London Stock Exchange

Building dialogue between investors and issuers on ESG

A report on disclosure trends

London Stock Exchange Group

Introduction

Investor focus on ESG continues to increase – a trend accelerated by the COVID-19 global pandemic. The challenge for issuers is to focus and improve their ESG performance as well as how they communicate and engage with investors.

London Stock Exchange's ESG Disclosure Score helps issuers to see where they might improve their most important sector-specific ESG metrics and understand how they fare in comparison to their peers. Now in its second year, the ESG Disclosure Score shows a positive trajectory of disclosure, but analysis found that more work is required to improve disclosure across all industries, and in particular for the 'Social' component of ESG.

The following report provides detail on the purpose of the score and explores the important role of disclosure for issuers and investors. We look at industry best practice, year-on-year developments and ask where is the 'S' in ESG?

The ESG momentum

The number and scale of investors emphasising ESG (Environmental, Social & Governance) factors in their decision-making and engagement processes continues to gather pace.

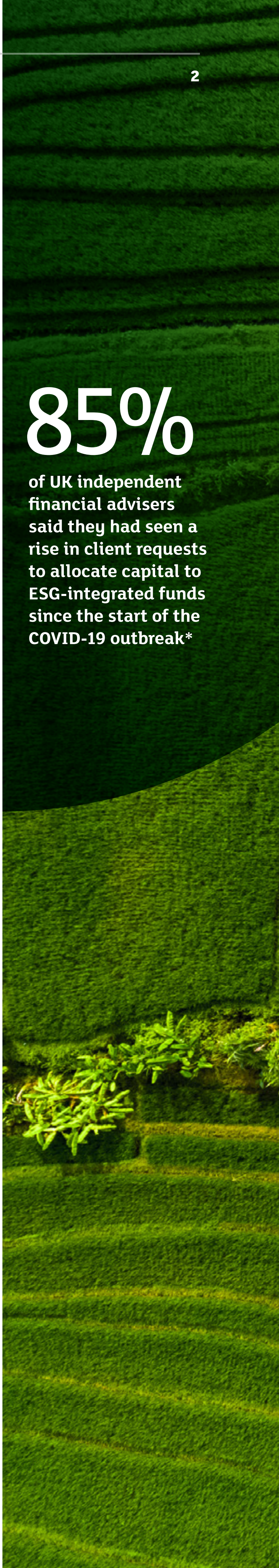
More asset managers are integrating ESG into their portfolio construction. Their growing conviction is that ESG and stronger returns are two sides of the same coin: **one survey last year of 607 institutional investors** found that 61% had increased their investment allocation to companies that excel when it comes to ESG factors.

This trend has been accelerated by the COVID-19 global pandemic. For many investors, the pandemic has highlighted the linkages between ESG issues and broader issues of economic and corporate performance.

This heightened focus reflects the agenda of institutional and retail investors. In **a poll of UK independent financial advisers (IFAs)** by asset manager Federated Hermes, 85% said they had seen a rise in client requests to allocate capital to ESG-integrated funds since the start of the COVID-19 outbreak, and 78% believed investors would be motivated to divest from companies that have failed to support their employees or society more widely through the crisis.

Climate change and environmental issues are at the forefront of the global agenda, and there is increasing public awareness of the need for action, putting pressure on governments and also businesses.

The demands from investors are matched by the growing variety and number of regulatory requirements globally. Increasing, too, is the number of surveys requesting further ESG information from companies by investors and assessment organisations.

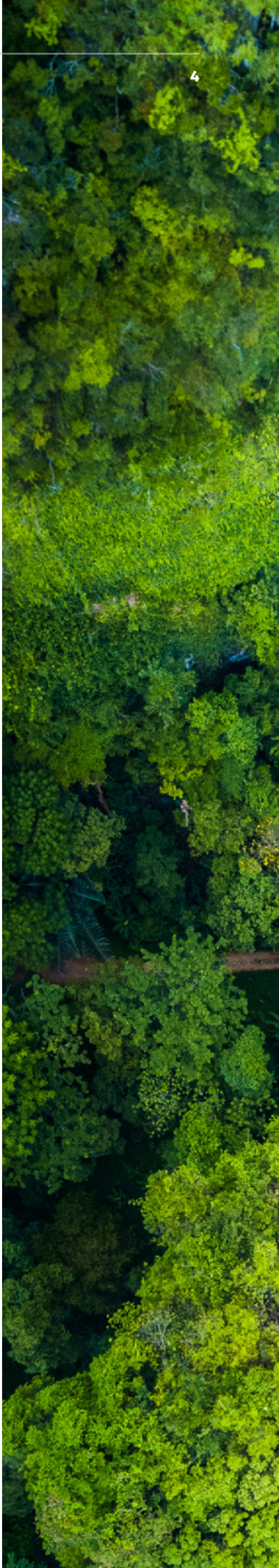


* in a poll of UK independent financial advisers (IFAs) by asset manager Federated Hermes

Challenges for issuers

The challenge for issuers is not only to focus and improve on their ESG performance but also how they communicate and engage with investors.

Besieged by requests for more ESG information, issuers are responding with greater levels of transparency and data disclosure. But the challenges are several. Steps have been made to establish global reporting standards designed to facilitate consistent disclosure in areas of investor focus – such as the Global Reporting Initiative (GRI) and the Sustainability Accounting Standards Board (SASB) – investors will use them on a bespoke basis, according to their priorities and requirements.



ESG Disclosure Score

To support issuers in addressing ESG challenges, London Stock Exchange created the ESG Disclosure Score, a unique tool which provides clarity and support for issuers and investors alike.

As one of the world's largest exchanges, with the most geographically and sector diverse issuer and investor base, London Stock Exchange has been helping issuers navigate the disclosure landscape for many years. We have chaired the UN Sustainable Stock Exchange Model Guidance on ESG Reporting; launched our own issuer **ESG reporting guidance**; and made available to issuers their **FTSE Russell ESG Ratings**.

The ESG Disclosure Score builds on this support. The score can support issuers in understanding what areas of disclosure need improvement. It provides a mechanism by which issuers can better assess their current levels of quantitative ESG disclosure relative to industry sector average and understand which additional metrics could be disclosed to improve their score and help give investors a clearer picture.

It is a tool for issuers to consider good practice in disclosure of key quantitative ESG metrics, by providing an indication of the most relevant ESG metrics in the issuer's industry and showing how their quantitative disclosure across these areas compares to industry peers. The score supports issuers to focus on their ESG disclosure, particularly the many issuers outside the FTSE 100, who are aware but may have fewer resources and less expertise in ESG.

In creating this tool, London Stock Exchange aims to help issuers by highlighting where they might improve their most important sector-specific ESG metrics. Vitally, issuers can then use this knowledge and information to enhance dialogue with the growing numbers of investors who have a focus on ESG disclosure and performance.

Calculating the ESG Disclosure Score: the factors

The ESG Disclosure Score is a percentage figure that represents the aggregated level of disclosure against certain quantitative ESG data points drawn from global standards, used by FTSE Russell and that are considered to be relevant for the issuer's sector. The methodology is discussed in detail **here**.

The score's data-driven approach offers an accurate and unbiased assessment of issuers' disclosure.

This data-driven approach offers an accurate and unbiased assessment. It does not represent any judgement on the nature of the disclosure or the quality of the policies i.e. whether specific policies or figures on emissions or diversity etc. are good or bad – investors will determine this for themselves. The score simply reflects that data is being disclosed providing an indication of transparency to investors. Any data point that is not disclosed gets a zero score. So, if an issuer does not disclose a policy that it actually has, then it penalises itself.

Individual scores are not made public: they are provided only to issuers themselves along with the average and top scores in their industry for comparison.

An online tool has been developed to enable those issuers not in the FTSE Russell research universe to self-calculate an indicative ESG Disclosure Score.

ESG disclosure in 2020: the trends

The ESG Disclosure Score was launched in 2019, so this year provides a first glimpse at how issuers are evolving their practices. Encouragingly, there is a general positive trend.

There has been notable progress among the top-scoring issuers. In 2020, twelve issuers scored over 90% and eight of these issuers scored 100%, compared to three in 2019. These eight issuers have a combined market capitalisation of £137bn.

Just over half of issuers that were given a score (207/385) achieved more than 50% and we saw a net improvement across the high-scoring percentiles: there was a 28% rise in the number of issuers who scored more than 75% (55 in 2020 compared to 43 in 2019).

12
issuers scored over 90%

8
issuers scored 100%

The sectors with the highest average scores were banks, construction and materials, and consumer products and services. One sector – real estate – made notable strides in its year-on-year performance with an improvement of 6%. Five of the ten issuers showing the biggest year-on-year improvements were in the real estate sector. These were Big Yellow Group, Civitas Social Housing, Capital and Counties Properties, Picton Property Income and NewRiver REIT. Considerable aggregate improvements were also made by banking and energy sectors.

Despite these many steps forward, however, it must be acknowledged that the disclosure scores for more than half of issuers remained static with some scoring lower than in 2019. There is more work to be done to improve disclosure across all industries. Across the ESG arena, issuers need more support and education.

ESG data is becoming an integrated part of investment decision-making worldwide. As a leading international capital market at the forefront of the work in ESG, London Stock Exchange is committed to supporting our issuers in this area with tools to assist meeting these growing investor needs.

Denzil Jenkins Interim CEO, London Stock Exchange plc

Year-on-year trends by sector

Sector	2020 average	2019 average	YoY improvement
Real Estate	48%	42%	6%
Energy	53%	48%	5%
Banks	67%	62%	5%
Health Care	58%	54%	3%
Basic Resources	56%	53%	3%
Food, Beverage and Tobacco	57%	55%	2%
Media	58%	56%	2%
Financial Services	49%	47%	2%
Automobiles and Parts	53%	51%	2%
Retail	51%	49%	1%
Chemicals	53%	52%	1%
Industrial Goods and Services	52%	52%	1%
Construction and Materials	61%	60%	1%
Consumer Products and Services	60%	60%	0%
Travel and Leisure	47%	48%	-1%
Utilities	48%	51%	-3%
Technology	46%	50%	-4%
Personal Care, Drug and Grocery Stores	53%	58%	-5%
Insurance	50%	55%	-5%
Telecommunications	51%	57%	-5%

Where's the 'S' in ESG?

E Environment
S Social
G Governance

This year has not only witnessed a global pandemic, but also widespread and growing concerns about social justice issues, most clearly evidenced by Black Lives Matter. While there has been considerable focus on the 'E' (environment) of ESG, the prominence of the 'S' (social) and 'G' (governance) is rising.

Yet despite growing investor focus on the social element of ESG, it remains the component that is most likely to be neglected by issuers in their disclosures. Across all sectors, it is the social element where ESG scores are lowest. From the issuers we have researched, there is evidence that these low scores appear to be due to a lack of disclosure, rather than poor policies in these areas.

In some cases, issuers may not disclose basic policies (e.g. recognition of union rights), even though such policies are in place and are being followed, because it is wrongly assumed that investors are taking them into account.

While legal requirements mandate disclosure in particular aspects – such as the requirement to publish an annual Modern Slavery Statement – it is evident that issuers could improve their overall ESG scores by disclosing further information on social factors such as labour standards, human rights and community, health and safety, and customer responsibility. We are poised to see how the broad corporate response to the COVID-19 pandemic, in which the safety of employees and customers became paramount, will affect our findings next year.

Lessons in ESG disclosure: the real estate sector

This year is notable for the presence of the real estate sector among those issuers who have demonstrated the greatest levels of improvement in their disclosure scores: seven out of the top 20 most improved companies are in real estate, and the sector accounts for more than one-third of the top 30.

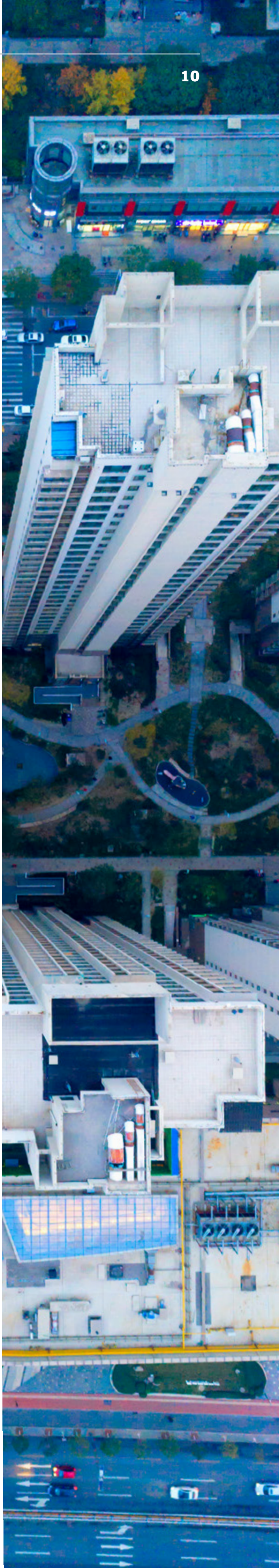
We have seen a significant upward trend in the adoption of ESG across the real estate industry. This has been driven predominantly by three factors: risk mitigation, investor pressure and looming regulatory change. The primary focus for risk mitigation is resilience, whether this is climate-related – especially relevant and material to this sector due to the physical nature of real estate – or generational resilience linked to changes in the mindset and expectation of occupiers. Investor expectation and associated pressure has been accelerated by access to transparent portfolio benchmark performance through voluntary assessments such as GRESB, which now evaluate comparable ESG performance of more than USD$4.8tn AUM globally. This has forced many portfolio managers to raise their ESG game, specifically to attract future investment. We anticipate that this upward trend will continue to accelerate, especially as tougher regulation kicks in, most notably the EU taxonomy.

Chris Bennett Managing Director, Evora Global *a specialist sustainability consultancy for the real estate sector*

Top eight performers in ESG disclosure

Coca-Cola European Partners plc
Coca-Cola Hbc Ag
Compagnie De Saint-Gobain
Crest Nicholson Holdings plc
Diageo plc
London Stock Exchange Group plc
Pearson plc
Standard Life Aberdeen plc

These eight issuers scored **100%** in their ESG Disclosure Score



Conclusion

The demand for ESG disclosure is only going to increase.

Requests for information from investors and regulators will grow. The influence of Millennials, who had already been strong in their demand for ESG products prior to COVID-19, will escalate further. Almost nine in ten wealth managers polled believed that the COVID-19 pandemic would result in increased investor interest in ESG investing, according to **a survey carried out by the FT and Savanta**.

The challenge for issuers is to have the most relevant ESG information always to hand and to communicate it swiftly and clearly. ESG reporting was once a niche expertise but now, with growing investor appetite for consistent quantitative ESG data, it is becoming mainstream.

The ESG Disclosure Score is an important tool provided by London Stock Exchange for its issuers. Given the growing importance of ESG data to investors, we hope it will prove useful for issuers as they plan their disclosure on key quantitative metrics, delivering greater levels of confidence to investors and broader stakeholders as the world focuses its lens on ESG.

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