4

ESG information sources

Finding ESG information often entails reviewing a diverse range of potential and sometimes conflicting sources. Company-reported information is often a useful starting point, but the lack of standards creates wide variation in the relevance and quality of the information provided. Dialogue with companies can be helpful to fill in the gaps, particularly for companies with less advanced reporting. In addition, while we question the utility of relying on an ESG score for use in fundamental analysis, ESG data and analyst reports from third-party service providers can be helpful to streamline data collection and pinpoint issues for further analysis. Information from news media often serves as an important check on company reporting, especially for identifying controversies and understanding stakeholders' perceptions of the company. It is also useful in identifying upcoming sustainability-related regulations or structural trends that may affect companies' ability to create value.

The sources listed in this section include examples that the authors find helpful in their daily work. Nevertheless, the volume, variety and quality of ESG information sources are constantly evolving and this should not be considered an exhaustive list.

4.1 Company-reported information

The main types of company reporting include sustainability reports and annual reports that include sustainability-related information, such as integrated reports. These are not the only sources, however. For example, quarterly financial presentations may contain relevant information, such as progress on sustainability related KPIs or the company's approach to complying with new regulatory requirements. Company prospectuses, when raising new equity or debt, or for corporate transactions, can also contain sustainability-related information, often buried in the long list of risk factors that few bother to read. Annual reports and prospectuses are subject to stricter regulatory disclosure requirements than standalone sustainability reports. At a minimum, the company's auditor will have read any ESG information in the annual report.

Company-reported information tends to be one of the most useful sources for ESG data. It is not without its limitations, however. While the lack of universal standards for ESG reporting allows companies to report in a manner tailored to their specific circumstances, it also increases the risk for selective reporting. Comparing reports from peer companies can help the analyst to pinpoint ESG information left out that could suggest the company's prospects are not as rosy as they may seem.

4.1.1 Company reporting

Although the practice is far from universal, most Nordic-listed companies produce some type of standalone sustainability report or integrate sustainability-related information into their annual report. Even for those that do neither, the annual report usually contains some type of sustainability-related information, for example in the management discussion.

Ideally, the company's sustainability reporting will include metrics demonstrating performance on KPIs linked to the company's strategy, as well as forward-looking targets. Either type of information (or their absence) is helpful to understand how the company's approach to ESG may affect its valuation. The following minimum recommendations for ESG reporting, from the Norwegian Society of Financial Analysts' Committee on Financial Information (Norwegian Society of Financial Analysts, Committee on Financial Information, 2019, p. 72), reprinted in the text box below, hint at some of the challenges in interpreting companies' sustainability reports.

ESG targets should be useful in forecasting required investments or net working capital requirements, for example. Nevertheless, the analyst will need to do a sanity check based on the company's expected ability to deliver on targets. Reported information on past performance is in this respect useful to assess whether the company is likely to meet its stated targets.

ESG reporting should be:

- Easy to understand
- Comparable across companies
- Comparable over time – consistent KPIs
- Desirable in a tabular format
- Advantageous to follow established standards as these develop

Source: Recommendations from the Committee on Financial Information for the Norwegian Society of Financial Analysts.

Comparing a company's past performance and stated targets to those of peers is a potentially helpful, but not always straightforward exercise. In the absence of legally mandated ESG reporting requirements and definitions, companies may use different metrics to communicate the same concept, e.g., carbon intensity of production. This can complicate the analyst's efforts to compare the company to peers. Divergence may reflect differences of opinion regarding the best way to measure performance along a specific dimension. There is also an inherent temptation for companies to use the metric that presents their performance in the best light. Given diverging metrics, the analyst will need to decide which best reflects company performance and make the necessary adjustments across companies. Adjustments over time may also be necessary, for example, if the analyst extracts data from previous years' reports for historical comparison.

Key questions for sustainability information in company reports:

Question	Implication
Does the company produce a stand-alone sustainability report?	If yes – typically a useful guide to company's priorities and performance over the past year. If not – check whether sustainability-related information is included in the annual report.

Question	Implication
Is the report prepared according to a standardised framework?	If yes – the framework may dictate the choice of metrics and/or the intended audience.
Has the company assured some or all sustainability-related information?	Level of confidence in reported information. Relatively common to assure e.g., GHG emissions, but not rest of report.
Is the company transparent on sustainability targets and progress towards these targets?	Forward-looking ESG information is typically rare, but useful for the analyst in modelling the impact on future cash flows. Consistent reports on progress suggest greater confidence that the company will execute its strategy as planned.

4.1.2 ESG reporting frameworks – a few examples

Governance information is often reported separately from sustainability information. For governance information specifically, many Nordic companies include reports against the national corporate governance code within their annual report. This is a listing requirement for companies listed on the Oslo Stock Exchange, for example (Oslo Stock Exchange, n.d.). These codes follow a "comply or explain" format, meaning that companies can deviate from the code, but must report on their rationale for doing so. Company websites are usually the most up-to-date source for board member and executive management biographic information. Companies in Norway, Sweden and Finland regularly publish lists of their largest shareholders on the company websites. Disclosure practices in Denmark, by contrast, are typically limited to controlling shareholders.

While an exhaustive discussion of *sustainability reporting frameworks* is beyond the scope of this guide, some of the most common include integrated reporting, the Global Reporting Initiative (GRI), the Sustainable Accounting Standards Board (SASB), the Task Force on Climate-related Financial Disclosures (TCFD) and the EU Taxonomy.

The *Global Reporting Initiative* framework, which inspires the Euronext Guidelines to Issuers for ESG Reporting (Euronext, 2019), are designed for reporting to a broad range of stakeholders, not solely investors (Global Reporting Initiative, n.d.). The starting point for companies reporting according to GRI is to conduct an assessment of relevant stakeholders' perceptions of the most important issues the company should address. The company then maps stakeholder perceptions with the company's internal view. Figure 4.1 shows an example from DNB's 2018 report (DNB, p. 2).

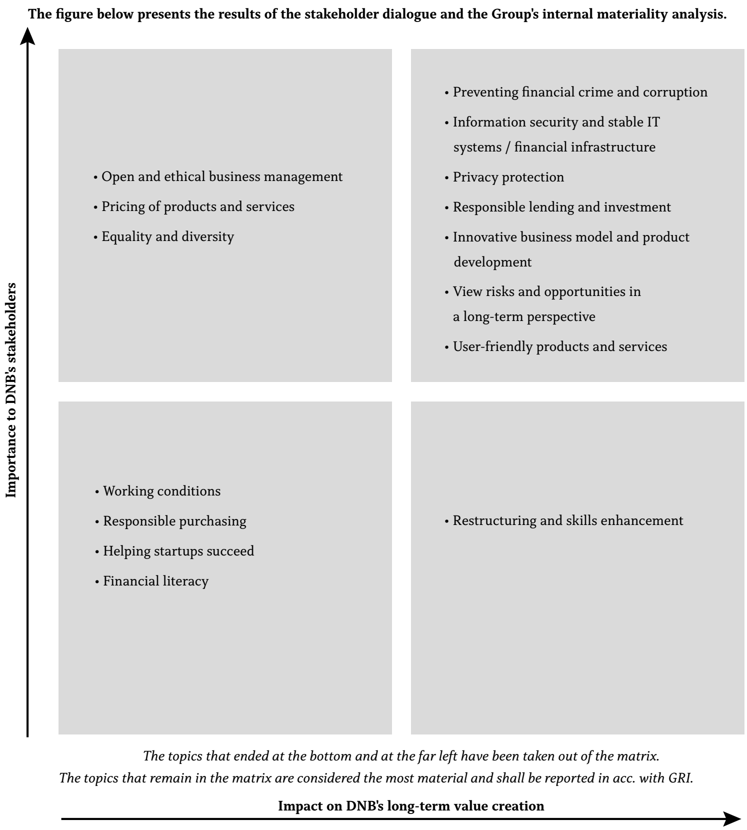

Figure 4.1 DNB's 2018 Materiality matrix. Source: DNB's annual reporting 2018.

The company then reports most thoroughly on issues found in the upper right quadrant. For the analyst, this can be a helpful shortcut to identify the company's sustainability priorities and match these against the analyst's knowledge of the company and industry. Is the company prioritising the critical issues? Another tip for the analyst reading a GRI report is to look for the GRI Index indicating on which page numbers the company has reported on key sustainability topics.

The *International Integrated Reporting Council (IIRC)* has developed a framework for integrating material ESG information into corporate annual reports. According to the IIRC: "The primary purpose of an integrated report is to explain to providers of financial capital how an organisation creates value over time." (International Integrated Reporting Council, 2013, p. 4) Integrated reports should therefore be a useful starting point for analysts in identifying how ESG-related factors affect the company's value drivers.[8]

As discussed in Section 2.5 on Materiality, the *Sustainable Accounting Standards Board (SASB)* is designed to provide financially material sustainability-related information to investors. The focus is therefore narrower than for GRI. In a joint op-ed, representatives from the GRI and SASB explained the differences between the two frameworks:

> ...GRI and SASB are intended to meet the unique needs of different audiences. The GRI standards are designed to provide information to a wide variety of stakeholders and consequently, include a very broad array of topics. SASB's are designed to provide information to investors and consequently, focus on the subset of sustainability issues that are financially material (Mohinoff & Rogers, 2017).

The advantages for the analyst in reading a report that follows the SASB standards are: 1) the use of standardised reporting metrics for each industry (comparable data), and 2) a focus on financial materiality.

[8] As of November 2020, the International Integrated Reporting Council (IIRC) and the Sustainability Accounting Standards Board (SASB) announced plans to merge into a new organization called the Value Reporting Foundation. Further details on the specific implications for future reporting standards were not available at the time of publication. (SASB, 2020)

SASB's advantage in comparability across firms within an industry is also its chief weakness, however. In practice, we find the SASB framework works best for industries that are relatively homogeneous, so that a common set of material indicators is easier to identify. It is less helpful for industries with wide variation – e.g., the relevant metrics for a large US-based beef producer are likely to be a poor fit for Norwegian salmon farming companies. For the same reason, SASB tends to work less well for conglomerates, for which multiple industry indicators may be relevant. As an industry-based standard, the SASB indicators are also generally less helpful in assessing companies in which the main risks derive from the company's geographic exposure, rather than its industry. Nevertheless, SASB indicators are often useful starting points for identifying material issues.

Another reporting standard that has become increasingly common since its development in 2017 concerns the *recommendations of the Task Force on Climate-related Financial Disclosures (TCFD)* (Task Force on Climate-Related Financial Disclosures, 2017). As the name indicates, this reporting standard applies solely to climate-related risk. The TCFD is a principle-based framework, designed to guide companies in reporting on the potential financial impact of their approach to climate risk management. Figure 4.2 lists the core elements of recommended disclosures.

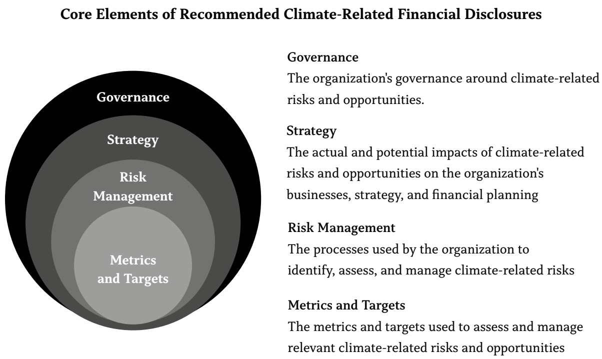

Figure 4.2: Task Force on Climate-Related Financial Disclosures, 2017, p. v.

Companies have a wide degree of latitude in determining how they will report according to the TCFD framework. For example, existing climate reporting frameworks, such as the *CDP reporting framework*, have incorporated the TCFD format into their questionnaires. For the analyst, the benefit of TCFD reporting is that it adopts an explicitly financial lens, challenging the company to report its approach to identifying, assessing and managing the financial impact of climate risk.

From January 2022, companies based in the EU/EEA with 500 or more employees will be required to report non-financial disclosures according to the *EU Taxonomy for sustainable activities* (European Commission, 2020). Using the NACE code system, the taxonomy attempts to find a common definition of sustainable economic activities – that is, activities that impact six of the EU's environmental objectives:

1. Climate mitigation
2. Climate adaptation
3. Sustainable use and protection of water and marine resources
4. Transition to a circular economy
5. Pollution prevention control
6. Protection and restoration of biodiversity and ecosystems

As of mid-2020, criteria were available only for activities that contribute to climate mitigation and adaptation, and not all industries were included. A technical expert group published a detailed classification of eligible activities under the climate mitigation and adaptation objectives in March 2020 (EU Technical Expert Group on Sustainable Finance, 2020). The EU Taxonomy Climate Delegated Act, formally adopted in June 2021, sets out the final criteria for these two climate objectives. See the example below for the manufacture of aluminium, indicating the level of detail included.[9]

[9] Draft per March 2020. At the time of publication, the final criteria for the aluminum sector had not yet been determined.

Definition of Taxonomy Eligibility for the Manufacture of Aluminium

Manufacture of primary aluminium is eligible if Criterion 1 (see below) is met in combination with either Criteria 2 or 3 (see below).

1. *Criterion 1:* Direct emission for primary aluminium production is at or below the value of the related EU-ETS benchmark. As of February 2020, the EU-ETS benchmarks values for aluminium manufacturing is 1.514 tCO_2e/t. Direct emissions are to be calculated according to the methodology used for EU-ETS benchmarks).

2. *Criterion 2:* Electricity consumption for electrolysis is at or below: 15.2Wh/t (European average emission factor according to International Aluminium Institute, 2017, to be updated annually).

3. *Criterion 3:* Average carbon intensity of the electricity that is used for primary aluminium production (electrolysis) is at or below: 100 g CO_2e/kWh (Taxonomy threshold for electricity production, subject to periodical update).

Source: EU Technical Expert Group on Sustainable Finance, 2020, p. 172.

Moreover, determining whether a specific activity is taxonomy-eligible is insufficient. In addition to meeting the specific definition, the activity should "do no significant harm" to any of the other five EU environmental objectives, e.g., the aluminium company cannot discharge untreated waste from production into the local environment. Lastly, according to Article 18 of the Taxonomy Regulation, the activity should meet minimum social standards: compliance with the OECD Guidelines for Multinational Enterprises and the UN Guiding Principles on Business and Human Rights (European Commission, 2020, p. 8). Figure 4.3 illustrates the process required.

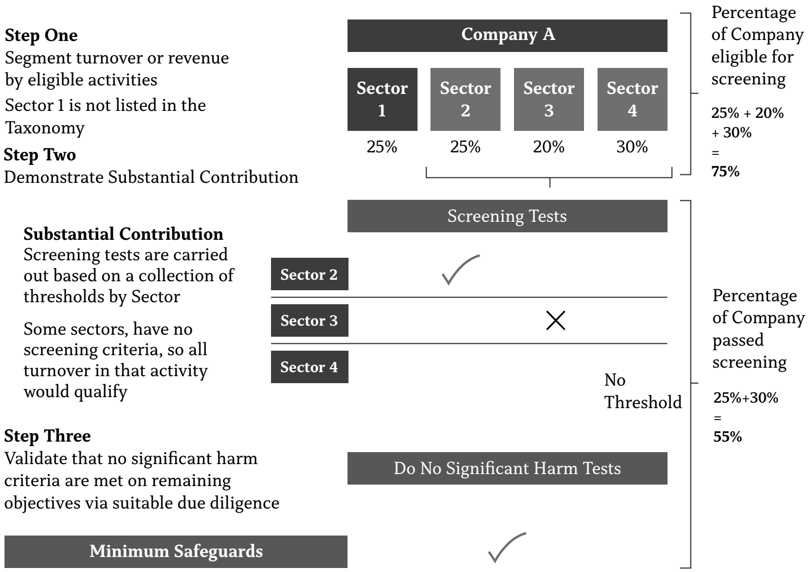

Figure 4.3 Process for assessing a company's taxonomy alignment. Source: EU Technical Expert Group on Sustainable Finance, 2020, p. 49.

For the analyst, the outcome of the EU Taxonomy is that companies from 2022 will be required to report more granular information on revenues and/or capex (depending on applicability) for activities that specifically contribute to the six EU environmental objectives. This will, for example, give analysts greater insight on capex dedicated to specific environmental technologies. As a result, companies will report information that might not otherwise have been available through existing segment reporting.

4.1.3 Dialogue with companies

The suggested questions presented throughout this guide are designed for use in meetings with companies. The level of depth should be adapted to the meeting participants, e.g., management versus board members versus dedicated resources on a specific topic, e.g., Head of Sustainability.

Meetings can be a useful venue for obtaining forward-looking information about the company's sustainability priorities, such as planned initiatives and improvements for the coming year or strategies to address coming regulations, as well as providing context for reported information. They may also be useful for getting a comprehensive overview of relevant and available documentation from internal and external sources.

For sell-side analysts and large shareholders, gaining access to company management teams is often relatively straightforward. Smaller shareholders, and others completing company valuations may have to look for alternative information sources, such as quarterly earnings presentations, which do not afford the same options to engage in detailed questioning. On sustainability topics in particular, small shareholders may find opportunities to pool their resources with others to engage in joint meetings with management – either through their own initiative, or through investor coalitions for joint engagement on specific sustainability topics, such as Climate Action 100+. Regardless, many of the suggested questions in the previous sections may be readily answered from the company's existing reporting.

4.2 Third-party service providers

This category includes both data providers, such as Bloomberg and Trucost, as well as providers of ESG analysis, such as MSCI and Sustainalytics. The distinction is not airtight, however.

Any discussion of third-party service providers risks becoming quickly outdated, since the industry has consolidated significantly over the past few years. Moreover, traditional "mainstream" financial data providers like Bloomberg and S&P continue to build their ESG offerings to simplify the information collection process. Perhaps unsurprisingly, these providers tend to be most useful for obtaining quantitative ESG data, although document search tools can be helpful for qualitative information if the analyst knows which query to use. Nevertheless, for smaller Nordic companies, and especially private firms, coverage can be patchy.

For providers of ESG ratings or scores, such as MSCI and Sustainalytics, the underlying analyst reports are likely to be more useful than the actual score. The correlation between ESG scores for the same issuer from different providers is surprisingly low (Berg, Kölbel, & Rigobon, 2020), suggesting there is no universal definition for what makes a company sustainable.

Nonetheless, it is not clear how one would meaningfully use an ESG rating in a fundamental equity analysis. The best service provider reports, on the other hand, can be useful as a shortcut to identify material issues for the company. Again, however, smaller issuers may not be covered. As the analyst typically assesses the company against the house methodology based on reported information, companies with limited reporting typically fare worse, independent of performance.

The Bloomberg terminal also provides access to company-level ESG data and ESG-related news articles. The functions "ESG" (Environmental, Social & Governance Analysis) and "FAESG" (Financial Analysis: Environmental, Social & Governance Overview) display data scraped from company reporting, including absolute terms and ratios. BI ESG also provides industry primers. Other useful functions include DS (document search) to look for specific terms or phrases in company reporting, e.g., "TCFD". Lastly, the keyboard function "MGMT" (for "management") provides an overview of company management and board membership, as well as cross-boarding, tenure and biographical information. In our experience, ESG data is not always up to date for smaller Nordic companies – particularly if they have just begun to publish a sustainability report. Therefore, we recommended cross-checking company reporting directly if ESG information is missing in Bloomberg for a specific firm. Trucost, in turn, provides environmental data, including environmental costs and estimated environmental parameters, such as emissions and water usage. Their datasets can be used in analyst models.

4.3 Media

A 2017 Norsif study of Norwegian asset managers found that news media was the most widely used type of source for ESG information about Norwegian companies, followed closely by company-reported information (Norsif, 2017). Although news aggregators such as Bloomberg or TrueValue Labs increasingly tag and organise ESG information published in Nordic-language publications, we find that ESG service providers do not always pick up local debates, e.g., criticism from a Swedish NGO of a local company's activities abroad or public debates between a company and locally-based shareholders. Another example (for debates surrounding the state's role as an owner, which naturally garner significant attention from the general public) would be local media, which typically remain the best source for understanding the dynamics at work.

4.4 Industry reports, thematic publications and sell-side analysis

Trade group sustainability-themed publications can be another source for relevant ESG information. These include both industry and trade group reports as well as sell-side analyses on specific themes. For example, the World Business Council for Sustainable Development (WBCSD) has published an industry overview and relevant performance indicators to assess industry-specific sustainable business practices for the cement industry (World Business Council on Sustainable Development, 2019), among others. For a list of relevant sustainability-related associations per industry, see the *Business Leadership in Society Database* (High Meadows Institute, 2020). Other useful sources include the World Resource Institute, CDP's sector reports on climate risk management, and 2DII Initiative reports on scenario analysis.

Bloomberg New Energy Finance publishes research on energy and environmentally themed topics, as well as downloadable datasets. Research firms like IHS, Wood MacKenzie and Rystad Energy provide access to asset-specific datasets as part of their research offering. Sell-side analysts also publish an increasing volume of ESG-themed analyses– including for Nordic companies – although quality varies considerably. Their advantage compared to ESG service providers is their depth of industry-specific knowledge. The best reports place the sector's material ESG risks in context and identify how players are positioned relative to one another, often based on risks that may play out over a longer time horizon than is typical of sell-side reports.