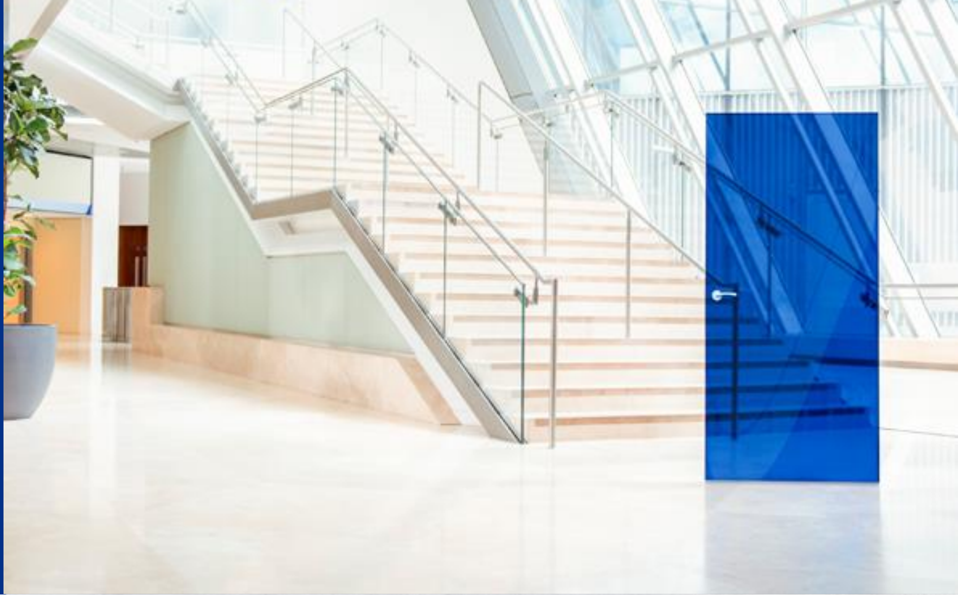
A conversation with investors

KPMG Board Leadership Centre



Engagement between companies' boards and the investment community is crucial, not only around financial matters but also areas of growing strategic importance such as ESG and diversity. Rick Lacaille of State Street and Edward Mason of Generation Investment Management joined a meeting of our FTSE100 Audit Committee Chairs Group to share their thoughts. A summary of the conversation is set out below.

With climate change, ESG and other issues such as diversity and inclusion firmly on the board agenda, it was timely to hear from two seasoned investment professionals who also have a specific interest in the environmental, social and governance agenda.

Rick Lacaille, Executive Vice President at State Street, is also the firm's ESG lead. As a passive investor tracking indexes, State Street are as interested in policy measures and the big picture as they are in individual companies. For Edward Mason, Director of Engagement at Generation Investment Management, meanwhile, the focus is very much on individual stocks. In its global equity strategy, the company is invested in around 40 to 50 companies with a philosophy of active engagement around sustainability and long-term performance.

UK report card: qualified positives

So, what are their perceptions as to how corporate UK is faring in relation to ESG goals, and climate related targets in particular? Both of them gave qualified approval, saying that the 'direction of travel' is positive and that awareness of the issues is higher than in some other parts of the world. But both also observed that the FTSE is quite heavily 'weighed down' by some big carbon-intensive players.

"With all the UK's renewable opportunities, we *should* be doing well," Rick said. "So I'd put it at OK to slightly better than average as things stand."

Meanwhile, Edward outlined the size of the challenge: "We're not where we need to be. We need to halve emissions this decade to be on track for the 1.5° target. We need to work together, businesses and investors and policy makers, relentlessly and with determination if we are to achieve that."

Edward said that at Generation they look for commitment to medium-term science-based targets, which also need to be validated. Similarly, Rick said that there needed to be a commitment to Net Zero by 2050, supported by shorter-term plans and commitments.

"These commitments become a forward-looking statement, which can cause some anxiety. Often as a result they are quite soft or conditional," he observed. "I fully understand it can be difficult – there are some quite technical factors involved after all."

Better disclosures needed

Alongside sustainability action and commitments, disclosure and reporting is also important. However, this is an area where Edward feels progress has been slow.

"We're not getting enough useful disclosure is the short answer," he said. "It absolutely starts with disclosure and this is an area where at Generation we have set out very clearly our framework of expectations – including disclosure of emissions, Scope 3 emissions, TCFD reporting etc. But some businesses still don't even disclose their own emissions. We're taking a very close look at these companies - we're making it clear that if they don't change their ways we will vote against their Chairs"

Rick also felt that disclosures did not entirely meet needs. However, he felt that the SASB guidelines with audited verification were a good starting point, together with TCFD for climate related information. Consistency is clearly needed. "Data from various sources – either direct from companies themselves or from third parties - can often seem contradictory. This is largely because people are trying to achieve different things with it. In some ways we need to live with that and even celebrate it as giving us a richer picture. But I strongly support the drive towards a single set of international standards for sustainability reporting."

This is something that Edward concurred with. "There needs to be more consistency and rigour because otherwise companies cherry-pick what and how they report. We need clear information on short, medium and long term targets together with information on the transition plan. It's reasonable not to have all the answers at this stage, of course, but we need to know companies are on it."

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The issue of how hard it is for companies to report on and evaluate some of these issues was something raised by one of the attendees at the event, who spoke also of "a fear of being too honest". This was a perspective that Rick and Edward had a lot of sympathy for, but encouraged boards to be as open as possible.

"The reputation of a board is always enhanced by authenticity and candour," Rick said. "They may end up 'stubbing their toes' on one or two non-starter initiatives, but overall it pays dividends in the long run to show that you are paying attention to big structural issues like climate and ESG."

Diversity and inclusion is on the radar

Away from ESG, another big topic is diversity and inclusion. For Generation, indeed, this is the second biggest priority behind climate change within ESG. Again, reporting was an area where Edward felt there was clear room for greater progress.

"Disclosure could be much better" he said. "We need more information on the company's strategies and policies to create change. There's such compelling evidence that better diversity and inclusion is good for business." It was noted that the Black Lives Matter movement had been positive in terms of momentum.

For Rick, he said we should all "start at home – in our own businesses." He is keen to see greater progress across businesses in the financial services industry. "At State Street, we have linked our targets to executive compensation. It would be hypocritical for the investment and financial services industry to talk about this if we don't also hold the mirror up to ourselves. There are glimmers of hope – with some good diversity coming through. We now need to nurture that talent with really good and authentic inclusion programmes."

Governance, stewardship and audit

Another area addressed in light of the proposed BEIS governance and audit reforms was whether the UK was an attractive place to do business.

Rick noted that the UK is fortunate in that it has always had high standards of governance and stewardship, "We need high standards and we need to attract good quality companies – the two shouldn't be in conflict"

Edward pointed out that, from a global perspective, the US was still the most attractive market. "There's a danger of the UK governance system becoming too restrictive, too rules-based. There are some potential downsides. It's a difficult balancing act to strike."

One attendee noted the recent BEIS proposal for audit committees to consult with shareholders over the external audit plan. Both Rick and Edward conceded that it can be hard for investors to respond on audit matters despite the fact that those connected to the audit are "the guardians of our investments" as Rick put it. "We need to be intelligently selective," he said. "We need to sharpen our pencils and find ways of doing better."

Overall, a fascinating and wide-ranging discussion amply demonstrated that there is no shortage of issues for investors to be discussing with boards and committees – meaning that ongoing and indeed increasing engagement will be key moving forward.

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