



ESG: Environmental, Social, Governance

An introductory guide for businesses



July 2020

kpmg.com/uk

Executive summary

The consideration of ESG (Environmental, Social and Governance) factors has become critical to the success of businesses across all sectors. Customers, employees, shareholders, lenders, rating agencies and regulators are demanding companies consider how their business impacts the world, their contribution to society and how they conduct themselves.

Businesses not taking ESG seriously are beginning to lose customers, employees and financing; eventually they will become unviable. Market leaders are taking a strategic response to ESG, changing their products and services, processes, operations and supply chains.

The first step to embed ESG into a business must be taken by the Board, taking on the responsibility and accountability to drive the transition towards becoming an environmentally and socially responsible business.

Stakeholders are pushing for increased transparency and it's working. New mandatory reporting standards are fast approaching and, where it's not mandatory, lenders and investors are still withdrawing funding from, and voting against, businesses not considering ESG.

COVID-19 has highlighted the social and governance elements within ESG as businesses seek to protect jobs, support efforts to control the spread of the virus and 'do the right thing'. It has highlighted the importance of resilience to extreme change and our ability to undertake radical transformation; it provides an opportunity to embed ESG into future board level decisions.

ESG isn't a hygiene factor for today. Its impact is already profound and it's a critical factor for businesses that want to be ready for further fundamental changes coming down the track. ESG is no longer a choice; it is an imperative.



What are E,S & G?



Environmental

Your impact on the world

- Climate change
- Greenhouse gas (GHG) emissions
- Natural resource depletion
- Waste and pollution
- Deforestation
- Hazardous materials
- Biodiversity



Social

Your contribution to your communities

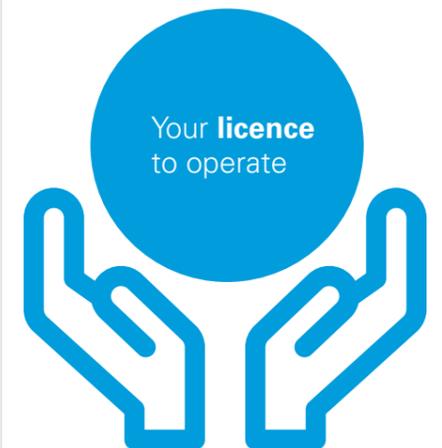
- Working conditions, including slavery and child labour
- Impact on local communities
- Conflict regions
- Health and safety
- Employee relations and diversity
- Product mis-selling
- Data protection



Governance

How you conduct yourself

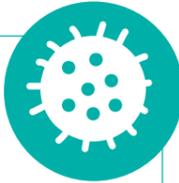
- Executive pay
- Bribery and corruption
- Political lobbying and donations
- Board diversity and structure
- Tax strategy
- Data breaches



Why should you act now?

As consumers, society and shareholders are increasingly demanding change, these ESG megatrends are set to shape the business landscape.

COVID-19



The pandemic has placed greater scrutiny on the ethical performance of businesses and highlighted the value of resilience over efficiency. The transformation to the New Reality is an unprecedented opportunity to embed ESG at the core of organisational purpose and operations.

Transition to Low Carbon Economy



Global energy demand will grow by at least **26%** over 20 years²
 Current ways of generating power are unsustainable and natural resources are becoming increasingly scarce. Industries need to become more energy efficient and reduce their carbon footprint as the UK Government seek to achieve their commitment to Net Zero by 2050 in alignment with The Paris Agreement.

Risk Management



The cost of climate change may reach **\$43tr³**
 6°C of warming represents present value losses worth **US\$43t** or **30%** of the world's entire stock of manageable assets.

Investor and Social Pressure



~ **\$30tn** in AUM is dedicated towards ESG investing¹
 Investors and customers are recognising their ability to impact corporate activities and to hold corporates accountable for not managing ESG risks. Investors are also increasingly recognising that ESG risk equals long-term investment risk. This will trigger a fundamental reshaping of finance with fossil fuel and other high-carbon heavy businesses experiencing higher costs of capital.

Regulation



Regulators are showing increasing interest through requirements under the [UK Companies Act](#), the [Taskforce for Climate Related Financial Disclosure](#), and [EU Requirements](#).
 Reporting of climate related financial disclosure will become harmonised and mandatory across all industries. Measures will be aligned with the Sustainable Development Goals (SDGs) and principal ESG domains of Principles of Governance, Planet, People and Prosperity.

Sources: 1) J.P Morgan Asset Management: How is ESG affecting the investment landscape, 2019. 2) International Energy Agency: World Energy Outlook Report, 2019 3) The Economist, The cost of inaction: recognising the value at risk from climate change, 2015

Decoding the ESG alphabet soup: What does it mean and is it relevant to me?

Companies are increasingly being subject to a suite of mandatory reporting requirements to evidence their response to their ESG impact. Our guide below breaks down some of the commonly used terms in ESG reporting.



What is TCFD?

Taskforce for Climate Related Financial Disclosures is a way of disclosing the impact of the environment on a company, in terms of climate risk. This helps investors to understand a company's exposure to climate risk. TCFD reporting will likely be mandatory by 2022 for large companies (all listed companies and large asset owners).



What is SECR?

Streamlined Energy and Carbon Reporting is the reporting of carbon emissions and energy use within the Director's and Strategic Reports, and is mandatory for all large UK companies (all listed companies and large asset owners) for years starting on or after 1 April 2019.



What is an SDG?

The 17 Sustainable Development Goals (SDGs) were set up by the United Nations as a universal call to action to end poverty, protect the planet and ensure that all people enjoy peace and prosperity by 2030.



What are GHG Emissions?

Greenhouse Gas Emissions are the emissions associated with energy and fuel use. They are split into Scope 1 (direct combustion – e.g. Gas), Scope 2 (indirect e.g. electricity) and Scope 3 (typically travel).



What are the WEF Metrics?

The World Economic Forum (WEF), together with the International Business Council, have worked with the Big Four to build a list of ESG metrics every company should be able to report against. This is currently under consultation.

Questions from our clients

ESG sets a clear strategic imperative for real and lasting change and it sits firmly on the C-Suite Agenda. Climate change topped the “threats to growth” in our last Global CEO Outlook and the ESG agenda is only increasing in its urgency. ESG challenges each member of the C-Suite – both in their functional areas of expertise, but also as a strategic growth and resilience priority.

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Which ESG opportunities should we prioritise and what risks are critical to mitigate?”



Strategy

How do I learn lessons from the COVID-19 pandemic and become a more sustainable business in the New Reality?

What is our relative ESG maturity?

Which ESG opportunities should we prioritise and what risks are critical to mitigate?

How do I set a strategy to respond to climate change?

How do I engage and ensure stakeholder buy-in for my ESG strategy?



Finance and Reporting

How are other businesses in my industry incorporating ESG into investment approaches and risk management?

What are investors looking for businesses to report on across ESG?

What disclosures are mandatory?

How do I both confidently and efficiently manage ESG reporting with requirements increasing?

Can I embed ESG into my debt financing and will it lower my cost of funding?



Operations

How do I optimise the ethical and sustainable footprint of my supply chain?

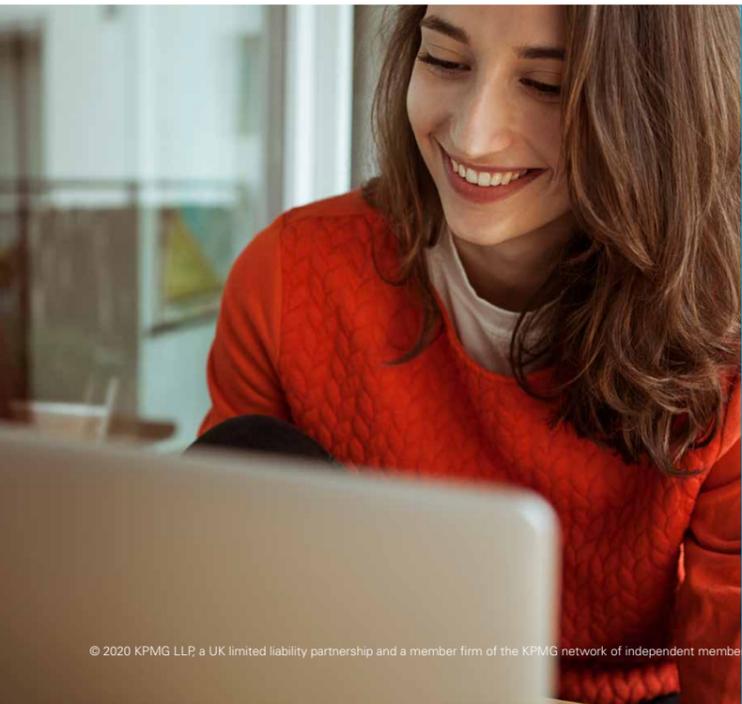
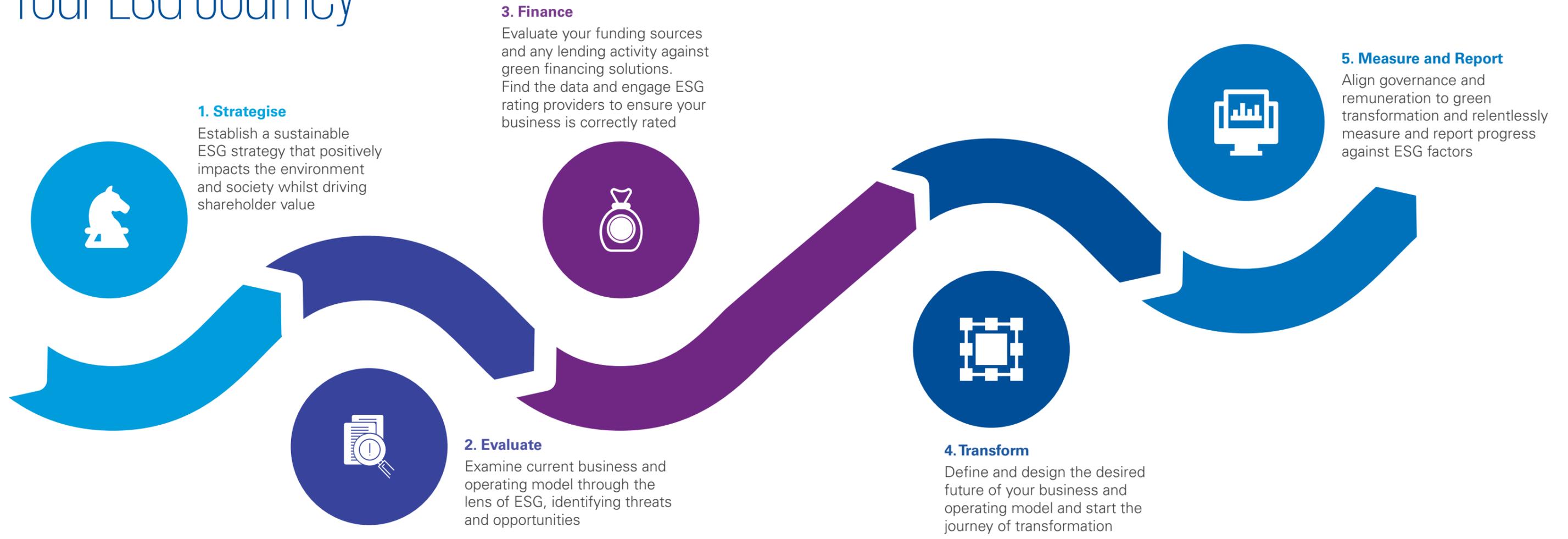
How can being ethical and environmental improve my resilience and profit margins?

How can digital help me to track and trace my products, enhance operational performance, and predict ethical and sustainable risks to my business?

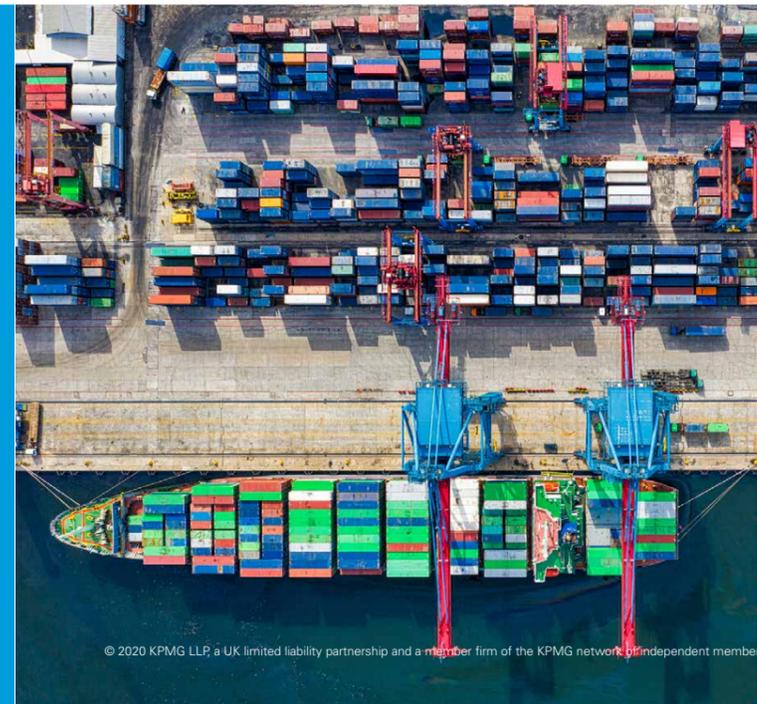
How do I ensure my third parties are compliant with existing and incoming regulation?

How do I adapt my operations to meet my business and ESG priorities?

Your ESG Journey



“ COVID-19 has highlighted the social and governance elements within ESG as businesses seek to protect jobs, support efforts to control the spread of the virus and ‘do the right thing’. ”



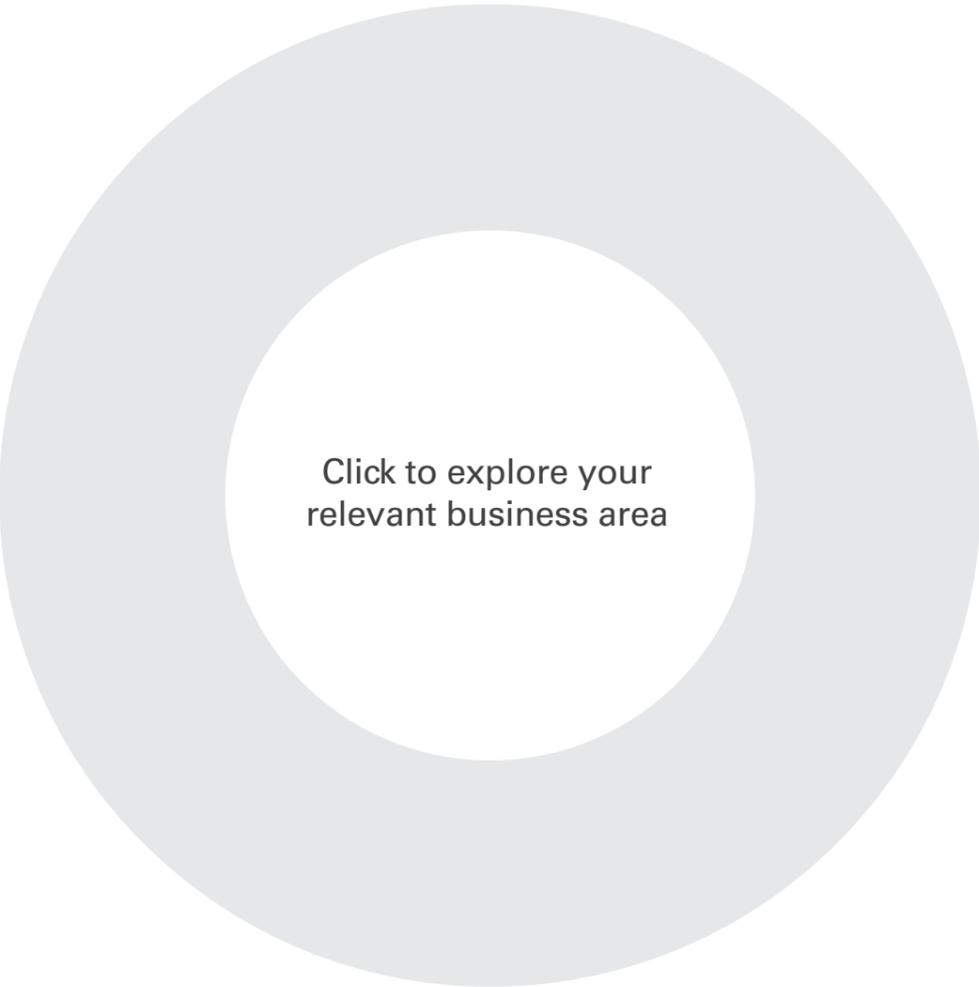
“ A strategic change in the operating model needs to consider the entire value chain, and as you transform, they need to follow your lead. ”

How we can help at a glance

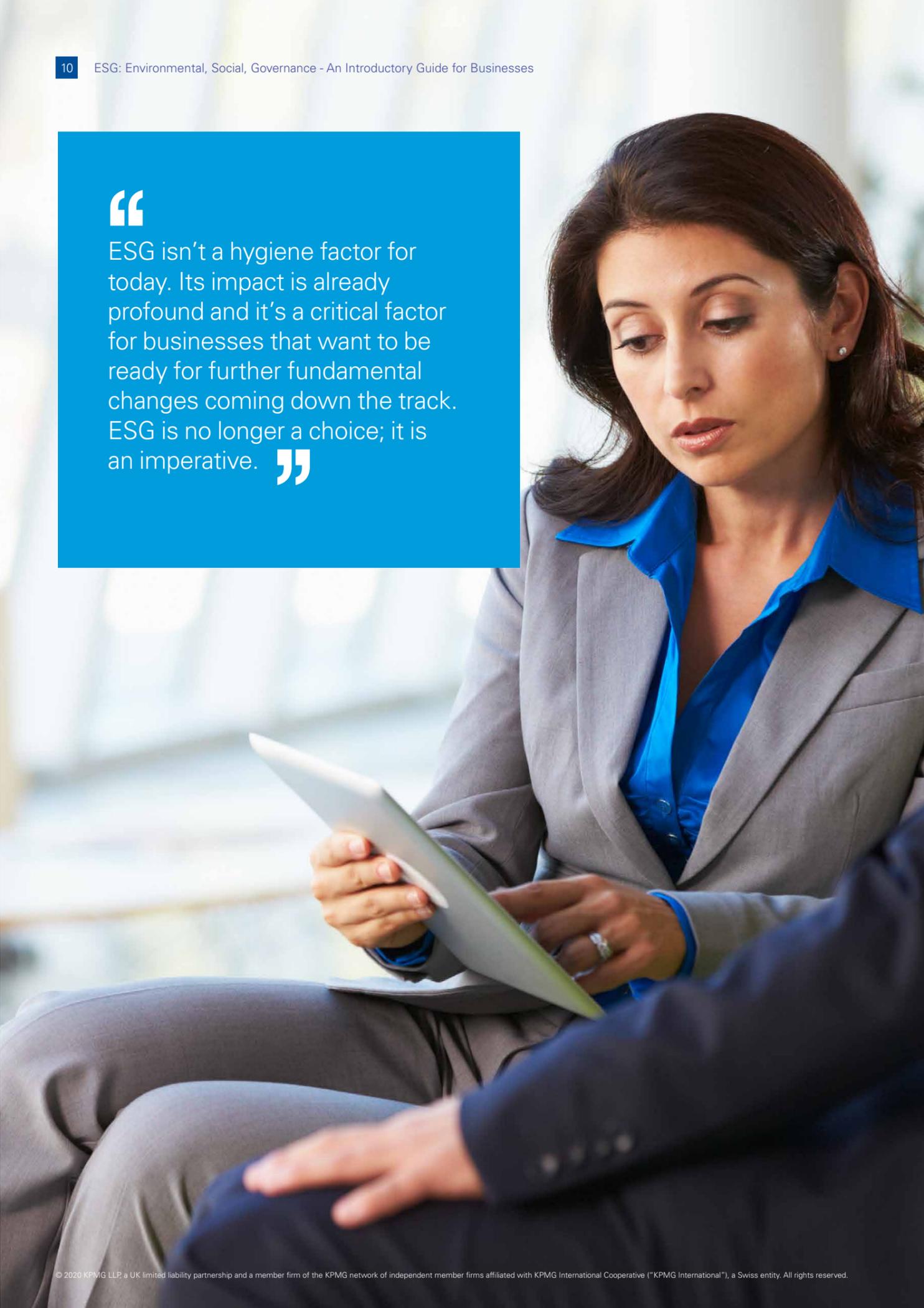
ESG: Our offering

Our teams can support you on your ESG journey across the business cycle.

Click on a relevant business area to explore some of the ways we're helping organisations embed ESG across their business.



Click to explore your relevant business area



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ESG Strategy

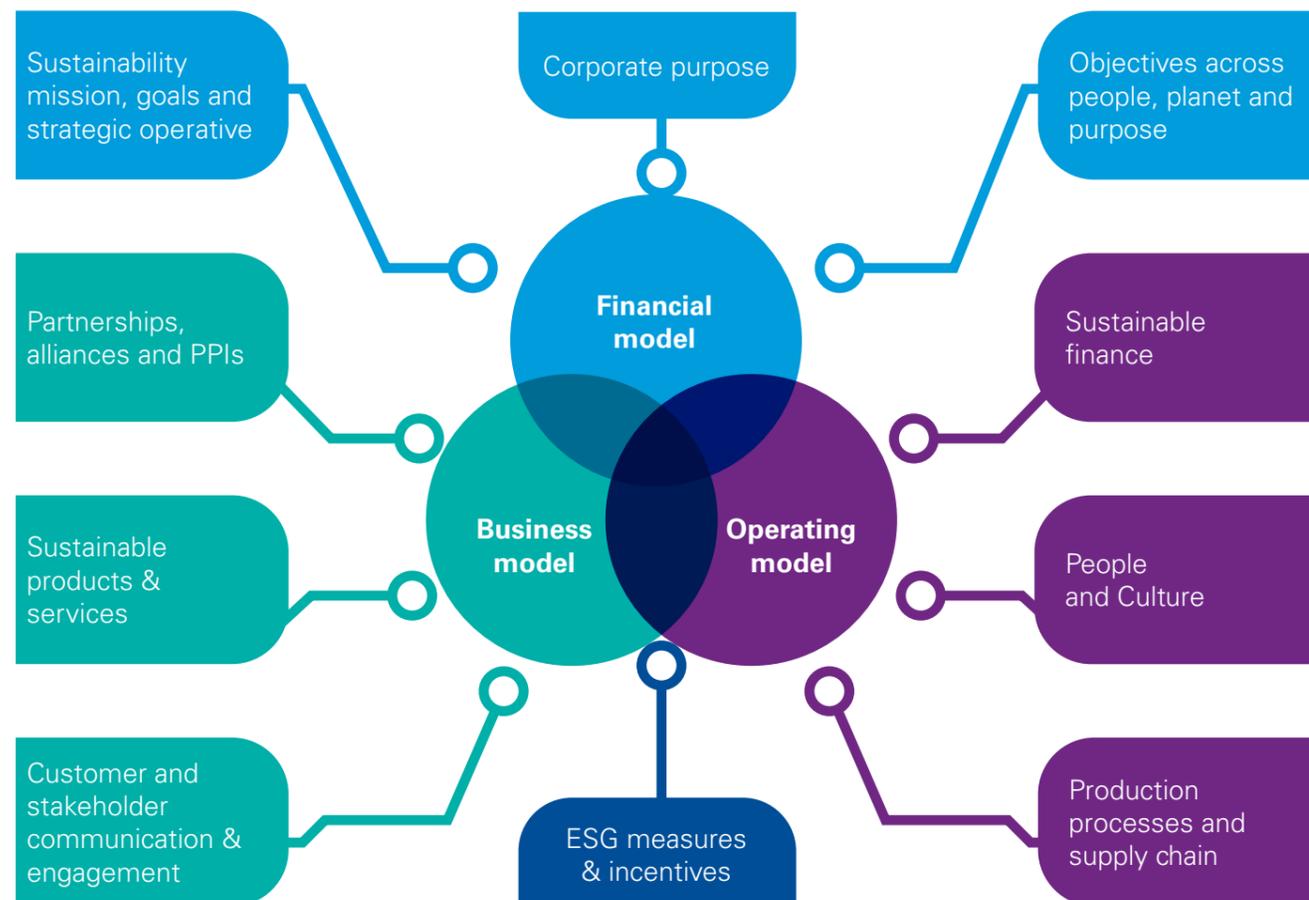
For an ESG strategy to have impact and create value, it needs to be authentic and part of the DNA of the business.

ESG must be recognised as a key driver of growth and business resilience and must be embedded in the business and operating model, and articulated as part of the corporate strategy.

We can work with you across the whole of 'E', 'S' and 'G', to address a number of key questions:

- Could ESG help our COVID-19 recovery and help create a more resilient and sustainable business?
- What are the key ESG risks and opportunities for us and which should we prioritise?
- What capabilities are required to capitalise on the opportunities or mitigate identified risks?

Through aligning strategic and financial ambition and the business and operating models, we can help you prioritise your ESG efforts and make some of the very difficult trade-offs easier.



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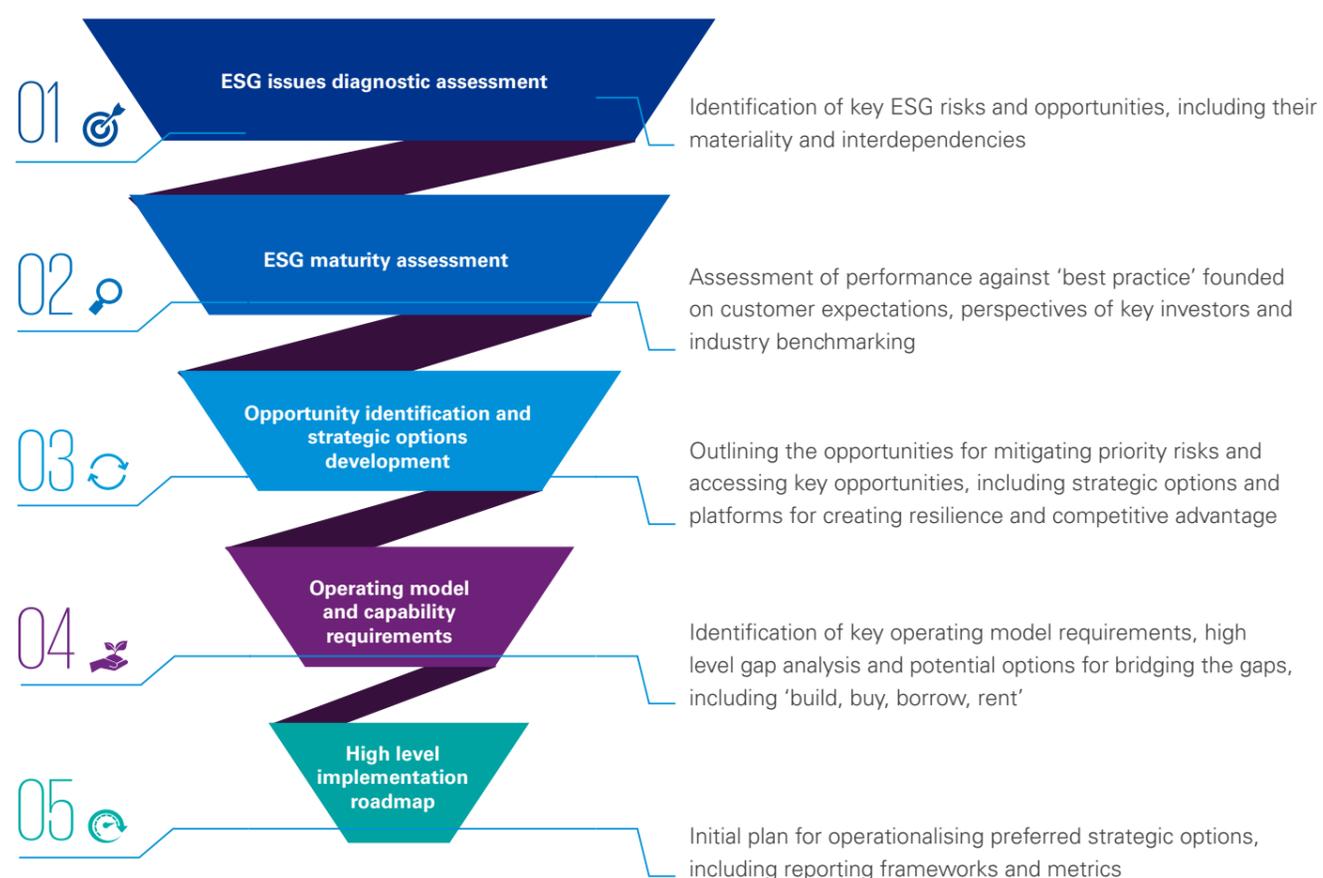
Having an ESG strategy is imperative for companies to address changing investor requirements and government regulation, as well as a way to build on their existing competitive advantage, improve resilience and drive value.

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KPMG's approach to ESG strategy development

Our approach to embedding ESG into the corporate strategy agenda follows a five-step approach.

Each step can be undertaken in isolation or as part of an end-to-end strategy development.



Our ESG issues diagnostic & maturity assessment tools

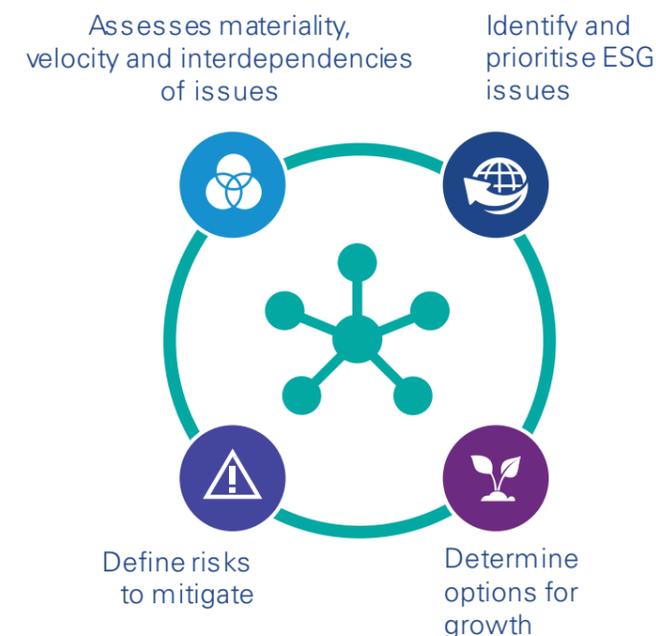
Our two tools can be seen as discrete pieces of work, or as part of a longer strategy setting project, to take both an outside-in and in-side out approach to rethinking your ESG strategy with an ESG lens.

ESG issues diagnostic assessment

The ability to 'cut through the noise' and identify the ESG issues and risks with the most material impact on the business is key.

KPMG's ESG issues diagnostic assessment tool uses qualitative and quantitative analysis to identify key ESG issues based on their materiality, velocity and interdependencies.

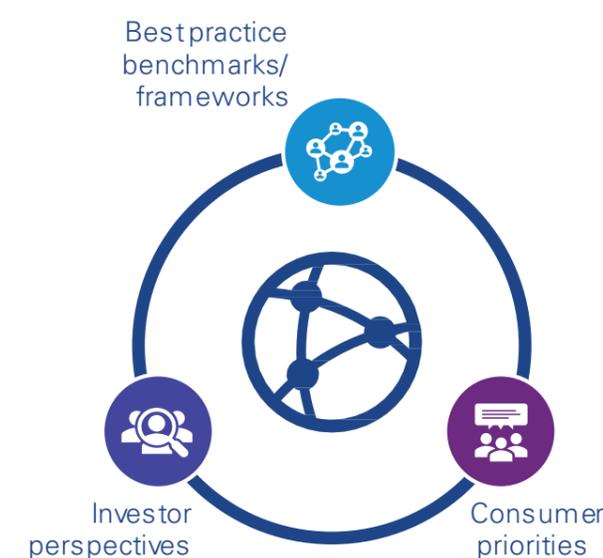
These insights give management teams a shared understanding of which ESG issues to prioritise, and provides a basis for identifying options for growth and mitigation of key risks.



ESG maturity assessment

The ESG maturity assessment gives a robust framework for assessing an organisation's relative ESG maturity when compared to industry and peer group best practices, the perspectives of investors, as well emerging customer needs and preferences.

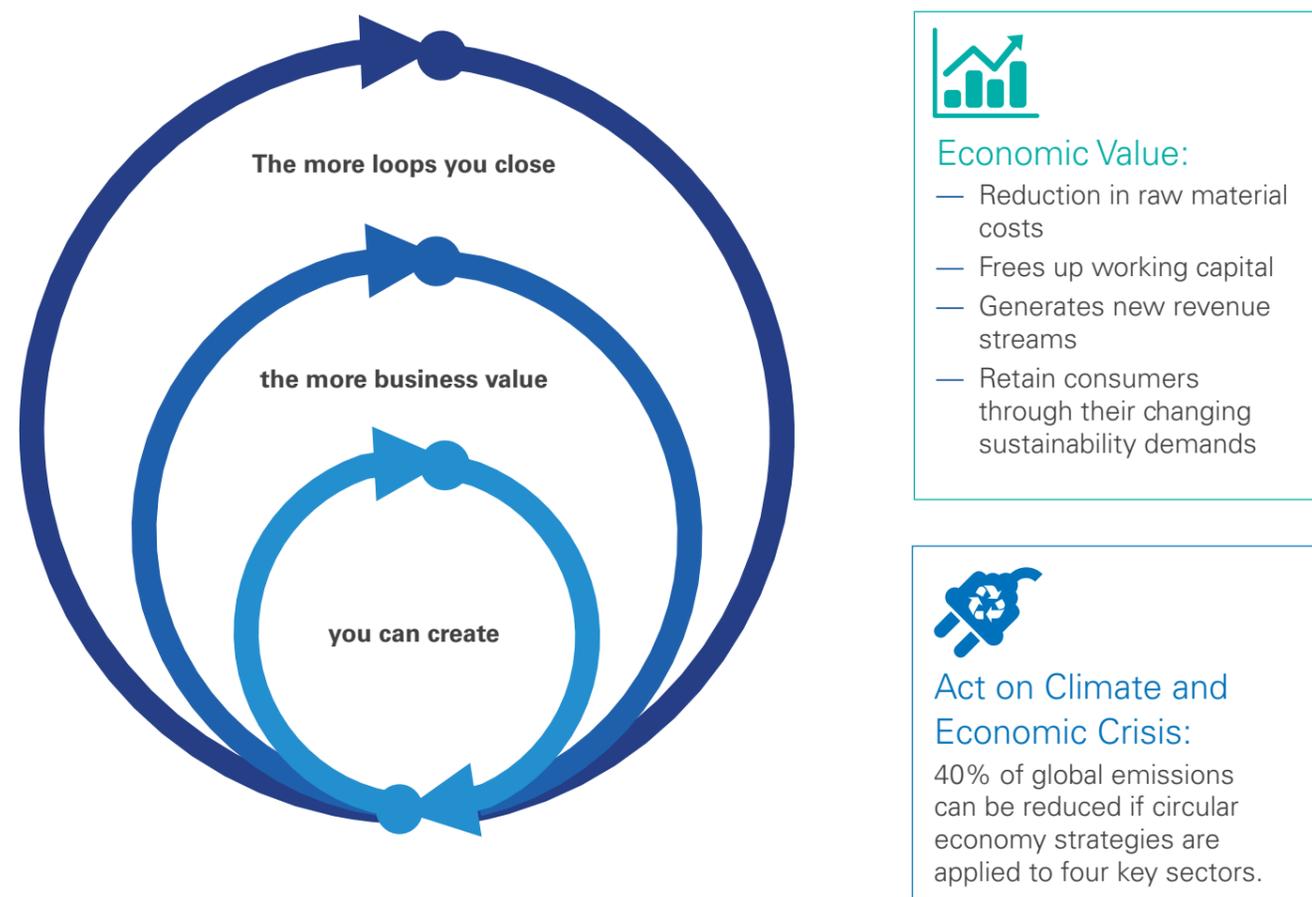
These insights highlight the operational readiness of an organisation and provides the basis for prioritising future initiatives and investment decisions.



The Circular Economy

A circular economy is an economic system of closed loops in which raw materials, components and products retain their value as much as possible, use renewable energy sources and put systems thinking at the core.¹

Sources: (1) Ellen McArthur Foundation definition



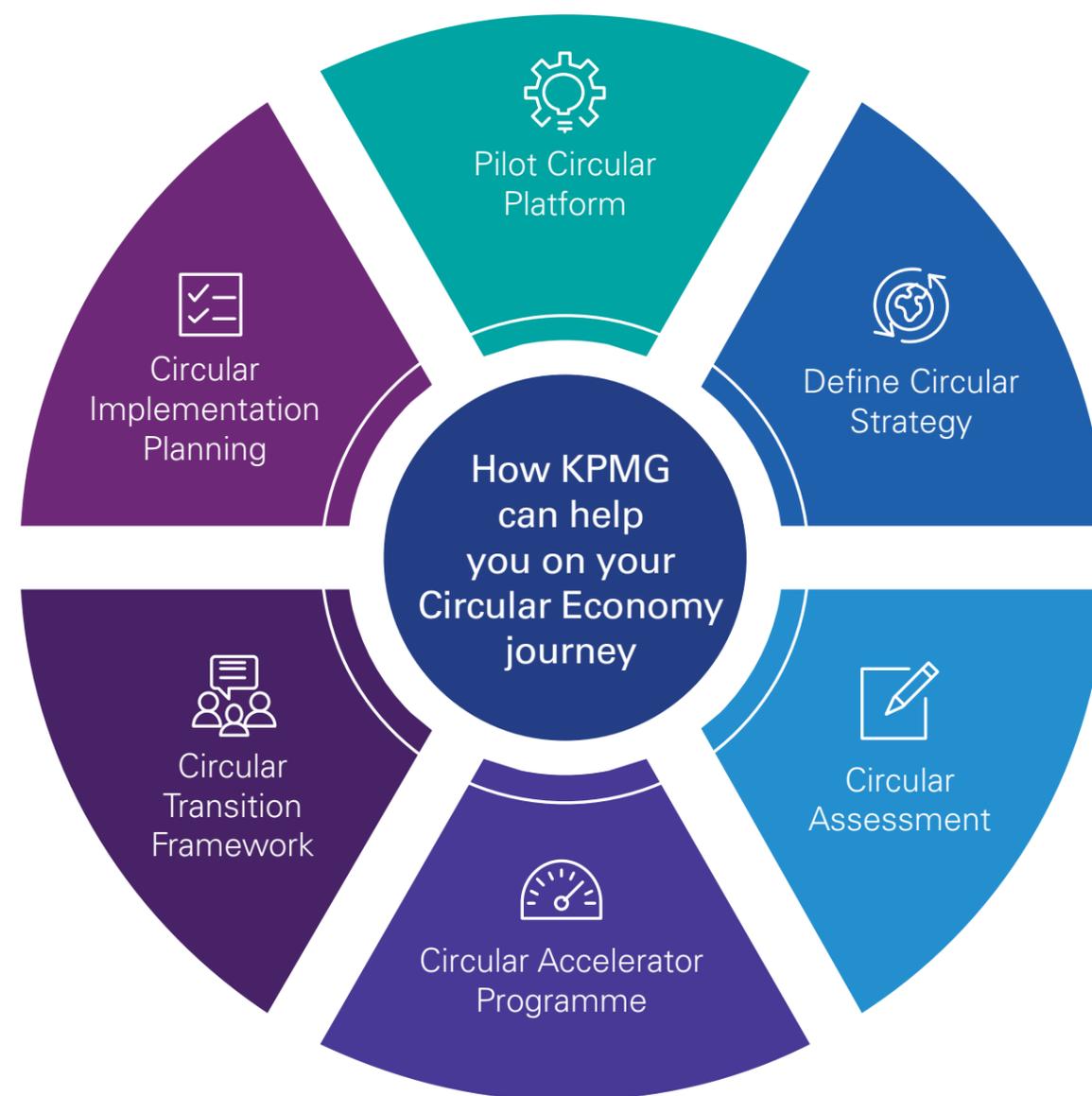
Mitigate Risks
A circular business model allows the redesign of products and services, utilising new technologies that enable future optimisation & virtualising e.g Track and Trace, Internet of Things & Block Chain.

Adapt to regulation:
New 'material use' regulation means clients that lack adaption will be impacted through taxation bills
Investment requirements from lenders require sustainability reports integrated with circular KPIs.

Our Circular Economy Solution

We have six discrete offerings which can be tailored to whatever a client's needs are on their circular journey.

These offerings can combine together, where needed, to provide a deeper and more holistic sustainability strategy solution.



Climate Risk & Decarbonisation Strategy

Many businesses are not adequately prepared to deal with macro-economic changes taking place to combat climate change.

Immediate action is needed to mitigate the risks of failing to react. However, there are even greater opportunities for early movers who position themselves at the head of the market in a new, climate-resilient future.



Measuring progress and reporting

Helping you effectively communicate with your stakeholders by:

- Helping you draft your external climate narrative
- Ensuring that your climate related disclosures are verifiable and meet mandatory reporting requirements
- Providing assurance over the data reported
- Benchmarking your reporting against your peers and best practice



The climate resilience journey

We can help clients identify where the risks and opportunities are on their "circuit" and make sure they have a strategy that keeps them in control of these risks and opportunities and at the front of the pack.

Our proposition is an iterative process to help our clients continuously improve their response to climate risks and hence financial performance in line with stakeholder expectations.



Transformation

Making the necessary changes to create a climate resilient business model by:

- Building out mitigation strategies for risks identified
- Identifying investments required to take advantage of the opportunities
- Setting metrics and targets to drive cultural change
- Setting and implementing metrics and targets
- Reviewing market disclosures



Strategic response

Planning for your company's future in an uncertain world through:

- Scenario analysis under both orderly and disorderly transitions
- Assessing your Board's risk appetite
- Defining your climate narrative
- Identifying quick wins



Risk and opportunity identification and qualification

Identifying your climate risk and opportunities by:

- Breaking down your company's value chain
- Identifying climate risks and opportunities at each stage of the value chain through our risk tool and meetings with management
- Undertaking Dynamic Risk Assessment analysis to assess the interconnectedness, time to crystallise and quantification of the risks and opportunities identified



Businesses not taking ESG seriously are beginning to lose customers, employees and financing; eventually they will become unviable.

Sustainable Finance

Financial services firms have a unique role to play in driving sustainability into the wider economy. This power of finance as a force for good puts financial services in the spotlight to adopt sustainable finance into business and operating models.

We look at sustainable finance for both borrowers and for lenders. We can help sustainable finance firms build sustainable finance as a core part of the investment strategy. For Corporates, we can support businesses include ESG factors into debt facilities to access broader pools of capital and debt pricing benefits for delivering ESG impact.



1 ESG Transformation

Both providers and recipients of finance must comply with upcoming ESG regulation. Using our ESG maturity assessment, regulatory decomposition, and target operating model design and implementation, we can help you start the journey of transformation for both regulatory compliance, but also to embed ESG into your business for a strategic advantage.

1

2 ESG Financing for Asset Managers

We help asset managers to comply with the continuing wave of regulation about the sustainability of who they loan to, insure, or "invest in". We also assist our clients to design ESG financing products to offer borrowers which incentivise sustainable activities whilst being competitively priced.



2



3 ESG Scoring

Our IGNITE platform rationalises ESG scoring discrepancies and creates a bespoke and transparent rating per portfolio for Asset Managers. Using this, we can provide a unique perspective and deep understanding of the materiality of your ESG risk exposures on an ongoing basis, and help you formulate your ESG strategy and communicate your ESG appetite to external stakeholders and the wider market.

3

4 ESG Financing for Corporates

We can facilitate access to ESG linked capital by helping articulate ESG strategy and credentials. We can help corporates engage on ESG with shareholders and lenders, in M&A transactions, as well as attracting ESG Finance through instruments such as ESG-linked bonds and loans.



4

Ethical Supply Chain

Using our market-leading technology such third-party intelligent diligence, dynamic risk assessment, and predictive supply chain management, we map the extended value chain, measure the ESG performance of operations, and prioritise key risks.

A strategic change in the operating model needs to consider the entire value chain, and as you transform, they need to follow your lead.

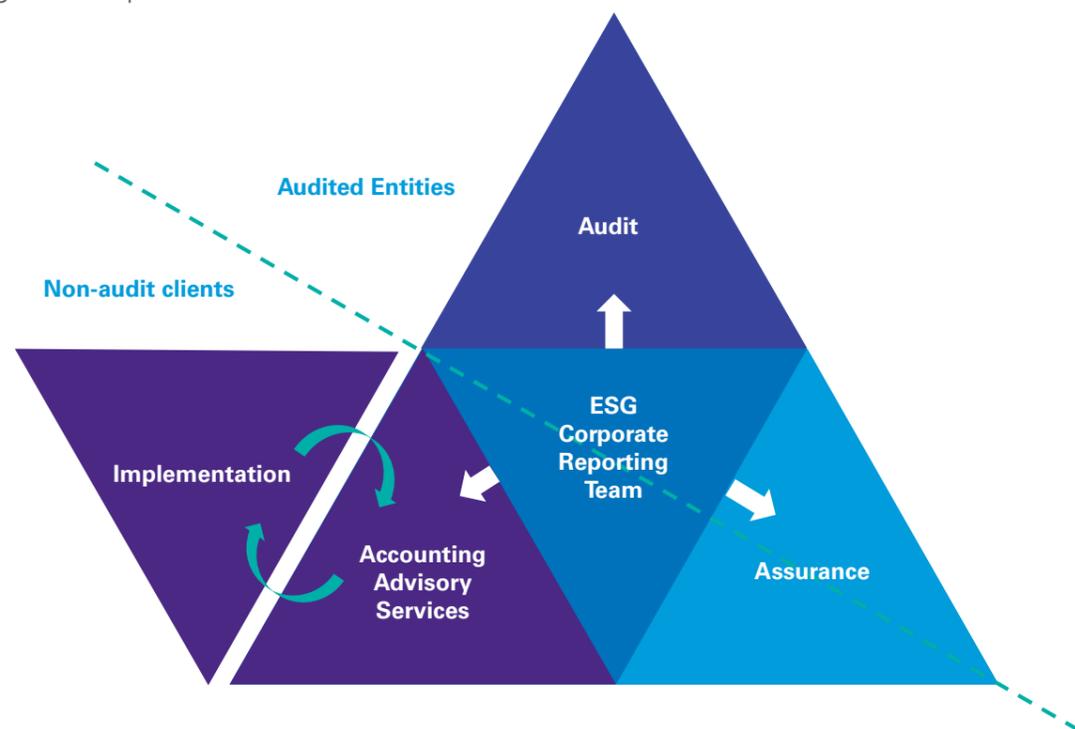
Bringing to life the ethical and sustainable vision of a business



Corporate Reporting

Providing external assurance opinions on the financial and non-financial, qualitative and quantitative, voluntary and mandatory ESG reporting requirements.

We can help clients understand regulation, benchmark across sectors, improve data quality, and meet upcoming TCFD requirements.



Corporate Reporting Advisory

- For our non-audit clients we can help them to understand regulatory requirements, and identify, gather and report information associated with regulation and best practice.
- This might include designing and implementing reporting systems to support day to day management and oversight.
- We can also help clients to capture and visualise ESG metrics/disclosures which engages the user and brings to life the organisation's corporate strategy.



Assurance for non-audit clients

- Some clients are much more progressed along the ESG reporting lifecycle and are seeking assurance over their metrics.
- We can also offer Readiness Assessments to review reporting with a critical eye without providing an opinion.



Audited Entities

- Some ESG information may feature in the audited financial statements, for example because it's needed to understand a key accounting estimate or judgement.
- Whilst information in the Strategic Report is not audited, the auditor will nevertheless read the other information and consider whether it is materially misstated or inconsistent with the financial statements.

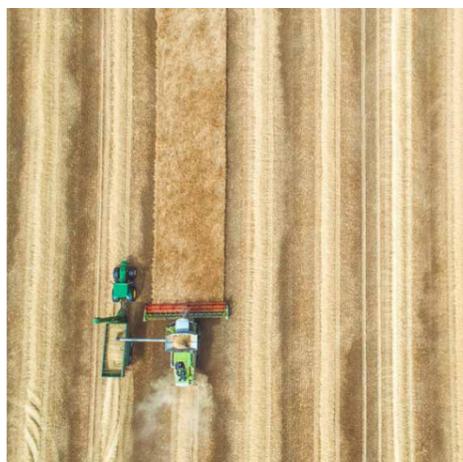


Assurance for Audited Entities

- The recent Updated Ethical Standard identifies specific permissible services which allow us to provide Assurance over ESG KPIs either included within the Annual Report or reports linked to the ARA.

ESG at KPMG: Our commitment

We are committed to our communities, promoting Inclusion, Diversity and Social Equality and protecting the environment.



Environment

- Science Based Target to be Carbon Zero by 2030
- Carbon Disclosure Project A and A- ratings (top 4% of organisations)
- Owned offices powered by renewable energy
- Removed 8 million pieces of single use plastic from business since 2013



Social

- Top 2 Social Mobility Employer: 12% from free school meal households
- 700+ apprentices employed
- £1million+ for NSPCC in 18 months
- 67,000 volunteering hours 2019
- KPMG Foundation: £16m to over 100 projects



Governance

- Gender parity on UK Board
- Firm oversight by Public Interest Committee of Independent NEDs
- Stonewall Top 100 Employer
- 5.4%/1.0% reduction in gender/ethnicity pay gaps in 2019
- 160 staff taken part in Black Heritage Reverse Mentoring

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National commitments to the 2015 Paris Agreement will enforce greater accountability for corporates to take climate action. UK target will require all greenhouse gases to be net zero by 2050 leading to higher taxation of GHG emissions.”



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