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Introduction to Business Ethics:

Sustainability Reporting and ESG Rating

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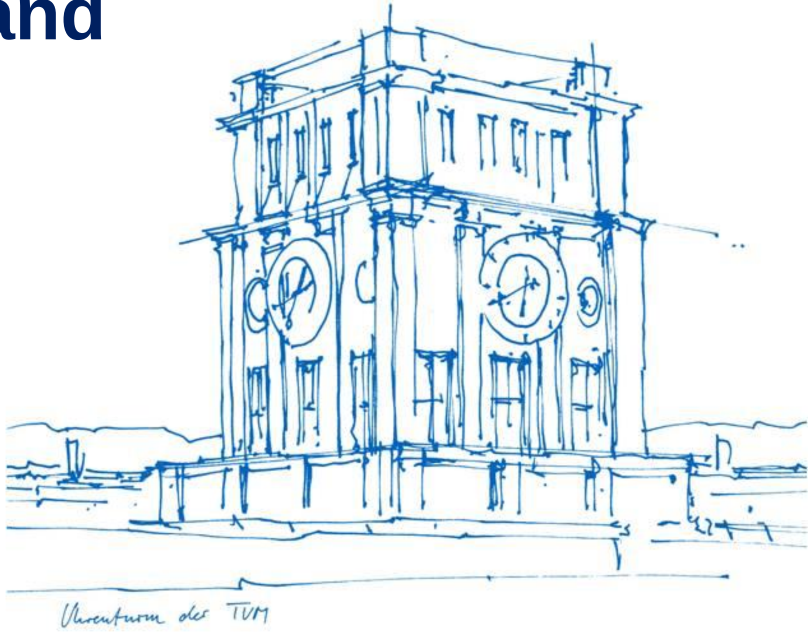


CSR, Sustainability Reporting and ESG Rating

Agenda:

Legislation on sustainability reporting in EU

Frameworks of sustainability reporting: Global Reporting Initiative (GRI)

ESG rating of corporations (ESG = Economic, Social and Governance)

Slido 2490883

Would any of you be interested in working with sustainability reporting?

Frameworks for sustainability reporting

United Nations

EU legislation

Global Reporting Initiative

United Nations

International organisation founded in 1945 for the purpose of securing international peace,

193 nation states as members

Forum for communication between nations

Security, peace, humanitarian aid, upholding international law .. and sustainable development.

Subdivisions: World Bank Group, World Health Organisation (WHO), World Food program, UNESCO and UNICEF

United Nations Global Compact

World Economic Forum and Global Compact

Initiated by Kofi Annan, General Secretary of the United Nations 1997 – 2006

In 1999 Kofi Annan gave a speech at the World Economic Forum in Davos: Protagonists of business, politics and academia meet once a year for discussions.

World Economic Forum: NGO for corporations

Founded in early 1971 by a the then 32 year old German business professor Klaus Schwab – the actual inventor of the concept of Stakeholders and stakeholder capitalism

Around 1000 member companies with more that $5 bn turnover.

Annual meeting in Davos: Business leaders and heads of state. Speakers: Greta Thunberg, Elton John, Prince William etc.

Kofi Annan speech:

Kofi Annan suggested to the business leader, that they should join forces and create a global compact for the purpose of protecting human rights, working conditions and environment. In 2004 they added anti-corruption.

“The spread of markets outpaces the ability of societies and their political systems to adjust to them, let alone to guide the course they take. History teaches us that such an imbalance between the economic, social and political realms can never be sustained for very long”

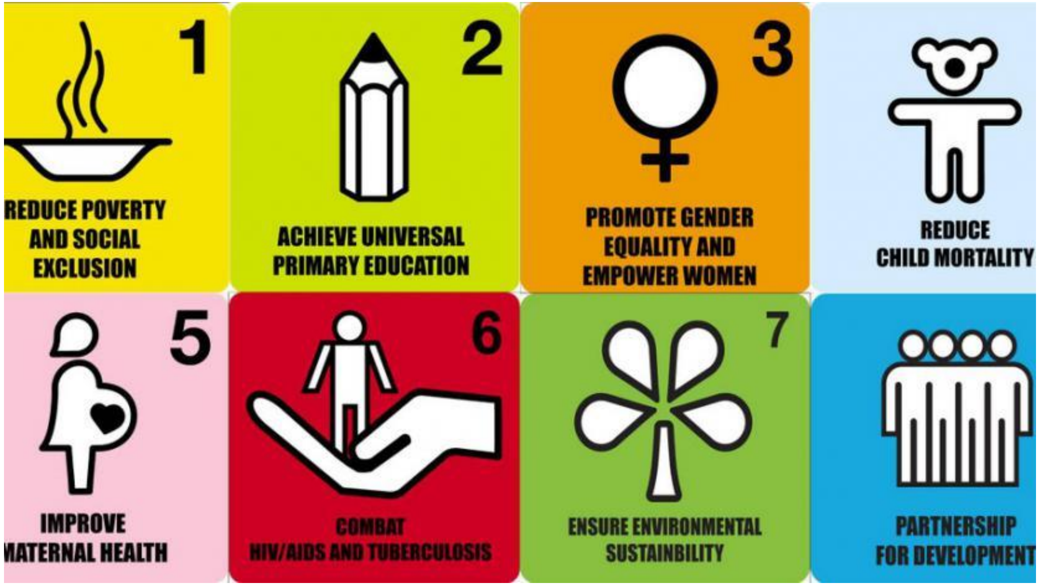
United Nations Global Compact, the largest voluntary CSR initiative world wide. 21.000+ members in 160 countries.

Basic idea: Business should cooperate with NGOs, labor organisations and governments in order to advance the broader goals of the united nations.

Basic requirements manifest in 10 Principles: Respect Human Rights, freedom of assoiation, eliminate forced labour and child labour, address environmental challenges and work against corruption in all its forms.

Recommendations and values

Year 2000: United Nations Millennium Development Goals



2015: Sustainable Development Goals (SDGs)

SDGs as language for sustainability

Enable corporations to describe the areas where they are making a contribution to sustainability

Either via their products and according to shared values principles. Example:

Novartis's Access Programs: Are delivering medicine in emerging economies sometimes at cost price developing markets in emerging economies.

Contributes to SDG 3: Good health and well-being.
In parallel they develop brand reputation in future markets

Or as description of projects and initiatives which are not part of core business

SDG in Business: BMW SDG 11

MOVEMENT BMW
HOME

October 1, 2018

The BMW Group is Working to Achieve Sustainable Development Goals

SUSTAIN

MOVEMENT BMW
HOME SUSTAIN IN

SDG 11 – Sustainable Cities and Communities: with our integrated mobility services and innovative approaches, we want to change mobility patterns in selected metropolitan areas in a sustainable way. These include our car-sharing services DriveNow and ReachNow, which increasingly offer electric vehicles, as well as the electric scooter specially designed for commuter traffic in cities. With the Urban Mobility competence center created in 2015, the BMW Group supports the paradigm shift from cities suitable for cars to cities suitable for people. The center acts as a platform through which the BMW Group works with cities and other partners to develop new concepts for future urban mobility with a view to making cities even more attractive to live in.

DriveNow => ShareNow=> Sold to Stellantis

From Computacenter – technological infrastructure

SUSTAINABLE DEVELOPMENT GOALS

UN Sustainable Development Goals
We are focused on where we can take meaningful action aligned to nine of the UN Sustainable Development Goals.

3 GOOD HEALTH AND WELL-BEING

Ensure healthy lives and promote wellbeing for all at all ages
We will support the mental and physical wellbeing of our employees by ensuring that our people have quality working lives and feel safe and protected.

4 QUALITY EDUCATION

Ensure inclusive and equitable quality education and promote lifelong learning opportunities for all
We will work to remove barriers that exist in our local societies, creating employment, training and educational opportunities.

5 GENDER EQUALITY

Achieve gender equality and empower all women and girls
We will continue to work towards achieving a balanced gender mix in a male-dominated industry.

8 DECENT WORK AND ECONOMIC GROWTH

Promote sustained, inclusive, and sustainable economic growth, full and productive employment, and decent work for all
We will maintain high standards of employment for our people and will work with our supply chain to build resilience and decent work.

9 INDUSTRY, INNOVATION AND INFRASTRUCTURE

Build resilient infrastructure, promote inclusive and sustainable industrialisation, and foster innovation
We will be responsible as a business to make a positive impact in our industry and wider communities.

10 REDUCED INEQUALITIES

Reduce inequality within and among countries
We will continue to foster an environment which enables employees to speak openly and ensure they have the knowledge they need to promote a positive and inclusive environment for all.

12 RESPONSIBLE CONSUMPTION AND PRODUCTION

Ensure sustainable consumption and production patterns
We will work with our technology partners and customers to promote sustainable technology sourcing, supported by our own Circular Services solutions.

13 CLIMATE ACTION

Take urgent action to combat climate change and its impacts
We will continue to take action to reduce our climate impacts both direct and indirect, aligned to science based targets.

16 PEACE, JUSTICE AND STRONG INSTITUTIONS

Promote peaceful and inclusive societies for sustainable development, provide access to justice for all, and build effective, accountable, and inclusive institutions at all levels
We will continue to be an ethical business while being mindful of the

Conflicts between SDGs

Some of the SDGs are conflicting

Nr. 1: “No Poverty” will be difficult to achieve without weakening SDG nr. 8: “12: “Decent Work and Economic Growth” and nr. 12: Sustainable Consumption and Production.”

SDG 7: Affordable and Clean Energy … momentarily either affordable or clean

Disadvantage is cherry picking: Which SDGs would suit the profile of the corporation

SDG 2 Zero Hunger => <= SDG 14: Life Below Water and SDG 15: Life o n Land

Sustainability Reporting

Legislation on sustainability reporting

Europe: Regulation since 2017: Companies of public interest (around 12.000 companies in EU) with more than 500 employees are obliged to disclose non-financial information. Sustainability with regard to environmental, social and governmental risks

From 2024 (for 2023) new Corporate Sustainability Reporting Directive (CSRD): Companies are obliged to disclose information when they have more than 250 employees and a turnover of more that 40 Million Euros.

Non-European companies are to disclose information of they have more that € 150 million turnover in Europe => 50.000 companies in the EU

CSRD part of European Green Deal

Initiative aiming at climate neutrality in 2050

Part of an overall European industrial strategy => twin transition to green and digital economy

Expectation from citizens that corporations understand their positive and negative impacts on society and environment and that they mitigate this risk

Corporations need to disclose information on economic, social and governmental aspects for directing financial and capital flows to sustainable investments

Information on sustainability => investors know where to invest

Future sustainability reporting

Transparency and accountability towards investors, NGOs and the general public

Double materiality:
Outside-in risks are the risks of sustainability issues affecting the company
Inside-out risks are the risks of the company negatively affecting society and environment

EU is developing an Eu sustainability reporting standard which will make sustainability reports comparable
(According to the directive from 2014, the corporations could choose their own standards; GRI, ISO 26000, OECD guidelines etc.)

Experiences from a smaller company (January 2023)

New legislation still in the process of implementation

Small and medium-sized Enterprises (SMEs) are part of supply chain for larger companies; accordingly, they must collect sustainability data as well because the larger corporations are required to screen their supply chain

Cases of SMEs being ahead of legislation in preparation for future requirements

“Tick the box” but also a driver of value and increasing awareness. Measuring electricity consumption is a prerequisite for reducing electricity consumption

Financial institutions

Investments in companies are increasingly considering ESG issues

Corporations which are carbon intensive, high consumptions of chemicals, plastic industry are not traded as often – irrespective of their profitability

M&A:

Investments in companies are increasingly considering ESG issues

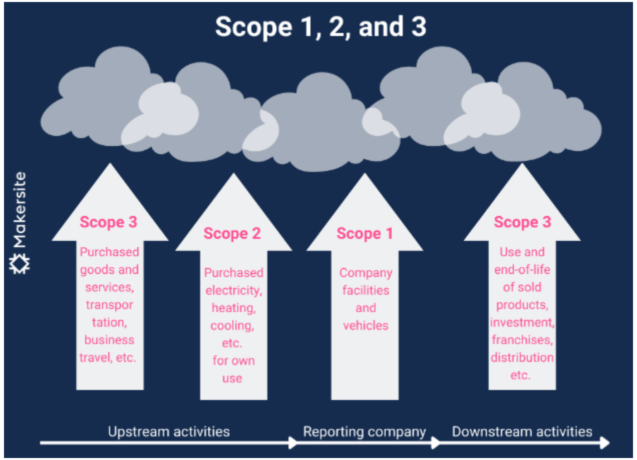
Corporations which are carbon intensive, high consumptions of chemicals, plastic industry are not traded as often – irrespective of their profitability

US legislation on sustainability reporting

No mandatory sustainability reporting

Securities and Exchange Committee (SEC) requires of corporations to disclose environmental, social and governance (ESG) risks which may be material (of decisive importance) to investors

New suggestion: Mandatory disclosure of C02 footprint scope 1, 2 and perhaps 3.



How to write a sustainability report

Sustainability reports are written according to standards.

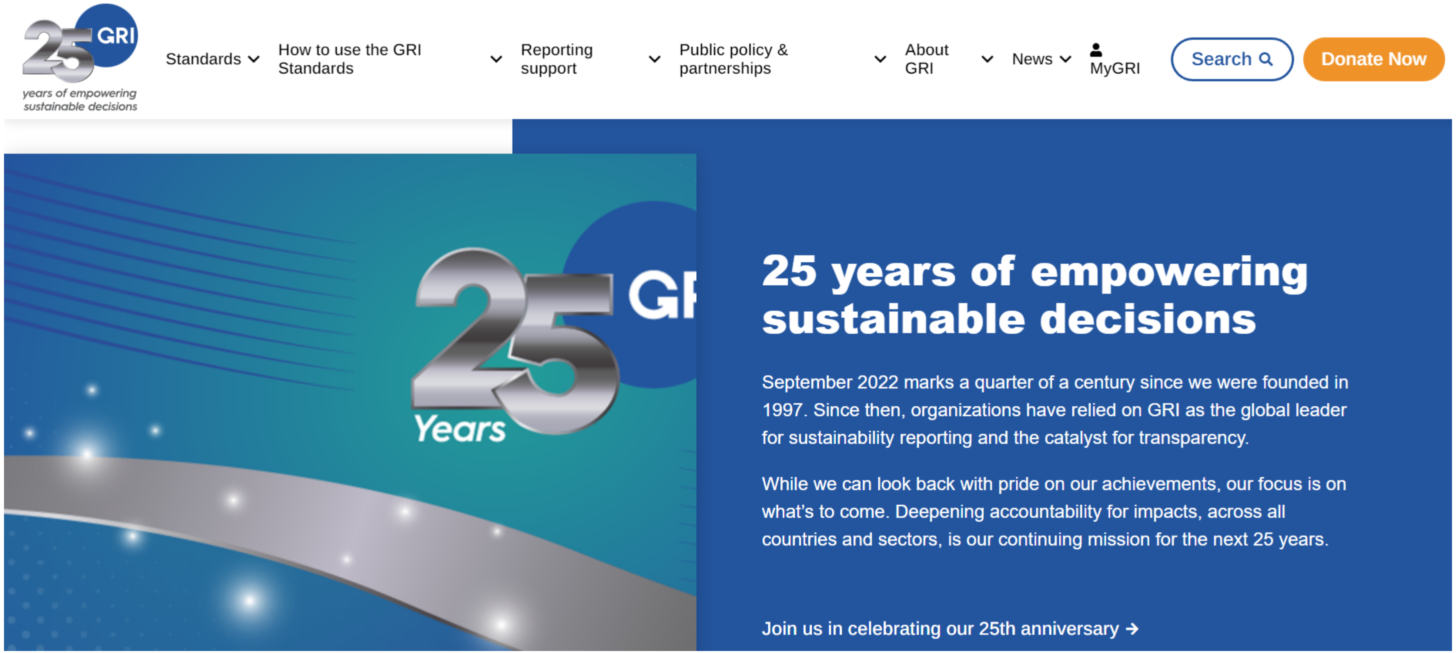
There are several different reporting standards – what should be included, and to what extent –

Most important of then is from Global Reporting Initiative,

GRI is an NGO founded in 1997 Continuous development of sustainability reporting standards in cooperation with United Nations

Momentarily EU is working on developing their own standards.

GRI


GRI
years of empowering sustainable decisions
Standards
How to use the GRI Standards
Reporting support
Public policy & partnerships
About GRI
News
MyGRI
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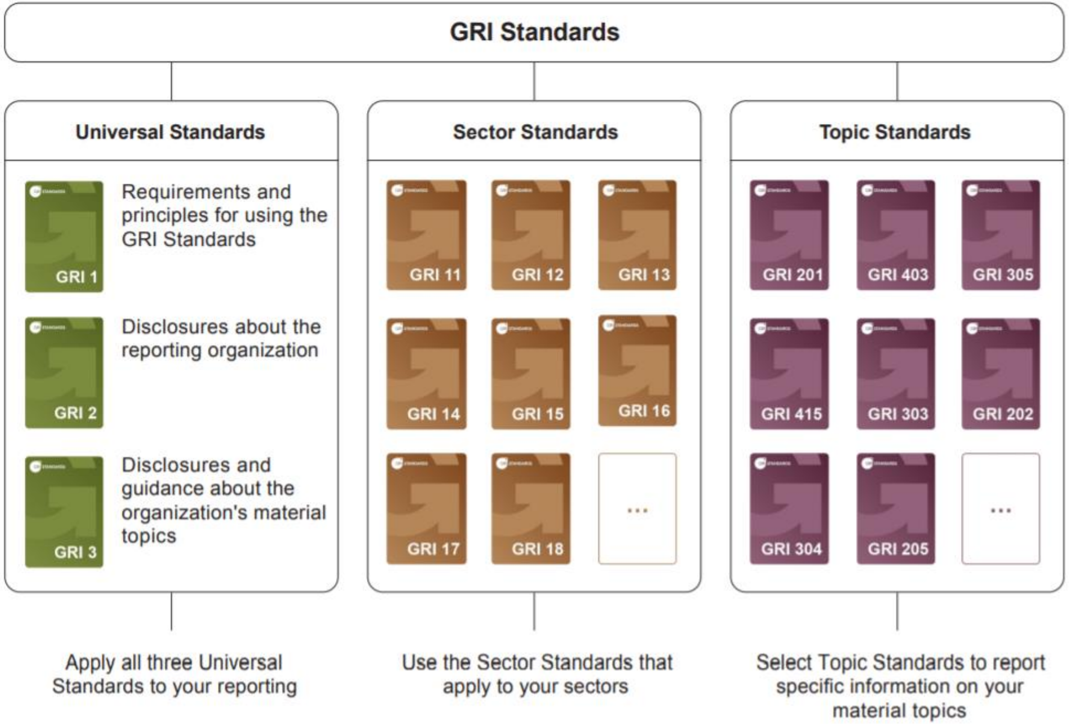
Years
25 years of empowering sustainable decisions
September 2022 marks a quarter of a century since we were founded in 1997. Since then, organizations have relied on GRI as the global leader for sustainability reporting and the catalyst for transparency.
While we can look back with pride on our achievements, our focus is on what's to come. Deepening accountability for impacts, across all countries and sectors, is our continuing mission for the next 25 years.
Join us in celebrating our 25th anniversary →

Figure 1. GRI Standards: Universal, Sector and Topic Standards



Purpose: Identify the business' effect on <u>economy, environment and people</u> with regard to sustainability. Describe how the organisation, identifies and prevents negative effects also on human rights.

Overview of the corporation: Names, places, subsidiaries, products, reporting practices and governance structures. How is management organised? How do they secure transparency and avoid conflicts of interest? Who keeps an eye on the management?

Understand organisations context, impact and significance of impact: **Materiality**: Review the Sector Standard and determine which topics are material => topics where the information would make a difference to population, investors, NGOs, stakeholders etc.

Example

GRI 2

Disclosures about the reporting organization

We are represented around the world and well positioned

The Salzgitter Group comprises over 150 subsidiaries and affiliated companies around the world. We are represented throughout the world through our international facilities which also demonstrate our geographical proximity to our customers.

Managed by Salzgitter AG as the holding company, the Group is divided into five business units: Strip Steel, Plate / Section Steel, Mannesmann, Trading and Technology. It also has stakes in further industrial companies, e.g. Europe's leading copper producer Aurubis AG as well as numerous service companies not assigned to any business unit.

The Strip Steel Business Unit produces, processes and distributes flat steel in a wide variety of metallurgical formulas and sizes. To do so, we operate a modern, environmentally friendly, integrated steel mill at our Salzgitter facility. It produces almost 5 million tons of crude steel and around 3.5 million tons of rolled steel per year. The most important feed materials are iron ore, coke, scrap and alloying agents. Most of the high-quality products are processed by the automotive sector. The pipe sector and industry (e.g. manufacturers of household appliances, mechanical engineering industry) are also among the most important customer segments.

As well as two plate mills, the Plate / Section Steel Business Unit operates an electric steel mill in which around 1 million tons of crude steel are smelted from scrap steel per year. This makes it a significant part of the materials cycle and its products demonstrate that steel can be recycled with no loss of quality. Plate is traditionally used in the metalworking, shipbuilding and mechanical engineering industry. Our mills have also established themselves in recent years as the preferred supplier of steel for the wind turbine industry. Our structural steel is used in the construction sector.

The companies in the Salzgitter Group making steel tubes are combined in the Mannesmann Business Unit. Three product segments offer a wide range of tube products for diverse applications from fuel injection systems, power plants and boilers to large diameter pipelines.

Sector standards determine materiality (relevance)

GRI 11 = The Oil Industry

Contents

Alternative to sector standards: SASB Materiality Finder

Dimension	General Issue Category	6 of SASB's 77 industries					
		Health Care Delivery	Non- Alcoholic Beverages	Electric Utilities & Power Generators	Advertising & Marketing	Auto Parts	Metals & Mining
Environment	GHG Emissions						
	Air Quality						
	Energy Management						
	Water & Wastewater Management						
	Waste & Hazardous Materials Management						
	Ecological Impacts						
Social Capital	Human Rights & Community Relations						
	Customer Privacy						
	Data Security						
	Access & Affordability						
	Product Quality & Safety						
	Customer Welfare						
	Selling Practices & Product Labeling						
Human Capital	Labor Practices						
	Employee Health & Safety						
	Employee Engagement, Diversity & Inclusion						
Business Model & Innovation	Product Design & Lifecycle Management						
	Business Model Resilience						
	Supply Chain Management						
	Materials Sourcing & Efficiency						
	Physical Impacts of Climate Change						
Leadership & Governance	Business Ethics						
	Competitive Behavior						
	Management of the Legal & Regulatory Environment						
	Critical Incident Risk Management						
	Systemic Risk Management						

Likely a material issue for companies in the industry   Want to find your industry? Search Industry   Access the Materiality Map Login

A more basic tool for identifying initial topics relevant (material) for a sustainability report

https://www.sasb.org/standards/materiality-finder/?lang=de-de30

Standards for specific topics identified as relevant in the sector standards

For example anti-corruption measures, training and education, specific environmental issues etc.

Example


GRI STANDARDS

GRI 201: Economic Performance 2016

201-4 Financial assistance received from government

Reporting requirements

Disclosure **201-4**

The reporting organization shall report the following information:

a. Total monetary value of financial assistance received by the organization from any government during the reporting period, including:

   i. tax relief and tax credits;

   ii. subsidies;

   iii. investment grants, research and development grants, and other relevant types of grant;

   iv. awards;

   v. royalty holidays;

   vi. financial assistance from Export Credit Agencies (ECAs);

   vii. financial incentives;

   viii. other financial benefits received or receivable from any government for any operation.

b. The information in 201-4-a by country.

c. Whether, and the extent to which, any government is present in the shareholding structure.

You do not need to know the details for the exam

8 GRI 402: Labor/Management Relations 2016

2. Topic disclosures

Disclosure 402-1 Minimum notice periods regarding operational changes

REQUIREMENTS

The reporting organization shall report the following information:

a. **Minimum number of weeks' notice typically provided to employees and their representatives prior to the implementation of significant operational changes that could substantially affect them.**

b. **For organizations with collective bargaining agreements, report whether the notice period and provisions for consultation and negotiation are specified in collective agreements.**

You do not need to know the details for the exam

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Would you consider working with sustainability reporting ?

ESG rating

Corporations are rated with regard to Environmental, Social and Governance risks

They measure primarily the outside in risk, i.e. the extent to which the environment may affect the corporation and the way the corporation is prepared for these risks

Good rating: Good for the reputation, for attracting work force, indicates that the company is well managed

- Good rating: The company might be included on lists of companies which big pension funds can invest their assets in (good for share price)

ESG ratings (mainly) created by commercial organisations – rating agencies

MSCI: Morgan Stanley

ISS ESG: Institutional Shareholder Service

S&P: Standard and Poor

Sustainalytics

Moody’s

MSCI

Used to be “Morgan Stanley Capital International”

MSCI ESG Ratings are created by MSCI ESG Research, one of the largest rating agencies. These ESG ratings are released for 14,000 different equity and fixed income issuers (Corporations).

Ratings measure a company’s **management of financially relevant ESG risks**

Create indexes: Lists of corporations representing state of the art – also with regard to ESG, climate etc.

MSCI ESG Ratings are generally known to be one of the industry leaders in publishing scores and rating

MSCI rating scale

[Übersicht über die wichtigsten ESG-Ratings – und was sie für die Finanzkommunikation bedeuten | NetFed]

ISS – partly owned by German “Deutsche Börse Group”

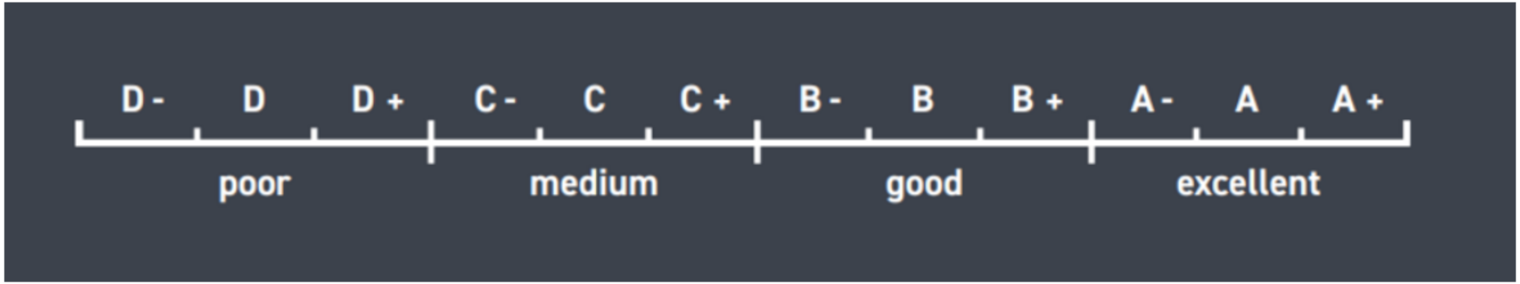
Institutional Shareholder Services Ratings and Rankings

ISS (Institutional Shareholder Services), provides company, country, and fund ratings as well as data and analysis across the full range of sustainable investment issues, including climate change, human rights, labour standards, corruption, and controversial weapons.

ISS ESG ratings can also help investors in determining compliance with ESGs and proactively address ESGs risks faced by companies.

ISS rating scale

Die Rating-Skala von ISS ESG



ISS ESG

Standard and Poor (S&P Global ESG)

Standard & Poor’s Global ESG is one of the largest companies that provide data analytics and reporting related to companies around the world.

S&P Global ESG Scores takes a more analytical look at how well companies perform in areas such as environmental practices and employee relations.

Their reporting allows investors and consumers alike to better understand ESG

S&P rating scale

"Once S&P Global Ratings has determined the company's ESG Profile score and Preparedness opinion, they are combined to produce a relative overall ESG Evaluation score on a 100-point scale."

Sustainalytics

Sustainalytics ESG Risk Ratings

Sustainalytics is an ESG rating and data supplier that provides ESG ratings on 20,000 companies and 172 countries. They rate 40,000 companies worldwide. Sustainalytics is a subsidiary of Morningstar, one of the largest stock market data providers in the world.

The ESG ratings from Sustainalytics measure environmental, social and corporate governance performance of companies on a global scale. They cover about 13,000 international equities across all regions worldwide.

Sustainalytics rating scale

Overview of Sustainalytics' ESG Risk Ratings

Sustainalytics' ESG Risk Ratings measure a company's exposure to industry-specific material ESG risks and how well a company is managing those risks. This multi-dimensional way of measuring ESG risk combines the concepts of management and exposure to arrive at an absolute assessment of ESG risk. We identify five categories of ESG risk severity that could impact a company's enterprise value

Negligible	Low	Medium	High	Severe
0 - 10	10 - 20	20 - 30	30 - 40	40+

The company would aim for a low score

Moody’s

One of the largest credit rating agencies in the world

Rating => investment criteria for investors.

Large pension funds with rules for rating requirements

Rating nations and corporations

Moody's ESG Rating Scale

Score		Definition
E-1 S-1 G-1	Positive	Issuers or transactions with a Positive E or S issuer profile score typically have exposures to E or S issues that carry material credit benefits. For G, issuers or transactions typically have exposure to G considerations that, in the context of their sector, positions them strongly, with material credit benefits.
E-2 S-2 G-2	Neutral-to-Low	Issuers or transactions with a Neutral-to-Low E or S issuer profile score typically have exposures to E or S issues that are not material in differentiating credit quality. In other words, they could be overall slightly credit-positive, credit-neutral, or slightly credit-negative. An issuer or transaction may have a Neutral-to-Low score because the exposure is not material or because there are mitigants specifically related to any E or S risks that are sufficient to offset those risks. Issuers or transactions with a Neutral-to-Low G issuer profile score typically have exposure to G considerations that, in the context of their sector, positions them as average, and the exposure is overall neither credit-positive nor negative.
E-3 S-3 G-3	Moderately Negative	Issuers or transactions with a Moderately Negative E or S issuer profile score typically have exposures to E or S issues that carry moderately negative credit risks. These issuers may demonstrate some mitigants specifically related to the identified E or S risks, but they are not sufficiently material to fully offset the risks. Issuers or transactions with a Moderately Negative G issuer profile score typically have exposure to G considerations that, in the context of the sector, positions them below average and the exposure carries overall moderately negative credit risks.
E-4 S-4 G-4	Highly Negative	Issuers or transactions with a Highly Negative E or S issuer profile score typically have exposures to E or S issues that carry high credit risks. These issuers may demonstrate some mitigants specifically tied to the E or S risks identified, but they generally have limited effect on the risks. Issuers or transactions with a Highly Negative G issuer profile score typically have exposure to G considerations that, in the context of their sector, positions them weakly and the exposure carries overall highly negative credit risks.
E-5 S-5 G-5	Very Highly Negative	Issuers or transactions with a Very Highly Negative E or S issuer profile score typically have exposures to E or S issues that carry very high credit risks. While these issuers or transactions may demonstrate some mitigants specifically related to the identified E or S risks, they are not meaningful relative to the magnitude of the risks. Issuers or transactions with a Very Highly Negative G issuer profile score typically have exposure to G considerations that, in the context of their sector, positions them very poorly and the exposure carries overall very high credit risks.

Source: Moody's Investors Service

https://www.ceres.org/news-center/blog/qa-moodys-investors-service

(Side comment on largest credit rating agencies)

Moody’s, Standard & Poor and the Fitch Group

They credit rate 95% of corporations and nations => hidden political power. Downgrade a country => increase the cost of borrowing money.

Gave Lehman Brothers an AAA rating => subprime mortgages => bankrupt in 2008 => financial crisis

Euro crisis in 2009????: Agencies downgraded Greece and thereby increased its costs of borrowing, which caused their situation to deteriorate further

ESG: Environmental, Social, Governance

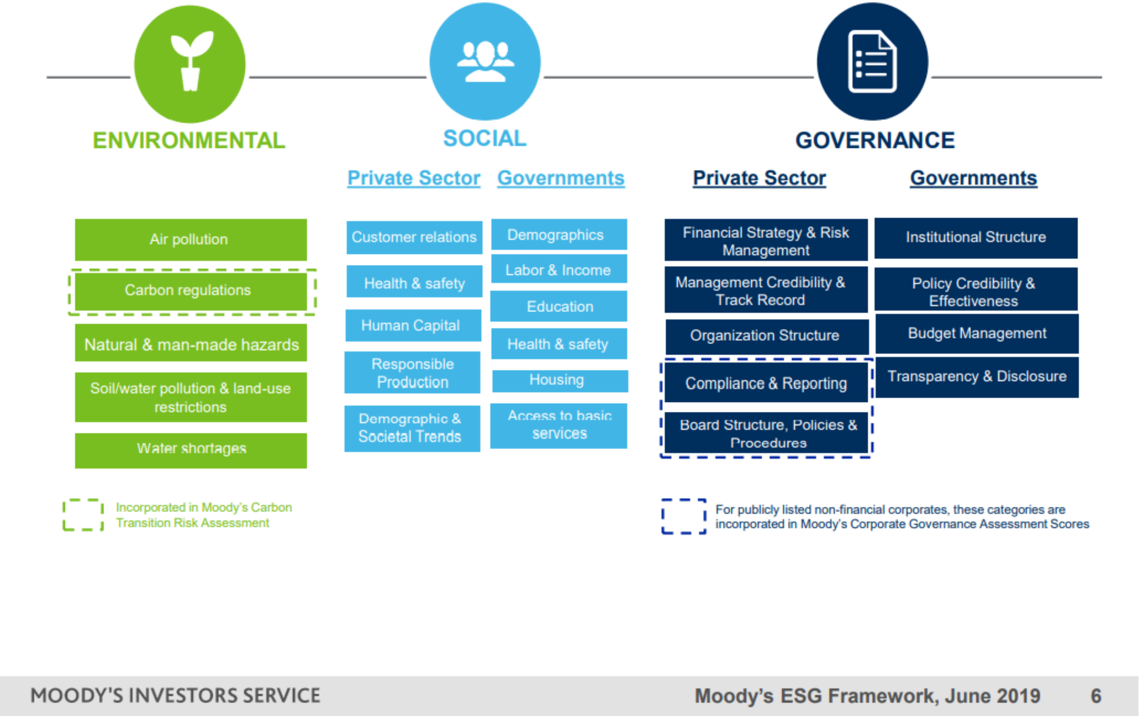
Criteria for screening investments.
Risk profile of the company

Financially (!) material ESG information

Which ESG risks can damage the profitability of the corporation
It indicates relation to society and environment => low risk = low potential damage to society, but this is secondary to the financial risk

Of relevance to investors => decisive for publicly traded companies
=> Influence their access to investors

Credit relevant ESG “Taxonomy” Created



[PowerPoint Presentation (structuredfinance.org)]

Example from Moody’s Methodology

EXHIBIT 2

Moody's Environmental Risk Categories

Carbon transition

- Current positioning for carbon transition
- Technology, market and policy risk
- Actions to mitigate risk
- Long-term resilience to risk of accelerated carbon transition

Physical climate risks

- Current and future effects of climate change
- Exposure to heat stress, water stress, floods, hurricanes, sea level rise and wildfires

Water management

- Non-climate-related risks
- Impact of economic activity
- Availability, access and consumption
- Innovations to enhance water use efficiency
- Risk of pollution-related regulatory violations

Waste and pollution

- Non-GHG air pollutants
- Land-based accidents, spills and leaks
- Hazardous and non-hazardous waste
- Circular economy

Natural capital

- Impact on natural systems (soil, biodiversity, forest, land, oceans, etc.)
- Dependency on goods and services derived from nature (agriculture, fiber, fish, etc.)

Note: Subcategories are representative and not exhaustive.
Source: Moody's Investors Service

Moody’s social risk categories

EXHIBIT 4

Moody's Social Risk Categories - Private Sector

Notes: While the categories of risk are reasonably distinct, in some cases there are interrelationships among the categories. Subcategories are representative and not exhaustive.

Source: Moody's Investors Service

Moody's governance risk categories

ESG Rating

Enables investors to evaluate which environmental, social and governance risks the corporation is facing and their severity.

Ratings have decisive influence on the price of capital, i.e., the price of borrowing money. High ESG risk => higher interest rates

Rates the *financial* risk, the risk ESG issues affecting profitability, and NOT the impact of the company.

Challenge: How to compare complex organisations?

Each rating agency has a specific methodology: which aspects contributes how much to the overall rating?

Methodologies

Rating created on the basis of thousands of data points.

<u>Materiality:</u> Which issues are material? Requires understanding the line of business and understanding the particular situation of the corporation. Each methodology (rating agency) has a different understanding of materiality

<u>Data harvesting</u>: More than half of the data are based on qualified guesses, on statistics on what is normal in this line of business – by the specific rating agency. If a corporation has an untypical issue, it is not included in the rating

<u>Scoring</u>: How much weight do you give to each cluster of data points? How important is lack of inclusivity compared to water consumption? This is determined by the <u>individual methodology</u> of the rating agency

Complexity => not possible for investors to understand the differences in detail => Moody's methodology is 69 pages long. If two corporations are rated by different agencies, the investor would have to understand the differences in methodologies *and their consequences for the rating*

Different metrics => data points are – by each rating agency - ascribed different importance relative to the overall score

Example: MSCI upgraded McDonald's rating by claiming climate change posed no risk to the business. (This claim is of course highly controversial since McDonald's is a major buyer of beef)

Adopting policies already integrated in the legislation will increase ESG score (Corporate Governance rules banning bribery)

Reply from MSCI: Ratings are about risks, and not about "goodness".
(https://www.greenbiz.com/article/secret-life-esg-ratings)

Criticism by Aswath Damodaran
Professor of Finance

Who does ESG rating serve?
The Investors? No, higher ESG rating gives them a lower return on their capital.
Only IPOs raise capital => other corporations do not raise capital
Investors in companies accept lower return for a high ESG rating
Individuals have outsourced responsibility
Future: Consultants and bankers will make money on ESG. Society will be worse off

BlackRock asset management company

2020: Announced that they will divest from carbon intensive companies and focus more on ESG

⇒ Republican (oil-friendly) are withdrawing from BlackRock because of their commitment to ESG

⇒ ESG as political battleground