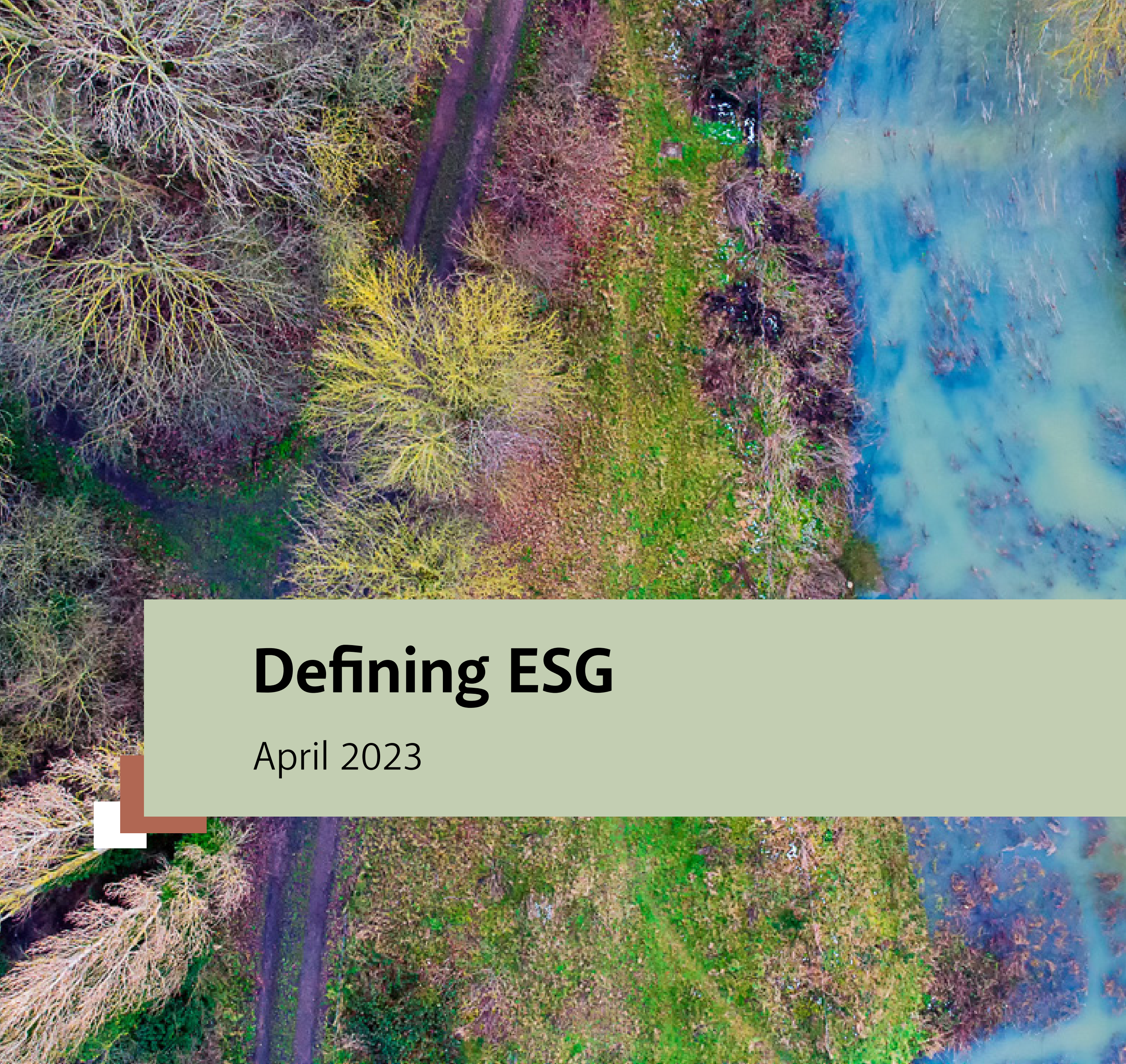


Defining ESG

April 2023

appg Environmental, Social, and Governance

appgesg.org
twitter.com/esg_appg

This report is based on roundtable discussions of the All-Party Parliamentary Group (APPG) on Environmental, Social, and Governance (ESG) held since the group's formation in March 2021 up until publication on the 25th of April 2023, and supplemented by case studies, research, and insight provided by the group's sponsors: BAE Systems, Bayer, CBRE Investment Management, CSR Accreditation, EMK Capital, Equiniti, ESG Book, greenpeople.earth, KPMG UK, Rigby Group, Sage, Shore Capital, and Six Group. This report is published by the APPG secretariat, College Green Group.

Contents

Parliamentary officers of the APPG on ESG

Chairman

Alexander Stafford MP, Conservative, Rother Valley

Vice chairs

Baroness Boycott, Crossbench
Dr Rupa Huq MP, Labour, Ealing Central and Acton
Baroness Northover, Liberal Democrats
Andrew Selous MP, Conservative, South West Bedfordshire

Officers

John Cryer MP, Labour, Leyton and Wanstead
Philip Dunne MP, Conservative, Ludlow
Natalie Elphicke MP, Conservative, Dover
Simon Fell MP, Conservative, Barrow and Furness
Rob Largan MP, Conservative, High Peak
Mark Logan MP, Conservative, Bolton North East
Jerome Mayhew MP, Conservative, Broadland
Lord McNicol, Labour
Andrew Rosindell MP, Conservative, Romford
Lord Sikka, Labour
Lord Whitty, Labour

Acknowledgements

Case studies provided by

BAE Systems
CBRE Investment Management
ESG Book
greenpeople.earth
KPMG UK

Additional thanks to

Richard Collins
Robbie Epsom
Hector Forrester
Dr Katrin Gülden Le Maire
Pierre Shepherd
Eva Vogt
Charlie Bay

Publisher

College Green Group

Foreword from the Chairman

Since its formation in 2021, the APPG on Environmental, Social, and Governance has functioned as an important forum to discuss issues around ESG and build consensus towards an improved policy infrastructure, which remains paramount. The March release of the new Green Finance Strategy is an important step towards filling that space, but we can and should go further.

The UK has a strong tradition in ESG. Businesses, regulators, and legislators all assure me that there is a bright future ahead if we make sure to fulfil our potential. The funds and assets held in the City of London, still very much the centre for global finance, are an £11 trillion lever that can quickly and effectively be directed towards sustainable and impact finance. Further, as UK firms hold assets in almost every country around the world, changes we make here will reverberate around the world, improving environmental, social, and governance impacts for all.

The UK remains well placed to oversee the adoption of ESG principles and the growth of sustainable finance globally. We must take this opportunity to restore our place in this position of leadership before we miss our chance.

Despite some geopolitical contentions about the definition or benefits of ESG, it is inherently international. Modern firms span the globe through supply chains, employee locations, or financial flows; so a cohesive definition and understanding of ESG, principally through creating frameworks channelling accurate and comparable data, will align international policy objectives with commercial objectives. This is of the utmost importance as the global economy seeks to undertake an immense transition away from fossil fuels, while improving standards of living and implementing good corporate governance practices.

While this report outlines the many drivers behind ESG uptake, our political and regulatory bodies still lag behind which destabilises our position as a global financial leader in this space. Furthermore, this will not occur in the absence of more robust debate among policymakers and regulators; debate that will continue to stall without widespread understanding of the issues facing the adoption of Environmental, Social, and Governance principles, terms and definitions used by those discussing the subject, and advantages of applying ESG frameworks.

My hope is that this report, in addressing the common confusions around ESG will not only raise its profile, and help fellow parliamentarians engage with the discussion, it will also give clarity of purpose across the political spectrum to how businesses can deliver public goods through the adoption of ESG frameworks. Businesses themselves benefit from the application of ESG frameworks and strategies by lowering costs, improving their reputations, and creating. Among these public goods are decarbonisation, brought about with less burden to the taxpayer. In any case, as this report illustrates, ESG is here to stay. Businesses will face pressures and burdens regardless of the UK Government's activity, or rather inactivity. More robust and better-informed debates in Parliament will be constructive, not only to embed ESG more effectively across the UK economy, but more efficiently too.

The APPG's vision is for a dedicated strategy to ensure numerous policy instruments work together to build an ESG ecosystem that is fit for purpose. For that to occur, parliamentarians and businesses alike need to understand what ESG is, as well as how it can deliver.

Alexander Stafford, Conservative MP for Rother Valley and Chairman of the All-Party Parliamentary Group on Environmental, Social, and Governance

Executive summary

Environmental, Social, and Governance is beset with confusion. ESG is not a concept as such, but typically accompanies words like 'framework' and 'strategy' in reference to the processing of data to aid decision-making so that a company can make their operations and products more sustainable. ESG is often conflated with sustainability, namely preventing the depletion of natural resources so that they will remain available in the longer term. Similarly, corporate social responsibility (CSR) is often used interchangeably with ESG when they are very much distinct.

This report was originally conceived as an information tool to address this confusion, in doing so, the APPG hopes to both inform and enlighten parliamentarians as well as other key stakeholders, thereby moving the agenda forwards.

Recommendations

The ESG strategy recommended on page 9 shows the many ways in which relatively light government intervention can steer the adoption of ESG principles and frameworks onto a much stronger course.

Part One – Defining ESG

Part one begins by exploring what is driving the uptake of ESG, which feeds into what is material for a business's disclosures to its stakeholders, principally investors. The final section focuses on the various confusions around ESG, such as corporate social responsibility (CSR), and touches on the politicisation of ESG in the United States.

Part Two – UK Government leadership and intervention

The second half of the report links back to the recommendation for a national strategy. The principal consideration is the potential for ESG frameworks and strategies to enable businesses to flourish while helping to meet public policy objectives. Section two demonstrates the UK Government's important role in stabilising ESG-related markets, both in terms of responsible finance and growing ESG ratings and consultancy markets.

Recommendations

The APPG **calls for the UK Government to launch an ESG strategy** to maximise the benefits stemming from the application of Environmental, Social, and Governance practices, while also strengthening the market in ESG-related products and services.

The strategy will link together existing policies and strategies such as the Green Finance Strategy released in March 2023, the Net Zero Strategy, The Net Zero Review, the Net Zero Growth Plan, the Energy Security Strategy, the Environmental Improvement Plan, Sustainability Disclosure Requirements, the UK Green Taxonomy, and the Financial Conduct Authority's sustainable investment labels. The strategy should undertake the following measures:

1. An action plan for a considerably wider disclosure regime applying to more businesses as well as more ESG factors, and to undertake legislative measures to ensure regulators have the powers they need.
2. An ESG disclosures Advisory Group composed of small and medium-sized businesses (SME), business groups, investors and larger businesses to provide recommendations for a sub-strategy on how to support SME disclosures. Among other things, the Advisory Body will explore technological solutions with regard to Scope 3 reporting and other data-related challenges for SMEs.
3. The Advisory Group will also examine ways of developing a larger UK cohort of ESG professionals.

To undertake a systematic sectoral analysis of the application of ESG principles. The analysis should:

4. Identify 'material' issues common to each sector.
5. Assess metrics across ESG in line with existing frameworks with the objective of standardising metrics to the fullest extent at the sectoral level.
6. Launch an ESG consultation with a focus on the availability of data to ensure accurate and comparable information is widely accessible for businesses and investors.
7. The consultation will seek to improve the quality of reporting, helping to tackle greenwashing, similarly, the strategy must develop policy options towards enforcement.

In line with the objectives laid out in the Green Finance Strategy, the APPG sees an accompanying ESG strategy as the ideal platform for the UK to take a lead globally, supporting the uptake of ESG risk, impact and opportunity analysis, making frameworks more usable, data more accessible and perhaps most importantly to ensure ESG is understood and applied appropriately.

Introduction

At COP26 in Glasgow, the British Government made a powerful statement to the international community that the UK would be at the forefront of Environmental, Social, and Governance (ESG) with its announcement that mandatory climate reporting for larger companies under the Taskforce for Climate-related Financial Disclosure (TCFD) would come into force the following April.

However, climate disclosures are not geared towards the 'S' and the 'G', and only part of the 'E'. Moreover, the reputation gained in Glasgow has subsequently withered as the UK has failed to overtake the European Union, having missed self-imposed deadlines for the UK Green Taxonomy – the subject of the APPG's previous report – and the revised Green Finance Strategy, the latter published in March 2023.

In many ways, it is surprising that the EU has been able to take this lead. The City of London is home to a unique ESG architecture that has served global investors over the past two decades as they have widened and deepened their analytical frameworks to account for non-financial information.

Global disclosure system, CDP – originally known as the Carbon Disclosure Project – was founded in London in 2000. The UK Government established the Carbon Trust in 2001. Other important institutions with their roots in the UK include The International Capital Markets Association (ICMA), which launched the Green Bond Principles; The Institutional Investors Group on Climate Change (IIGCC); ShareAction; and the TCFD itself, which was led by former Bank of England Governor Mark Carney (see Figure 1 for information about other important frameworks). The International Sustainability Standards Board (ISSB), formally launched at COP26, is widely expected to unveil its landmark standards at its conference in London in June.

Figure 1. International ESG frameworks and bodies

Taskforce on Climate-related Financial Disclosures (TCFD)
A disclosure framework that enables businesses to improve their own understanding of their long-term climate-related risks and opportunities.

Global Reporting Initiative (GRI)
A set of universal reporting standards. The standards cover reporting requirements for a range of ESG issues, and are designed to identify a company's material impact.

CDP
A disclosure system in the form of a questionnaire asking not only companies, but also cities and governments how they manage climate change, water security, and deforestation.

International Financial Reporting Standards (IFRS)
A not-for-profit organisation that develops globally accepted accounting and sustainability disclosure standards. The IFRS oversees the International Accounting Standards Board (IASB) and the ISSB (see below).

International Sustainability Standards Board (ISSB)
A standard-setting body established to develop a single set of standards to meet investors' information needs.

Taskforce on Climate-related Financial Disclosures (TCFD)
Formed by the G20's Financial Stability Board (FSB) of central bank governors to review climate-related factors in financial services, the Taskforce went on to identify information required by financial institutions, leading to the creation of a body of disclosure recommendations. In the UK, TCFD disclosures are expected to be superseded by norms established by the ISSB.[1]

UK PLC and the City of London have continued on this trajectory in applying ESG frameworks to assess non-financial risk; a PwC survey found that 85% of investors thought companies should embed ESG data into their corporate strategies.[2] This awareness and level of expectation contrasts with Parliament, where a minority of MPs and peers raise ESG frameworks and strategies' tremendous potential for meeting public policy objectives while delivering value for shareholders. Environmental, Social and Governance and its abbreviation have been mentioned fewer than 30 times in the past year in the House of Commons. The APPG's chairman, Alexander Stafford, has been by far the most prolific. Furthermore, in the wake of a fierce anti-ESG backlash in the United States, the UK should anticipate political headwinds. Indeed, ESG is increasingly mentioned in Parliament in a negative sense, even though the UK is still playing catch-up with the EU.

1 Reuters, 'Urgent progress needed on company climate disclosures, G20 task force says', October 2022
2 'PwC's investor survey: the economic realities of ESG', March 2022

This report is founded on two imperatives: firstly, for Parliamentarians to become better acquainted with ESG. What it is and what it is not so that the agenda can move forwards in order to satisfy the second imperative, for the UK to reclaim global leadership in ESG by overtaking the EU, and showing the pathways forwards.

In order to have that debate, ESG needs to be understood, which is surprisingly difficult due to confusion around what it is exactly. As one head of ESG and impact at a private equity fund told the APPG, "Environmental, Social, and Governance is not a thing in itself". A fiduciary manager told the group at a roundtable in 2022 that ESG should be viewed as an adjective more than a noun. Indeed, ESG is typically mentioned alongside the words framework, disclosure, metric, strategy, principle, and programme, among many others. The APPG acknowledges that a standalone reference to 'ESG' can be unhelpful. Despite this, we take the view that context often allows for ESG to be mentioned alone, without qualification.

This report is divided into two parts. Part one defines ESG. Part two demonstrates how, without government leadership, ESG will likely fail to help meet public policy objectives. The second half of the report examines the growing market for ESG-related products and services, notably ratings and responsible financial products such as green bonds. The report is interspersed with case studies for illustrative purposes.

Part 1. Defining ESG

Any definition of ESG, such as that featured below may seem overly conceptual, hence this paper's purpose in defining it, and therefore may be difficult for businesses to put into practice in any real-world, meaningful way. ESG and its inherent challenges are perhaps therefore better understood by its drivers and how it functions, which sets the scene for the great conundrum at the heart of ESG: should it be oriented chiefly towards evaluating risk, or should it be broader? This question lies at the heart of the 'materiality' debate (section two).

Figure 2. Definition of ESG

Environmental, Social, and Governance refers to non-financial criteria used by different stakeholders to judge a given asset's profile, such as risk, impact, or onward trajectory. ESG frameworks facilitate flows of information that assist with informed decision-making, whether from an investment or an operational perspective.

Environmental criteria will apply to a business's climate policy, its energy and water use and greenhouse gas emissions, as well as its impact on biodiversity and resource use/depletion – water stress and waste generation are key factors.

Social considerations are both internal, a company's staff and external, the local community, and supply chain partners – their surrounding communities and employees.

Governance standards apply to transparency, leadership, accounting and other practices that help preserve a business's integrity. Key factors include corruption prevention, cyber and data security, and compliance with ESG regulations.

Arguably the easiest way to grasp ESG is as a flow of non-financial information that principally aids decision-making. For a company that decision may be to reduce energy use, for an asset manager it would be to invest or not, and for an investor – whether a pension fund or an individual – it may help reassure them that savings are not funding unethical economic activities. The same principle would apply to a procurer such as the UK Government.

ESG drivers

Major drivers of ESG uptake within a business are typically climate change, investor activism, regulatory requirements, the principles of a new generation of workers and creating value. With the effects of climate change increasingly visible – droughts and forest fires for instance – businesses increasingly want to be seen to be doing their bit to transition to net zero.

A cross-cutting consideration is whether ESG should be used as a risk management tool or a great deal more: a versatile set of frameworks, enabling businesses to measure impact; a platform for transition planning; and a vehicle for creating value (for insight into how a business perceives ESG, see Case study 1. on BAE Systems).

Climate change, amid wider environmental and social awareness and activism, is arguably the principal driver of ESG, giving rise to a culture of investor activism and landmark policies like net zero.[3]

While the rise of ESG may be synonymous with increasing concern of a climate crisis, it has also been driven by anxieties concerning human rights abuses and environmental degradation, leading to widespread recalibration of investor priorities. Research by PwC has found that 7% of investors agree that ESG risks are an important factor in investment decision-making. If ESG issues are not being addressed by companies, 49% of investors have also said that they would be willing to divest. It is further telling that 34% of investors would accept a lower return in exchange for societal or environmental benefit.[4]

PwC's findings help explain the phenomenal rise of sustainable investment. Morgan Stanley's analysis of Morningstar data found that sustainable assets under management amounted to $1.4 trillion in 2018, rising to $3.5 trillion by 2021, although the figure dropped to $2.8 trillion by 2022 as those investors less interested in sustainability and more attracted to higher returns switched to stronger performing (at least in the short term) traditional funds.[5] The drop may also be the end result of reconsiderations of what constitutes sustainable investment – underlining the need for robust instruments like the Green Taxonomy and sustainable investment labels – leading to asset downgrades.

Figure 3. Scope 1, 2, and 3 reporting

By identifying and reporting on all three scopes of emissions, companies can gain a comprehensive understanding of their climate impact and work to reduce their carbon footprint. The Greenhouse Gas Protocol provides the accounting standards for Scope 1, 2, and 3 reporting.

Scope 1 emissions are direct greenhouse gas emissions from sources that are owned or controlled by an organisation. This could include emissions from burning fuel in company-owned vehicles or from on-site industrial processes.

Scope 2 emissions are indirect greenhouse gas emissions, which result from the production of the electricity, heat, or steam that a company purchases or consumes.

Scope 3 emissions are an indirect consequence of a company's activities, but they are not directly owned or controlled by it. These emissions occur up and down a company's value chain and include sources such as the production of purchased goods and services, and the use of a company's products by customers.

For more insight into how Scope 1, 2, 3 is applied, see Case study 1. (CBRE Investment Management) and Case study 2. (BAE Systems).

3 FinExtra, 'The Rise of "S" in ESG', April 2023
4 PwC, 'The economic realities of ESG', October 2021
5 Morgan Stanley, 'Despite Market Challenges, Demand for Sustainable Funds Remains Strong', 2023

Case study 1. CBRE Investment Management redevelopment, 10 Brindleyplace, Birmingham

CBRE IM's redevelopment at Brindleyplace transitioned the asset to a zero emissions building, one that is highly energy efficient and fully electric with its low energy needs met with onsite or offsite renewables. Consequently, both landlord and tenant operational greenhouse gas emissions across Scope 1, 2, and 3 - resulting from energy use - are fully abated.

- **100%** construction waste diverted from landfill.
- **65%** annual energy savings compared to a typical equal-size office.
- **100%** renewable energy-powered electric system.
- **658** tonnes of Co2 saved per year.

Opportunity

Following a major tenant departure, there was an opportunity to combine 8 and 10 Brindleyplace into one building to create 210,000 square feet of high-quality grade A office space. From the outset, sustainability has been key to this development.

Solution

- Focus on smart technology, sustainability, and wellness.
- Retain the existing building foundations, basement and structural frame, saving circa 60% embodied carbon compared to a new development.
- Implement smart building features that offer occupiers building function controls such as heating, lighting and real-time air quality monitoring.
- Commit to new social engagement initiatives and add 5% social value.

Results

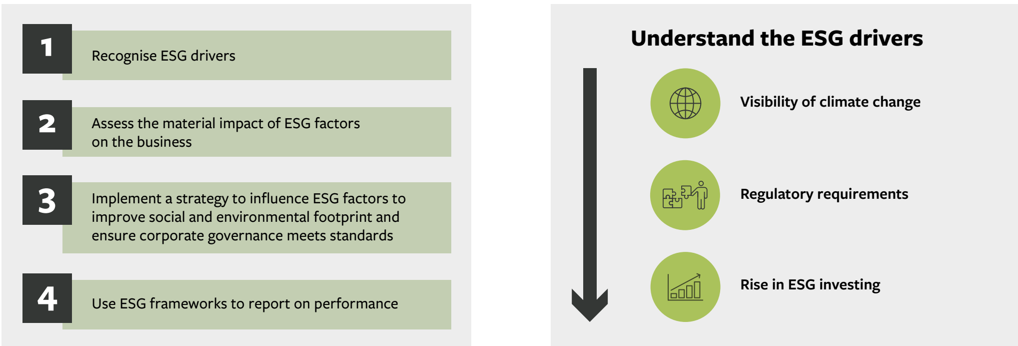
- Reduced operational carbon by 53% compared to the building pre-refurbishment.
- Built 840 sq ft of on-site solar PV, 100 cycle spaces and 24 EV charging bays and green roofs/terraces.
- Achieved BREEAM Excellent and targeting a 5-star NABERS rating.
- Became the first Fitwel accredited office in Birmingham.
- Implemented a social value plan to increase opportunities for disadvantaged people, improve staff wellbeing/mental health, reduced crime, meet diversity targets, and foster local small business and community opportunities.

The same values shape jobseekers' decision-making. Post-pandemic, many businesses have had to work harder to attract and retain staff, which will only become harder as expectations that businesses act responsibly become more entrenched.[6] [7] This issue is exacerbated by low birth rates and mass retirements of the baby-boomer generation.

Mandatory TCFD disclosures introduced in April 2022 mean that larger UK businesses are obliged to adopt ESG practices, albeit limited to the 'E'. In 2024, the EU will go further with the introduction of the Corporate Sustainability Reporting Directive (CSRD), which will apply to 50,000 companies. Note, the TCFD was created as a voluntary disclosure framework at the Paris Climate Summit (COP21) to help limit the average global temperature rise to 1.5C, with businesses and financial institutions playing their part.

Business and Trade Minister Kevin Hollinrake MP confirmed at an APPG roundtable in February that smaller businesses in the UK would not face statutory reporting requirements. Given the resource constraints SMEs typically face, this is a sensible position. Nevertheless, SMEs are already being asked to provide ESG disclosures by the companies they supply to (see Figure 3 on Scope 1, 2, and 3 emissions). Similarly, in a global financial marketplace, UK businesses often comply with at least some aspects of the EU's reporting architecture regime – the Green Taxonomy for instance – to enhance their ESG reporting and attract investors.

Figure 4. What ESG looks like inside a business



An ESG process such as that indicated above can be outward and enterprising in nature, particularly when considered against young workers' increasingly common preference to be employed by businesses that are ethical, and consequently apply ESG practices. A survey by KPMG UK found that 55% of 25 to 34-year-olds value ESG commitments from their employer, compared to 48% of 35 to 44-year-olds - 18 to 24-year-olds stood in-between (51%), but were the most likely to seek jobs linked to ESG (14%); the average across all age groups was 9%.[8]

ESG is often viewed as a set of data-driven frameworks to support risk assessment and risk management, which are linked to *protecting* a company's value. The TCFD, for example, is a risk-based disclosure framework. But evaluating ESG-related opportunities can also *add* value for a company. Value creation can stem from improving the perception of a business, enabling a business to recruit top-quality talent without paying higher salaries, and then delivering higher levels of employee satisfaction and retention together with enhanced company culture.

6 BBC, 'Where the boss-worker power struggle goes next', September 2022
7 Huffington Post, 'Workers are quitting jobs because of ethical values and we're here for it', February 2023
8 KPMG, 'Climate quitting - younger workers voting with their feet on employer's ESG commitments', January 2023

Case study 2. Company ESG profile: BAE Systems

Sustainability is fundamental to BAE's business performance. The products BAE designs and builds now will remain in service for decades to come, which emphasises the need to develop long-term sustainable solutions.

BAE is aligned with the UK Government's national decarbonisation programmes, working closely with customers and partners in developing sustainable solutions, as well as setting a target of achieving net zero greenhouse gas emissions (Scope 1 and 2) across its operations by 2030. BAE is also committed to reducing the impact of its products and the wider value chain (Scope 3). To achieve this objective, BAE is collaborating with its customers and partners with the aim of reaching this target by 2050.

BAE's ability to meet these complex engineering and technology challenges depends on the commitment, skills and talent of its people. It is critical for the company to continue to attract, retain and develop the very best talent. To do this, the company must ensure workplaces provide an environment where employees feel valued, included and able to thrive in their professional development.

By contributing to activities and organisations that align with the business, BAE aims to make a positive social and economic contribution to the communities in which it operates. More than 40% of BAE Systems' workforce comes from Britain's most deprived local authorities and in 2020, BAE spent nearly £700m on supply chain purchases in these areas.

BAE invests around £100 million in education and skills each year. Working with partners in the community, BAE aims to inspire young people to consider a career in science, technology, engineering and maths (STEM) and play its part in helping to address national skills shortages.

New product lines can create value, as can cost-savings and efficiencies, for instance in energy and materials. Sustainability-linked loans can deliver lower costs of capital. These, along with new merger and acquisition strategies geared towards aligning revenues with green taxonomies are illustrative, not only of how ESG can facilitate value growth, but also of the extent to which responsible business strategies are being embedded, making disclosures and reporting essential.

Materiality

Materiality is where sustainability and corporate responsibility within a given business meet accounting. The US Securities and Exchange Commission describes something as "material if there is a substantial likelihood that a reasonable person would consider it important".[9] Consequently, materiality is automatically open to interpretation, particularly with regard to ESG, which is often referred to as non-financial reporting in accountancy. Just as a finance manager would have to make a judgement on what constitutes material financial information, with the proliferation of ESG, they are being asked to make the same judgement with regard to environmental, social, and governance. This judgement is fraught with difficulty as the scope is so wide, and the frameworks and definitions in place are relatively nascent. Furthermore, as the previous section highlighted, materiality in the context of ESG is not limited to disclosures, and should be considered in the broader sense of what the reasonable person might think *matters* for the company, informing its business strategy.

The TCFD has sought to clarify what non-financial, sustainability-related information is financially material.[10] However, the taskforce is rooted in ensuring financial stability as opposed to climate stability. In one of the TCFD's founding documents, published in 2015 by the Financial Stability Board (FSB), it is suggested that "financial institutions also could be encouraged to disclose their exposures to climate risks and management of those exposures" providing "a source of data that can be analysed at a systemic level, to facilitate authorities' assessments of the materiality of any risks posed by climate change to the financial sector."[11]

A useful hypothetical example of this vision of materiality, described at more than one roundtable of the APPG, is of a factory situated on a floodplain. Climate change will raise the likelihood of flooding, which is materially significant for the factory's risk profile and value.

However, this is not the only approach taken to the materiality problem: in 2021, Eric Usher, the Head of the UN Environment Programme Finance Initiative, said that the TCFD's "exclusive focus" on systemic risk to the finance sector led to a "short-term outside-in approach to materiality", rather than a more holistic approach that Usher calls for; which should show "inside-out leadership, focusing on the impact of financing [on] the targeted outside dimension, which aligns financing and financial portfolios with societal objectives, such as keeping the climate within 1.5 degrees of warming."[12]

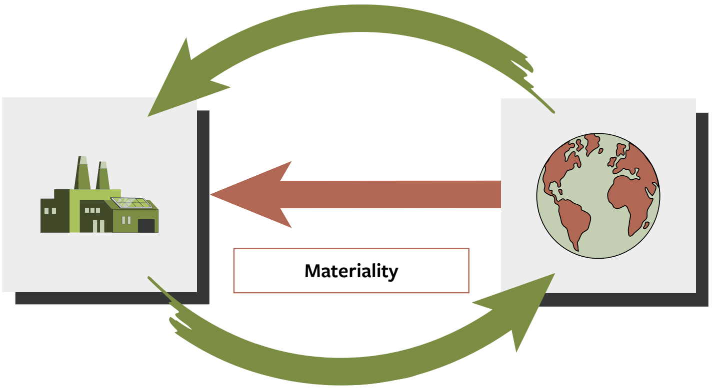
9 SEC, 'Staff accounting bulletin: No. 99 – Materiality', August 1999

10 Climate Disclosure Standards Board, 'Position paper; materiality and climate-related financial disclosures', 2018

11 'Financial Stability Board proposes creation of disclosure task force on climate-related risks', November 2015

12 ESG Investor, 'TCFD View of Materiality No Longer Adequate – UNEP FI Chief', 2021

Figure 5. Materiality and double materiality



Double materiality concerns both how a business is affected by climate change and how that business contributes to, or mitigates against, climate change (see Figure 5). The EU's guidelines accompanying the Non-financial Reporting Directive state that "a company is required to disclose information on environmental, social and employee matters, respect for human rights, and bribery and corruption, to the extent that such information is necessary for an understanding of the company's development, performance, position, and impact of its activities. Climate-related information can be considered to fall into the category of environmental matters."[13]

The distinction between single and double materiality is intertwined with some of the intense scrutiny applied to ESG in 2022. In July, The Economist published a front cover with the words: "ESG – three letters that won't save the planet".[14] Two months earlier, Stuart Kirk, then head of responsible investing at HSBC's asset management arm, equated ESG with "cancel culture", telling a conference that there was "no place for virtue signalling in finance".[15] Kirk resigned in July. A few months later, he wrote an op-ed in the FT (see excerpt below).

> *The flaw is that ESG has carried two meanings from birth. Regulators have never bothered disentangling them, so the whole industry speaks and behaves at cross purposes. One meaning is how portfolio managers, analysts and data companies have understood ESG investing for years. That is: "taking environmental, social, and governance issues into account when trying to assess the potential risk-adjusted returns of an asset." Most funds are ESG on this basis. Weather, corporate culture or poor governance always influence valuations to some degree.*
>
> *But this approach is very different to investing in "ethical" or "green" or "sustainable" assets. And this second meaning is how most people think of ESG – trying to do the right thing with their money. They prefer a company that doesn't burn coal, eschews nepotism and has diverse senior executives.*[16]

13 European Commission communication, 'Guidelines on non-financial reporting: Supplement on reporting climate-related information', June 2019

14 The Economist, 'Three letters that won't save the planet', July 2022.

15 Financial Times, 'HSBC suspends banker over climate change comments', May 2022

16 Financial Times, 'Stuart Kirk: ESG must be split in two', September 2022

Even under Kirk's narrow lens, at least some aspects of double materiality are applicable. If a business chooses not to reduce its energy consumption or improve the gender balance of its workforce, its reputation will likely suffer. For the hypothetical "reasonable person" this could qualify as material and hence affect the business's value or attractiveness to investors or potential employees.

There may be two underlying drivers of ESG, that are different from one another, as suggested by Kirk, however, such is the expectation that businesses operate ethically, the differentiation is increasingly irrelevant.

More importantly perhaps, materiality is at the heart of what makes ESG practices mean something, protecting businesses from risks and delivering value. If materiality is applied intelligently, businesses will apply ESG tools to assess both assess risks (single materiality) and impacts (double materiality) and develop strategies that will look to amplify the positive impacts and mitigate the negative.

Materiality must be understood clearly so that it is applied properly – underlying the purpose of this report. A drawback of ESG is its vastness, compounded by the higher relevance of some factors over others, and their greater materiality to a given business or sector – hence this report's recommendation to assess what is material to each sector. The wide scope means companies with large negative social and environmental footprints have ample opportunity to 'cherry-pick' ESG factors that portray them in the best possible light, rather than the material ones.

These kinds of practices lead to greenwashing and do not lead to any form of meaningful environmental or social transition. Consequently, policymakers need to be mindful of the need for some form of regulatory intervention.

ESG confusions and conflations

ESG and sustainability are often used interchangeably. This is understandable, however it is a subject of much debate in the market due to different technical interpretations of the two terms. A company's strategy often leans towards using 'sustainability' and is likely to consider the UN's 17 Sustainable Development Goals (SDGs) – a combination of social (gender equality, zero hunger) and environmental (climate action, life below water, affordable and clean energy) objectives. SDGs and the notion of sustainability itself, namely striving towards a less depleted natural environment and a more stable society, represent the "thing" to ESG's "adjective".

A helpful way of distinguishing the two, suggested by a member of the APPG's Advisory Board, is sustainability as a holistic term closely linked to strategy covering multiple topics. ESG on the other hand is criteria, data, and detail orientated.

While equating sustainability with ESG helps give some understanding of the latter, in policy discussions, this is not helpful as it detracts from how we apply those ESG data and criteria to help sustainability-related decision-making, whether to attract responsible investors or benchmark transition towards more sustainable practices.

Similarly, corporate responsibility (CSR) is often conflated with ESG. The former is increasingly considered a component of the latter. CSR is a key concept in its own right with regard to the ethical deployment of capital and company culture. While ESG deliverables are information-based, largely for the benefit of senior management, the boardroom, and investors; CSR is delivered from below and forms part of a business's unique culture.

However, ESG is less and less confined to the boardroom. It is increasingly common for ESG to have its own business function, often alongside sustainability. This development is at least partly driven by the recognition of double materiality and the imperative to deliver impact. The other key driver is simply that without a designated ESG officer or unit, ESG-related functions will be undertaken only intermittently, not routinely, which is becoming increasingly necessary for the reasons outlined in this report.

A common concern raised at the APPG's roundtables is that if ESG is viewed and treated by businesses as a pipeline for information, then it will likely turn into a 'box-ticking' exercise, consequently failing to act as a decision-making tool. A regular theme of the APPG's roundtables is the need for ESG metrics to inform board-level decisions. In most cases, ESG frameworks and disclosures should be accompanied by strategy (see case study below), which is where ESG and CSR will intersect within any given business.

Case study 3. KPMG UK's work with the Transition Plan Taskforce (TPT)

While many companies have committed to targets to reach net zero, there is now an increased focus on how organisations will actually reach those targets.

At COP26, the UK Government announced the creation of the Transition Plan Taskforce (TPT), which was launched in April 2022 with the two-year mandate to develop a disclosure framework and implementation guidance for transition plans.

KPMG has seconded two members of staff to the TPT Secretariat to support the UK Government's ambition for transition plans across the economy and develop a gold standard framework to help allocate finance into activities which support the low-carbon transition.[17] [18]

US culture wars

Another, more cynical misunderstanding of ESG, particularly, in the United States, is as a weapon in the country's culture wars. Just as discrimination and inclusion policies are disliked by certain political factions of US Politics, so are the ESG disclosures that come with them, leading to social and governance reporting being seen, not as non-financial information to aid business decision-making, but as unashamed political activism.

17 KPMG, 'What is a Climate Transition Plan?', June 2022
18 KPMG, 'UK Transition Plan Taskforce consultation', 2022

In February 2023, Florida's Republican Governor, Ron DeSantis announced a ban against applying ESG criteria for the issuance of municipal bonds, telling a press conference:

> *We're also finally going to make sure that ESG is not infecting other decisions at both the state and local government. So no investment decisions at the state or local government with ESG, no use of ESG in procurement and contracting and no use of ESG when issuing local or state bonds.*[19]

DeSantis has frequently described ESG as "woke" but, as we shall see in part two, the APPG strongly disagrees with these kinds of disparaging claims. The group views corporate and financial considerations of ESG factors from a risk, impact and opportunity perspective, and recognises their value in helping to meet public policy objectives, with the support of government. This lies in stark contrast with the political objectives being pursued by Florida's Governor. Nevertheless, as the below case study helps illustrate, businesses with robust ESG strategies do face challenges in accessing finance, emphasising the need for Environmental, Social, and Governance to be seen and used responsibly in a policy context that is mainstream and non-divisive.

Case study 4. BAE Systems and the defence industry's access to finance

In recent times, BAE Systems has seen that the lack of consensus in defining ESG compliance, with multiple ESG indices adopting different approaches to benchmarking, has caused some investment funds to universally exclude defence stocks. To some extent, the war in Ukraine has provoked a renewed debate around the value of our sector.

If funds are unable to invest in defence, it will constrain BAE Systems' ability to invest in skills and technologies to sustain indigenous defence capabilities and support economic prosperity.

The geopolitical situation has gone some way to demonstrating the importance of a national and sovereign defence capability and large multinationals such as BAE Systems.

However, there have been other instances where companies within the defence supply chain, often SMEs, have been refused access to open bank accounts with high street banks. This simple action can have far-reaching consequences and ignores the enormous positive impact that the industry has in the UK.

19 Fortune, 'Up next in Ron DeSantis' war against the "woke agenda": No ESG criteria in municipal bonds', February 2023

Part 2. Government leadership and intervention

Historically, free enterprise has been phenomenally effective at creating value, however, this is a separate undertaking to meeting public policy objectives. They can be aligned, but generally, this is only brought about through government intervention. ESG alignment, however, is a clear route to bringing about both value-creation as well as achieving climate, social, and governance objectives.

Externalities are negative impacts caused by economic activity such as greenhouse gas emissions, biodiversity loss, or social deprivation and cause market failure. It is the government's role to resolve market failure by limiting these externalities. Since its formation in 2021, the APPG has heard countless calls for more UK Government involvement in ESG both to help reduce negative impacts such as greenhouse gas emissions and to resolve sources of market failure, such as greenwashing, in markets closely linked to ESG. Part two is divided along these lines, aligning public policy and strengthening ESG markets, and underlines the importance of the recommendations on page 9.

Since its formation in 2021, the APPG has heard countless calls for more UK Government involvement in ESG both to help reduce negative externalities such as greenhouse gas emissions and to resolve sources of market failure, such as greenwashing, in markets closely linked to ESG. Part two is divided along these lines, aligning public policy and strengthening ESG markets, and underlines the importance of the recommendations on page 9.

Aligning public policy with business objectives via ESG

In January 2023, former Energy Minister Chris Skidmore MP published his independent review into the benefits and opportunities of reaching net zero, and made recommendations towards decarbonising the UK economy by 2050. The review featured a submission from the Institute of Directors (IoD), which stated:

> *The interests of the business community will be best served by a managed transition marked by effective government leadership on, and commitment to, net zero. Business is on board with the necessity of the transition and is looking for guidance and leadership from government as to how to achieve it efficiently and effectively.*[20]

The IoD's call for greater leadership is, in the organisation's view, directly linked to the uptake of ESG. Once the signals are given, for example through regulations or incentives, businesses will use ESG tools to meet expectations. Figure 5. consists of just a handful of the review's 129 recommendations that relate to ESG.

20 HM Government, 'Mission Zero: Independent Review of Net Zero', January 2023

Figure 5. Mission zero independent review recommendations directly related to ESG

1. Government should publish an overarching financing strategy covering how existing and future government spending, policies, and regulation will scale up private finance to deliver the UK's net zero enabled growth and energy security ambitions. This should include setting out the role of UKIB, BBB, BII, IPA and UKEF in the transition.

3. Government to lead a bespoke consultation on funding scheme design – with a ministerial champion – to report on the issues and recommend reforms to government.

12. Government to commission the ONS and/or UKRI to lead an engagement exercise with businesses to define their data needs and develop bespoke recommendations to address these.

14. Government to endorse and implement the International Sustainability Standards Board (ISSB) standards as soon as possible. The UK should lead by example, launching a formal adoption mechanism as soon as the ISSB standards are published and moving swiftly to assess and endorse the standards for use in the UK. The UK should aim for 2024/25 as the first sustainability reporting cycle for companies in scope, encouraging companies to apply the ISSB's standards voluntarily in 2023/24.

15. UK to continue its pioneering work in transition plan disclosures led by the UK Transition Plan Taskforce, share them internationally, and once more developed, Transition Plan Taskforce standards to be made mandatory for both listed and private firms to ensure comparable disclosure standards across the economy, in line with previous government commitment.

16. To ensure Government facilitates sufficient investment in transition economic activity, investors need information on transition pathways to put transition plans into context, as well as common categories and definitions of what economic activities are aligned with the transition to net zero. Government to consider the appropriateness of a transition taxonomy (alongside a green taxonomy) that is simple and proportionate; and work with international partners to ensure the UK approach is interoperable and harmonised with others' approaches.

58. By Autumn 2023 HMT should review how policy incentivises investment in decarbonisation, including via the tax system and capital allowances.

68. Review how the UK can become the most competitive financial centre for green and transition listings, capital raising and project financing; to include reviewing prospectus and listing regimes to encourage integrity and growth in the market for green finance instruments, exploring new opportunities arising for professional services, climate and nature data and analytics and innovative product development.

60. Through its update to the Green Finance Strategy, Government should set out a clear, robust and ambitious approach to disclosure, standard setting, and scaling up green finance – including how it will meet existing commitments to implement Sustainable Disclosure Requirements across the economy; how it will provide a clear, long-term plan for attracting capital to meet net zero ambitions, and how to maintain the UK's position as the leading green finance hub internationally and metrics for success.

As a collective, these recommendations would set powerful expectations on businesses, obliging them to apply ESG-related data and analytical tools to assess supply chain partners, the quality of the management systems and so forth to ensure standards are met.

Moreover, because ESG is so broad, as UK environmental and social policy shifts to other priorities, businesses will face other expectations which will be fed into their ESG analysis, both of themselves and their stakeholders. If we take the example of plastic waste in the oceans, the UK produces the second-largest amount of plastic waste per capita. If the Government were to launch a landmark waste plastic strategy, companies would be held responsible for their plastic waste to a higher degree through one another leading to the ramping up of data, metrics and reporting on plastic waste.[21] This underlines the extent to which ESG practices are led by external forces made up of scientific evidence, public reaction and government policy.

Market failure in ESG

In June 2022, the APPG held a roundtable with the International Regulatory Strategy Group (IRSG) following the publication of the group's report warning that ESG ratings display "huge variations" in their methodologies. Additionally, the report warned "assessments are open to interpretation" with much of the data being "self-reported from companies, or proxy data that isn't verified or audited".[22] The IRSG's representatives at the roundtables emphasised the "nascent state" of the ESG ratings market, consequently, there is "still a long journey if it's to fully assist issuers and investors in embedding ESG factors into their corporate strategies and decision-making".

The IRSG proposed encouraging greater transparency of ratings methodologies and sharing best practice to help narrow the disparities in ratings, which can be enormous and destabilise the market. ESG ratings have a huge amount of catching up to do with credit ratings.

In March, the UK Government launched an ESG ratings consultation towards ensuring "improved transparency and good conduct in the ESG ratings market" with a view to establishing a "potential regulatory framework".[23] The consultation was launched alongside the revised Green Finance Strategy, which highlighted the threat of greenwashing following a 2022 consultation, to which the APPG submitted. The document states: "Stakeholders have been clear there is a role for the UK Government to facilitate financial markets to deliver this, as well as to ensure green finance markets are robust and that protections against greenwashing are in place for consumers."[24]

21 The Guardian, 'US and UK citizens are world's biggest sources of plastic waste – study', October 2020
22 International Regulatory Strategy Group, 'ESG Ratings and ESG Data in Financial Services – A view from practitioners' February 2022
23 HM Treasury, 'Future regulatory regime for Environmental, Social, and Governance (ESG) ratings providers', March 2023
24 HM Government, 'Mobilising Green Investment: 2023 Green Finance Strategy', March 2023

Case study 5. greenpeople.earth tackling greenwashing in carbon markets through tracking and bespoke solutions

Bespoke and tailored technological and financial solutions for carbon computation and reduction could go some way in improving carbon accountability, especially in voluntary carbon markets.

Carbon offsets have a role to play in enabling British businesses to meet their net-zero targets. However, Carbon Markets have increasingly associated with greenwashing and a lack of accountability.

Credibility in the voluntary markets can be restored through the implementation of robust tracking systems that generate an audit trail for each credit from the buyer back to the originating project, as well as financial structures that protect the buyer in the event of under-delivery.

UK start-up, greenpeople.earth carried out two pilots of clean and improved cooking initiatives to trial the legal, financial and technological tracking mechanisms for this specific type of project.

Tailored and bespoke solutions with ongoing engagement with all parties are key to eliminating greenwashing and adding transparency and reliability to the system. This has the added advantage of removing single points of failure, which often result from one-size-fits-all verification and project management protocols.

Specialised protocols for different domains and industries, whether in carbon footprint computation or for carbon reduction within the broader climate action space could help address reliability and traceability issues.

Greenwashing occurs when businesses and financial institutions intentionally or unintentionally market sustainable assets as green. Any number of failures in a reporting chain can give rise to greenwashing. It can even be brought about in compliance with government standards. The EU Taxonomy includes natural gas. Consequently, a fully compliant green bond or Exchange Traded Fund (ETF) might not actually be environmentally friendly. If it is to meet sustainable objectives through private enterprise, the Government has a responsibility to embed appropriate rules and standards that build trust in markets, thereby tackling market failure (see the APPG's UK Green Taxonomy report).

The structural weaknesses in ESG markets extend to consultants, many of whom lack the necessary expertise. KPMG's 2021 report, 'Looking ahead: ESG 2030 predictions' colourfully states:

> *As the lucrative nature of successful sustainable business models become apparent, bad actors will attempt to exploit the 'wild ESG west.' ESG Cowboys and profiteering ESG advisors will benefit from disingenuous and unsubstantiated claims, until consumers and society demand to view and validate their ESG credentials.*[25]

25 KPMG, 'Looking ahead: ESG 2030 predictions', 2021

Greenwashing will thrive without common ESG metrics, standards, frameworks and disclosures, and crucially, clearly understood definitions of what constitutes sustainable and social responsible economic activity. If "ESG Cowboys" are permitted to flourish and undermine the market, businesses will find it even more difficult to prove they are good corporate citizens and for investors to identify them.

A small enterprise invited to speak at the APPG's roundtable on SMEs said their head of sustainability had voluntarily appointed themselves out of personal interest, but lacked knowledge. In such circumstances, smaller businesses may hire an underqualified adviser, increasing the risk of inaccurate disclosures that can lead to harmful accusations of greenwashing.

Technological solutions are available to assist medium and small businesses (see Case studies 5 and 6). Policy frameworks are still needed to bring about common and comparable metrics, allied with clear definitions of what qualifies as green or environmentally responsible.

Case study 6. ESG Book, applying technology to tackle greenwashing

The challenge ESG faces is a technological one. Whether mitigating risk or promoting sustainability, markets, and policymakers need clearer signals from companies and market participants in order to allocate capital and to design legislation and regulation.

ESG Book is a technology company making corporate sustainability and ESG data accessible, transparent and comparable through a central, public platform enabling corporates to upload and report in real-time, free from annual reporting cycles.

Technology-first, coordinated approaches to disclosure make ESG and sustainability data available and comparable for all stakeholders, solving many of the challenges the APPG addresses:

1. **Assessing policy feasibility**: Centralised, comparable data enabled ESG Book to analyse 30,000 listed companies in 2022. Only 1% of their revenues were derived from green activities as defined by the EU Taxonomy, and 12% from brown. This raised questions over the utility of the Taxonomy and risks of stranded assets. Similar analyses will be required as the UK develops its own Taxonomy.
2. **Assessing policy progress**: Combining data with climate science enables ESG Book to produce implied temperature rise pathways for companies, enabling us to track net zero pathways. Analysis shows that between 2015 and 2021, the share of FTSE100 companies aligned with the Paris Goal of limiting temperature rises to 1.5C by 2050 grew.
3. **Clearer labelling of investment products**: Analysing 36,000 funds worth $40 trillion, ESG Book found an average of 20% of assets per fund failed to disclose emissions. Of 515 climate/ESG-labelled funds analysed, 73 showed greater emissions intensity than the average across the 36,000 funds. Greater access to data enables clearer product labelling.
4. **Demonstrating value**: Access to data raises awareness of the value of mitigating ESG risk. ESG Book found that stock funds outperformed globally over five years if they were weighted toward companies with positive ESG scores.

Green and responsible finance

While responsible finance and ESG are not the same, they are often closely linked to one another. The APPG's submission to the 2022 Green Finance Consultation is illustrative of the link back to policy, and importantly for this paper, it is a reminder of what ESG is not.

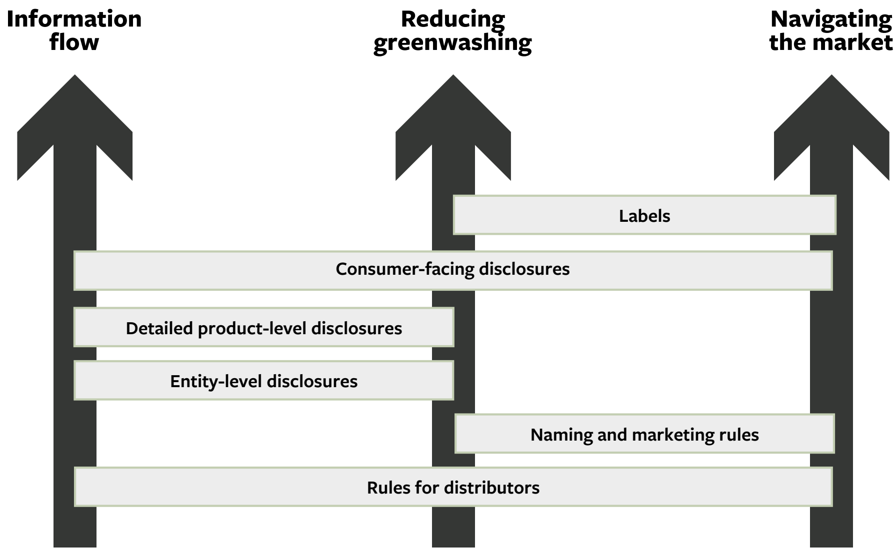
International organisations like the ISSB, the FSB (founder of the TCFD) and GRI set standards and frameworks for an international marketplace so that metrics and disclosures can be compared across markets. However, the underlying data is typically regulated at the national level, or by the EU in the case of most European businesses, which can lead to discrepancies across jurisdictions.

For example, an investment manager in real estate told the APPG that ESG data from tenants, such as energy consumption, is often challenging to access which can lead to data gaps or quality issues which can weaken confidence in the data reported to investors.

Releasing more data will lead to more green investment, helped further by the introduction of sustainable investment labels unveiled by the Financial Conduct Authority (FCA) in October 2023. The labels sit on top of Sustainability Disclosure Requirements (SDR) and the Green Taxonomy, which collectively define sustainable investment, and account for the ESG component of sustainable finance.

The FCA's SDR and investment labels consultation lists "information flow" – in other words, ESG – as the first of its three overarching objectives in this area. Labels are a cross-cutting delivery mechanism that apply to objectives two and three, "reducing greenwashing" and helping consumers "navigate the market" for sustainable investment products. Consumer-facing disclosures contribute to all objectives (see Figure 7. below).

Figure 7. FCA's Proposals and broad objectives under SDR and investment labels



Credit: The FCA[26]

26 Financial Conduct Authority, 'Consultation paper: Sustainability Disclosure Requirements (SDR) and investment labels', October 2022, p19

The FCA has proposed three labels: Sustainable Focus, Sustainable Improvers, and Sustainable Impact. The APPG held a roundtable with the FCA in October 2022, the same day the labels were published (see Figure 8). Notably, some participants did not see a material difference between Sustainable Focus and Sustainable Impact, highlighting the challenge at hand.

Note, the regulator had originally considered five labels. The APPG fears an opportunity risks being missed to drive capital towards meeting policy objectives through the introduction of more targeted labels. For example, a clean energy label for *new* renewable energy assets to help meet the UK Government's ambition of reaching 50GW of capacity by 2030 under the 2022 Energy Security Strategy. Capacity currently stands at 21GW.[27 28]

Figure 8. Proposed sustainable investment label descriptions and objectives

Category Name	No sustainable label	Sustainable Focus	Sustainable Improvers	Sustainable Impact
Description	Products that do not meet the criteria for a sustainable label	Products with an objective to maintain a high standard of sustainability in the profile of assets by investing to (i) meet a credible standard of environmental and/or social sustainability; or (ii) align with a specified environmental and/ or social sustainability theme	Products with an objective to deliver measurable improvements in the sustainability profile of assets over time. These products are invested in assets that, while not currently environmentally or socially sustainable, are selected for their potential to become more environmentally and/or socially sustainable over time, including in response to the stewardship influence of the firm	Products with an explicit objective to achieve a positive, measurable contribution to sustainable outcomes. These are invested in assets that provide solutions to environmental or social problems, often in underserved markets or to address observed market failures
Consumer-facing description	Invests mainly in assets that are sustainable for people and/or planet	Invests mainly in assets that are sustainable for people and/or planet	Invests in assets that may not be sustainable now, with an aim to improve their sustainability for people and/or planet over time	Invests in solutions to problems affecting people or the planet to achieve real-world impact

Credit: The FCA[29]

Organisations, like UK Sustainable Investment and Finance Association (UKSIF), Morningstar and investor group the IIGCC have all signalled their approval of the FCA's proposed labels. Speaking at a panel discussion in January, James Alexander of UKSIF said: "We agree with the FCA's characterisation set out of what constitutes a sustainable investment, which represents a marked improvement on the EU's SFDR".[30]

However, the Investment Association warned the Treasury Sub-Committee on Financial Services Regulations that stricter labels would lead to "different potential bubbles in different parts of the value chain", including providers of ESG data and a "rush into a narrow range of funds".[31] Meanwhile, the IIGC have warned that labels appear mutually exclusive.

27 HM Government policy paper, 'British energy security strategy', April 2022
28 National Grid, 'Britain's Electricity Explained: 2022 Review, 2022
29 Financial Conduct Authority, 'Consultation paper: Sustainability Disclosure Requirements (SDR) and investment labels', October 2022, p31
30 ESG Clarity, 'FCA sustainable fund label proposal nuances hammered out by industry', January 2023
31 UK Parliament, Treasury Sub-Committee on Financial Services Regulations, 'MPs investigate whether 'sustainable' investment funds are greenwashing', February 2023

Figure 9. Articles 8 and 9 of the EU Sustainable Financial Disclosures Regulation (SFDR)

Article 8 – light green
"A Fund which promotes, among other characteristics, environmental or social characteristics, or a combination of those characteristics, provided that the companies in which the investments are made follow good governance practices."

Article 9 – dark green
"A Fund that has sustainable investment as its objective or a reduction in carbon emissions as its objective."

Establishing what qualifies as "sustainable investment" and "impact investment" is fraught with difficulty. The EU Green Taxonomy includes natural gas and nuclear energy as transitional fuels. Meanwhile, the EU's de facto sustainable investment labels, Articles 8 and 9 of the Sustainable Finance Disclosures Regulation (SFDR – see Figure 9. above and Case study 7.), have been subject to criticism and revision.[32]

In March of this year, Bloomberg reported that asset managers were pulling out of impact-oriented Article 9 funds after the EU was forced to revise its definition.[33] The Article 8/9 framework does not seem to have prevented greenwashing either. In March 2022, Morningstar found that only one of the top 20 Article 8 funds included a reference to responsibility in its name.[34] Similar reports of fossil fuels featuring in Article 9 funds surfaced in November last year.[35]

32 Bloomberg, 'ESG Funds Hit by 'Staggering' Inflows Face Issuance Freeze', March 2023
33 Ibid
34 ESG Clarity, 'One year on from SFDR: More confusion and greenwashing?', March 2022
35 ESG Clarity, 'Greenwashing claims as half of Article 9 funds invest in fossil fuels' November 2022

Case Study 7. KPMG UK's SFDR support for a global investment manager

There is greater demand in the market for funds with tangible ESG objectives and measurable impacts, as well as a growing recognition that ESG factors can offer a competitive advantage in the market. This is amidst the context of new regulations and updates to existing obligations across Europe.

One such piece of regulation is the Sustainable Finance Disclosure Regulation (SFDR), which was introduced by the European Commission as part of a package of legislative measures arising from the EU's Action Plan on Sustainable Finance. SFDR aims to bring a level playing field for financial market participants and financial advisors, in relation to sustainability risks, the consideration of adverse sustainability impacts in their investment processes and the provision of sustainability-related information with respect to financial products.[36] [37]

KPMG UK has helped a global investment manager to coordinate the completion of all SFDR disclosures, by working closely with their investment teams, sustainability team and external legal counsel. KPMG UK has also supported with the implementation of wider EU ESG regulation, such as Taxonomy Regulation, and MiFID /AIFMD/UCITS ESG Amendments.

The introduction of sustainable investment labels represents solid UK ambition. Meanwhile, the errors and subsequent amendments committed by the EU have vindicated the slower and steadier approach taken by the UK Government. Under the revised Green Finance Strategy, the Green Taxonomy consultation is being pushed back to Autumn 2023. The UK now has an excellent opportunity to step up its policy infrastructure considerably with instruments, such as the Taxonomy, sustainable investment labels, and SDR, that crucially, will have been thoroughly consulted upon. Together with the other commitments and ambitions laid out in the Green Finance Strategy, such as the consultation on ESG ratings, the UK has an excellent platform to claim global leadership.

The diversity of energy security and environmental plans published by the Government in March, the Green Finance Strategy among them, illustrate the broad range of objectives policymakers are trying to achieve alongside one another. The revised strategy will help accelerate progress. But in order for that progress to be sustained, there needs to be a greater understanding of ESG in Parliament, and that understanding must extend to all three letters, not just the 'E'.

36 KPMG, 'UK Sustainability Disclosure Requirements for Asset Managers', December 2021

37 KPMG, 'SFDR, the final countdown to compliance: key considerations for asset managers when applying SFDR', February 2021

Figures Index

Case studies index

Glossary

APPG - All-Party Parliamentary Group
CDP – Carbon Disclosure Project
CSR – Corporate Social Responsibility or Corporate Responsibility
CSRD - Corporate Sustainability Reporting Directive
ESG - Environmental, Social, and Governance
ETF – Exchange Traded Fund
FCA – Financial Conduct Authority
FSB – Financial Stability Board
GRI – Global Reporting Initiative
HMG – His Majesty's Government
HMT – His Majesty's Treasury
ICMA – International Capital Markets Association
IFRS – International Financial Reporting Standards
IIGCC – Institutional Investors Group on Climate Change
IoD – Institute of Directors
IRSG – International Regulatory Strategy Group
ISSB – International Sustainability Standards Board
SDGs – Sustainable Development Goals
SDR – Sustainability Disclosure Requirements
SFDR – Sustainable Finance Disclosure Regulation
SME – Small and Medium-sized Enterprises
TCFD – Taskforce on Climate-related Financial Disclosures
UKSIF – UK Sustainable Investment and Finance Association

References

Reports, papers and surveys

National Grid, 'Britain's Electricity Explained: 2022 Review, 2022
KPMG, 'Climate quitting - younger workers voting with their feet on employer's ESG commitments', January 2023
Morgan Stanley, 'Despite Market Challenges, Demand for Sustainable Funds Remains Strong', 2023
International Regulatory Strategy Group, 'ESG Ratings and ESG Data in Financial Services – A view from practitioners' 2022
PwC, 'PwC's investor survey: the economic realities of ESG', 2022
KPMG, 'Looking ahead: ESG 2030 predictions', 2021
KPMG, 'SFDR, the final countdown to compliance: key considerations for asset managers when applying SFDR', 2021
PwC, 'The economic realities of ESG', 2021
KPMG, 'UK Sustainability Disclosure Requirements for Asset Managers', 2021
KPMG, 'UK Transition Plan Taskforce consultation', 2022
KPMG, 'What is a Climate Transition Plan?', 2022

International, intergovernmental, governmental, regulatory and legislative documents

HM Government policy paper, 'British energy security strategy', April 2022
Financial Conduct Authority, 'Consultation paper: Sustainability Disclosure Requirements (SDR) and investment labels', October 2022, p19
Financial Stability Board, 'Financial Stability Board proposes creation of disclosure task force on climate-related risks', 2015
HM Treasury, 'Future regulatory regime for Environmental, Social, and Governance (ESG) ratings providers', 2023
European Commission communication, 'Guidelines on non-financial reporting: Supplement on reporting climate-related information', 2019
HM Government, 'Mobilising Green Investment: 2023 Green Finance Strategy', 2023
UK Parliament, Treasury Sub-Committee on Financial Services Regulations, 'MPs investigate whether 'sustainable' investment funds are greenwashing', 2023
HM Government, 'Mission Zero: Independent Review of Net Zero', 2023
Climate Disclosure Standards Board, 'Position paper; materiality and climate-related financial disclosures', 2018
SEC, 'Staff accounting bulletin: No. 99 – Materiality', 1999

Media

Bloomberg, 'ESG Funds Hit by 'Staggering' Inflows Face Issuance Freeze', 2023
ESG Clarity, 'FCA sustainable fund label proposal nuances hammered out by industry', 2023
ESG Clarity, 'Greenwashing claims as half of Article 9 funds invest in fossil fuels' 2022
Financial Times, 'HSBC suspends banker over climate change comments', 2022
ESG Clarity, 'One year on from SFDR: More confusion and greenwashing?', 2022
ESG Investor, 'TCFD View of Materiality No Longer Adequate – UNEP FI Chief', 2021
FinExtra, 'The Rise of "S" in ESG', April 2023
The Economist, 'Three letters that won't save the planet', 2022
Fortune, 'Up next in Ron DeSantis' war against the "woke agenda": No ESG criteria in municipal bonds', 2023
Reuters, 'Urgent progress needed on company climate disclosures, G20 task force says', 2022
The Guardian, 'US and UK citizens are world's biggest sources of plastic waste – study', 2020
BBC, 'Where the boss-worker power struggle goes next', 2022
Huffington Post, 'Workers are quitting jobs because of ethical values and we're here for it', 2023

Environmental, Social, and Governance

appgesg.org
twitter.com/esg_appg