ratings reflect different analytic frameworks used by the rating provider or asset manager, which place different weights on different ESG components. LGIM's ESG scores, for example, will be different than those of third party rating groups.



**Boards' responsibility regarding ESG disclosures goes beyond the company's own reporting**

# LGIM’s use of third-party providers

We set out below the various ESG proprietary tools and ESG data providers LGIM uses:

## LGIM ESG score

- Comprises 28 Environmental, Social, Governance and Transparency metrics. This score is used in the construction of index funds and as an engagement tool. The data is also used in active integration. Company scores are made public on our website. LGIM’s ESG score was created to raise the bar on issues that can affect the entire investment universe.

More information [here](https://www.lgim.com/files/_document-library/capabilities/lgims-esg-score-information-for-companies.pdf): [https://www.lgim.com/files/\\_document-library/capabilities/lgims-esg-score-information-for-companies.pdf](https://www.lgim.com/files/_document-library/capabilities/lgims-esg-score-information-for-companies.pdf)

## LGIM ESG view

- An essential component of the overall active research process for integration of ESG into core active funds
- Quantitative input: uses the data providers below, reported company data and proprietary LGIM analysis
- Qualitative inputs: ESG insights from LGIM's company analysis and engagements

More information [here](http://www.lgim.com/files/_document-library/capabilities/corporate-governance-2019-full.pdf): [http://www.lgim.com/files/\\_document-library/capabilities/corporate-governance-2019-full.pdf](http://www.lgim.com/files/_document-library/capabilities/corporate-governance-2019-full.pdf)

## LGIM climate impact pledge

- Assessment of companies on their climate governance and contribution to the low-carbon transition. It draws on the data points from the following third party providers and also company public disclosures. A qualitative overlay based on engagement applies to our final annual divestment (Future World range) / voting decisions (across all other funds which cannot contractually divest).

More information [here](https://www.legalandgeneralgroup.com/media/17251/21062019-climate-impact-pledge-2019-tackling-the-climate-emergency.pdf): <https://www.legalandgeneralgroup.com/media/17251/21062019-climate-impact-pledge-2019-tackling-the-climate-emergency.pdf>

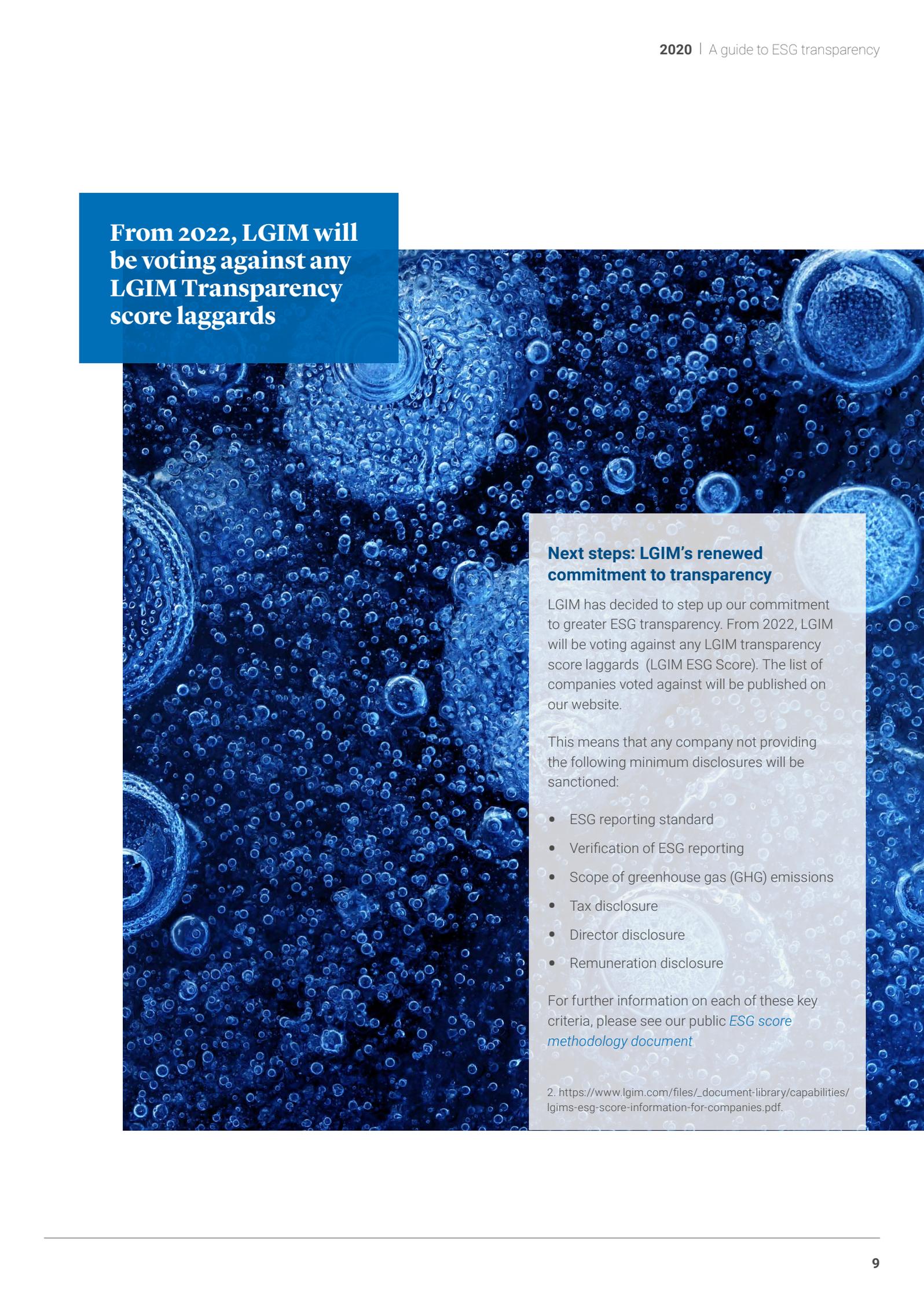
## LGIM future world protection list

- A set of exclusions for those companies that we believe have failed to meet the minimum standards of globally accepted business practices. This list draws on data from the providers below in combination with the LGIM in-house methodologies. Please note that all Future World funds apply LGIM’s Future World Protection List and this list may be adopted by any client for their segregated mandate.

More information [here](https://www.lgim.com/files/_document-library/capabilities/future-world-protection-list-public-methodology.pdf): [https://www.lgim.com/files/\\_document-library/capabilities/future-world-protection-list-public-methodology.pdf](https://www.lgim.com/files/_document-library/capabilities/future-world-protection-list-public-methodology.pdf)

## The ESG data providers LGIM uses

	LGIM ESG score	LGIM ESG view	LGIM climate impact pledge	LGIM future world protection list
Destination@Risk / LGIM Analysis			✓	
Bloomberg		✓		
CDP			✓	
HSBC	✓	✓		
Influence Map			✓	
ISS		✓		
MSCI		✓		
Reprisk		✓		
Refinitiv	✓	✓		
Sustainalytics	✓	✓	✓	✓
Transition Pathway Initiative			✓	
Trucost	✓	✓	✓	✓
Verisk Maplecroft		✓		



**From 2022, LGIM will be voting against any LGIM Transparency score laggards**

**Next steps: LGIM's renewed commitment to transparency**

LGIM has decided to step up our commitment to greater ESG transparency. From 2022, LGIM will be voting against any LGIM transparency score laggards (LGIM ESG Score). The list of companies voted against will be published on our website.

This means that any company not providing the following minimum disclosures will be sanctioned:

- ESG reporting standard
- Verification of ESG reporting
- Scope of greenhouse gas (GHG) emissions
- Tax disclosure
- Director disclosure
- Remuneration disclosure

For further information on each of these key criteria, please see our public [ESG score methodology document](#).

2. [https://www.lgim.com/files/\\_document-library/capabilities/lgims-esg-score-information-for-companies.pdf](https://www.lgim.com/files/_document-library/capabilities/lgims-esg-score-information-for-companies.pdf).

## Contact us

For further information about LGIM, please visit [lgim.com](http://lgim.com) or contact your usual LGIM representative



### Important information

The value of an investment and any income taken from it is not guaranteed and can go down as well as up, you may not get back the amount you originally invested.

Unless otherwise stated, references herein to "LGIM", "we" and "us" are meant to capture the global conglomerate that includes Legal & General Investment Management Ltd. (a U.K. FCA authorized adviser), LGIM International Limited (a U.S. SEC registered investment adviser and U.K. FCA authorized adviser), Legal & General Investment Management America, Inc. (a U.S. SEC registered investment adviser) and Legal & General Investment Management Asia Limited (a Hong Kong SFC registered adviser). The LGIM Stewardship Team acts on behalf of all such locally authorized entities.

© 2020 Legal & General Investment Management Limited. All rights reserved. No part of this publication may be reproduced or transmitted in any form or by any means, including photocopying and recording, without the written permission of the publishers. Legal & General Investment Management Ltd, One Coleman Street, London, EC2R 5AA Authorised and regulated by the Financial Conduct Authority.

CC64082020