THE IMPORTANCE OF KNOWING YOUR INVESTORS AND HOW THEY USE ESG RATING AGENCIES

Today, companies are more aware than ever of the growing concerns around environment, social and governance (ESG) factors that need to be taken into consideration. The rate of ESG-oriented investing has risen significantly, with sustainable investments now topping over $30 trillion, up 68 percent since 2014[1]. The evidence is rising and demonstrates that companies who are addressing ESG issues are performing better and reducing downside risk.

In our recent **Issues for Companies: ESG Integration** publication, we identified how institutional investors are integrating ESG factors into their investment decision making. Increasingly, investors are using ESG rating agencies to peer benchmark companies and understand, at a high level, the ESG exposure of their portfolios. However, with the proliferation of an increasing number of ESG rating agencies and their unique surveys, companies are struggling to keep up with the growing number of survey requests.

With ESG rating agencies reaching out directly to companies to complete their questionnaires, it is challenging to determine which ones should take priority. For Australian companies, MSCI, Sustainalytics, CDP and RobecoSAM stand out as a few of the most prominent and important ESG "raters". The following are definitions of these rating agencies and their respective survey due dates:

[1] Global Sustainable Investment Review 2018, Global Sustainable Investment Alliance, 2018, gsi-alliance.org

ESG Rating Agency	Description	Survey Due Date
MSCI	• MSCI is a global independent provider of research-driven insights and tools for institutional investors. • Bloomberg ESG and CDP derive their information from MSCI ratings.	Year-round engagement to ensure reports are accurate.
Sustainalytics	• Sustainalytics is an ESG and corporate governance research and ratings provider. • Their research is published within the proxy reports published by Glass Lewis. • Bloomberg ESG and the CDP derive their information from Sustainalytics.	Year-round engagement to ensure reports are accurate.
RobecoSAM Corporate Sustainability Questionnaire	• This Assessment serves to measure corporate sustainability performance and forms the construction of the Dow Jones Sustainability Indices (DJSI). The DJSI tracks financial performance of companies in terms of economic, environmental and social criteria. • Companies are invited to participate in the Questionnaire – if they do not participate, their score will be determined by publicly-disclosed information. • In 2019, S&P Global acquired the ESG Ratings Business from RobecoSAM and product solutions for its customers.	Questionnaire opens: April 1, 2020 Responses due: May 28, 2020
Carbon Disclosure Project (CDP)	• The CDP is a not-for-profit charity where a company responds to a suite of voluntary questionnaires about their environmental performance on three topics: climate, water and forests. • The CDP is aligned with other frameworks and standards such as the Dow Jones Sustainability Indices, the GRI and the Institutional Investors Group for Climate Change (IIGCC). • CAER, MSCI and Sustainalytics derive information and results from the CDP score to determine their own ratings. • Scores are public and available on CDP's website.	Questionnaire opens: April 13, 2020 Responses due: July 29, 2020

Often these rating agencies will reach out to companies and request them to complete their comprehensive, and often time-consuming, questionnaires whilst investors also expect to receive similar information during engagement meetings.

As such, many investors rely on ESG ratings firms to form a critical understanding of how companies integrate ESG in their operations, with the results forming a basis for how ESG is incorporated into their investment and proxy-voting strategies. For some investors, ESG ratings are their only insight into this kind of evaluation, whereas for others, such ratings are an 'input' into their own unique ESG analysis.

To truly understand how ESG ratings impact your company, it is imperative to understand your investors.

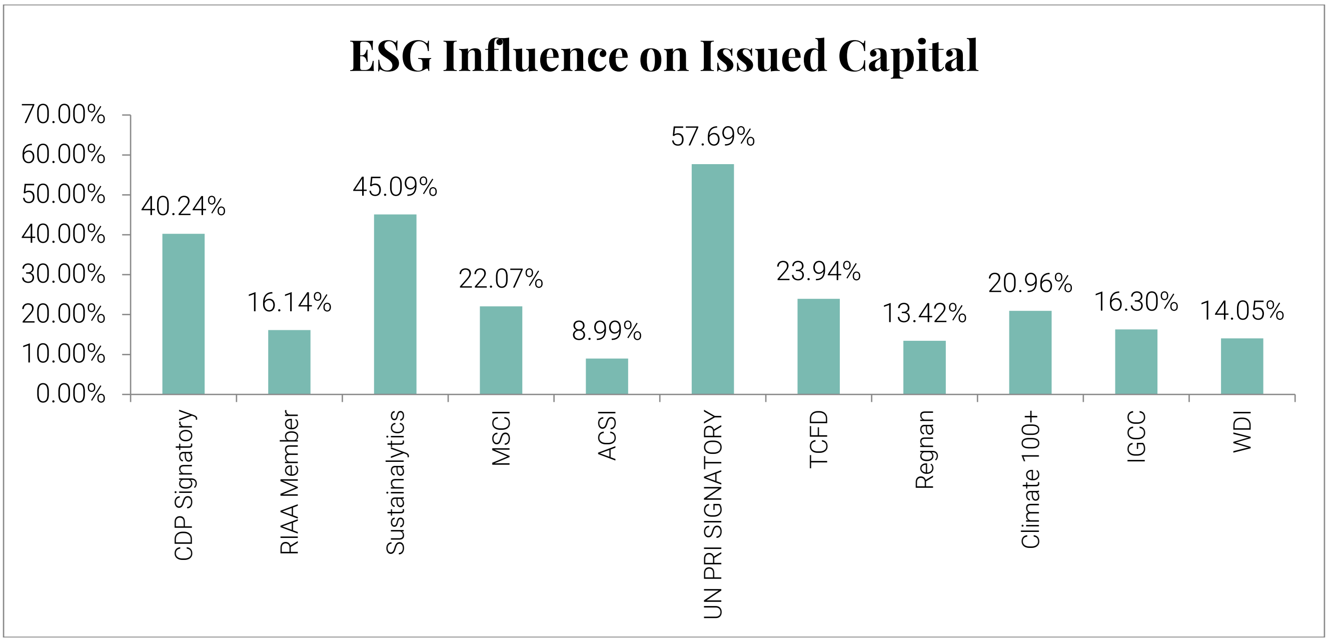

Chart: Example of Morrow Sodali's ESG influence analysis of an ASX300 company

This example graph clearly outlines the level of influence of ESG associations, service providers, rating agencies, and frameworks on a company's share register.

From conducting an analysis like this, companies can not only prioritise the questionnaires that will **make the most impact** and therefore avoid 'survey fatigue', but also **more efficiently direct their engagement with ESG-conscious investors** and the ESG rating agencies themselves. Once these parties are identified, companies can provide detailed information to them on a regular basis, ensuring that data is not misconstrued, ultimately improving the accuracy of ratings and reports.

On occasion, the ESG ratings that are produced can be at odds with a company's own interpretation. As such, there is a push for companies to disclose the information that is collected in these ratings, not only so that the reports are more accurate and reliable, but to properly reflect the company's own view of its ESG risks and opportunities.

In this way, ESG questionnaires can be viewed as less of a burden but more as another opportunity for companies to own their ESG narrative, rather than relying on ratings to tell their story.

For a broader view on the additional steps issuers should take to effectively deal with shareholder expectations about sustainability across the Australian/Asia Pacific, European and US markets, see our Issues for Companies: Sustainability article.