



ESG AND SUSTAINABILITY

INTERNATIONAL TRENDS AND
EUROPEAN DRIVERS

AN FTI CONSULTING REPORT

EXPERTS WITH IMPACT™

TABLE OF CONTENTS

INTRODUCTION	2
EU SUSTAINABLE FINANCE AGENDA - DRIVING ESG INTO THE MAINSTREAM	3
KEY INTERNATIONAL TRENDS IN ESG FOR THE 2020s	4
1. Climate change : the path to net zero	5
2. The governance of E&S: the next phase of good governance	5
3. ESG disclosures: the new normal	6
4. ESG investing : from stewardship to integration	7
5. ESG engagement : asset managers take the lead	7
6. Economic activism : governance as a driver for change	8
7. Data & technology : smarter analytics drive esg practices, protocols	9
8. Diversity & inclusion : beyond boardroom diversity	10
9. Executive compensation : increased focus on metrics & goals (ESG)	11
10. Political impacts : geopolitics & public pressure	12
PLAYING ESG CATCH UP? KEY FINDINGS ON ESG FROM RECENT SURVEY	13-15
CONCLUSION	16
ABOUT FTI CONSULTING	18

INTRODUCTION



We begin the 2020s with global wealth as measured by GDP higher than at any time in human experience, but experiencing a bout of extreme weather events across the world, bringing the effects of climate change into stark and immediate reality for more and more people, and **underlining the urgency of tackling a crisis that is occurring alongside an equally ominous and precipitous decline in global biodiversity and the natural ecosystems** on which our societies depend for their prosperity.

For good reason, the annual WEF global risk report identifies its top five risks as environmental - but also recognizes how interlinked these are also to social risks and the challenge, in particular, of inequality, which poses fundamental questions for the way in which our economies work to deliver outcomes that have sufficiently widespread popular support.

It is a good and indeed genuinely important moment, therefore, to also consider the specific way in which companies are responding to these challenges, and to do so through the lens of environmental, social, and governance (ESG) which investors in particular use to determine how to make decisions about capital allocation.

In this note, we briefly consider three aspects of this issue:

- the way in which EU policy and regulations on sustainable finance are a key force in driving ESG and sustainability internationally
- the main ESG trends we see in coming decade
- recent survey evidence from the FTI Risk Barometer which sheds light on how well companies are doing in addressing these issues

EU SUSTAINABLE FINANCE AGENDA - DRIVING ESG INTO THE MAINSTREAM

Following the strong political signal sent by the European election results, the new European Commission President has made a European Green Deal the centerpiece of her, and as a result, the EU's political agenda for the coming five years.

With its central ambition to make Europe the first climate neutral continent, and to achieve that by 2050, the wide-ranging set of policies that it encompasses is not just the first example of a major economy making a wholesale transformation of its model of development its driving political objective.

“ IT ALSO DELIBERATELY SEEKS TO HAVE AN EFFECT NOT JUST ON THE WAY THE EUROPEAN ECONOMY WORKS, BUT TO OFFER A MODEL OF DEVELOPMENT WHICH IS INFLUENTIAL ACROSS THE WORLD. ”

At the heart of the European Green Deal is an agenda on 'sustainable finance', including on ESG specifically, which could well shape the way companies in other parts of the world approach these issues, given the obligations that it will entail for any that operate in or through the EU, as well as because other countries and regions could well take its approach as a template, much as has happened in the case of chemicals and the EU's REACH framework, and data and the EU's GDPR. It is too soon to be sure, but with attention growing internationally in these issues, it is at the very least well worth considering this possibility as a strong one.

Amongst the key elements of the Commission's approach, there is an investment plan which aims to mobilise at least E1 trillion in sustainable investments over the next decade. Although this is not large in comparison to the size of the EU and global economies, perhaps more significantly, in order to drive multiples of that figure towards its climate neutral goal in particular, it will build on the recently agreed 'taxonomy' of what constitutes a sustainable investment (and therefore what does not, or is only a transitional or enabling one) to inform all of its other decisions and policies, and to make it binding in key respects, too.

A legislative package that is due to be published in late 2020 will include an EU standard for green bonds, a sustainability label for retail products and a revision of corporate disclosure duties for companies on ESG through its so-called 'Non-Financial Reporting Directive'. A consultation process on the latter was launched in late February and is particularly relevant because not only registered companies will be compelled to report their climate-change impact, but smaller, unlisted companies might be included in the scope of the Directive as well. The intent behind the broadening of the scope is that the Commission is convinced that extra details in reports will aid banks and asset managers to invest in greener projects, protect against the impact of climate change, and prevent a sudden move away from fossil-fuels from creating 'stranded assets' and leaving a hole in their balance sheets. The review of the Directive will likely include the EU units of foreign groups as well.

This initiative builds momentum around ESG that has been building internationally, and more and more strongly as the last decade developed. Let us now briefly look back to look forwards to what they herald more broadly for the coming decade, as we are likely see a pronounced shift from debate to action.



KEY INTERNATIONAL TRENDS IN ESG FOR THE 2020s

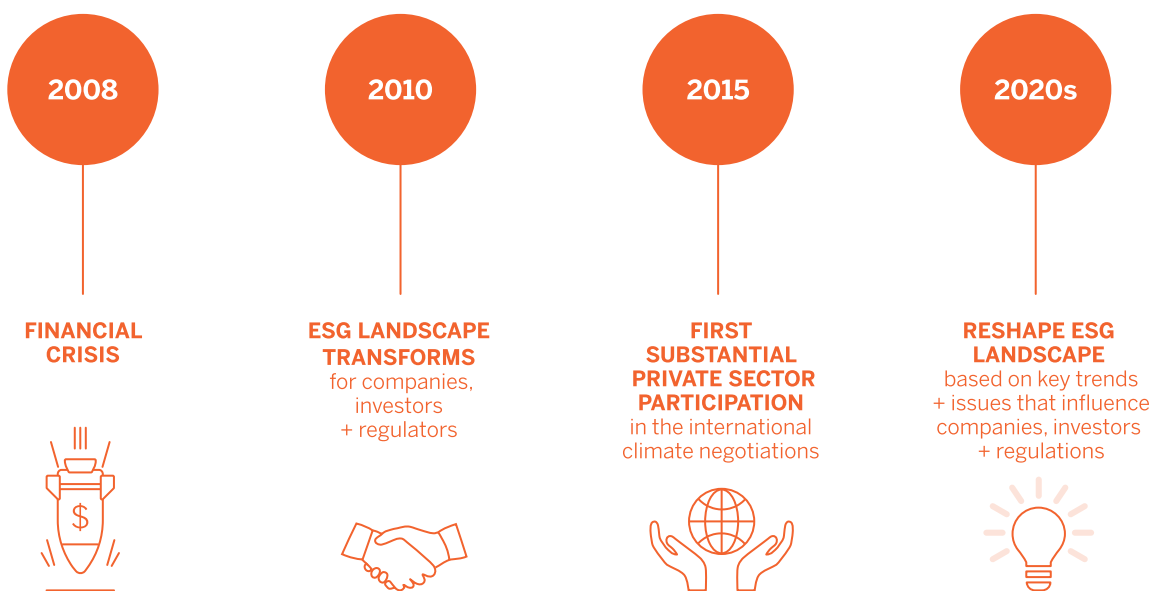
To fully appreciate the expected shift from debate to action, it is instructive to reflect on where we have been.

The 2010s transformed the ESG landscape for companies, investors, and regulators. The decade began with market participants embracing corporate governance reform focused on restoring trust in the capital markets following the aftermath of the 2008 financial crisis. Laws, codes of best practice, investment stewardship efforts, and company initiatives focused on board oversight and accountability firmly took root. This included “say on pay,” which became standard practice in most major jurisdictions, as well as several regulatory and investor-led initiatives focused on board quality, including board diversity, independence, refreshment, and responsiveness to shareholders.

In the second half of the decade, environmental and social issues gained significant momentum. Several corporate crises affecting consumers, the environment, and society at large (including the Deepwater Horizon oil spill, the Wells Fargo account fraud scandal, the Equifax data breach, concerns over data privacy at Facebook, the #MeToo movement, and several high-profile incidents of sexual harassment, among many others) prompted calls to action for sustainable business practices. In 2015, the UNFCCC COP21 saw the first substantial private sector participation in the international climate negotiations. The resulting Paris Agreement boosted the ESG movement by creating urgency and a globally recognized framework of concrete objectives for addressing climate change risks. Further, as asset managers and asset owners became UN PRI signatories in record numbers, a corresponding surge in ESG-related investor activity gained momentum, including increased support for environmental and social shareholder proposals, capital inflows into ESG-themed investment products, and heightened pressures on companies to improve disclosures related to ESG.

The 2010s developments paved the way for a more sophisticated ESG environment in this new decade, which will allow the widespread implementation of ESG related practices.

Following on the pages, we outline some of the key trends and issues we believe will feature prominently in the actions of companies, investors, and regulators in ways that will reshape the ESG landscape for years to come.



1. CLIMATE CHANGE : THE PATH TO NET ZERO

Climate change will dominate the discussion, as governments across the globe introduce more climate-related regulations.

As a result, expect commitments to net-zero emissions by companies and investors to become standard practice by the end of the decade. All sectors - including emissions-intensive sectors that may have shown resistance in previous years - will participate in the transition to the low-carbon economy, as companies recognize the risks and opportunities linked to proactively addressing climate risks. Many firms will look to seize new business opportunities and to position themselves as climate leaders. At the same time, investors will increase engagements around climate change, and will likely begin to incorporate climate risk into their voting policies, potentially voting against the boards of laggard companies.



GLOBAL CLIMATE CHANGE REGULATIONS



NET-ZERO EMISSIONS
low-carbon economy



CLIMATE LEADERS
many firms position themselves



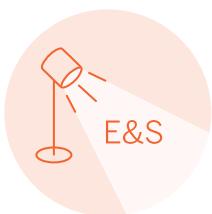
CLIMATE RISK
investors incorporate into voting policies

2. THE GOVERNANCE OF E&S : THE NEXT PHASE OF GOOD GOVERNANCE

While traditional corporate governance will remain an area of focus - particularly around initiatives to improve board quality, shareholder rights, and management incentive structures - the governance of environmental and social (E&S) issues will take center stage for investors and boards.

The management of E&S risks will emerge as the new standard of comprehensive corporate governance practices. Expect the corporate social responsibility efforts of companies to move beyond simply “giving back to society” to incorporate sustainability as a tool to systematically manage risk and create long-term shareholder value.

Additionally, understanding a company’s impact on the environment and society will feature as essential expertise at the board level, with sustainability experts becoming key additions to many boards.



E&S ISSUES TAKE CENTRE STAGE
for investors + boards



MANAGEMENT OF E&S RISKS EMERGE
as new standard of practice



INCORPORATE SUSTAINABILITY AS A TOOL
to manage risk + create shareholder value



UNDERSTAND COMPANY IMPACT
on environment + society

3. ESG DISCLOSURES : THE NEW NORMAL



Disclosure on ESG factors will become standardised and widespread by the end of the decade.

As with corporate governance reform, intensified pressure from investors will serve as a major catalyst for change. Regulations will also play a critical role, with comply-or-explain codes of best practices potentially addressing E&S issues. Early signs of regulatory initiatives on corporate disclosures are already under development in some jurisdictions and may become more widespread. Remember, corporate governance codes, executive compensation disclosures, say-on-pay, and board gender diversity mandates spread rapidly across the globe during the past decade, as different jurisdictions learned from each other in implementing governance standards. Existing reporting standards may serve as the blueprint for any mandated reporting, including reporting standards intended for the investment community (such as SASB and TCFD) as well as reporting frameworks addressing broader stakeholder audiences (such as GRI). Verification and assurance will play an ever-increasing role in confirming the accuracy of these disclosures.

4. ESG INVESTING : FROM STEWARDSHIP TO INTEGRATION

Expect asset managers to transition from ESG stewardship to ESG integration. Enhanced ESG disclosures will pave the way for investment professionals to better incorporate ESG risk assessments into their investment decisions.

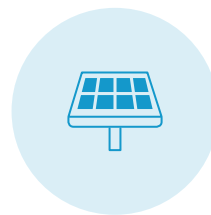
Engagement and proxy voting will move beyond the proposals listed on the meeting agenda, as more investors systematically assess companies based on ESG risks. It remains unclear when or to what extent the inclusion of ESG risk assessments will impact capital flows. That said, the investment industry will need to address growing criticism over “greenwashing”, as new ESG products are brought to market by leading asset managers. Regulatory initiatives (such as the EU Action Plan) and market-driven solutions will likely play a significant role in creating standards for sustainable finance.



INVESTORS
 assess companies based on ESG risks



ESG RISK ASSESSMENT
 impact unclear on capital flow



ESG PRODUCTS
 new products brought to market



SUSTAINABLE FINANCE
 regulations like EU action plan + market driven solutions will play significant role in creating standards

5. ESG ENGAGEMENT : ASSET MANAGERS TAKE THE LEAD

Despite recent U.S. regulatory actions that may make it more difficult for shareholders to file resolutions, ESG-related shareholder activism will continue to rise in the 2020s.

For decades, shareholder resolutions have served as a mechanism for investors to identify and vet governance issues (including the governance of E&S), leading to reform in corporate practices and the adoption of standards, such as annual director elections and proxy access, among many other topics. Until recently, asset managers had largely participated in driving change to corporate practices by reacting to shareholder proposals or proxy advisor policies. However, in the past five years, many large and prominent asset managers shifted to a more proactive stance, leading policy initiatives focused on board refreshment, board gender diversity, and director over-boarding. Recent letters penned by the CEOs of BlackRock and SSGA signal further leadership from asset managers in introducing reforms and holding boards accountable to a higher standard of ESG practices. That said, shareholder resolutions will continue to play a major role in driving change, even if the proposal filing process becomes more challenging for proponents.



SHAREHOLDER RESOLUTIONS
 serves as a tool for investors to identify + vet governance issues, leading to reform + adoption of standards



PAST RESOLUTIONS
 asset managers were responsible for driving change to corporate practices by reacting to shareholder proposals or proxy advisor policies



RECENT RESOLUTIONS
 asset managers shift to a more proactive stance, leading policy initiatives focused on board refreshment, board gender diversity + director over-boarding



FUTURE RESOLUTIONS
 shareholder resolutions will continue to play a major role in driving change, even if the proposal filing process becomes more challenging for proponents

6. ECONOMIC ACTIVISM : GOVERNANCE AS A DRIVER FOR CHANGE

Expect corporate governance factors to feature more prominently in proxy fights, as activists attempt to build a case for the replacement of board members.

The view that improved governance can enhance long-term shareholder returns is resonating with a growing number of large asset managers (including prominent index funds), indicating that good financial performance alone will not be enough to shield companies from economic activism. Financial factors that make companies vulnerable to activism will continue to drive the main arguments. However, expect activist campaigns to focus on corporate governance as a means to further unlock superior returns. Poor oversight of environmental and social issues that have material impact on businesses may also be used against management in contested situations.



7. DATA & TECHNOLOGY: SMARTER ANALYTICS DRIVE ESG PRACTICES, PROTOCOLS



Data and technology will drive significant changes in our ability to measure, calculate, and monitor ESG factors and assess their materiality and impact on long-term value creation.

Better visibility on challenging metrics like resource consumption and biodiversity will likely allow for the creation or enhancement of international frameworks and targets on several key issues, mirroring the Paris Agreement on climate change. Improved and standardised disclosures will give investors the ability to assess the impacts of ESG factors on valuations. Expect artificial intelligence to play a major role in identifying patterns linking economic performance to ESG factors.

“IN ADDITION, COMPANIES THAT CAN BETTER MEASURE THEIR ESG IMPACTS AND RISKS WILL BE BETTER POSITIONED TO MAKE IMPROVED CAPITAL ALLOCATION DECISIONS.”

8. DIVERSITY & INCLUSION : BEYOND BOARDROOM DIVERSITY



In addition to boardroom diversity, the focus for companies and investors will shift towards diversity across the organisation, from the C-Suite to the general workforce.

In addition, policies on equal pay, equal opportunity, and corporate culture will come under more intense scrutiny. Expect U.S. boards to cross the 30-percent threshold of female participation in the early part of the decade, edging closer to gender parity by the end of the decade, especially for larger firms.

“THE NUMBER OF TOP FEMALE EXECUTIVES WILL MORE THAN DOUBLE BY THE END OF THE DECADE, EVEN THOUGH WE ARE STARTING FROM A SHALLOW BASE.”

Currently, women make up approximately only 6 percent and 5 percent of U.S. company CEOs and board chairs, respectively.

9. EXECUTIVE COMPENSATION : INCREASED FOCUS ON METRICS & GOALS (ESG)

The trends we saw in the 2010s will continue, with a greater proportion of incentive awards becoming performance-based instead of time-based, and the use of restricted stock continuing to outpace the use of stock options.

Expect large investors to refine their executive compensation assessment methodologies, independent and beyond existing evaluation benchmarks set by proxy advisors and other third parties. This trend may lead to increased opposition to executive pay programs at say-on-pay votes, with a greater emphasis on the transparency and appropriateness of performance metrics and the robustness of targets. As ESG considerations gain prominence, more companies will link executive incentives to ESG-related metrics. The appropriateness and robustness of ESG metrics and targets linked to executive compensation will become a potential topic of contention, especially if such measures are used to drive higher compensation while financial performance and shareholder returns disappoint.



**LARGE INVESTORS
REFINE THEIR
ASSESSMENT
METHODOLOGIES,**
independent + beyond
existing evaluation
benchmarks



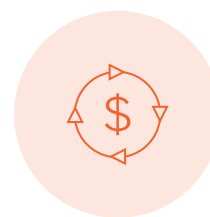
**INCREASED OPPOSITION
TO EXECUTIVE PAY
PROGRAMS**

at say-on-pay votes,
with a greater emphasis
on transparency
+ appropriateness of
performance
metrics + targets



**ESG CONSIDERATIONS
GAIN PROMINENCE**

more companies will link
executive incentives to
ESG-related metrics



SUSTAINABLE FINANCE
regulations like EU action
plan + market driven
solutions will play significant
role in creating standards

10. POLITICAL IMPACTS : GEOPOLITICS & PUBLIC PRESSURE

Politics will play an ever-increasing role in shaping the ESG landscape, as geopolitical tensions, trade wars, and populism, directly and indirectly, influence corporate behavior.

In the energy, technology, and industrials sectors, national security concerns may affect business partnerships and mergers and acquisitions, as was the case in the Qualcomm-Broadcom deal, which was blocked on such grounds by a presidential executive order in 2018. The Carlos Ghosn saga also demonstrates how politics at the national level can have a direct impact on corporate governance. Sanctions against individuals and companies of specified countries are likely not going away. Further, public pressure, and - very often - populist rhetoric on a wider range of social and environmental issues may put additional regulatory pressure on companies and their shareholders in relation to ESG issues.



PLAYING ESG CATCH UP? KEY FINDINGS ON ESG FROM RECENT SURVEY

Amongst an array of surveys on these issues, we conclude by drawing out some of the most salient points from the recently published FTI’s annual Resilience Barometer - which shows both the growing appreciation of the importance of ESG to a company’s success, but also a clear risk that the agenda is moving more quickly than many company executives quite appreciate - at least at present.

From the survey (which interviewed thousands of senior executives from companies operating in all markets globally), there is increasing recognition that sustainability factors add financial value to a company. Overall, the executives FTI Consulting surveyed believe that there could be an average increase of 33% to their corporate value if they had an extremely positive or high ESG rating, up from 27% last year. Whether this is as a direct result of a positive ESG score, pro-active future proofing of the company or perception of the leaders, the impact on value is considerable.



Our findings show that companies tend to be more positive about their efforts to address social issues rather than environmental issues by an average margin of 8%. Of those that companies that reported their materiality/ sustainability activities, most focused on social issues, rather than environmental factors: consumption (65%); employee health and safety (60%); labour practices (54%); anti-corruption practices (53%) and management of the legal and regulatory environment (52%). We may expect this focus to shift over the coming year and beyond, as the environmental issues highlighted by the WEF receive even greater policy and regulatory impetus. It is no longer possible for companies to trade off their good performance on one sustainability measure with their underperformance in another. Just because a company performs well on addressing social concerns, doesn’t mean it shouldn’t prepare for environmental risks. Sustainability issues need to be embedded in a company’s business strategy in a comprehensive and holistic way.



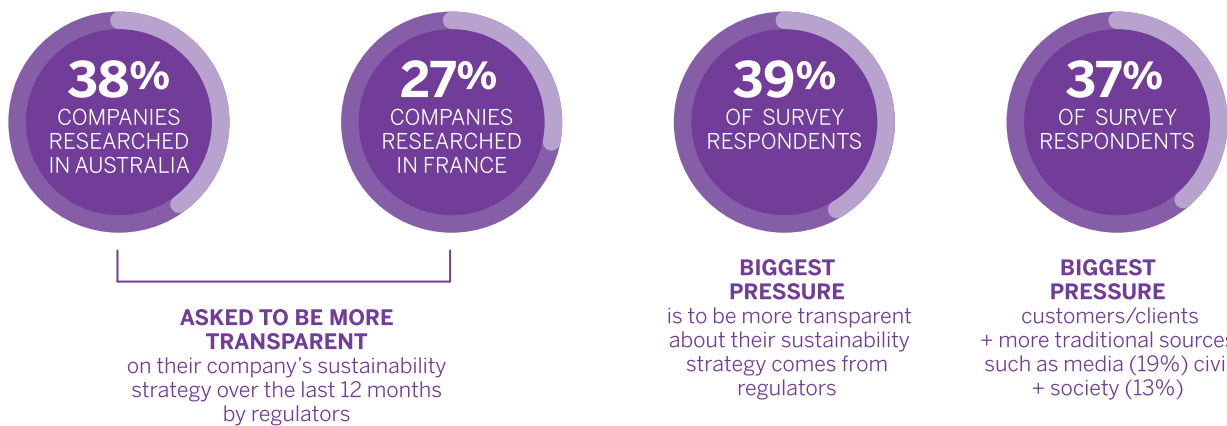
PLAYING ESG CATCH UP? KEY FINDINGS ON ESG FROM RECENT SURVEY



Given the intense focus on climate change by regulators and the public, it is striking that just 37% of G20 business leaders disclose their Greenhouse Gas Emissions, for example. This at a time when a raft of mandatory carbon emissions regulations emanating from the European Union is expected to have widespread ramifications for all companies across industries and jurisdictions. That nearly two thirds of companies are not reporting their Greenhouse Gas Emissions suggests a severe lack of resilience in preparing both to report and reduce emissions over the coming decades.



The Resilience Barometer also finds that the financial services industry, as a key focus for regulators, has been feeling the most pressure on ESG issues over the past year, particularly in Europe. The sector plays a key part in extended value chains and G20 leaders expect a ripple effect to result, as other sectors along the supply chain are pressured to become more transparent and proactive in the managing ESG risks. At the upper end of the scale 38% of companies researched in Australia were asked to be more transparent on their company’s sustainability strategy over the last 12 months by regulators, compared to 27% in France at the lower end - but this may be a case of catch up rather than anything else. Also of interest is that 39% of respondents in our survey say the biggest pressure to be more transparent about their sustainability strategy comes from regulators, compared to 37% for customers/clients and the more traditional sources of pressure, such as media (19%) and civil society (13%).



While the foundations have been laid for many of the trends and issues highlighted earlier, we expect to witness the widespread implementation of ESG-related practices across industries and jurisdictions in the next ten years. Companies, investors, and governments who fail to act on ESG will likely face greater risks and miss significant opportunities compared to ESG leaders in many key areas, ranging from better access to capital, to operational improvement, and pursuing new business ventures. Demonstrating leadership in ESG will ultimately become a differentiating factor for entities in the public and private sector, and market participants have much to gain from embracing ESG stewardship as part of their competitive advantage.

CONCLUSION

In conclusion, however, there still appears to be a mismatch between the extent to which ESG expectations are changing, both in the political and regulatory arena, and the way in which companies currently are managing them.

This gap will need to close rapidly if there are not to be a disruptive process of innovation that becomes dominant, with all the difficulties that poses in terms of management. A more holistic, integrated and urgent approach to ESG, embedding it in corporate strategy as well as all Board-level activities more systematically has become imperative - and not just because of formal reporting and disclosure obligations arising from ESG.

A hand is shown holding a small, transparent globe of the Earth. The globe is centered on the Americas, with North and South America visible. The background is a soft, out-of-focus blue, suggesting a sky or a blurred office environment. The lighting is cool and blue-toned, creating a sense of global responsibility and environmental focus.

“A MORE HOLISTIC,
INTEGRATED AND
URGENT APPROACH
TO ESG, EMBEDDING
IT IN CORPORATE
STRATEGY **HAS
BECOME
IMPERATIVE.**”

ABOUT FTI CONSULTING

EXPERTS WITH IMPACT

FTI Consulting is an independent global business advisory firm dedicated to helping organisations manage change, mitigate risk and resolve disputes: financial, legal, operational, political & regulatory, reputational and transactional.

FTI Consulting professionals, located in all major business centres throughout the world, work closely with clients to anticipate, illuminate and overcome complex business challenges and opportunities. For more information, visit www.fticonsulting.com

AUTHORS



Kosmas Papadopoulos
Senior Director
FTI Consulting, USA
Kosmas.Papadopoulos@fticonsulting.com



Martin Porter
ESG Adviser
FTI Consulting, Belgium
Martin.porter@fticonsulting.com

FTI CONSULTING
CONTACT



Max Gebhardt
Head of Strategic Communications Practice
FTI Consulting, South Africa
Max.gebhardt@fticonsulting.com



FTI Consulting South Africa

Cape Town

8th Floor
125 Buitengracht Street
Cape Town
8001
South Africa
Tel: +27 21 487 9000
Fax: +27 21 426 0582
Website: www.fticonsulting.com

Johannesburg

WeWork Link
Ground Floor
173 Oxford Road
Rosebank
Johannesburg
2196
South Africa
Tel: +27 11 214 2400
Website: www.fticonsulting.com

Stellenbosch

76 Dorp Street
Stellenbosch
7600
South Africa
Tel: +27 21 887 5678
Website: www.fticonsulting.com

About FTI Consulting

FTI Consulting is an independent global business advisory firm dedicated to helping organisations manage change, mitigate risk and resolve disputes; financial, legal, operational, political & regulatory, reputational and transactional. FTI Consulting professionals, located in all major business centres throughout the world, work closely with clients to anticipate, illuminate and overcome complex business challenges and opportunities.

The views expressed in this article are those of the author(s) and not necessarily the views of FTI Consulting, its management, its subsidiaries, its affiliates, or its other professionals.

For more information, visit www.fticonsulting.com and connect with us on:
Twitter-
@FTIConsulting
Facebook and LinkedIn-
@FTIConsultingSouthAfrica