WHITEPAPER

From CSR to ESG, a NAVEX Global Primer

Ten years ago, issues of corporate social responsibility (CSR) – such as measuring carbon footprints, socially responsive company policies, or ethical supply chains – might have been championed by activist employees or customers, but they were not a business objective for most organizations.

What a difference a decade has made. Social change, advances in technology, and the ability to prove ROI have elevated issues of environmental, social, and governance (ESG). These are now hot topics in the boardroom and increasingly a requirement for investors, employees, and customers.

ESG began as a grassroots initiative. Today, it is top-down.

ESG issues are important to businesses that prioritize sustainability, and to investors looking for socially responsible investment opportunities. To attain ESG status, organizations must build an ESG program, create awareness with an ESG rating, and hit metrics that matter to forward-thinking investors.

Read on to see why ESG issues are critical for compliance and risk managers, what the benefits of sustainability are, how to kickstart your ESG program to get a good ESG rating, and ways sustainability software can help with data collection and reporting:

1. What is "ESG"
2. Distinctions between CSR and ESG
3. Examples of CSR and ESG
4. The benefits of investing in ESG
5. (More) business benefits of sustainability
6. Importance of ESG for risk and compliance managers
7. What are ESG ratings?
8. Using an ESG Framework to get ESG-rated
9. Popular ESG Frameworks?
10. ESG software

WHAT IS ESG

ESG stands for environmental, social, and governance standards. The acronym refers to a trio of business measures used by socially conscious investors to identify and vet investments.

- **Environmental** benchmarks address the way an organization responds to environmental issues, such as climate change and greenhouse gas (GHG) emissions, energy efficiency, renewable energy, green products and infrastructure, carbon footprint, and water conservation.
- **Social** benchmarks address how companies respond to the complex and evolving issues like data privacy, pay equity, health and safety, diversity and inclusion, social justice positions, and employee treatment.
- **Governance** deals with issues such as executive compensation, golden parachutes, diversity and independence of the board of directors and management team, proxy access, classified board of directors, whether chairman and CEO roles are separate, majority vs. plurality voting for directors, dual- or multiple-class stock structures, and transparency in communication with shareholders.

THE DISTINCTION BETWEEN CSR AND ESG

CSR, which stands for "corporate social responsibility," has been on the business radar for years and refers to "softer," qualitative issues. As time went by, social issues came into focus, and technology advanced, it has become possible (and desirable) to quantify a company's use of natural resources, conflict minerals, social composition and impact, and good governance. ESG data elevates these issues to the investor position, while technology has made it possible to gather more granular reporting data.

ESG is the quantifiable measure of a company's sustainability and societal impact, using metrics that matter to investors.

WHAT ARE SOME EXAMPLES OF CSR VS. ESG?

There is still some confusion in the industry around these terms. As a rule of thumb, CSR is about providing accountability within your organization while ESG aims to collect and measure metrics relevant to your business objectives and stakeholders.

Here are a few examples of each:

Examples of CSR (Corporate Social Responsibility)	Examples of ESG (Environmental, Social, & Governance)
Community involvement or volunteering	GHG emissions and climate risk
Helping employees advance careers	Racial, ethnic, and gender make up of the Board and executive management
Participating in fair trade agreements	Pay equity, diversity, and inclusion
Donating products or services	Ethical behavior and anti-corruption

Advances in technology – both in data collection as well as analyzing and reporting on that data – have made detailed ESG reporting easier.

In the past, CSR was about telling a story. Today, ESG offers analytical, actionable data.

WHAT ARE "ESG COMPANIES"?

An ESG company is one that embraces ESG factors and is transparent about sharing its performance against those metrics. Further, these companies have concrete business objectives focused on ESG initiatives. Investors' Business Daily points to Nvidia as a great example of a company with proactive ESG initiatives. Nvidia is a semiconductor company that manufactures AI chips for autonomous vehicles, data centers, and warehouse automation. The initiatives from their award-winning ESG program include:

- A board-level nominating and governance committee that oversees ESG issues
- A dedicated recruitment program to create a diverse talent pipeline
- Pay equity
- Ensuring that the minerals used in its chips are responsibly sourced and not from conflict zones

ESG companies also have a positive ESG rating. (Read on for more on ESG ratings)

IMPORTANCE OF ESG FOR RISK AND COMPLIANCE MANAGERS

The United States does not have a mandated and standardized ESG disclosure framework in place at the federal level – but that is likely to change soon; and in the meantime, high-performing companies are finding ways to build resilience, satisfy investors, and be transparent with their customers.

WHY COMPLIANCE PROFESSIONALS SHOULD CARE ABOUT ESG

There is every reason to believe these issues will be part of the federal regulatory landscape in 2021 and beyond. The new head of the current Administration's Securities and Exchange Commission (SEC), Gary Gensler, "is likely to heavily reform and broaden ESG investing and corporate disclosure rules in the U.S.," according to NASDAQ. The acting committee chair noted that investors and the public need better information about how companies are managing climate risks, adding, notably, "Realistically, that can happen only through mandatory public disclosure."

Despite the lack of a standardized federal disclosure framework, many state-level laws exist. The best-known example is California's Public Employees' Retirement System (CalPERS) and its State Teachers' Retirement System (CalSTRS), which use ESG factors to direct its massive pension investments. Elsewhere, for example, Illinois' Sustainable Investing Act became effective January 2020; Massachusetts, Minnesota, New Jersey, New York, and Vermont all have pending legislation limiting fossil fuel investment from publicly managed funds, according to Bloomberg Law.

Outside the U.S., regulation abounds for companies that operate in or sell to the EU and UK. The European Parliament, for example, finalized a landmark ESG agreement in December 2020 establishing standards to determine whether an economic activity is environmentally sustainable. According to Compliance Week: "Under the [ESG agreement], all financial products that claim to be 'sustainable' will have to prove it based on strict criteria, supported by scientific evidence and drawn up by scientists and academics." The Taskforce on Climate-Related Financial Disclosure (TCFD) is another E.U. disclosure initiative.

WHY ESG IS IMPORTANT FOR RISK MANAGERS

Environmental, social, and governance impact risk management in several critical ways. For example, lenders are starting to ask more detailed questions about ESG risks in conjunction with lending to corporate customers.

If investors and lenders can see your company is purposefully managing all risks, including ESG, it can dramatically impact their perception of your business' resilience. Demonstrating ESG focus builds confidence that the investment carries lower risk. This in turn is reflected in interest rates and other investment terms.

On the other side of the coin, there are risks associated with a lack of ESG awareness: "The focus on climate risk is driven largely by a younger generation of investors who want their money invested with sustainability in mind. They also want to avoid companies with bad track records on ESG issues that could face future fines," according to CNBC's Emma Newburger.

Read it: **The New Urgency for ESG Risk Management**

THE BUSINESS BENEFITS OF SUSTAINABILITY

There are many business benefits associated with building and maintaining an ESG program:

1. Improved resource management and sustainability
2. Better risk management
3. Proactive regulatory compliance
4. Greater profitability
5. Attractive to investors
6. Ability to attract and retain employees
7. Satisfy customer and stakeholder demands

1. IMPROVED RESOURCE MANAGEMENT AND SUSTAINABILITY

Companies focused on ESG see benefits in efficiency and cost reduction: efficiencies due to resource allocation, employee retention, and regulation in many industries. Many of the costs (and risks) associated with resource consumption – for example, resource needs for data processing centers, or transportation costs – can be reduced with ESG-focused resource allocation.

2. BETTER RISK MANAGEMENT

ESG issues include many risks – and failing to address ESG issues is not the least among them. ESG risk management includes business continuity planning and supply-chain management, to mitigate the effects of business disruptions large and small. It helps companies act on values such as gender parity in leadership or diversity in board composition, have a ready public response to social justice issues like #BlackLivesMatter, mitigate and prepare for the effects of climate change, and many other risks.

3. PROACTIVE REGULATORY COMPLIANCE

If ESG regulations don't affect you yet, they will soon. State and global regulations, and anticipated federal regulations, require data collection and reporting on ESG issues. Other regulations, such as the European Parliament Agreement, referenced above, require organizations that make ESG claims such as "sustainable business practices" to meet and report on standardized criteria.

A wave of ESG regulation is likely coming in the United States as well.

4. GREATER PROFITABILITY

Recent studies have found that companies that purposefully manage ESG risk tend to manage all risk within their business. There is a strong correlation between better ESG/Risk Management and higher profitability.

Additionally, a growing number of investors, individual consumers, B2B buyers, and job seekers, are passing on companies that are not responsive to ESG issues. There is risk associated with loss of investment, defecting customers, and an inability to attract and retain top talent.

5. ATTRACTIVE TO INVESTORS

ESG investors want to incorporate values, such as responding to climate change, into their portfolio – in addition to the traditional factors of potential profitability and risk. ESG initiatives are attractive to this segment of investors with deep pockets and a consumer mandate to seek out ESG-specific opportunities.

If your customers are managing ESG and you are not, you are likely to lose your customers. The same may be true for consumers, who are increasingly savvy about the processes, ingredients, and components in the goods they buy.

If your company doesn't yet have ESG initiatives, it's not hard to make the case: These values are attractive to a segment of investors with a mandate to seek out ESG-specific opportunities. And ESG investors have deep pockets. According to Blackrock's first Global Client Sustainable Investing Survey, $23 billion was invested in ESG companies in 2020, compared to $450 million in 2019. Further, half of the C-suite respondents wished to double their organizations' exposure to sustainable assets within five years.

The Dow Jones publication also noted that investment flowing into ESG funds was up 102% in 2020 compared to 2019.

It turns out, sustainability is just as good for the bottom line as it is for society and the planet. According to Barron's, in 2020, ESG stocks outperformed the stock market by 46% in the U.S., by 20% in Europe, and by 77% in Asia.

6. EMPLOYEE RETENTION

Employees have an increasing preference to engage with businesses that prioritize purpose alongside profitability. This is true of both consumer buying habits as well as a company's ability to attract and retain top talent. According to Barron's third annual ranking of America's Most Sustainable Companies, employee turnover is 25-50% lower at sustainable operations.

7. CUSTOMER AND STAKEHOLDER DEMANDS

Many regulations such as conflict minerals and frameworks such as SASB require companies to perform due diligence on their supply chains and resolve risks. If your customers are managing ESG and you are not, you are likely to lose your customers. The same may be true for consumers, who are increasingly savvy about the processes, ingredients, and components in the goods they buy. Many search for labels such as Conflict Free, Fair Trade, USDA Organic, Rainforest Alliance, Certified B Corp, and other standards to help them make buying decisions or justify higher costs.

WHAT ARE ESG RATINGS?

ESG ratings are an offering from agencies and analysts, intended to measure a company's resilience to long-term, industry material environmental, social, and governance risks. Many different organizations provide ESG ratings, which help investors identify such investments.

ESG ratings are often modeled in a bond-rating style; for example, MCSI's ESG Ratings range from "leader" (AAA, AA), "average" (A, BBB, BB) to "laggard" (B through CCC).

A FEW OF THE ESG RATINGS AGENCIES

- **MCSI ESG Ratings**, published by Morgan Stanley Capital International, "is designed to measure a company's resilience to long-term, industry material ESG risks."
- **S&P Global Ratings** describes their ESG rating as a proprietary assessment of "a company's ESG strategy and ability to prepare for potential future risks and opportunities. The ESG Evaluation is the ideal tool for investors in that it provides a forward-looking, long term opinion of readiness for disruptive ESG risks and opportunities."
- **European Commission's** Taxonomy Regulation introduced an EU-wide taxonomy for ESG-related investments, creating "a workstream to support the European Green Deal channeling private investment to the transition to a climate-neutral economy."
- **Fitch Ratings** shows relevant environmental, social, or governance risks that can impact credit quality.

EXISTING ESG RATING FRAMEWORKS

ESG frameworks are used by organizations to create a standardized ESG program; used by investors to assess the impact of the sustainability and ethical practices of a company.

WHAT ARE POPULAR ESG FRAMEWORKS?

SASB (Sustainability Accounting Standards Board): The SASB framework is focused on ESG issues determined to be financially material. This includes sector-specific guidance on a broad range of ESG topics, covering issues such as greenhouse gas emissions, energy and water management, data security, and employee health and safety, while providing sector-specific guidelines emphasizing topics SASB believes are material for issuers in those.

TCFD (Taskforce on Climate-Related Financial Disclosure): The Taskforce on Climate-related Financial Disclosures (TCFD) was recently developed by the Financial Stability Board to improve and increase reporting of climate-related financial information. The UK has announced its intention to make TCFD-aligned disclosures mandatory across the economy by 2025, with a significant portion of mandatory requirements in place by 2023.

UN "17 Goals" of Sustainable Development: Each of the U.N.'s 17 goals includes targets and indicators: No Poverty, Zero Hunger, Good Health and Well-being, Quality Education, Gender Equality, Clean Water and Sanitation, Affordable and Clean Energy, Decent Work and Economic Growth, Industry, Innovation and Infrastructure, Reduced Inequality, Sustainable Cities and Communities, Responsible Consumption and Production, Climate Action, Life Below Water, Life on Land, Peace and Justice Strong Institutions, Partnerships to achieve the Goal.

Global Reporting Initiative: The GRI covers topics like labor and human rights issues, biodiversity, and energy use and reduction, assesses materiality based on impacts made by issuers on the economy, environment, and society.

HOW ESG MANAGEMENT SOFTWARE CAN HELP

As you can see, the ESG frameworks above, among others, have different areas of focus. Challenges arise when stakeholders follow different ESG frameworks. ESG software like NAVEX ESG helps manage internal ESG initiatives and external activities and reporting. ESG software can help:

1. COLLECT SUSTAINABILITY DATA FROM ACROSS THE ENTERPRISE, AND MANAGE MULTIPLE ESG FRAMEWORKS

Collect sustainability data from across the organization and its suppliers. Instantly map ESG performance indicators to GRI, SASB, UN SDGs, CDP, Certified B Corporation, or other frameworks to show progress and discover new sustainability opportunities.

2. AUTOMATICALLY CONVERT RESOURCE USAGE TO DETERMINE YOUR CARBON FOOTPRINT

Import environmental resource usage from around the world to understand specific emissions, generation, resource mix, and other attributes related to managing your carbon footprint and emission estimates.

3. RESPOND QUICKLY TO INTERNAL AND THIRD-PARTY REQUESTS

Create and manage assignments related to third-party requests for greenhouse gas and ESG information. Provide an auditable, single source of truth for sustainability initiatives.

4. MANAGE USER ASSIGNMENTS FOR ESG REPORTING FRAMEWORKS

Manage users, stakeholders, and their assignments to ensure timely data collection, follow-ups, questionnaires, and other sustainability initiatives.

ESG software helps companies aggregate investor-ready data and address metrics that decision-makers care about. Whether your goal is values-based business development or making the world a better place, ESG software can help you build a best-practice program and put you on a path for sustainable future growth.

See how **NAVEX ESG can help your company build an ESG program**.

ADDENDUM: HOW INVESTORS, EMPLOYEES AND CUSTOMERS CREATED THE ESG IMPERATIVE

It is cause for celebration when corporate responsibility and sound business decisions are perfectly aligned – and that is where we find ourselves today with respect to environmental, social, and governance (ESG) awareness and reporting. In light of the increasingly clear social and business benefits, ESG has recently become a focus for many organizations. Not incidentally, investors are incorporating ESG performance into their valuation calculus. Until recently, ESG metrics were often considered too esoteric to be reliably quantified and too difficult to track manually. Reporting on ESG performance, if done at all, took a backseat to more traditional financial measures. But that is changing.

Now there is a growing understanding that positive ESG measures are associated with better overall business performance. Forward-thinking organizations know ESG impacts their overall risk profile. The challenge is how to collect and analyze ESG data with the same rigor as other risk and compliance data.

It's natural that ESG metrics should be considered in the context of an organization's broader risk and compliance program. Progressive companies recognize that ESG-related risks carry the potential to impact share price, company reputation, regulatory exposure, and employee engagement; it is a risk area that warrants board-level review. Active ESG management and reporting helps organizations address business risks related to climate change, sustainability, data privacy, workforce gender composition, company culture, human rights, anti-bribery and anti-corruption efforts, and other key areas.

With this new lens to reveal both risk and opportunity, it should come as no surprise that commercial and investment banks are starting to ask about ESG risks when evaluating the creditworthiness of corporate customers. In fact, investors of all types recognize that ESG-related issues are critical to a company's financial performance. Firms like BlackRock, Putnam, and Vanguard have all made commitments to invest in companies with strong ESG performance because they bring less risk and more resilience to their portfolios. Impact investing index funds have been growing in popularity and have now topped $250 billion. According to Morningstar, these investments have doubled over the past three years and the U.S. market now accounts for 20% of impact investing total assets.

It's no wonder that ESG is in the spotlight – from boardroom conversations to investment portfolios, and within leadership teams around the world. Social justice movements such as #BlackLivesMatter, demands for gender equality, combating climate change, and others reveal a new facet of customer expectations. These movements have also shown that businesses have many opportunities to do better. Customers, employees, and other constituencies care deeply about these issues and expect more from companies in exchange for their loyalty. Embracing ESG metrics as part of a truly comprehensive risk and compliance program – and transparently reporting on the results – is a good place to start.

ABOUT NAVEX GLOBAL

NAVEX Global is the worldwide leader in integrated risk and compliance management software and services. Our solutions are trusted by thousands of customers around the globe to help them manage risk, address complex regulatory requirements, build corporate ESG programs and foster ethical workplace cultures.

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