

Hot ESG Topics for boards and executives to consider: are you ready?

Zurich, November 10, 2021 - We all are confronted with ESG topics, constantly, every day. But what is relevant for governance and deserves our attention? In this newsletter, we assess, qualify and comment on some of the current developments as well as expected challenges.

Boards and executives must understand how these developments, confronting their company from all sides, will eventually affect their organization's business model and possibly require strategic transition:

- A siloed approach to ESG by just allocating sustainability to a non-strategic "ESG department" will no longer be sufficient,
- Companies must accept the challenging task of reconsidering the most fundamental aspects of their established businesses, and
- Companies will need to move away from the currently rather short-term view and constant benchmarking by allocating resources for their long-term success, even if this may lead to a negative short-term impact on revenues and profits.

ESG-related challenges and opportunities need to be assessed alike – making the topic possibly the most important aspect of modern-day boardroom practice. Directors need to understand in particular that ESG regulations locally and internationally are affecting their institutional shareholders who may, in turn, impact day-to-day corporate life and reputation.

I. Not losing sight: The strategic relevance of ESG

Current developments

- There is broad agreement amongst companies and institutional investors that the overall responsibility for the ESG strategy lies with the board of directors (see [SWIPRA Survey 2020](#)).
- In the past, this responsibility was often delegated to an internal ESG specialist team.
- Today, the board together with management is expected to assume leadership for a strategically integrated ESG-approach, including decisions on (i) how

Next Events

Chlauchhöck

Event with IR-Club (by personal invitation only)
24 November 2021

SWIPRA Corporate Governance Survey

Presentation of key findings
8 December 2021

Board Leadership Circle

Event with KPMG (by personal invitation only)
19 January 2022

to structure management and the board, (ii) skills and experiences required at management and board level as well as throughout the organization, (iii) adapting strategic KPIs and aligning them with incentive systems, (iv) how to allocate capital within the company, (v) how to extend risk management by defining ESG-related processes, and (v) how to communicate intentions and integrate reporting.

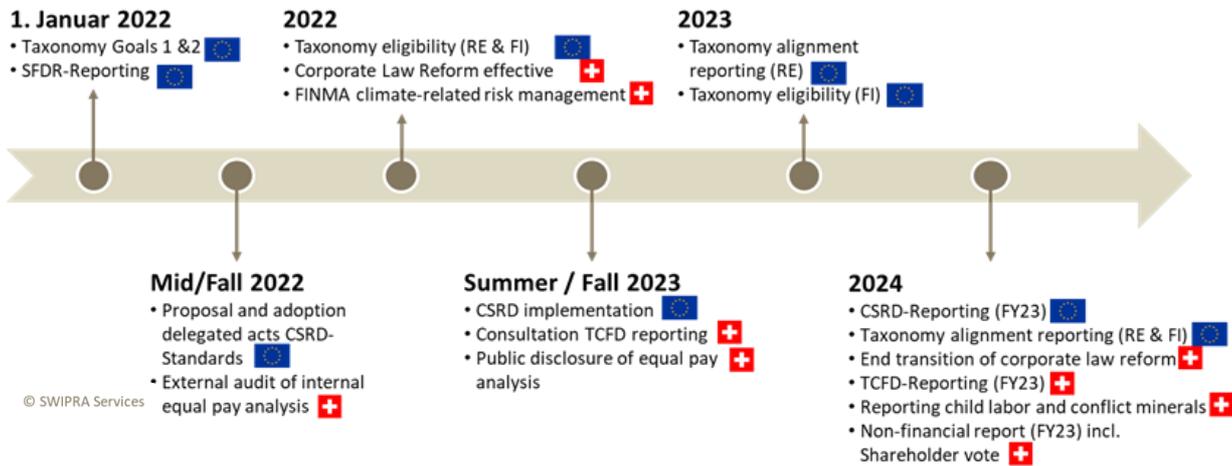
- These challenges are far-reaching and ultimately decisive on whether a company will be successful in the long run. They require a board to develop (i) awareness, (ii) knowledge, and (iii) the capabilities to identify opportunities for the company's business in today's fast moving ESG environment.

Task-force on Climate-related Financial Disclosure (TCFD)

- Putting the board and a company's governance structure at the center of ESG is consistent with the TCFD-approach, which defines governance and strategy as starting points for climate-related scenario analyses and ESG materiality assessments.
- In Switzerland, the Federal Council will launch a consultation on a mandatory TCFD reporting by Swiss-listed companies in 2022 with a potential implementation as early as 2024 (covering the financial year 2023) and the Swiss Financial Market supervisory authority (FINMA) includes TCFD in its concept to supervise climate-related risk management, with expected implemented in 2022.
- Currently, TCFD is applied by approximately $\frac{2}{3}$ of SMI® and about $\frac{1}{8}$ of the next largest 80 companies in



Figure 1: Regulatory developments in the Real Economy (EC) and the Financial Industry (FI)



Switzerland (see [SWIPRA AGM Analysis 2021](#)), mirroring the effort and resources required to implement this comprehensive standard.

- It is in the best interest of all market participants, not least the companies themselves, if the currently limited understanding of the link between ESG and strategy improves (see [SWIPRA Survey 2020](#)). Due to the upcoming shareholders' say on sustainability ("SOS") in Switzerland, processes and responsibilities with respect to strategic integration of ESG will become much more transparent, bearing the risk of negative-reputation events if stakeholders consider a company's awareness insufficient.

Relevance of value-creation and balancing stakeholder expectations

With all the political and regulatory initiatives happening at the same time (see Figure 1 for an overview), we must not forget to speak about the relevance of value-creation, an economic principle that was forgotten in a world of short-termism. Boards and management have to reclaim this debate by taking strategic decisions on how to put ESG factors at the center of a company's value creation and transparently communicate this. Decisions must no longer focus on qualitative long-term E&S targets, but on near-term quantitative goals to get there, for example aligned with the Science Base Targets initiative (SBTi).

Non-financial reporting: waiting for new standards?

Processes needed cannot be delayed much longer and holding out until there is one global standard is not a promising option. With the non-financial report being up a

shareholder approval in Switzerland by 2024, decisions on material ESG factors, how they are measured and integrated in the current performance assessment will have to be taken soon.

The challenge for companies:

- Assume a more active role in steering non-financial reporting and overall ESG-related processes and communication to manage a strategic transition and create positive reputation, a key asset of a company.
- Don't wait for the regulator to decide on a single ESG reporting framework. The shareholder vote at the 2024 AGMs will provide a formal indication of how far a company has progressed in integrating ESG and offer an opportunity for benchmarking. Leaders will benefit from a positive impact on reputation and ultimately on their cost of capital.
- Be aware that institutional shareholders are increasingly looking for independent external assessments of your board's composition, processes and collaboration to better understand its capabilities and readiness for current and future challenges.
- Be prepared to speak about a much broader set of topics than in the past, but realize that the "E" and the "S" topic cannot be discussed in an isolated manner and that long-term value-creation remains key.
- The current raft of regulations (including the directives on child labor or conflict minerals) does not only target and impact the largest companies, but will cascade down the supply chain to even the smallest companies.



II. Financial Services Industry: Passing on the pressure

The developments

- It was concluded early that governments will take too long to enact effective regulation against climate change and that the public acceptance of such regulation will generally be low. A faster means with broader public acceptance was thought to be the regulation of the financial services industry. As central player in allocating capital in the economy, this industry decides over realization or abandonment of projects.
- With progress perceived as being too slow, public and regulatory pressure on the financial services industry to become more active has increased.

The consequences (see Figure 2)

- The financial services industry has become more vigorous in its financing and investment activities and increasingly relies on ESG metrics
- Portfolio companies are increasingly asked to report according to ESG frameworks such as GRI, SASB or TCFD
- In industries where sustainability is critical, investors increasingly seek the dialog with the board to better understand the ESG strategy integration.
- The fast-growing support of institutional investors net-zero investment approaches such as the net-zero asset manager initiative (USD 57tr AuM) or the net zero asset owner alliance (USD 10tr AuM) is a clear indication that

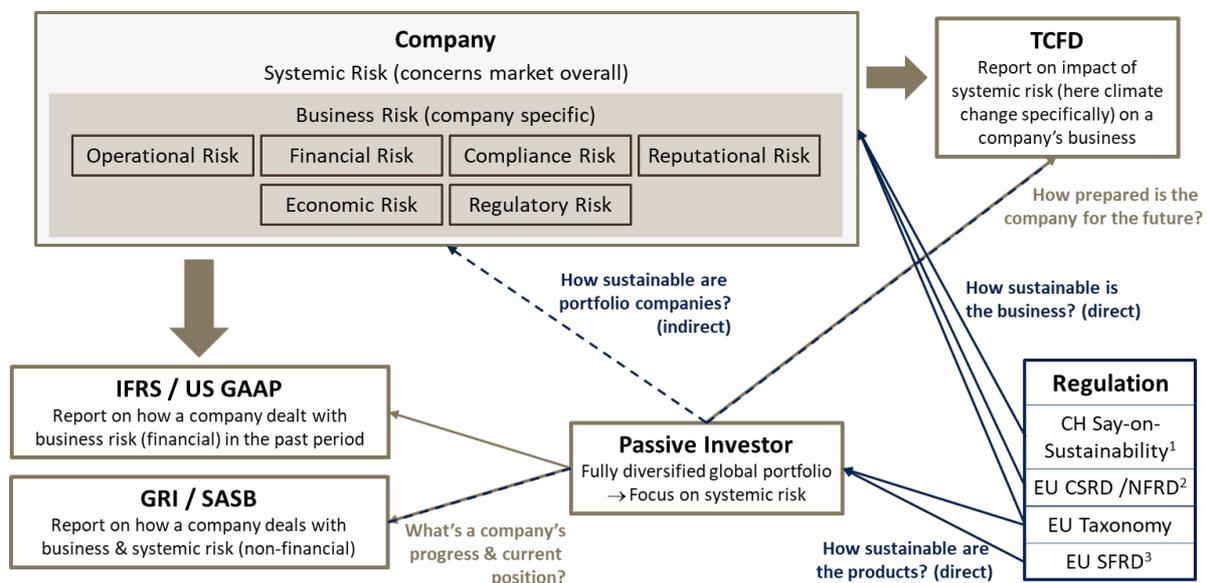
sustainability-related expectations towards the real economy will further increase.

- To facilitate its efforts to allocate funds in ESG-positive investments, the financial industry is increasingly requesting governments and regulators to implement regulatory steps with respect to ESG disclosure for other market participants, too.
- According to the [SWIPRA Survey 2020](#), more than 60% of the institutional investors supported further regulation of the real economy to report according to an international ESG disclosure standard.

The challenge for companies:

- Be aware that the political and regulatory pressure in and outside of Switzerland on the financial services industry will spill-over to the real economy and affect a much broader group of companies, including private firms.
- Expect institutional investors to increasingly bundle their efforts (e.g., in initiatives like climate action 100+) to substantiate their requests towards companies.
- Take note that beyond and above ESG-metrics, investors are increasingly looking to have somebody at board level, preferably the board chair, to explain how ESG is incorporated in the company's business strategy.
- Regularly assess the risks of your company's governance and sustainability framework as well as the consistency in messaging, to actively work towards

Figure 2: How ESG Standards influence the capital market



¹ Includes reporting on conflict minerals and child labor where applicable
² Corporate Sustainability Reporting Directive / Non-Financial Reporting Directive
³ Sustainable Finance Disclosure Regulation



building and preserving reputation and preempt unexpected activist or shareholder interventions.

III. Other developments

Listed companies: Is the Corona-AGM regime still appropriate?

- In the most recent update of the Covid-19 ordinance, the Swiss Federal Council has extended the possibility for companies to hold general meetings without the presence of shareholders (as long as they can exercise their voting rights through an independent proxy) by another year.
- At the AGMs 2021, only about ¼ of the largest 100 listed companies in Switzerland provided an AGM broadcast and less than half offered an AGM specific Q&A, considerably limiting the shareholder interaction (see [SWIPRA AGM Analysis 2021](#)).
- This renewed decision of holding AGMs without shareholders presence should be seen as a fallback possibility in case the Covid-19 situation significantly deteriorates.

Asset manager's risk management and its impact on the real economy

- Large money managers have been shifting their focus towards the non-diversifiable systemic risk of the market, notably climate change.
- These investors are increasingly willing to support actions with a possibly negative impact for an individual company in the short-term, if expectations are that this will reduce overall systemic risk and positively impact the diversified portfolio overall.
- This development reinforces the challenge for companies to not only consider shareholder or NGO requests according to their investment in the company, but rather the credibility of their arguments and capability to generate support amongst institutional

investors. Various examples (see, for example, Exxon) show that it is possible for small players to gather significant support fast.

Asset managers: ESG ratings or how to make a real impact?

- Asset managers are constantly forced to become more efficient and minimize costs. Consequently, the reliance on ESG ratings and third-party ratings to allocate funds in “green” or “social” investments increased.
- Wide disparities exist amongst rating providers on how to assess a company's ESG efforts, as there is no universal definition of “green” or “social”.
- Different asset managers relying on different ratings may result in an aggregate rating across asset managers that is average. The benefits of the much-hailed capital allocation process through sustainability ratings are, therefore, limited at best.
- Instead of using ESG ratings to allocate capital for impact, investment decisions should be based on engagements with portfolio companies, which has been shown by independent economic research to be truly impactful.
- If the financial sector wants to overcome the increasingly regulatorily scrutinized “greenwashing” claims, additional investments in such engagements efforts are needed.

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About SWIPRA Services

SWIPRA Services provides **corporate governance and corporate social responsibility services** for listed companies and their boards of directors. We provide our clients with hands-on advice that takes into consideration relevant stakeholder opinions with aim of increasing the value of the company in the long term, based on principles of value-based management and empirically relevant criteria. www.swipra.ch

SWIPRA Services is working with a high-profile think tank to further develop corporate governance and CSR in Switzerland.

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