Issue 7

luminous.co.uk

Reporting Matters

ESG integration and disclosure within FTSE 100 corporate reporting

luminous

Introduction to Luminous

A strategic comms partner

We provide Brand & Culture, Investor Engagement & ESG Disclosure and Sustainability & Impact expertise that connects insight and creativity to business outcome.

In this issue

Introduction

Luminous is delighted to present the seventh edition of Reporting Matters, focused on ESG integration and disclosure within FTSE 100 corporate reporting.

Since the COVID-19 pandemic, Environmental, Social and Governance (ESG) has become even more of an important subject for clients and investors as it is both a way to do well and a way to mitigate risk in the long term.

Globally, sustainable funds based on ESG themes pulled in a record-breaking $20.6 billion of new money in 2020 – almost four times the 2019 figure of $5.5 billion, itself a record.

The ESG reporting landscape is complex, ranging from frameworks that include the Sustainability Accounting Standards Board (SASB), the Task Force on Climate-related Financial Disclosures (TCFD) and the Global Reporting Initiative (GRI) to organisations like Sustainalytics that rate the sustainability of listed companies based on their ESG performance, to name but a few.

There are significant moves to create more harmony between the various standards and frameworks, such as the merger of SASB and the International Integrated Reporting Council (IIRC), collaboration between GRI and SASB and the proposed creation of an IFRS sustainability standard which in many ways could be a game changer on the investor engagement side.

The simple truth is that not taking ESG reporting seriously is no longer an option. Listed companies must understand how investors analyse ESG and respond to that in their reporting because this will ultimately impact the availability and cost of capital open to them.

In this report, we examine 39 Annual Reports from FTSE 100 companies. Using the London Stock Exchange's industry labels, we analysed the most recent reports of the two largest companies in each industry by market cap, covering:

The report offers practical advice on integrating ESG into corporate reporting and what best practice looks like today.

If you would be interested in hearing more about the research, how well your company is integrating ESG into its reporting and how Luminous can help you meet your investor needs, please do get in touch.

Lastly, I would also like to take this opportunity to thank Nina Kefer, Sarah Roper, Rachel Madan and Sheila Morrison for their input into this research.

Stephen Butler
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Best-in-class case study

We are seeing two main approaches to best-in-class ESG reporting - a ‘family of reports’ ESG suite and a more integrated Annual Report. The broader ‘ESG suite’ approach is more effective in the way it targets different audiences and layers information through multiple delivery channels.

CREATING AN AWARD-WINNING ESG SUITE FOR SEVERN TRENT

Severn Trent Water stood out in our review as a company that genuinely walks the talk, with social purpose and sustainability fully embedded in what it does and, in turn, fully integrated its ESG story across its reporting suite and corporate communications.

Best communication of ESG, FTSE 100
The IR Society Best Practice Awards

Best Investor Day
IR Magazine Awards

Best Annual Report, FTSE 100
The IR Society Best Practice Awards (shortlist)

BRINGING ESG TO LIFE IN THE ANNUAL REPORT

As ESG rises up the corporate agenda, there is a good deal of talk about purpose-led companies and the role of corporate business in wider society. Severn Trent Water's Annual Report contained several standout ESG features including its opening strong commitment to purpose and values, its detailed ESG disclosures, its 'Living our values' employee focus and its thoughtful s172 statement.

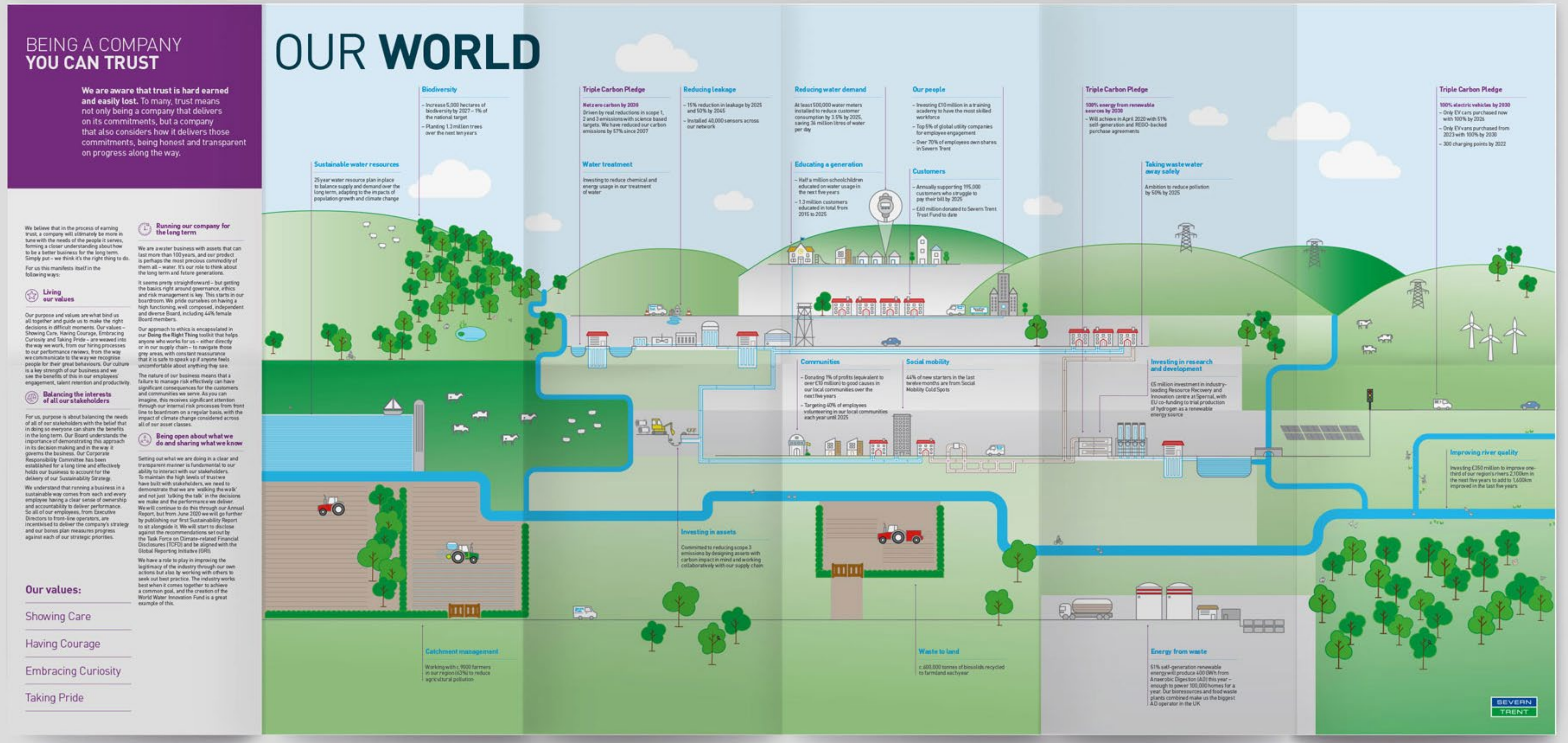
The Annual Report presented a strong commitment to purpose and values, detailed ESG disclosures and key achievements of its 'Living our values' employee campaign.

The visual treatment, which focused on people and nature, combined with ESG-focused narrative to deliver powerful purpose-led corporate reporting.

Infographics were used to present complex information in an accessible manner.

The expert's view: Stephen Butler, Director of Investor Engagement & ESG Disclosure

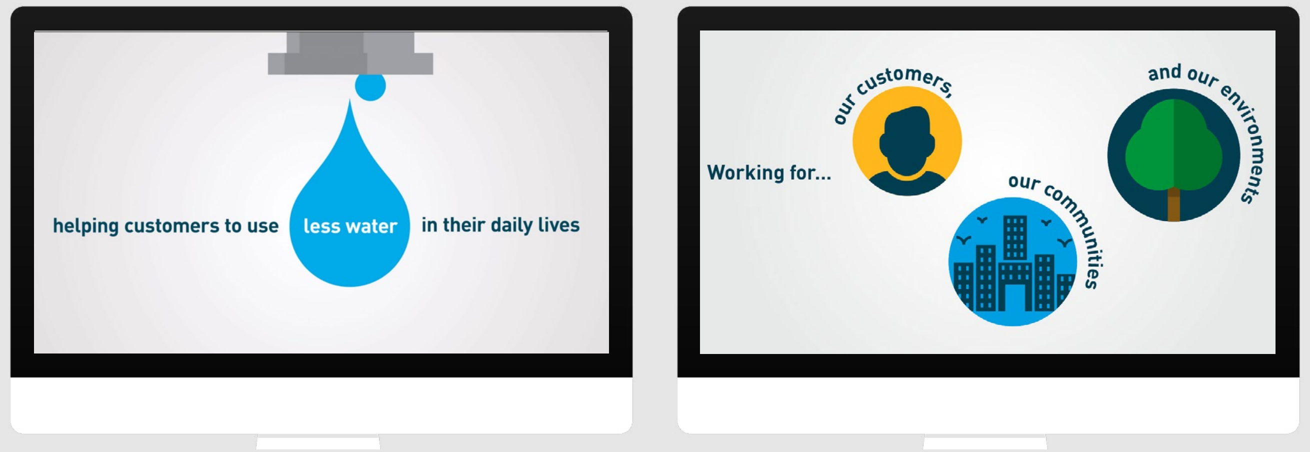
Severn Trent's Annual Report is a leader in many of our categories. The report evidences a clear approach, with a consistent point of view on material ESG issues and long-term focus on value creation.



AN ESG STORY ON A PAGE

Severn Trent Water cemented its position as a strong ESG stock at its Capital Markets Day. To give the audience a useful reference guide, Luminous created a foldout poster and infographic which outlined the organisation's approach to sustainability.

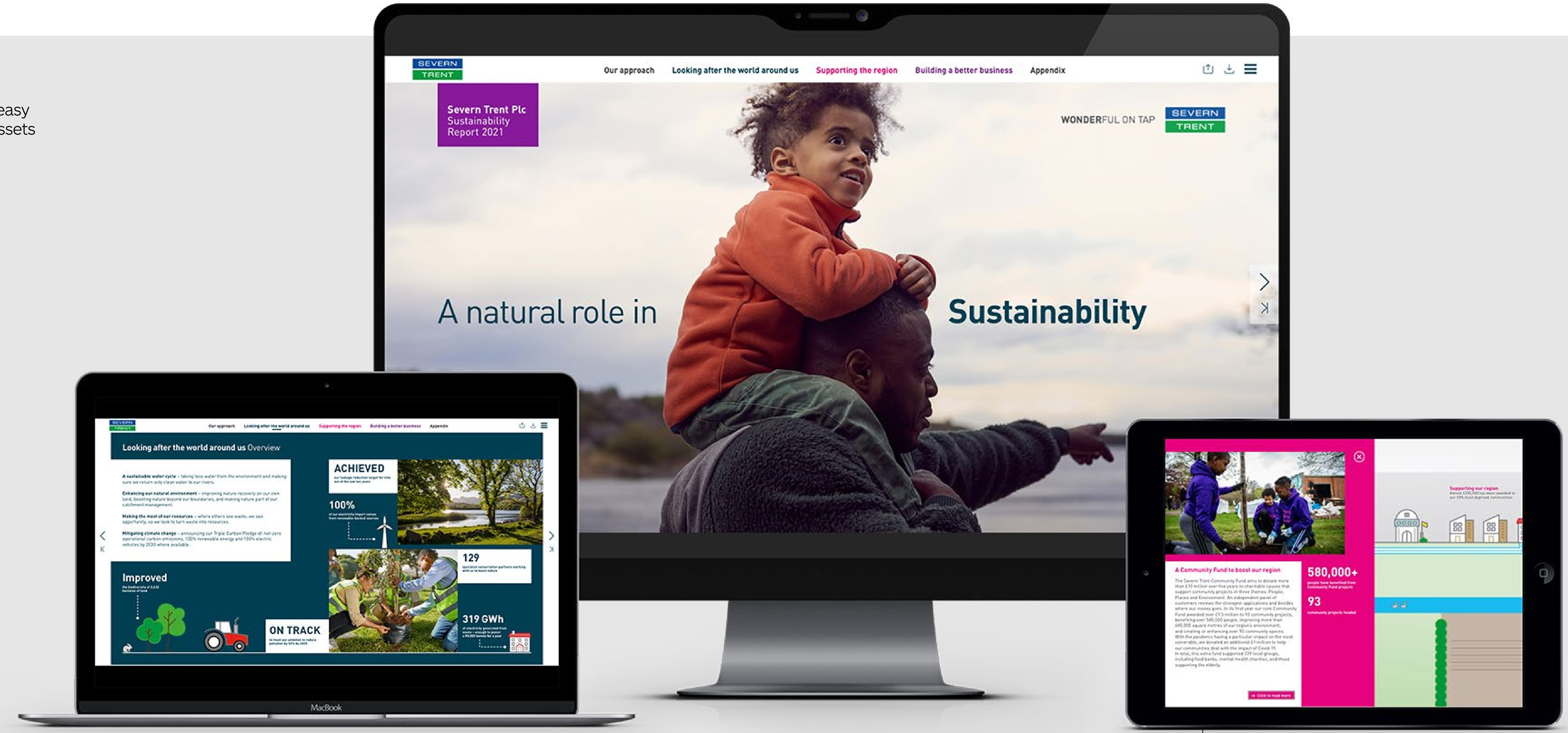
The foldout included key data and stories about ESG activities.



The simple graphic creative style enabled easy repurposing of visual assets across social channels.

PRESENTING THE ESG STORY ON FILM AND SOCIAL

The animation showed how Severn Trent Water was investing billions in creating a better environment: improving biodiversity, reducing leakage and educating the next generation about water and the environment. A shorter edit was repurposed for use on social media.



The digital-first approach meant designing the report in a way that worked responsively across all kinds of mobile devices.

A DIGITAL-FIRST APPROACH TO SUSTAINABILITY REPORTING

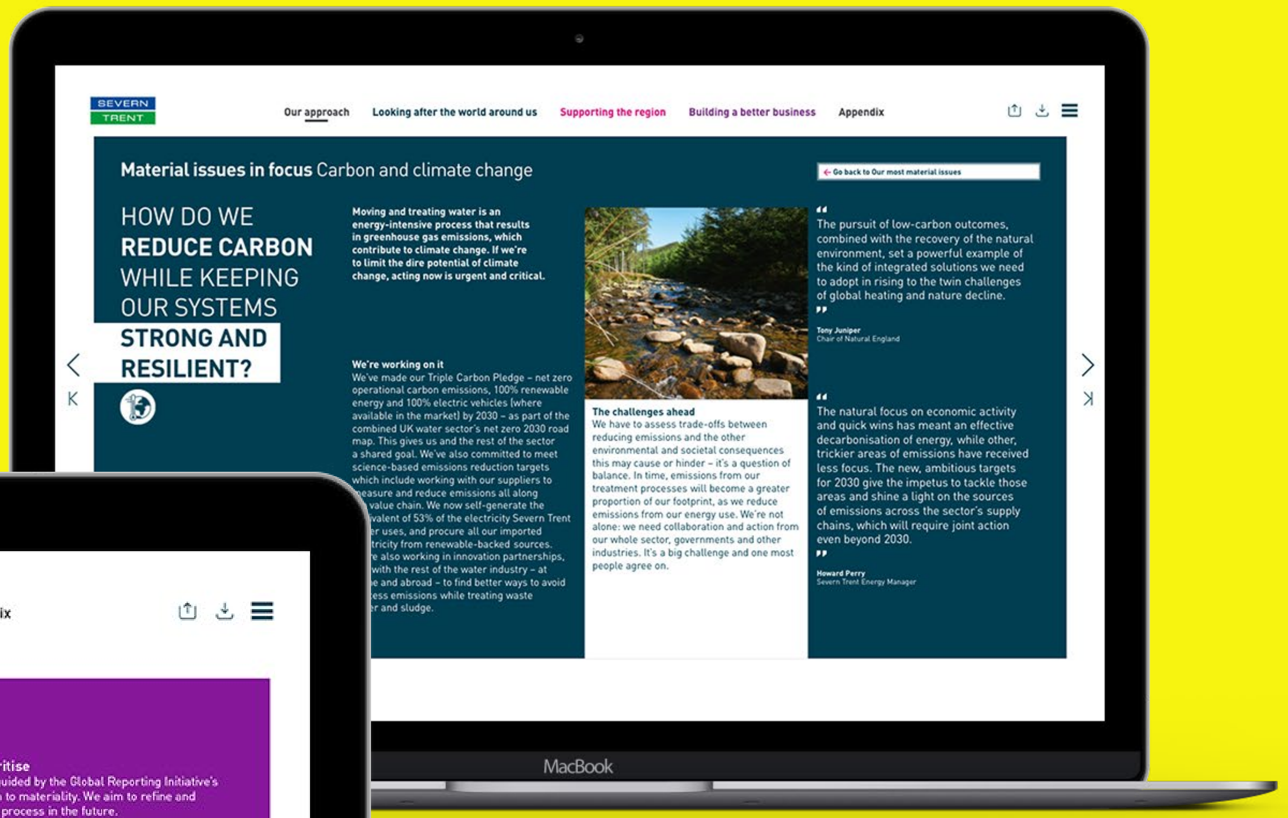
Having created Severn Trent's first standalone Sustainability Report in 2020, in 2021 we adopted a 'digital-first' approach, creating the report as a landscape interactive PDF which includes animated content, hyperlinked page drivers and a top navigation to provide a 'browser-like' experience.

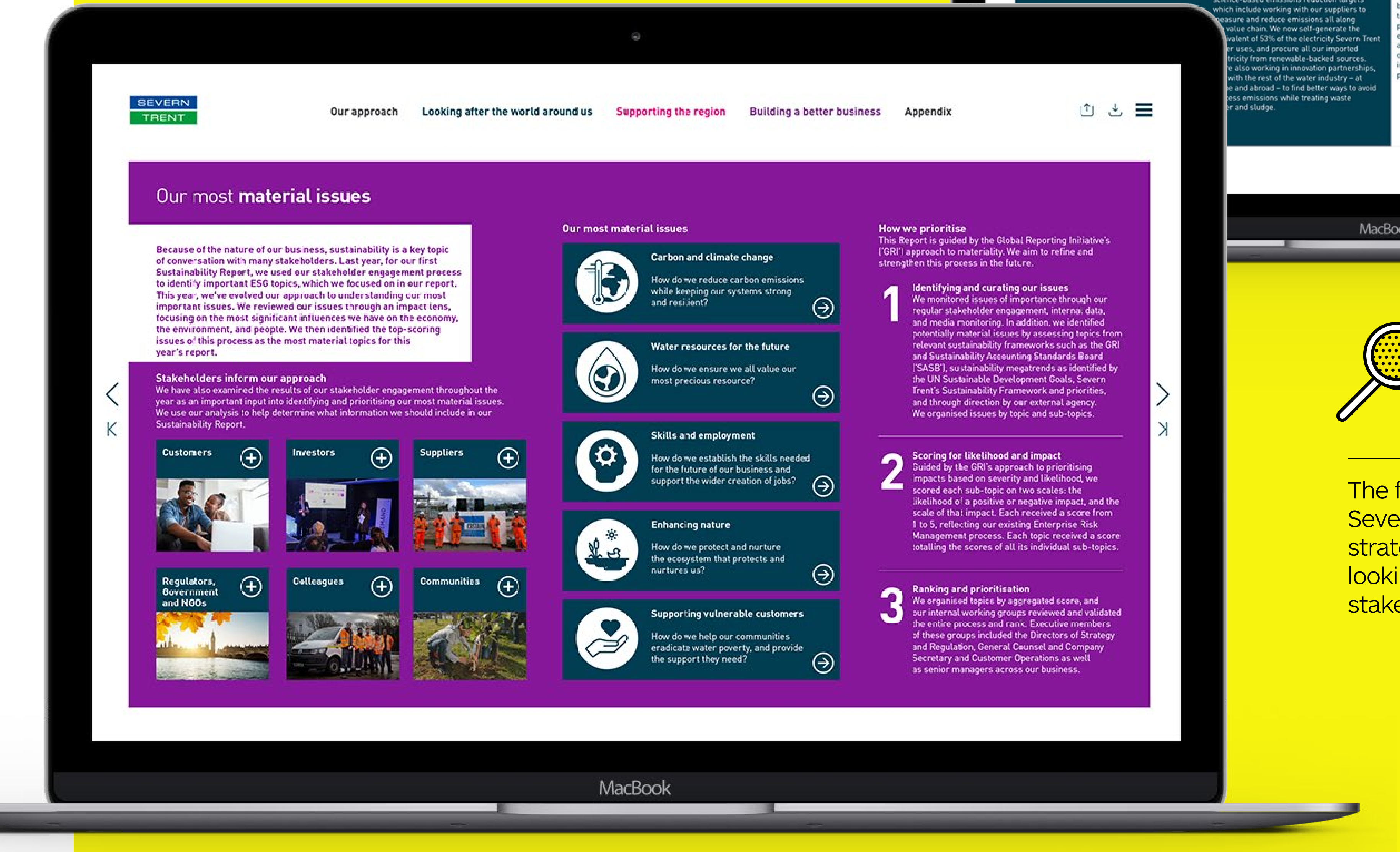
The expert's view: Rachel Madan, Director of Sustainability & Impact

Severn Trent's Sustainability Report is as credible as it is engaging. The in-depth analysis of material issues is supported by a solid strategy and detailed case studies, backed up by robust targets and KPIs. This is brought to life through interactive elements. The content is serious, but the experience of reading it is fun.

We helped the core sustainability reporting team to identify the universe of potential material issues, sourced through peer benchmarking and identifying sector trends in GRI, SASB, UN SDGs, and other sector-led initiatives.

We validated Severn Trent's existing stakeholder engagement process for completeness and created a prioritisation scoring rubric aligned with the company's enterprise risk management framework.



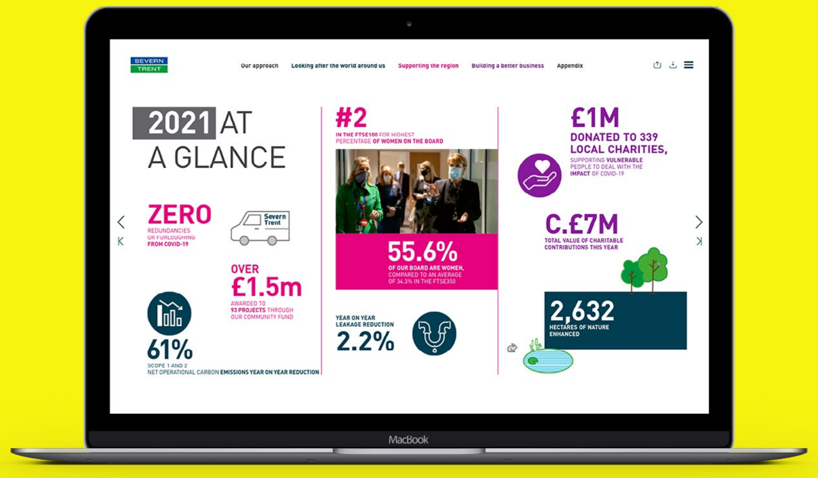


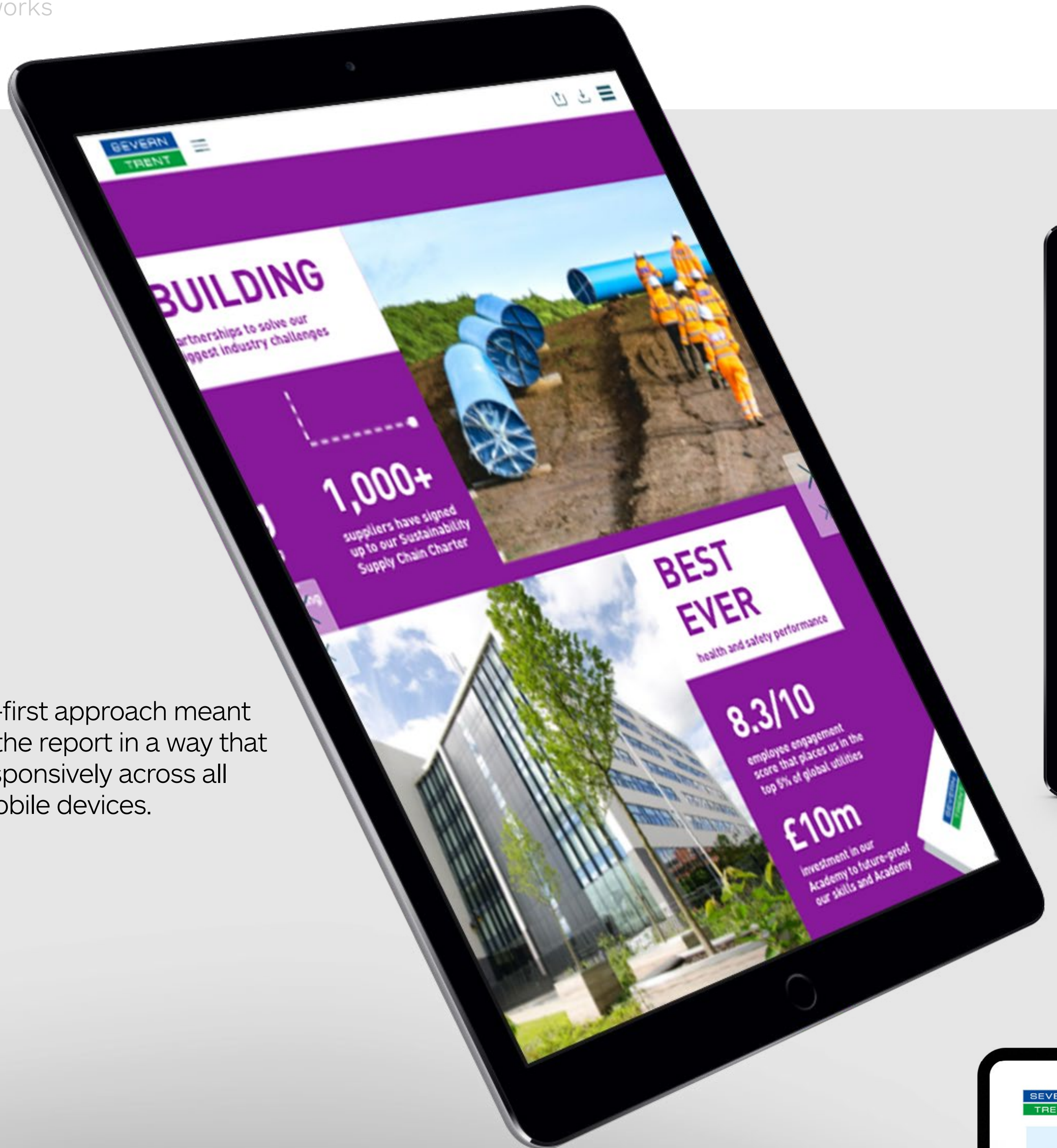
The final shortlist of material issues is linked to Severn Trent's most important KPIs and sustainability strategy. Each material issue is examined in a forward-looking deep dive, which adds external insight and stakeholder voices.

DOUBLE MATERIALITY

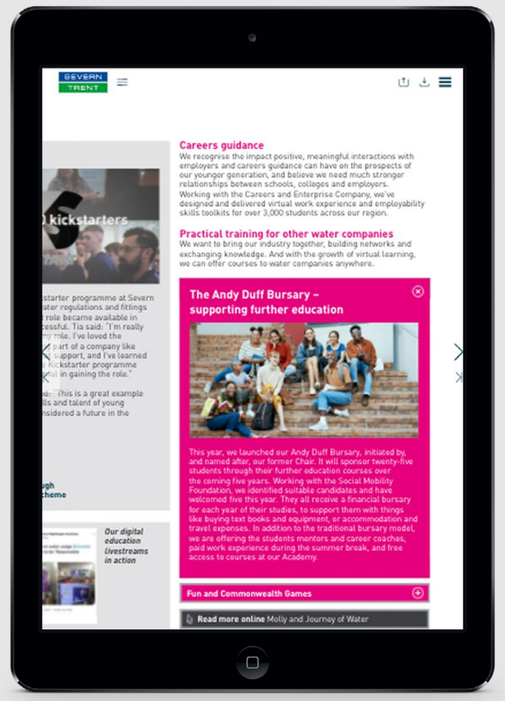
Luminous' Sustainability & Impact team conducted a double materiality assessment to identify material issues and provide a solid foundation for Severn Trent Water's sustainability strategy and reporting.

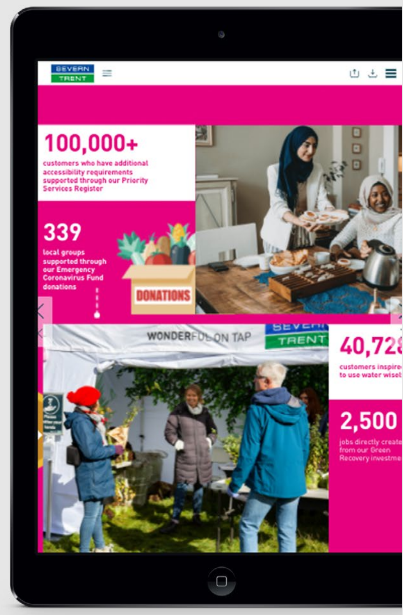
The at a glance section provides a snapshot of achievements which can be easily repurposed in social media channels.

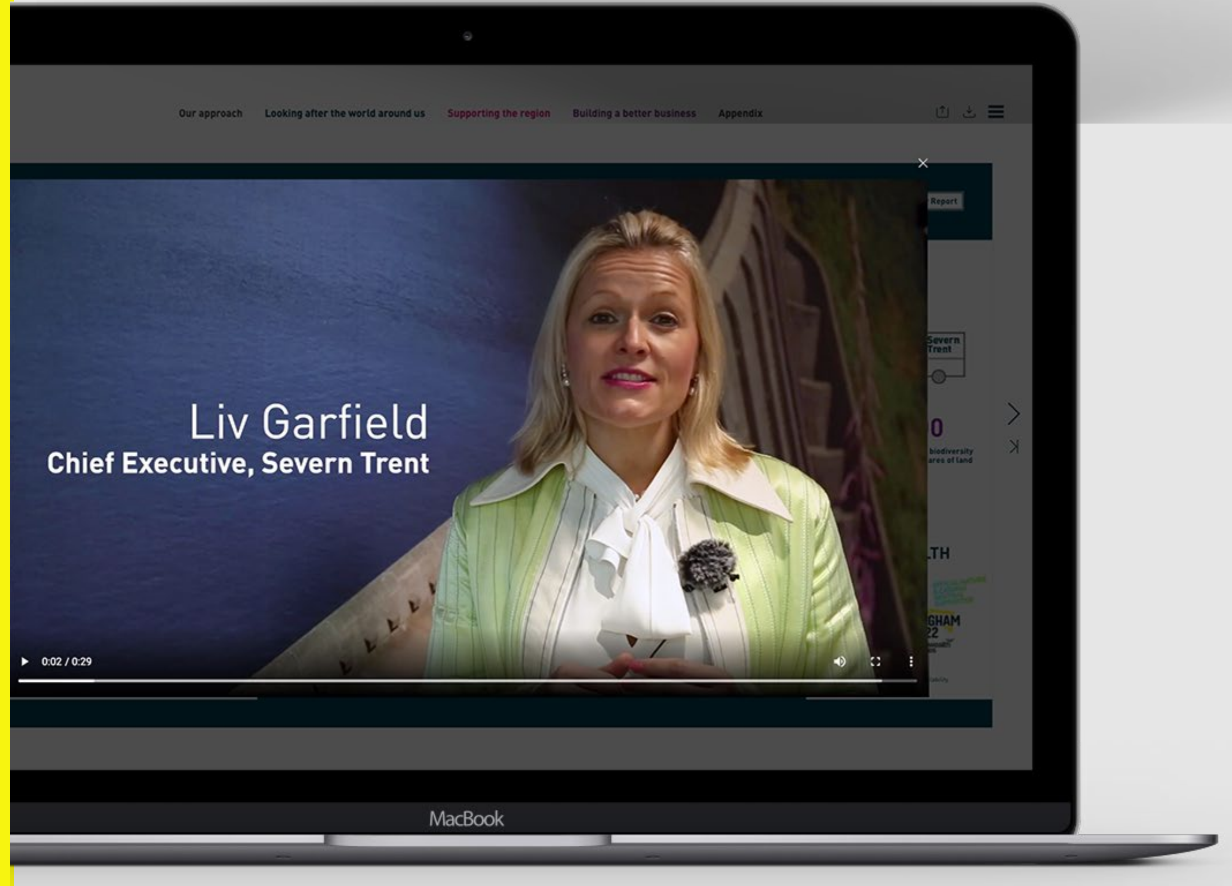




The digital-first approach meant designing the report in a way that worked responsively across all kinds of mobile devices.







To highlight the importance of sustainability to the business at leadership level, a video from the Chief Executive featured prominently, introducing the report and setting out the Group's strategic ambitions in the ESG space.

A high-level animated infographic highlights the most important impacts, and readers can zoom in on these stories for an introduction to the topic. Each pop-up then connects to a further section within the report.

Meet the team

Nina Kefer
Consultant

Rachel Madan
Director of Sustainability & Impact

Stephen Butler
Director of Investor Engagement & ESG Disclosure

Sarah Roper
Junior Consultant

Sheila Morrison
Director of Brand & Culture

Summary of key findings

ESG is increasingly integrated in the Annual Report of FTSE 100 companies...

54% of companies mention ESG in key sections throughout the Annual Report

90% have formulated an ESG strategy or integrated ESG elements into their corporate strategy

31% have a stated ESG strategy

87% have identified material ESG issues

61% have built their ESG strategy around their material issues

87% have set timeframes for some or all of their ESG priorities

26% track all their material issues in a performance table

80% are fully or partially aligned with the TCFD

TCFD

20% align their corporate or ESG strategy to the UN Sustainable Development Goals (SDGs)

SDGs

82% have identified a person or committee with an ESG remit

... but there is still room for improvement

31% do not discuss their materiality assessment

13% do not explain why they are committed to their ESG priorities

13% have no timeframes for their ESG priorities

31% do not consider ESG in executive remuneration

66% disclose little or no detail about their non-financial due diligence process

8% align their ESG reporting with SASB or GRI

13% mention ESG in leadership statements

33% have set targets for their ESG priorities

ESG INTEGRATION

Overview

With ESG emerging as a topic investors increasingly expect businesses to focus on, most FTSE 100 companies have an ESG or a similarly named section in their Annual Report.

Traditionally, this will be a section where the bulk of the ESG discussion takes place. It usually covers everything from information required by the Companies Act 2006 (Strategic Report and Directors' Report) Regulations 2013 and EU Non-Financial Reporting Directive (NFRD), such as greenhouse gas (GHG) emissions and diversity data, to non-financial case studies and specific ESG strategies. However, it is important to recognise that more and more FTSE 100 companies are coming to understand the significant and intrinsic link between their ESG performance and the overarching success of their business. As such, they increasingly adopt an 'integrated' approach to reporting, whereby ESG information features in some or all key sections of the report. Therefore, in terms of best practice in corporate reporting, a key indicator of a company's ESG commitment involves it having ESG-related discussions integrated throughout its Annual Report.

What we are seeing

In the context of this Luminous study of integrated reporting, over half of the companies in our sample discussed ESG in key sections of their Annual Report, such as leadership statements, business model, strategy and KPIs.

Additionally, one-third of our sample primarily discussed ESG in a designated section of the report with brief mentions elsewhere. This is a significant finding as it suggests 87% of sampled companies have chosen to adopt a substantially 'integrated' approach to reporting in their most recent disclosures. However, it must be mentioned that to score against these criteria, the most basic of ESG information outside the designated ESG section would qualify. Therefore, these statistics are partly derived from sometimes generic mentions of sustainable growth, compulsory carbon intensity ratios or broad, unsupported statements of ESG commitment.

When diving deeper into the data detailing where ESG information featured in the Annual Reports of our sample, leadership statements emerged as the most common section of the Annual Report to hold such content. Traditionally, leadership statements outline the highlights of the year for the business. As 37 out of 39 sampled reports mentioned ESG topics in the leadership statements, it can be concluded that ESG is a key message that leaders are trying to communicate to investors and stakeholders alike through their opening letters. This finding is significant as it indicates that ESG is recognised as an important issue from the top down.

Furthermore, the second most common section of the report to feature ESG was the risk management section. This may be a reflection of the increased focus on climate-related issues by the quoted company sector which has now been formalised through the Financial Conduct Authority (FCA) making TCFD reporting mandatory in the Annual Report for premium-listed companies with reporting periods beginning on or after 1 January 2021. The TCFD was established by the Financial Stability Board with the aim of improving the reporting of climate-related risks and opportunities and involves disclosing how organisations identify, assess and manage climate-related risks. The ESG risks presented in 12% of the sampled reports mostly sat under the 'E' measure of ESG. This included companies identifying climate change and its impacts, such as severe weather, water stress, cost and accessibility of materials or shifts in the political and regulatory landscape, as a principal, long-term risk. Consequently, this finding correlates to the UK Government's plan of rolling out TCFD reporting more widely going forward. However, while it is encouraging that climate change is increasingly recognised as a principal or at least an emerging risk, it must be emphasised that the TCFD is about identifying opportunities as well as risks.

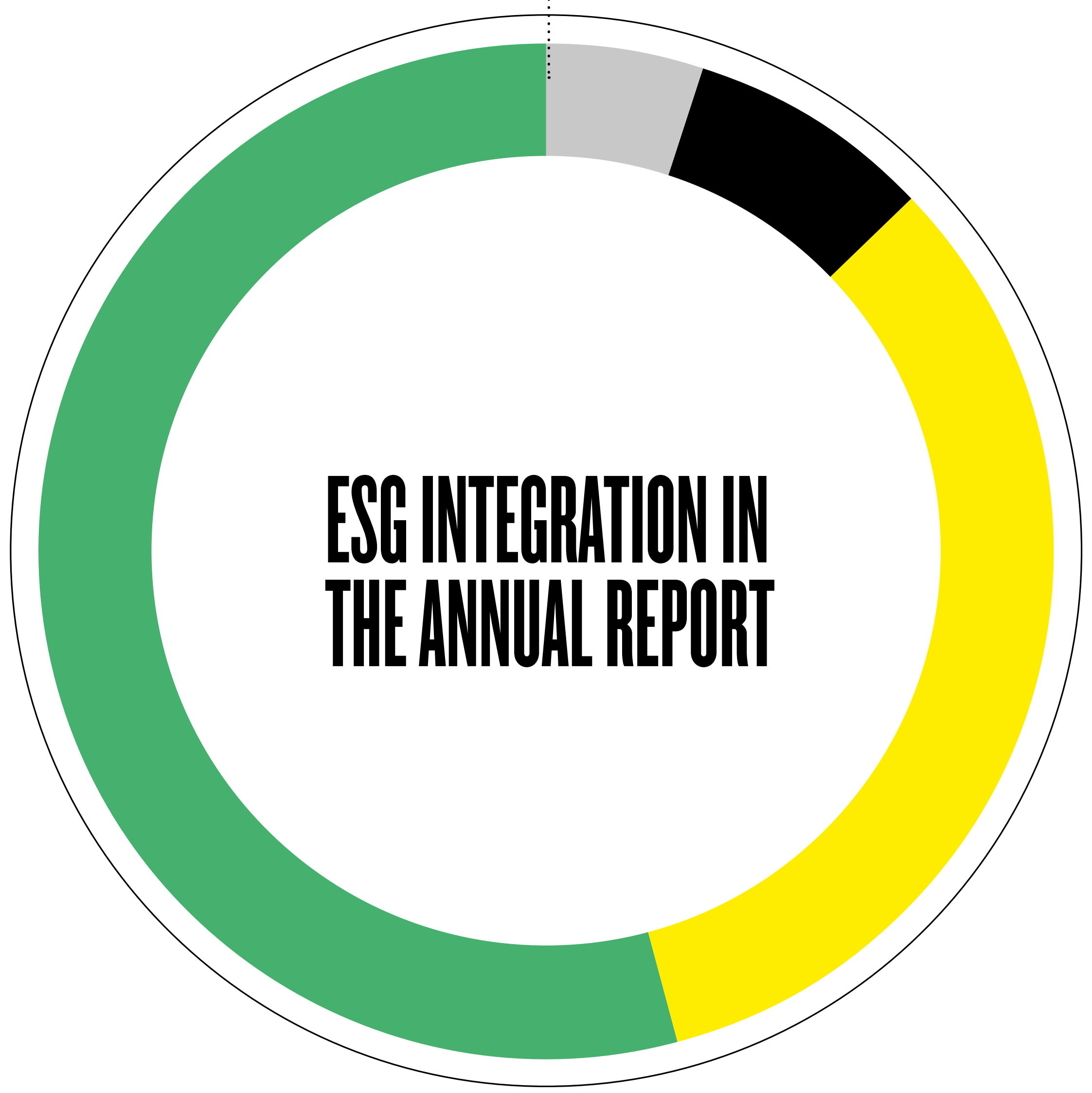
Lastly, a severe lack of ESG integration was highlighted in the corporate purpose statements of the reports sampled. This conflicts with the Financial Reporting Council's (FRC) ambition to encourage more companies to use their purpose as a 'North Star' to guide group strategy. With only 9% of our sample presenting a group rationale linked to ESG, it can be suggested that businesses should do more to underline the credibility of their ESG commitments by linking ESG into their corporate purpose and from there into strategy, given that the UK Corporate Governance Code (2018) requires companies to shown alignment between the two.

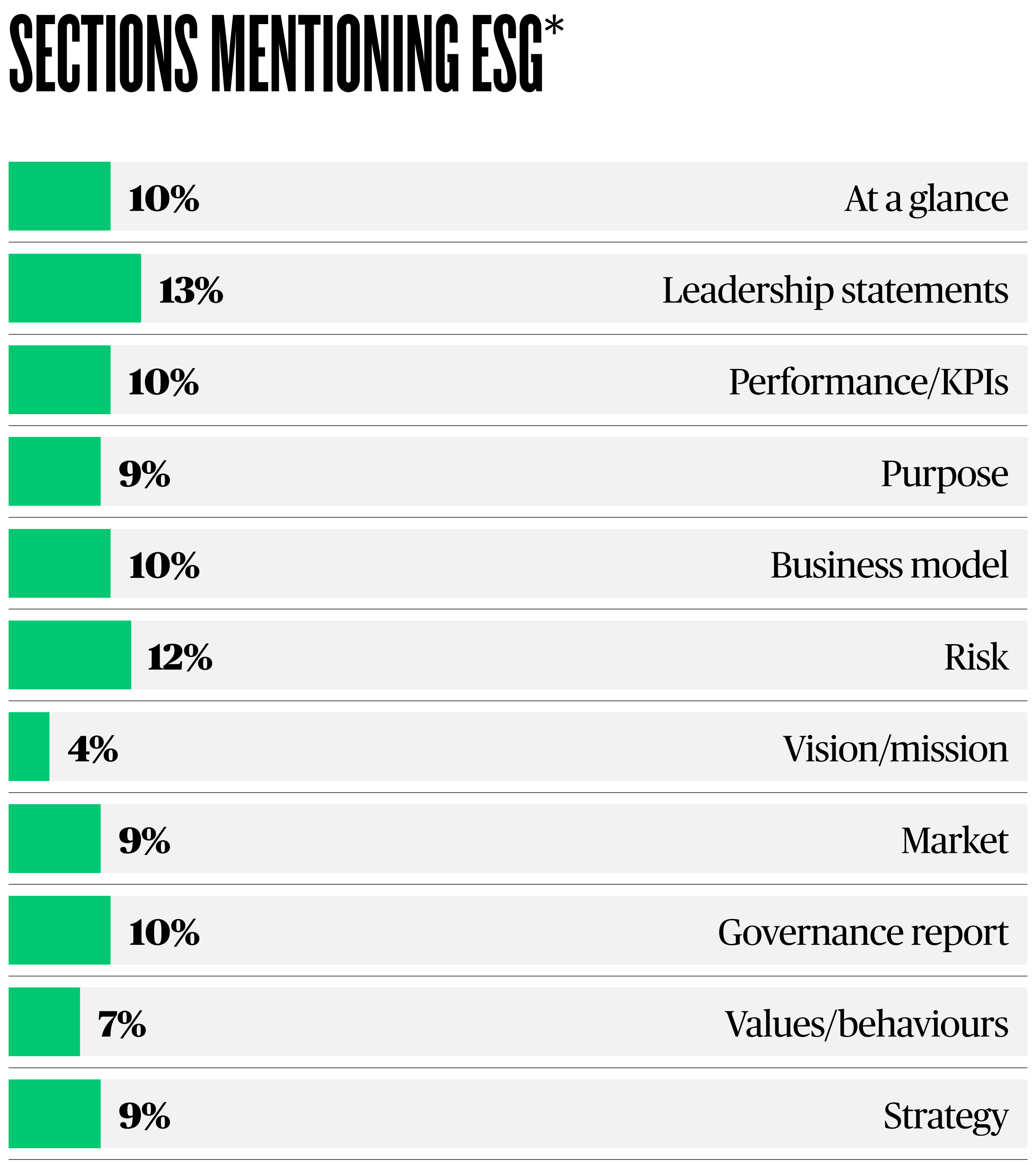
ESG discussed in key sections throughout entire report
54%

ESG discussed primarily in ESG section but briefly elsewhere in the report
33%

ESG discussed only in separate ESG section
8%

No qualitative ESG discussion outside mandatory statements
5%





*outside a dedicated ESG section

Best-practice considerations

So how should companies approach ESG integration and what should they consider when communicating ESG information in their Annual Report? Below, and at the end of each subsequent section, we share our key recommendations. For a full list of our ESG-related services including ESG disclosure and integration, TCFD guidance, reporting framework alignment, KPI development and target setting, ESG capital markets events and Board and Executive Committee training on ESG issues, please see page 27.

Demonstrate the link between corporate purpose and ESG.

Detail the key capitals used to create and sustain value and give examples of how a sustainable business creates value.

Address long-term sustainability commitments and sustainability performance in your leadership statements.

Reference relevant sustainability principles in your strategy.

Outline key non-financial risks and opportunities.

Add non-financial performance to the key highlights, alongside financial and operational performance, to demonstrate equal footing.

Reports in focus

SSE Annual Report 2020

SSE neatly integrates ESG discussion into key sections of its 2020 Annual Report. The company's commitments are comprehensive, detailed and action the best-practice guidelines outlined above. The report makes great effort to demonstrate the link between corporate purpose and ESG especially through SSE's leadership statements and strategy discussion. From beginning to end, the report details high-quality ESG information, most notably through the storytelling tools of case studies supported by compelling schematics and page design.

Download the report here

ESG MATERIALITY

Overview

In order to develop an effective ESG strategy, a company first has to identify the 'E', 'S' and 'G' issues that are material to its particular business. It then needs to explain to the readers of its Annual Report the approach it took, what the outcomes were and why it believes the issues it has identified represent an appropriate basis for its ESG strategy, so investors and other stakeholders can understand the rationale underpinning it. While there may be some overlap with risk assessment, for example mitigating reputational or climate risk by reducing the company's carbon footprint, this can also include taking advantage of opportunities, such as fulfilling growing demand for low-carbon products or being able to attract and retain talent through workforce engagement, diversity policies and positive ratings on external platforms like Glassdoor.

What we are seeing

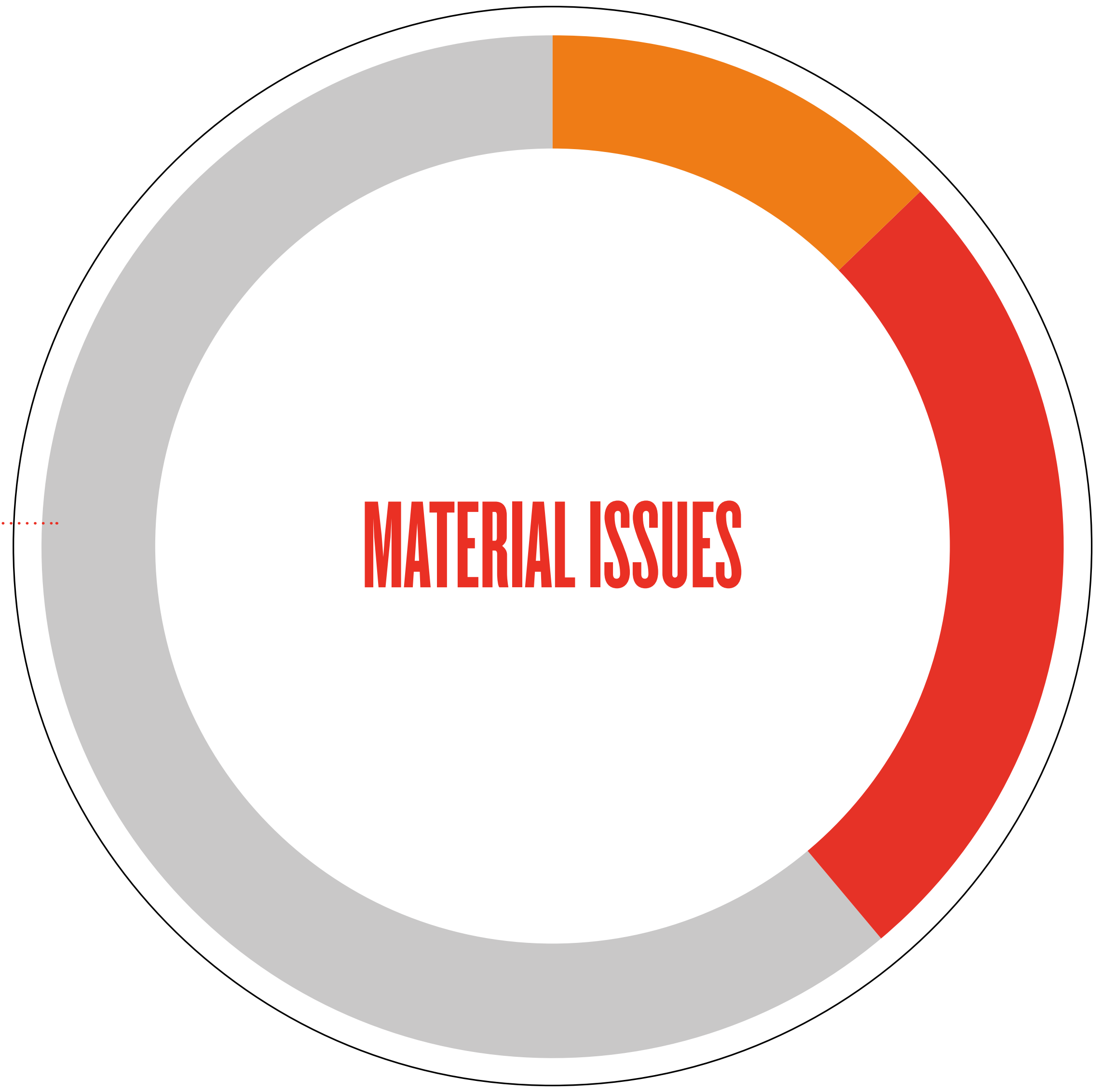
The majority of companies in our sample did indeed identify specific 'E', 'S' and 'G' issues they are committed to and the ESG discussion in their Annual Report was directly built around them, usually in the sustainability section. Typically, this took the form of dedicating a page or more to each issue or group of issues, often supported with pull-out statistics or charts. However, over one-third of our sample did not explicitly link these issues to their ESG strategy or lacked a clear ESG strategy and 13% had not identified any issues.

The expert's view: Rachel Madan, Director of Sustainability & Impact

A materiality assessment is the bedrock of a credible sustainability or ESG strategy. Yet the lack of explanation of process or rationale linking material issues to strategic goals is in some ways unsurprising. While the concept of financial materiality has been around for decades and has a grounding in accountancy, borrowing the language and principles of materiality for the purposes of understanding the size and scope of sustainability impacts has proved more difficult for many companies. Many companies take a more subjective approach to ESG materiality, perhaps stemming the recency of the concept of materiality for non-financial or pre-financial issues, which was only introduced with any rigour in recent years, following the introduction of GRI's G4 materiality framework and SASB's sector-specific materiality map.

To enhance the rigour and credibility of the materiality process, companies should follow a double materiality assessment, which examines ESG impacts from two parallel perspectives. The first is to examine the impacts of sustainability issues on the company's financial performance. This is an 'outside in' perspective, using investors as the main stakeholder of interest. The second is to examine the impact of the company's operations and activities on people, societies and the environment. Using these two perspectives together offers a more holistic and robust picture of the relationship between corporate performance and sustainability risk and opportunity.

Once companies start using this approach, it is a more natural process to connect material issues to corporate strategy.

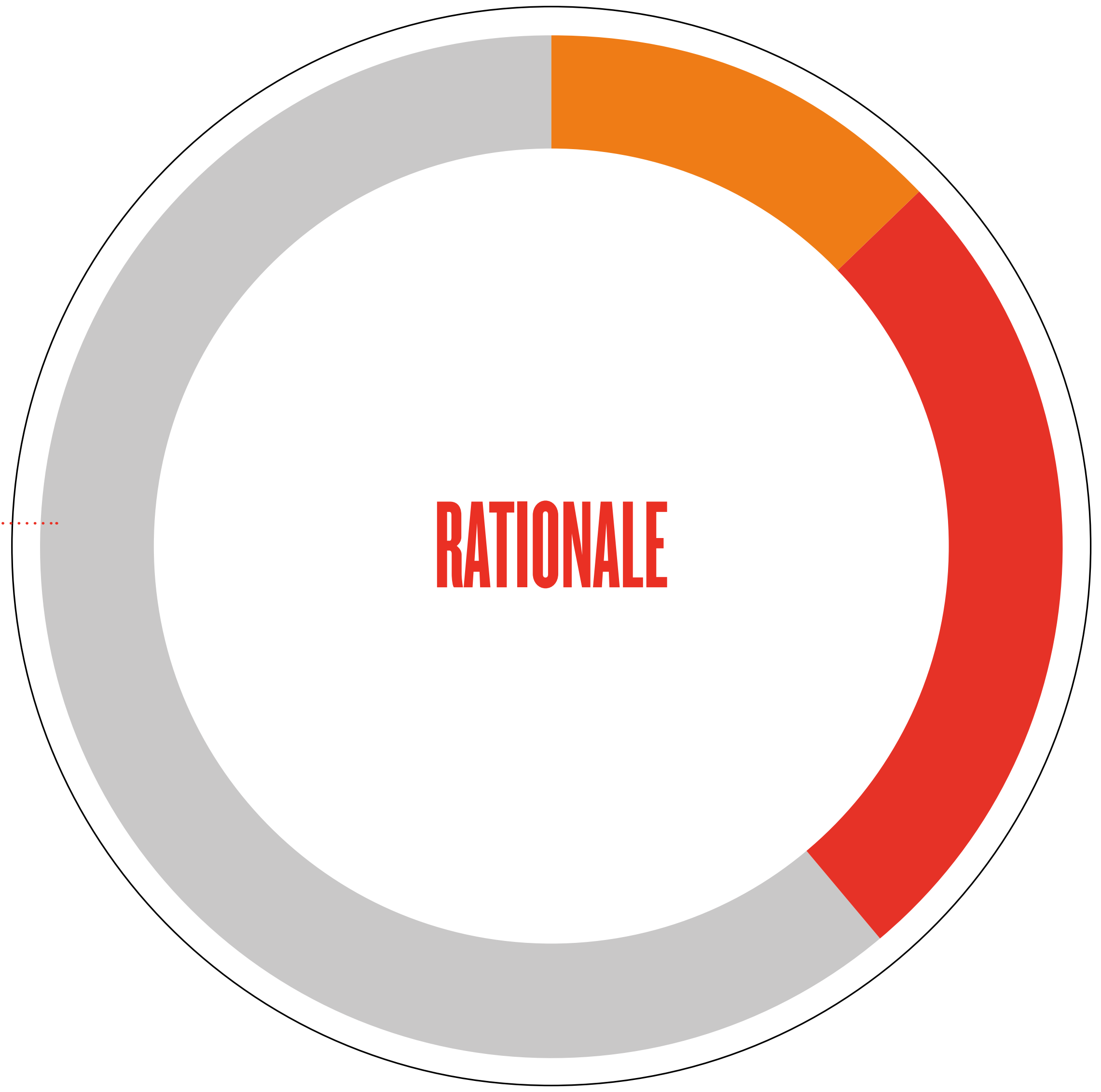


No ESG issues identified
13%

ESG discussion is loosely built around material issues
26%

Material issues clearly identified and ESG discussion directly built around these
61%

Even those companies which had built their ESG strategy directly around material issues did not necessarily explain why they were committed to them. They showcased initiatives related to them, illustrated them with case studies and highlighted achievements, but only about half of our sample provided an explanation for each of their material issues and 13% did not explain their rationale at all.



No explanation of rationale behind commitment
13%

Basic statement covering all material issues
33%

Explanation provided for each material issue
54%

Further, over 80% of companies in our sample only explained in basic terms how they identified ESG issues as material to them, often with a generic reference to stakeholder opinion, or offered no explanation at all. In some cases, this was because the materiality discussion took place in a separate Sustainability Report, but companies should bear in mind that ESG is rapidly becoming integrated into mainstream investing and that shareholders and potential shareholders – the key audience for the Annual Report – increasingly take the impact of non-financial issues on investee companies into account when making investment decisions. It is therefore

No materiality discussion
31%

Basic discussion of the materiality process
51%

Detailed explanation of the materiality process
18%

important to include the results of a materiality assessment in the Annual Report so that all interested stakeholders can find them, no matter which set of documents they refer to. However, only 18% of our sample provided a detailed explanation of their materiality assessment in their Annual Report, typically including a matrix or heat map or a graphic illustrating the process itself.

Best-practice considerations

Carry out a double materiality assessment to identify the ESG issues that are material to your company.

Explain the assessment process and its outcome, using a heatmap or matrix.

Explain why the issues you have identified as material are important for the long-term success of your company.

Set out a clearly defined ESG strategy with focus areas which are based on these issues.

As far as possible, ensure that readers of the Annual Report can follow all of the above without having to refer to your website or separate publications.

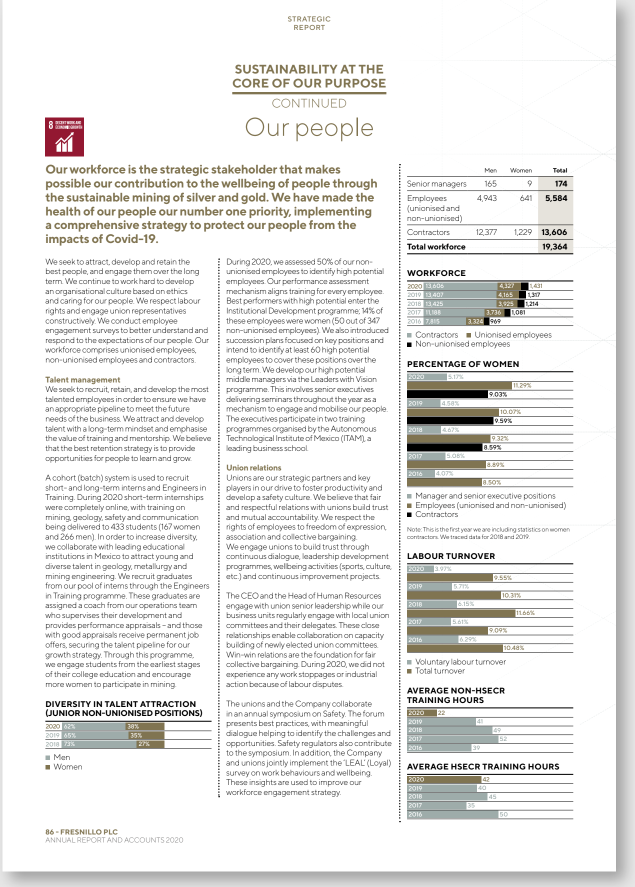
Reports in focus

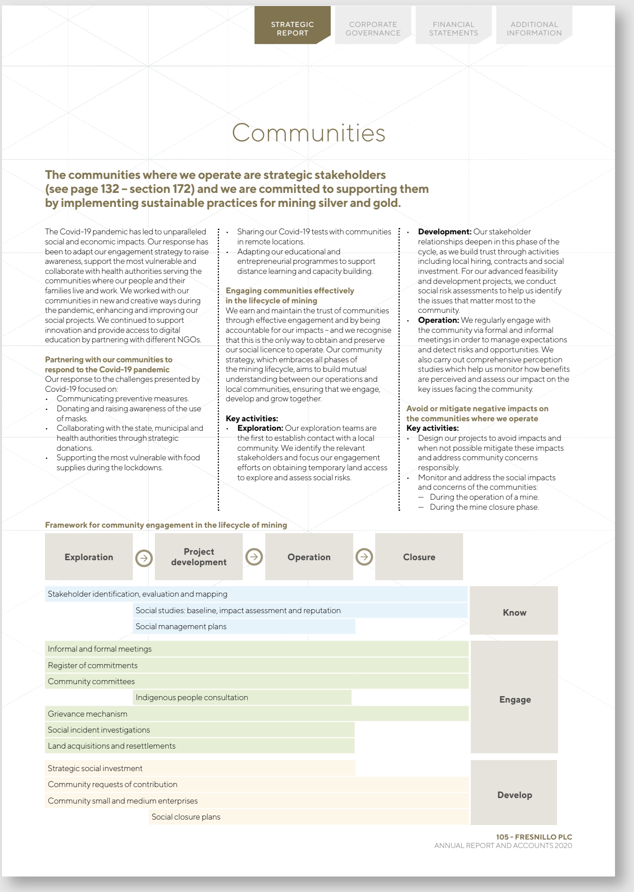
Fresnillo Annual Report 2020

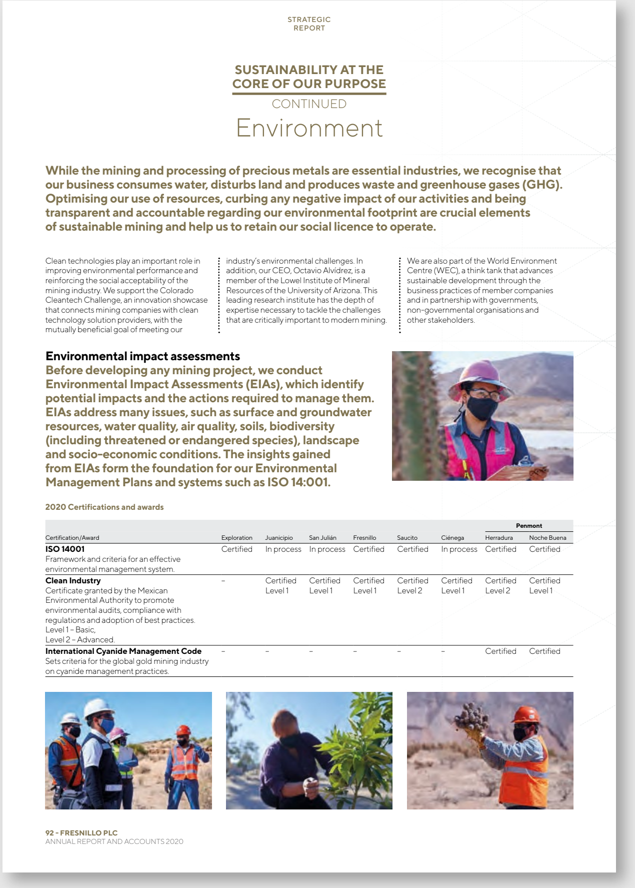
Fresnillo's Annual Report illustrates some of the best-practice considerations set out above. It explains clearly how ESG issues that are material to the company are identified by conducting a materiality assessment. A graphic illustrates each step of the assessment process while a matrix shows the importance of various ESG issues for the business and stakeholders. A second matrix forecasts the importance of these issues in 10 years' time. The issues the company has identified as material as a result of this assessment are grouped into four categories, which form the focus areas of its ESG strategy.

The rationale for each focus area of the ESG strategy is explained with reference to its importance for the success of the company, including key stakeholder groups, such as employees and indigenous communities, an ethical corporate culture and good environmental stewardship. Several pages are dedicated to showcasing the company's initiatives and achievements in each focus area, including statistics, cases studies and testimonials.

Download the report here







ESG STRATEGY

Overview

In ESG strategies, we see a company's understanding of how they can best use their products and services to help society achieve a greener, more equitable and more sustainable future.

A dedicated and effective approach rests on including both positive impact for society and implications for the bottom line.

The COVID-19 pandemic has shone a light on the link between ESG and the resilience of a company's business model. A resilient ESG approach is no different from any other business strategy created to propel a company forward in the context of its risks and opportunities. Leading ESG approaches share a common thread starting with purpose, outlining oversight structures, defining an ESG strategy and communicating that strategy through policies, programmes and metrics. This section investigates how successfully leading companies are adopting such approaches.

What we are seeing

The majority of companies in our sample presented a separate ESG strategy in their Annual Report - so much so that 15% more companies published a separate ESG strategy as opposed to integrating ESG fully into an overall Group strategy. Key reasons for this trend include:

1.

Large companies being on a journey towards full ESG integration. It takes time and capital to plan, agree and embed a sound ESG strategy into an existing corporate strategy. Therefore, ESG integration is a gradual process. Only 26% of our sample had an ESG approach that was fully integrated into their corporate strategy.

2.

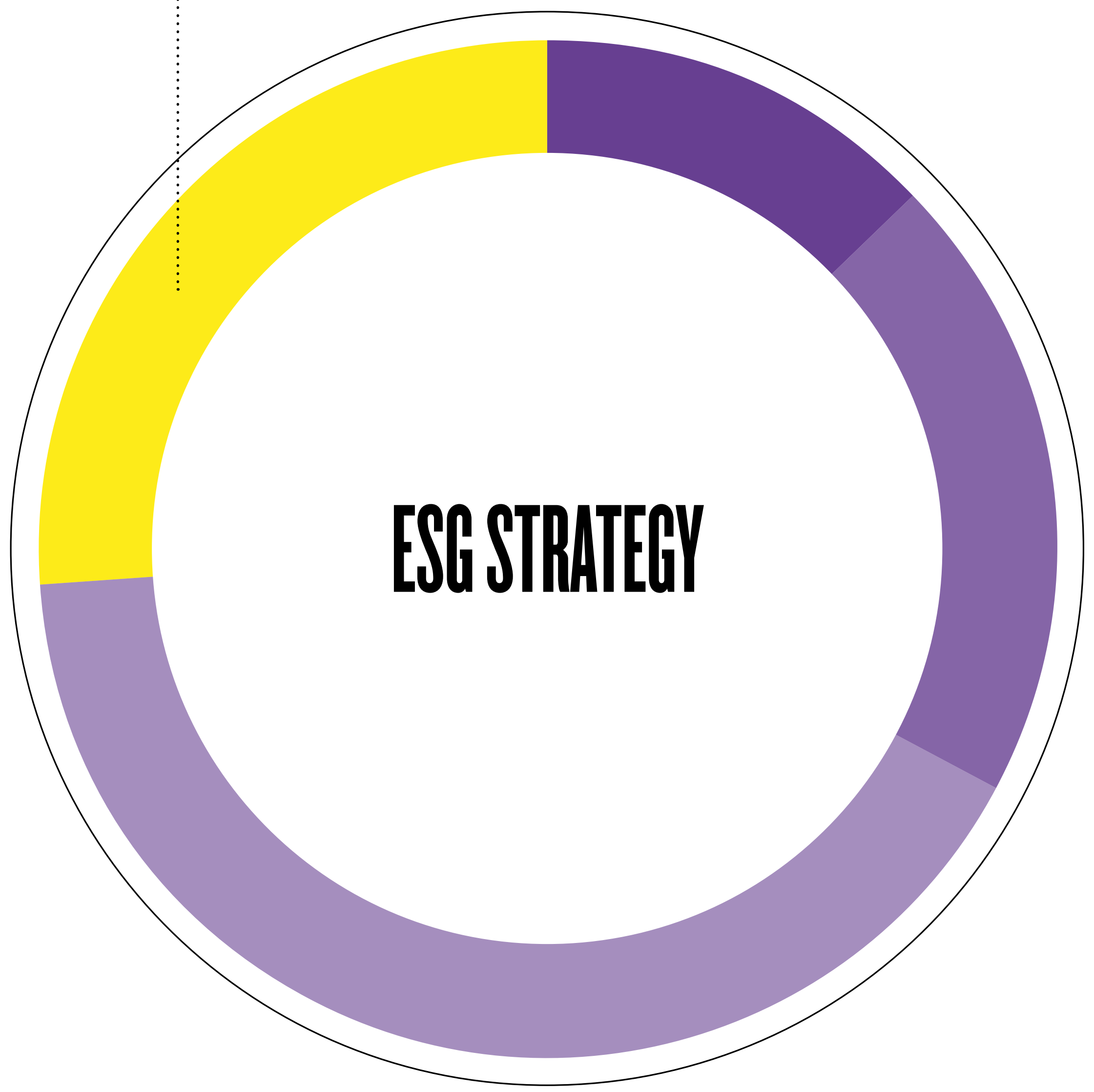
For some companies, a cohesive ESG and corporate strategy may be inappropriate. For example, separate ESG strategies might be seen as the best option for corporations who have many divisions, and an overarching strategy may not fit seamlessly with all the moving parts of a business.

No stated/explicit ESG strategy
13%

ESG elements incorporated into overarching Group strategy
20%

Separate ESG strategy
41%

ESG strategy fully integrated into corporate strategy
26%



Based on the premise that having a stated ESG approach can boost corporate credibility, potentially impacting who buys from and does business with a company, 13% of our sample nevertheless presented no explicit ESG strategy in their Annual Reports.

We were surprised by this for several reasons. Firstly, investors and other stakeholders are increasingly losing their tolerance for ESG-related incidents from data security breaches through to the high-profile destruction of cultural heritage sites. Secondly, ESG is expected to hold larger significance in the longer term as the Gen Z workforce is ethically orientated and tends to align behaviours, investment opportunities and employment with its ESG values. Thirdly, investors are increasingly focusing on the significance of the 'S' element of ESG post COVID-19, compared with pre COVID-19, and now expect companies to explain how they safeguard and nurture their employees. Lastly, the 13% of companies in our sample which did not have an ESG strategy may lose out given that investors increasingly believe that companies with a proactive approach to ESG present a lower risk and therefore offer a higher return on investment.

Additionally, the middle ground of the study's data – where 20% of sampled companies included traces of ESG information in an overarching group strategy – also presents cause for concern as this seems to suggest a lack of commitment or transparency. While, in some cases, more details were promised in the next Annual Report as work was under way to develop and roll out new ESG strategies, our study suggested that there is a good deal of work to be done to shift this middle sample into the next stage of the ESG integration process.

The expert's view: Rachel Madan, Director of Sustainability & Impact

A strategy is a plan designed to achieve a particular long-term aim. An ESG strategy is a guide to integrating sustainability issues into everyday practice and performance. So if few companies consider ESG as an important part of their purpose – less than 10% of our sample (see page 10) – there is no guiding vision from which to draw strategic inspiration. And if only some companies thoroughly identify material risks and opportunities arising from ESG issues (see page 13), there is no guidance for prioritisation or urgency.

A credible, effective ESG strategy provides the company's long-term vision of its contribution to sustainable development, defining what a company is trying to achieve and why. Companies should take a logical and sequential approach. Start with reviewing the corporate purpose. Does it contain any reference to ESG or sustainability? If not, why not? Once ESG is integrated into the company's vision, the next step is to identify priorities for action – the material issues. And finally, a strategy which encapsulates how the company intends to achieve its goals can be developed.

Best-practice considerations

Define what your audience needs to understand about your ESG efforts.

Act on the ESG issues that are significant for your company, as identified by your materiality assessment, by developing a clearly defined ESG strategy.

Ensure that your ESG strategy aligns with your corporate strategy and purpose.

Consider how you can demonstrate the success of your ESG strategy.

Reports in focus

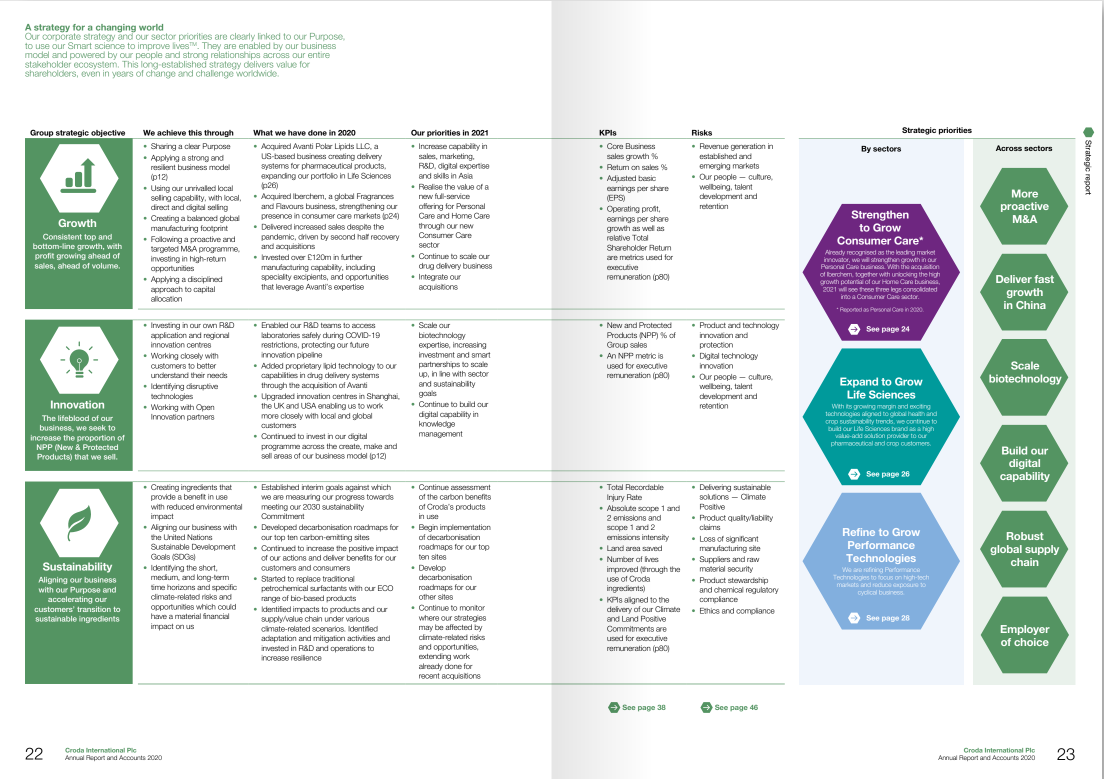
Croda Annual Report 2020

Croda International uses a comprehensive, circular model to present its purpose-led corporate strategy. ESG commitments are unmistakably fully integrated into the three-pillared approach, which signals the company's aim of becoming climate, land, and people positive by 2030. Furthermore, the integrated ESG group strategy aligns to nine UN SDGs, which heightens the focus of the disclosure.

In a separate spread, the report further describes the Group's progress in reaching the strategic objective of 'sustainability'. Performance, priorities, KPIs and risks are presented to give the readers a well-rounded understanding of Croda's sustainability commitments.

What is very impressive about this report is the disclosure of ESG milestones under each of the three strategic pillars: to become climate, land and people positive. The milestones are highlighted through green pull-out boxes and citations add depth to discussion. This helps to demonstrate the success of Croda's ESG strategy, define what its audience needs to understand about its ESG efforts and aligns with the corporate strategy and purpose.

Download the report here



ESG PERFORMANCE

Overview

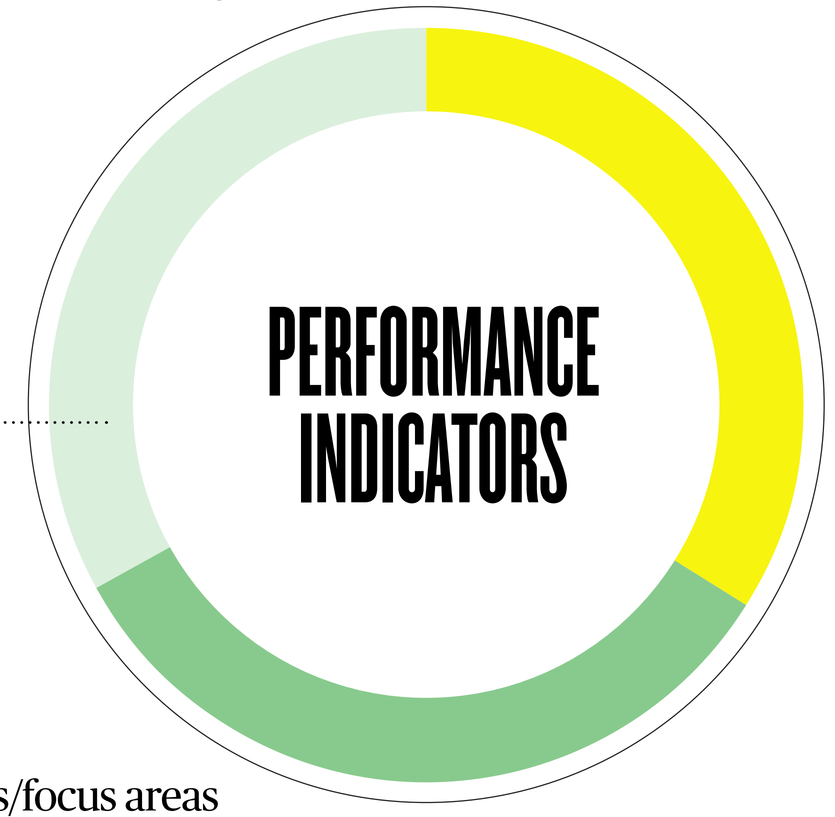
Once a company has identified its material ESG issues and formulated a strategy to address them, it has to consider how to measure its success in doing so.

This involves choosing performance indicators, presenting them in the Annual Report and deciding whether or not to include them in executive remuneration. This can range from grouping material issues into focus areas and reporting on its initiatives in each area, all the way to including delivery against specific targets in the remuneration of its executive directors.

What we are seeing

Most companies in our sample had defined focus areas for their ESG strategy and developed initiatives or objectives associated with them, but only about one-third had actually set targets.

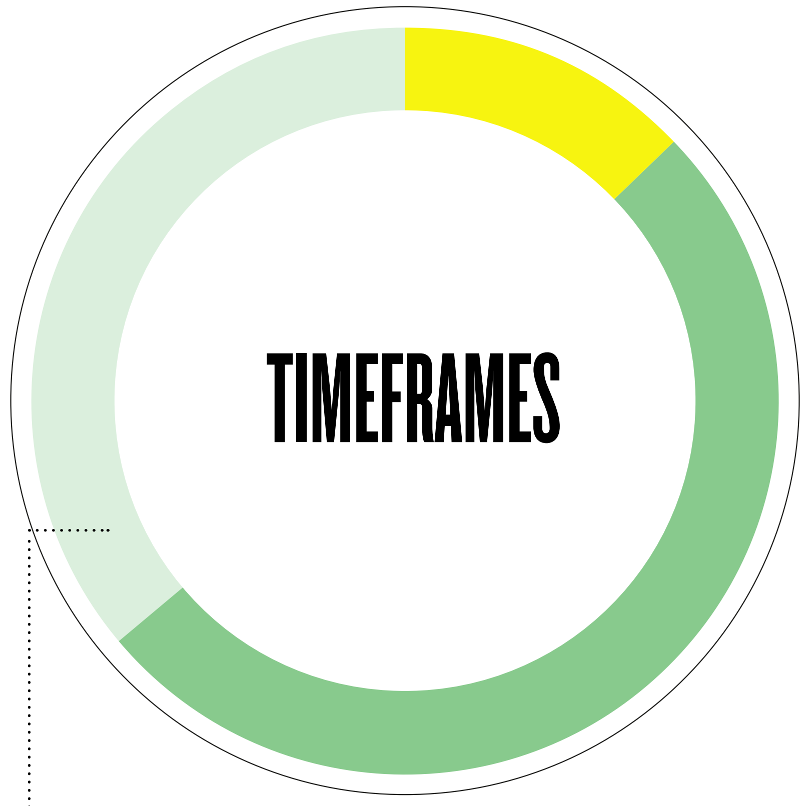
Further, if they had set a target, it was often a generic commitment to the UK Government target to bring all GHG emissions to net zero by 2050 (recently upgraded to reducing emissions by 78% by 2035) or the Paris Agreement to limit the global temperature increase in this century to 2°C above pre-industrial levels, while pursuing the means to limit the increase to 1.5°C. Company-specific targets were less common and tended to focus on emissions and other environmental data, some of which was already captured as part of mandatory reporting requirements, such as Streamlined Energy and Carbon Reporting (SECR) disclosure. Social and governance commitments tended to centre around employee engagement, reducing the gender pay gap and increasing diversity, but were often aspirational rather than having stated targets.



Priorities/focus areas
34%

Objectives/strategic initiatives
33%

Targets
33%

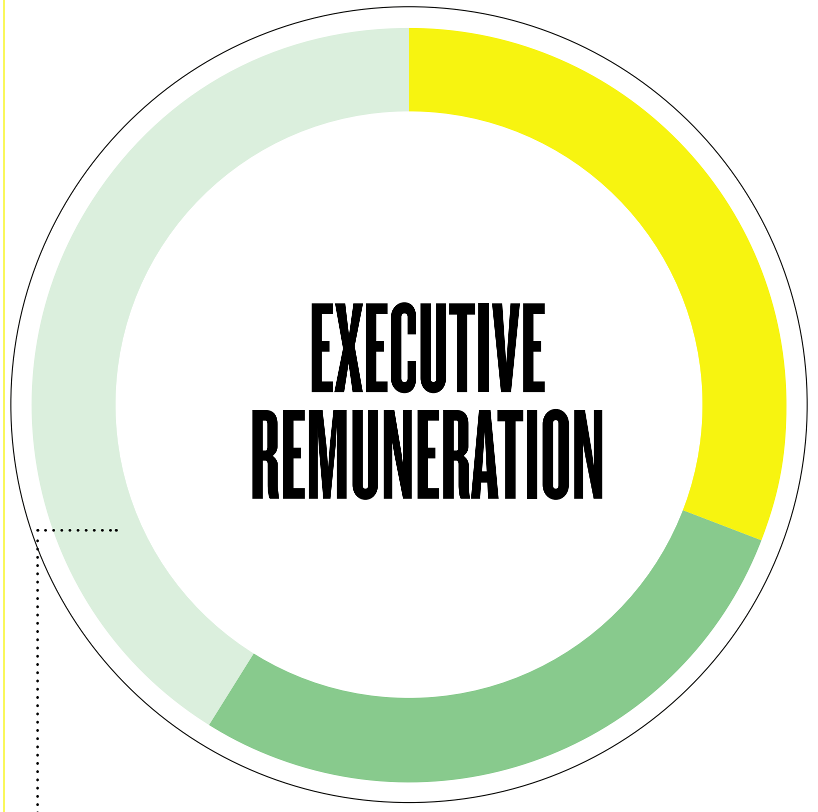


No timeframes
13%

Timeframes provided for some priorities or objectives
51%

Timeframes provided for all priorities or objectives
36%

Even when company-specific objectives or targets were set, only about half included timeframes against which progress could be measured and only one-third of the companies in our sample had timeframes for all their ESG objectives or targets. The overwhelming majority of companies which had set timeframes had at least one target based on timeframes of five years or more, but this was often not more than a generic commitment to net zero by 2050. Company-specific targets tended to be less long term and 13% of our sample had no timeframes at all for their targets, making it more difficult for readers of the Annual Report to assess the effectiveness and success of the company's ESG strategy.

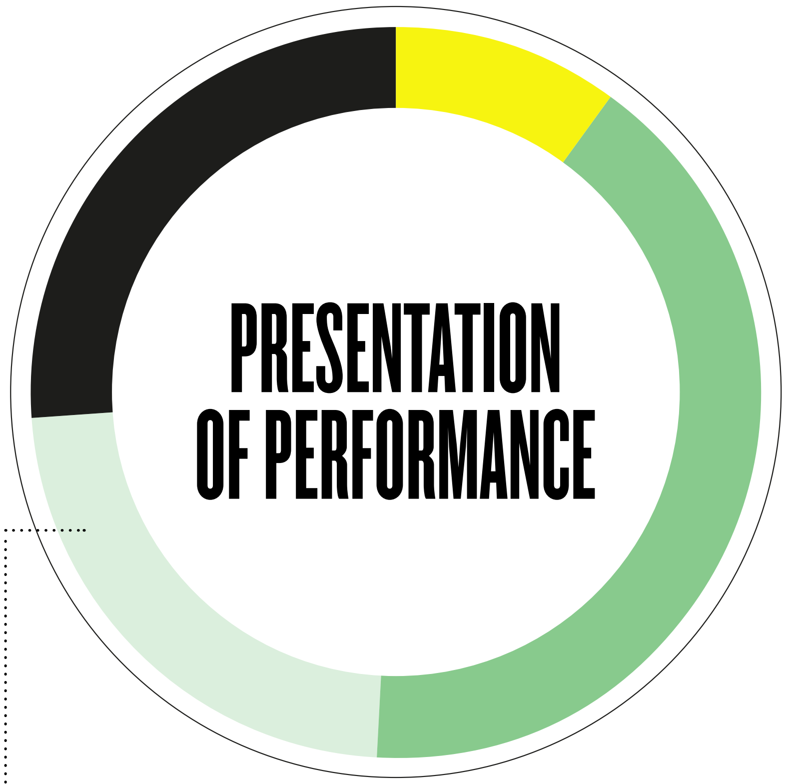


No discussion of non-financial executive remuneration
31%

Brief discussion of non-financial executive remuneration
28%

Detailed discussion of non-financial executive remuneration
41%

Where objectives or targets were set, they were in some cases included in executive remuneration, boosting the credibility of the company's ESG commitments, or in others stated as being under consideration, often in response to shareholder pressure. Over half of those companies which already included non-financial performance indicators in executive remuneration, usually in the bonus or long-term incentive (LTIP) schemes, made considerable efforts to show this in the ESG or KPI sections of their Annual Report, the Remuneration Report or both. This is particularly important if there is a separate ESG strategy whose performance indicators are different from the non-financial performance indicators of the corporate strategy. However, one-third of companies in our sample did not include any non-financial performance indicators in their remuneration policy.



Performance discussed as part of main narrative only
10%

Highlighted through pull-out statistics or charts
41%

Table for some material issues or priorities or as summary of ESG performance as a whole
23%

Full table for all material issues or priorities
26%

Moving on to how ESG performance was communicated in the Annual Report, given the relatively low granularity of performance indicators, the presentation of performance data tended to be high level. The most popular format, used by almost half of companies in our sample, was to highlight selected achievements through pull-out statistics or charts. The other half used a tabular format, but in many cases this covered only a selection of their material issues. Only 26% of our sample disclosed performance data for all their material issues together in a full dashboard or table; and 10% only discussed ESG performance as part of the main narrative, without tables, charts or other visual support.

Best-practice considerations

Define focus areas for your ESG strategy by grouping your material issues into focus areas, as identified by your materiality assessment.

Set performance indicators for each focus area, focusing on appropriate short- and long-term goals across the value chain, and report year-on-year progress against them.

Set timeframes for each performance indicator to show if you are on track to achieving your goals.

If possible, pull together all focus areas, goals and performance indicators in one dashboard to give a clear overview of the components of your ESG strategy, how its success is measured and your progress towards this.

If any of the performance indicators contribute to executive remuneration, show this clearly and prominently in the dashboard and also in the Remuneration Report as an important indicator of ESG commitment and integration.

Do the same for non-financial KPIs of the corporate strategy.

Reports in focus

Polymetal Annual Report 2020

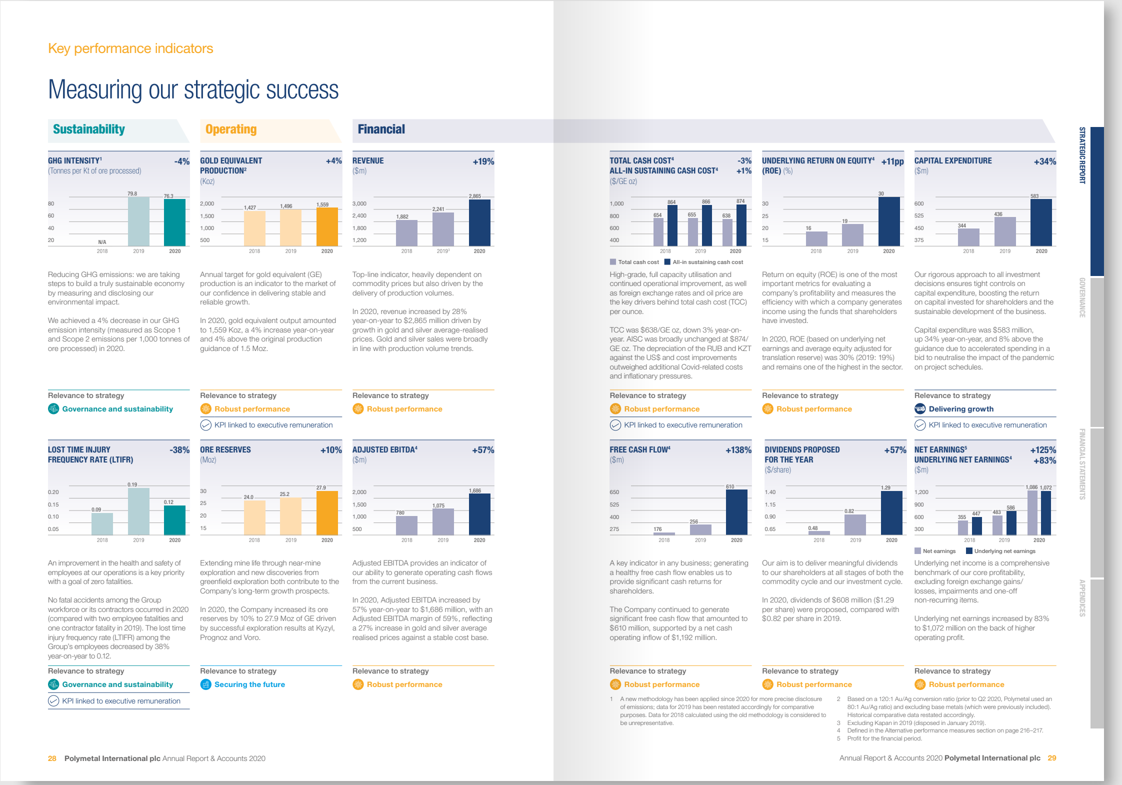
Polymetal's Annual Report clearly defines its strategy by ordering its four strategic priorities, including governance and sustainability. These priorities are explained with reference to risk and performance during the reporting period. The use of colour coding and icons makes them easy to spot throughout the report, including in the Remuneration Report.

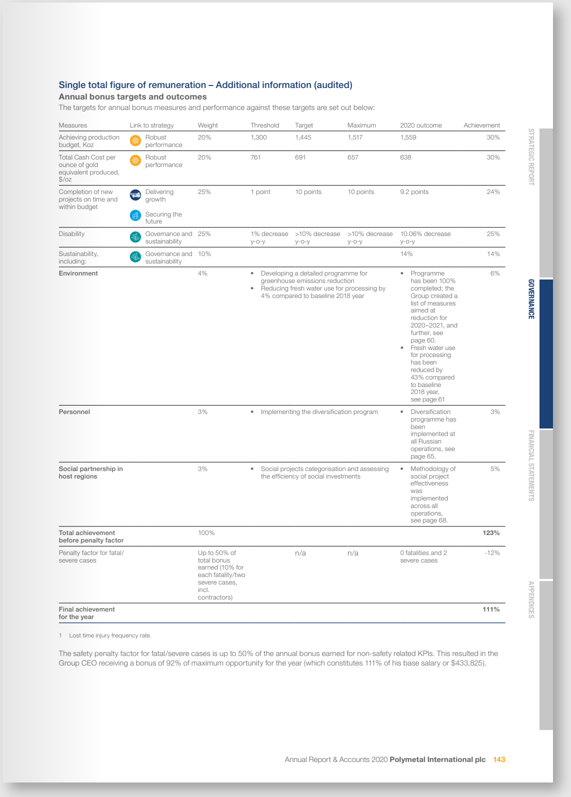
In its sustainability section, the company presents a dashboard with targets for all its material ESG issues, including health & safety and GHG emission reduction, progress towards them during the reporting period and whether or not it has achieved them. Icons engage the reader and make the complex information easy to digest.

An informative KPI spread illustrates the sustainability, operating and financial performance of the company. Relevance to strategy is explained with descriptions of results for each performance indicator and all indicators are linked to the strategic priorities.

The Remuneration Report opens with a helpful overview, which explains the components of the remuneration policy, their key features and their link to the company's strategic priorities. The report then goes on to show which performance indicators contribute to executive remuneration, which component of remuneration they contribute to, how much they contribute, the thresholds for triggering the contribution and which strategic priority they are linked to.

Download the report here





ESG GOVERNANCE

Overview

Governance is the foundation upon which the environmental and social components of ESG are built.

There is also substantial evidence to suggest that a proactive approach to accountability and good governance ultimately yields better corporate returns as strong corporate ethics, an independent and diverse Board and engagement with stakeholders, including shareholders, help to reduce or mitigate financial and non-financial risks and build customer and employee loyalty, as research by Ceres, the OECD and others has shown.

What we are seeing

The most significant trend indicated from the data was that nearly half of the sample presented an organisational chart that identified a designated ESG Committee or Non-Executive Director responsible for ESG matters. 49% of our sample scored against this criterion and a further 33% provided personal statements or letters by those in charge of ESG, so nearly half of the sample presented good communication of, and commitment to, ESG responsibility at Board level and one-third exhibited excellent communication and commitment.

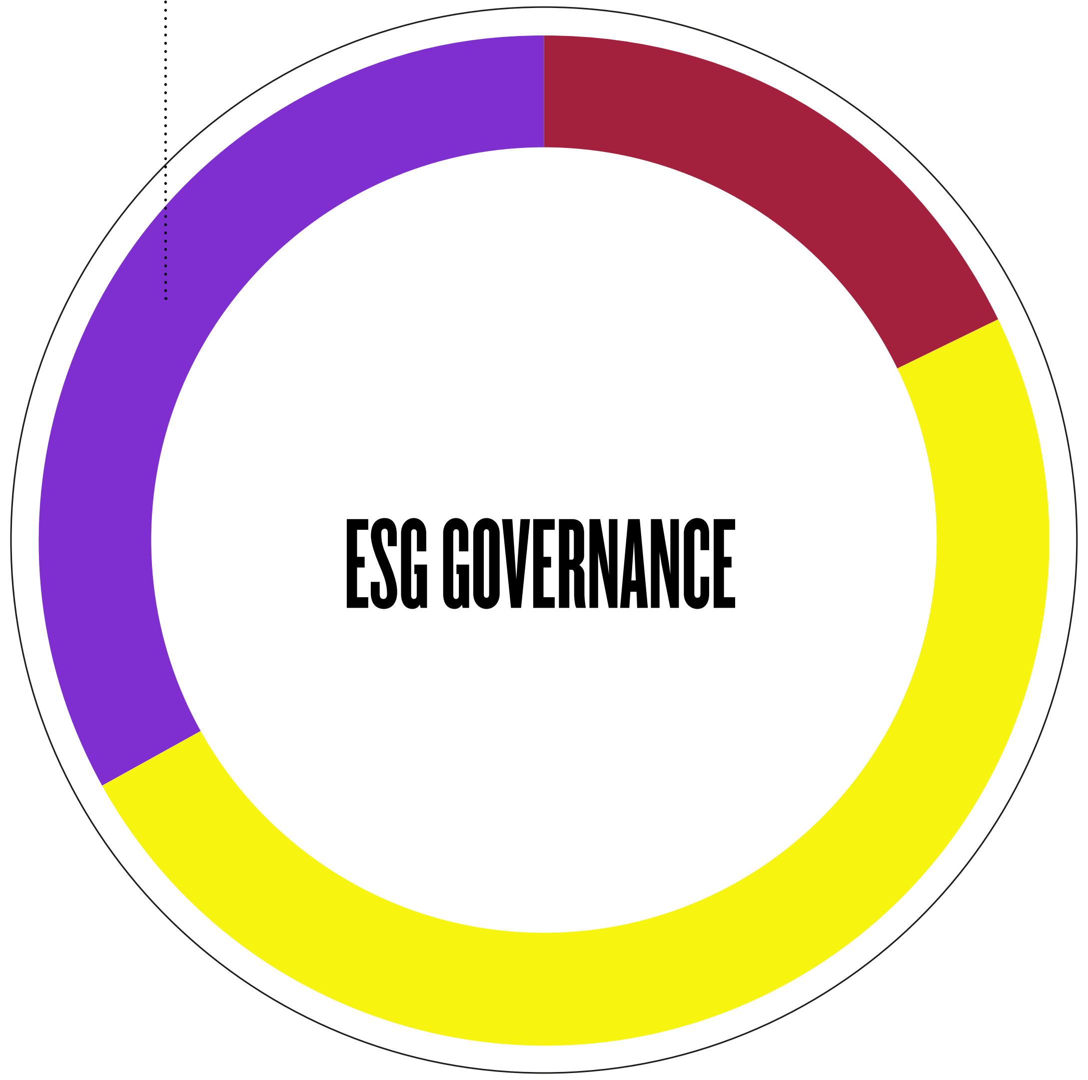
That said, some reports which scored against this criterion did not provide an organisational chart, but merely identified a designated Non-Executive Director or committee with an ESG remit within the text. Nevertheless, the data suggests that 82% of the companies sampled have invested resource into identifying a committee or Director to oversee ESG matters. This suggests that a large proportion of companies recognise the importance of ESG as well as accountability.

18% of the sample did not identify any individual or committee with an ESG-related remit, highlighting that ESG committees and individuals in charge of ESG are not yet universal in the FTSE 100 or that they are not considered important enough to be mentioned in the Annual Report. This indicates that there is a movement towards expanding accountability and good governance to ESG but, as there is no regulatory requirement for Board-level ESG roles, the onus is on businesses to consider creating room for ESG roles and/or specific skill-sets on their Boards.

No individual or committee with ESG remit identified
18%

Organisational chart showing designated NED with ESG remit or ESG Committee
49%

Personal statement or letter
33%



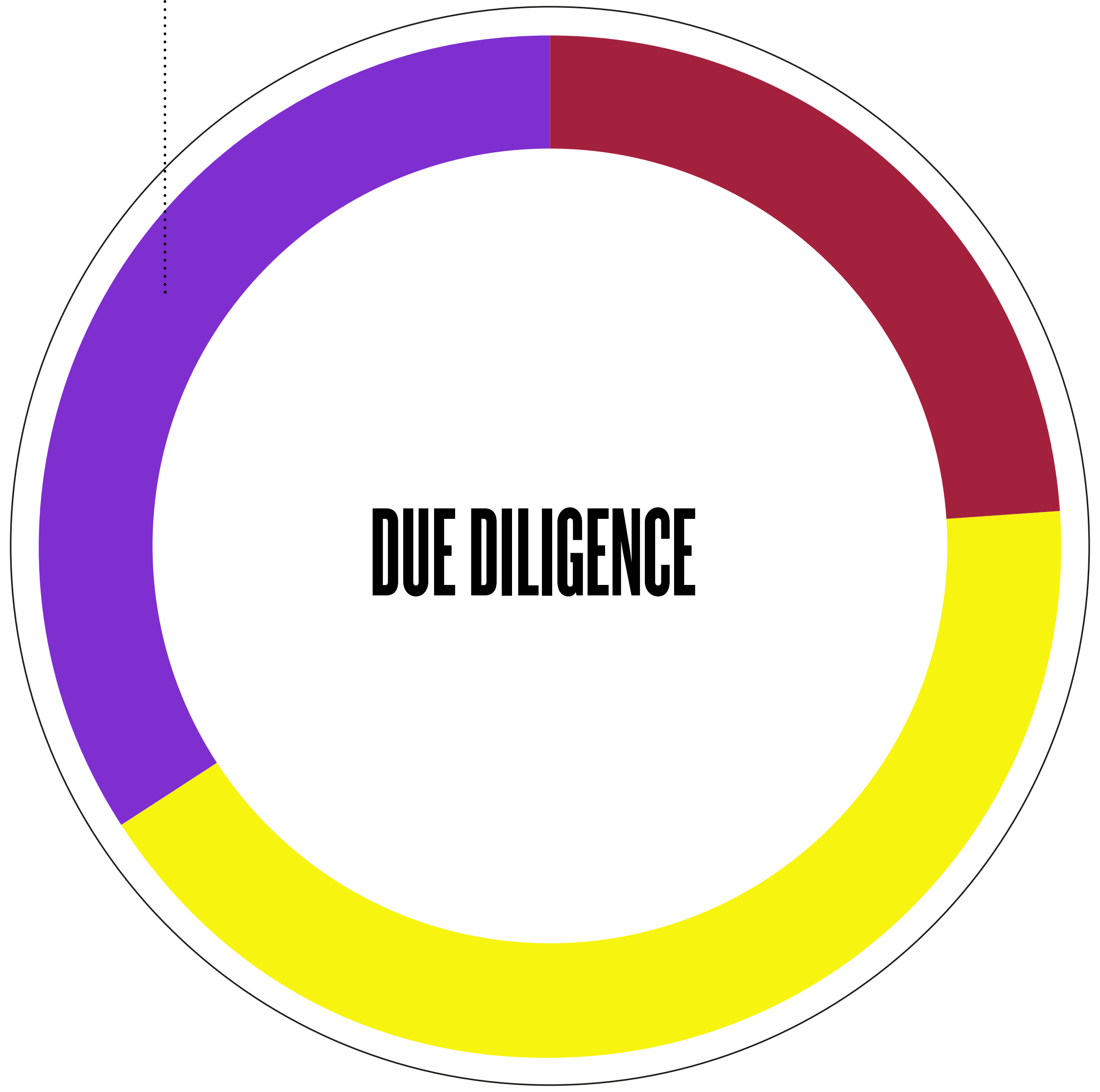
Diving deeper into our governance findings, just over one-third of our sample was found to discuss the due diligence processes it undertakes in line with the EU Non-Financial Reporting Directive (NFRD), which requires companies with over 500 employees to explain their due diligence processes in relation to the environment, employees, social matters, human rights, and anti-corruption and anti-bribery matters. It is good practice for companies to align to this Directive as it can determine material ESG risks and effectively mitigate against them.

By far the largest proportion of our sample (42%) only referred to their non-financial due diligence processes through brief, vague and unsupported statements and almost one-quarter did not overtly mention non-financial due diligence beyond the non-financial information statement. For businesses within this group the path ahead looks lengthy, but attainable provided they adopt a more proactive approach to good governance.

No discussion of non-financial due diligence
24%

Brief discussion of non-financial due diligence
42%

Detailed discussion of non-financial due diligence
34%



Best-practice considerations

Detail your ESG governance structure, ideally using an organisational chart.

Explain the role of the person or committee in charge of ESG or sustainability in detail.

Consider including a personal letter or Q&A with the head of your sustainability committee in the Annual Report to demonstrate personal ownership.

Include commentary on ESG and good governance more broadly in your leadership statements, for example the Chairman's introduction to the Governance Report, to demonstrate leadership commitment at Board level.

Detail your due diligence processes and relevant Codes of Conduct in your Annual Report so readers can understand them, ideally without referring to separate policy documents or your website.

Reports in focus

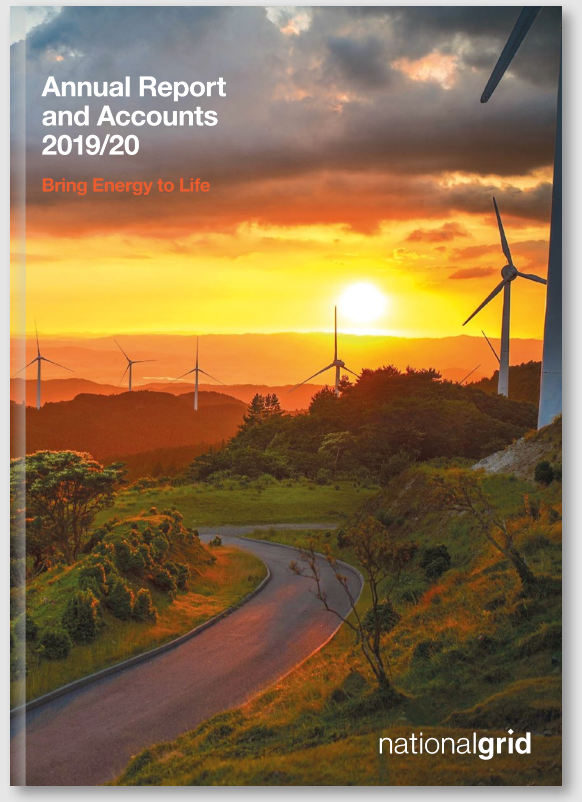
National Grid Annual Report 2020

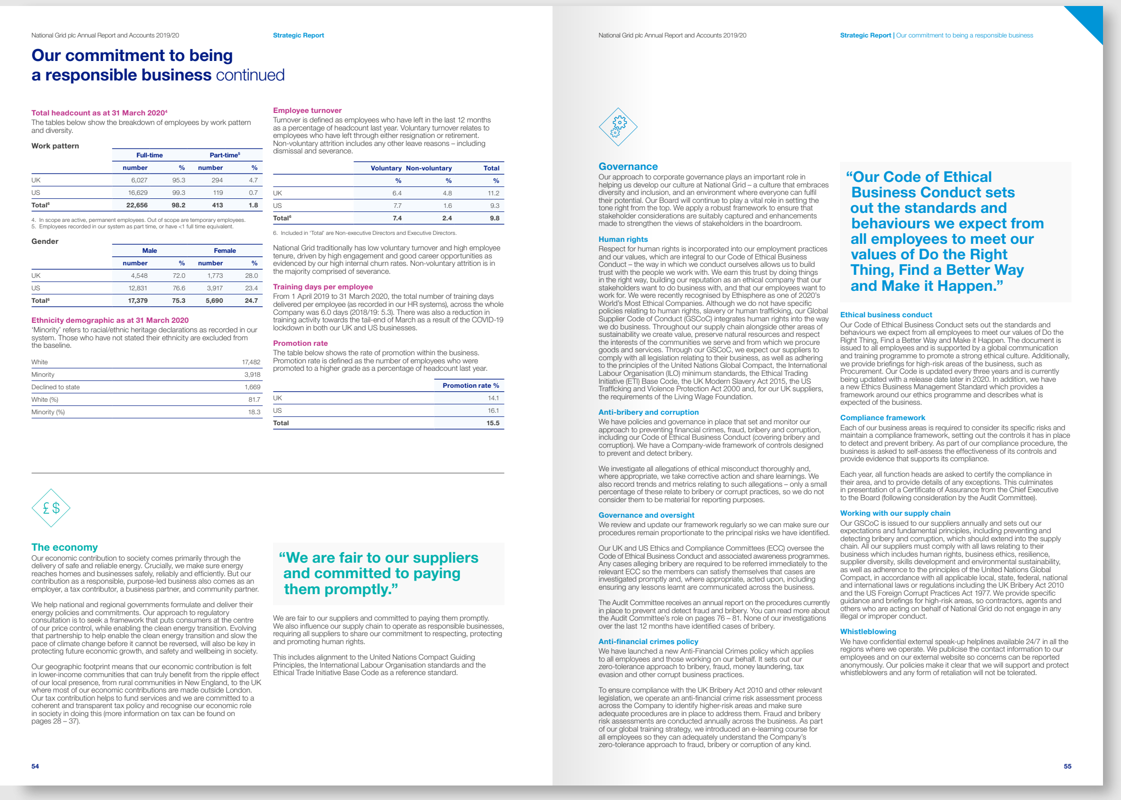
National Grid's 2019/20 Annual Report demonstrates the company's commitment to being a responsible business in its Strategic Report. A double-page spread discussion aligns to the NFRD, explaining the company's due diligence processes in relation to human rights, anti-bribery, anti-corruption, anti-financial crimes and its ethical business conduct.

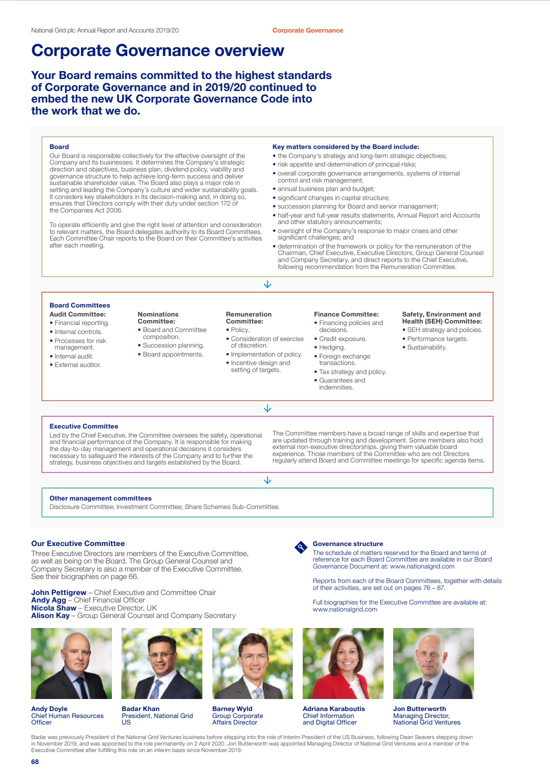
At the start of the Governance Report, a letter from the company's Chairman describes the Board's progress in promoting a desired culture throughout the organisation as well as the Board's succession plans that meet diversity targets. The company also sets out its governance structure through an organisational chart which highlights the responsibility of Board committees, including the Safety, Environment and Health Committee. Furthermore, the report highlights the continual journey the group is on to building and monitoring an inclusive company culture by use of a compelling flow diagram. These disclosures follow the best-practice recommendations outlined above, giving a pertinent sense that the company is governed with ESG in mind.

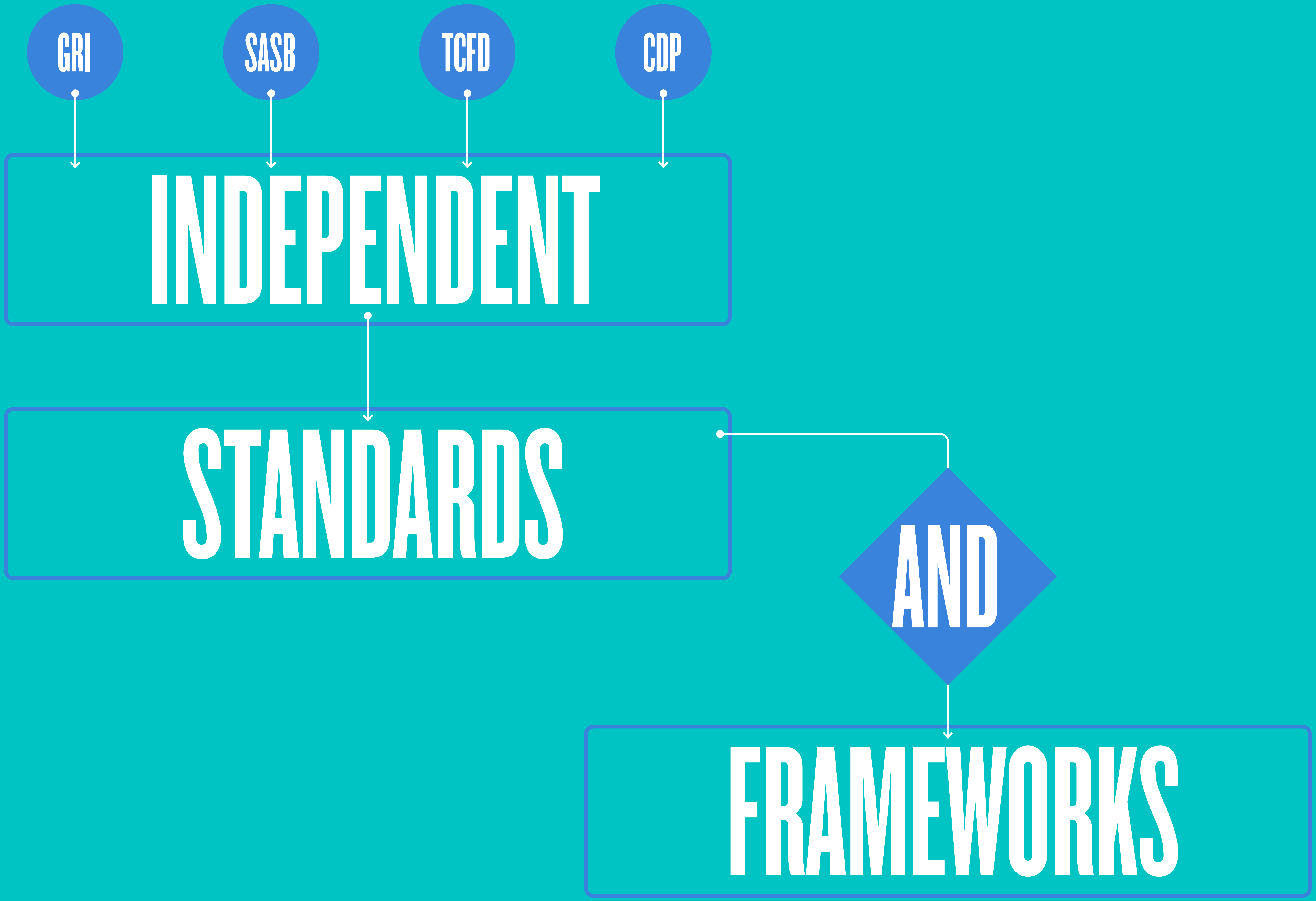
National Grid also recognises the importance of ESG responsibility at Board level through its Safety, Environment and Health Committee whose Chair sits on the main Board. The committee chair is given a single-page report in the Governance Report to discuss key areas focused on throughout the reporting period, reviewing performance and outcomes and highlighting priority areas for next year.

Download the report here









Overview

The multitude of different standards and frameworks relating to ESG, including GRI, SASB, TCFD and CDP (formerly the Carbon Disclosure Project), have prompted comments about an 'alphabet soup' of regulation, but there are now efforts underway to harmonise and consolidate them.

The Better Alignment Project, for example, is a ground-breaking two-year initiative focused on driving better alignment in the corporate reporting landscape to make it easier for companies to prepare effective and coherent disclosures that meet the information needs of capital markets and society. The aim of the merger between the IIRC and SASB, meanwhile, is to produce a framework which combines the SASB standards with the six capitals of the IIRC.

Clearly, using a recognised standard or framework provides a means to measure, assess and report on ESG initiatives, risks and opportunities and ultimately improves the comparability of ESG data, thereby making it easier for investors to assess potential investee companies when considering whether or not to add them to their portfolios. For the company, disclosure of ESG data can therefore represent an important point of differentiation. It can also be valuable from a reputational perspective to highlight where its ESG efforts have been acknowledged by a third party, for example if it has been awarded an 'A' score by the CDP or if it has been included in the FTSE4Good Index.

Conversely, poor reporting of ESG data can lead not only to low scores from influential rating agencies, such as Sustainalytics or MSCI, but also to negative investment decisions which could ultimately result in a lower stock market valuation. And while most standards and frameworks have traditionally been voluntary, this is starting to change. As we mentioned earlier, the FCA now requires premium-listed companies to align their climate-related disclosures with the TCFD and there is appetite among investors and regulators – most notably the FRC – to expand mandatory non-financial reporting to other frameworks, particularly SASB.

What we are seeing

The fact that TCFD disclosure is becoming mandatory in the UK was recognised by the vast majority of companies in our sample. Almost half already reported all 11 recommended disclosures, many having done so previously on a voluntary basis. A further 40% were beginning to align with the TCFD or had at least stated their intention to do so, including plans to carry out a scenario analysis in the near future. Typically, TCFD disclosure tended to be located in the sustainability section of the Annual Report or, less often, in the risk management section, with companies further along the TCFD journey increasingly adept at identifying climate-related opportunities in addition to risks. However, 10% of our sample did not mention the TCFD at all, despite the incoming regulatory requirement.

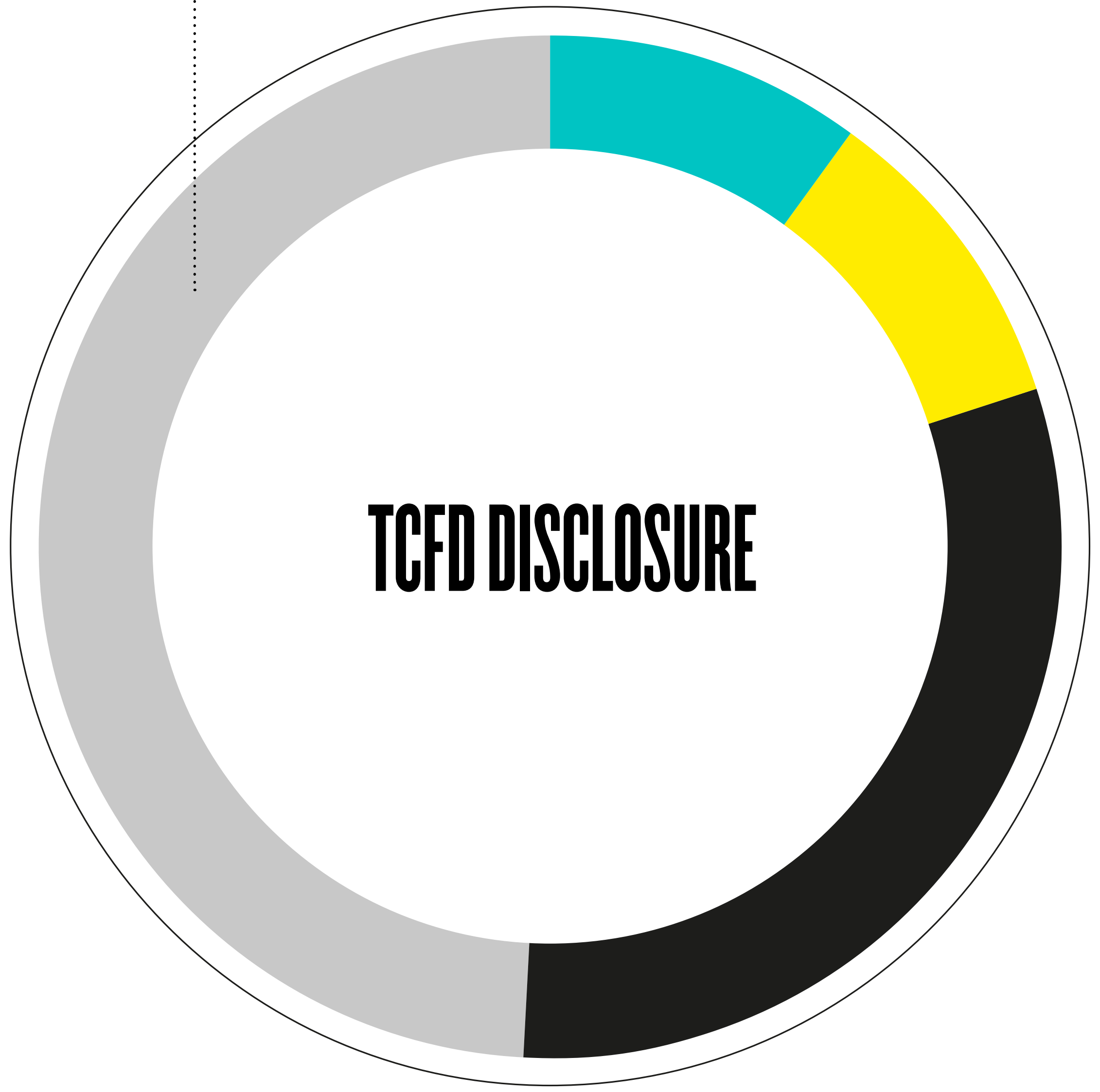
Among the other standards and frameworks mentioned in the Annual Reports we analysed, the UN SDGs were by far the most prevalent. 20% of companies in our sample mapped their ESG strategy to SDGs they believed they contributed to or, less often, those SDGs which they believed to be most affected by their particular business and where targeted support would therefore have the greatest impact. However, this score also included generic references to supporting the SDGs in general and even where the ESG strategy was mapped to specific SDGs, it was often not clear if and how the company's contribution was measured. Statements of support for the UN Global Compact, made by 12% of our sample, tended to be even more generic, perhaps because its principles are already covered by various non-financial reporting requirements, for example under the Companies Act 2006. And while inclusion in the FTSE4Good Index, highlighted by 11% of our sample, is a laudable achievement, it is not a proxy for diligent reporting of 'E', 'S' and 'G' data.

No mention of TCFD or data
10%

Company discloses intention to align to TCFD
10%

Company beginning to report on TCFD
31%

Company discloses a full TCFD report
49%



STANDARDS AND FRAMEWORKS

2%	No reference to either
8%	Global Reporting Initiative (GRI)
12%	UN Global Compact (UNGC)
16%	Carbon Disclosure Project (CDP)
20%	Sustainable Development Goals (UN SDGs)
2%	Business in the Community (BITC)
11%	FTSE4Good Index
8%	Dow Jones ESG Index
8%	SASB
13%	Other

Given the granular nature of CDP disclosure, it was encouraging to see that 16% of companies in our sample referred to their CDP score or response, signalling that they had completed a comprehensive questionnaire which is publicly accessible. However, the relatively rare mention of SASB and GRI should give companies pause for thought, given the widespread support these frameworks enjoy among investors, and none of the reports we analysed overtly referred to the IIRC's Integrated Reporting Framework. Lastly, the relatively high 'Other' score included a range of industry-specific frameworks, such as the Global Real Estate Sustainability Benchmark (GRESB).

The expert's view: Rachel Madan, Director of Sustainability & Impact

There is much debate about the future of ESG and sustainability reporting frameworks, with some hoping for consolidation of standards, as seen with the SASB – IIRC merger into the newly formed Value Reporting Foundation, and others looking for 'one standard to rule them all' in the form of a long-hoped-for global sustainability reporting standard.

At least in the short term, new transparency requirements suggest adopting a 'both/and' rather than 'either/or' approach to sustainability reporting frameworks.

As independent standard-setters such as the GRI, SASB, CDP and TCFD move ever closer to alignment, it is clear that 'harmonisation' does not necessarily mean 'consolidation'. Each framework is intent on carving their own piece of the sustainability reporting pie and this isn't bad news for corporate reporters. Leading companies are using all these standards in tandem to ensure that they are covering off the expectations of all their stakeholders.

For example, the GRI, SASB, and TCFD all treat climate risk and opportunity from different lenses, and by evaluating the full complement of information, companies and their stakeholders have a more meaningful understanding of impact going forward. We can expect report readers to demand alignment with multiple standards going forward, rather than reporting a narrow slice of data.

Best-practice considerations

Identify the 'E', 'S' and 'G' data that is material to your company and disclose it in your Annual Report.

Map your audience against the disclosures. For example, SASB is the preferred standard for the UK regulator, the FRC, and large investors such as BlackRock.

Align your corporate or ESG strategy only with the SDGs that are most relevant to your specific business and ESG commitments and map out how you will act.

For premium-listed businesses, look to address TCFD reporting early, possibly with a gap analysis provided by Luminous as a starting point for mandatory reporting in 2022.

Disclose your company's third-party ESG scores and accreditations.

Reports in focus

SEGRO Annual Report 2020

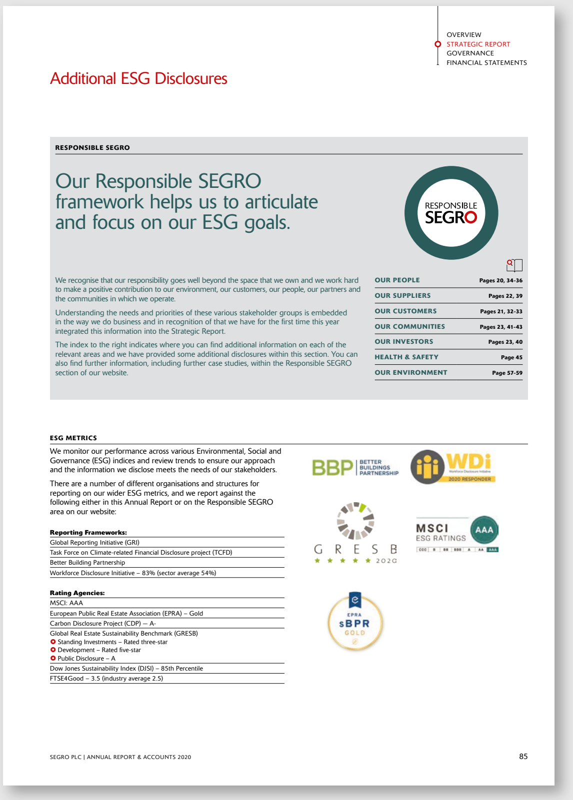
SEGRO's Annual Report illustrates some of the best-practice considerations set out above.

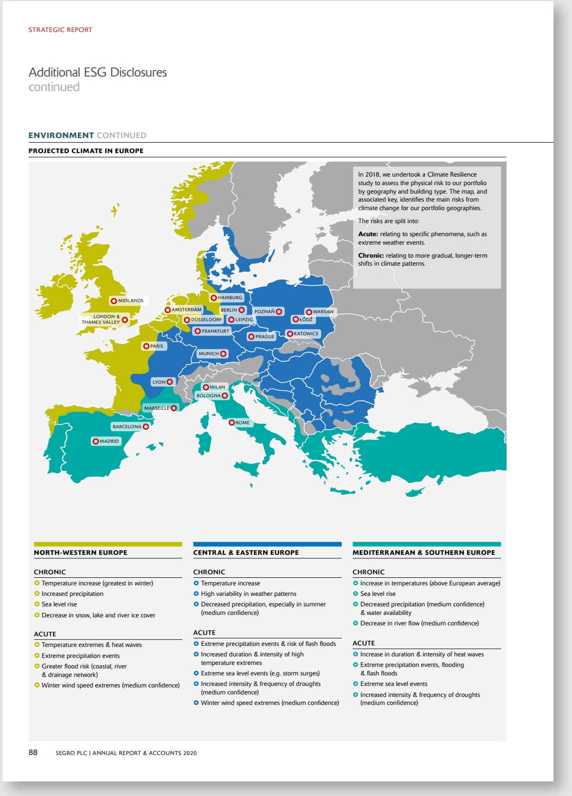
The company has reviewed the UN SDGs against its own ESG framework to understand which are particularly significant to its business and ESG strategy.

The ESG section of SEGRO's Annual Report has its own index to guide the reader to where ESG information can be found throughout the report. The ESG frameworks used to disclose the company's performance and the scores it has received from various rating agencies are summarised.

SEGRO confirms its commitment to implementing the TCFD recommendations and presents an overview of its pathway to becoming a net zero carbon business by 2030. It summarises the climate-related transition risks and opportunities it has identified the reports also shows the frameworks it uses to disclose this progress, including the GRI, SASB and GRESB.

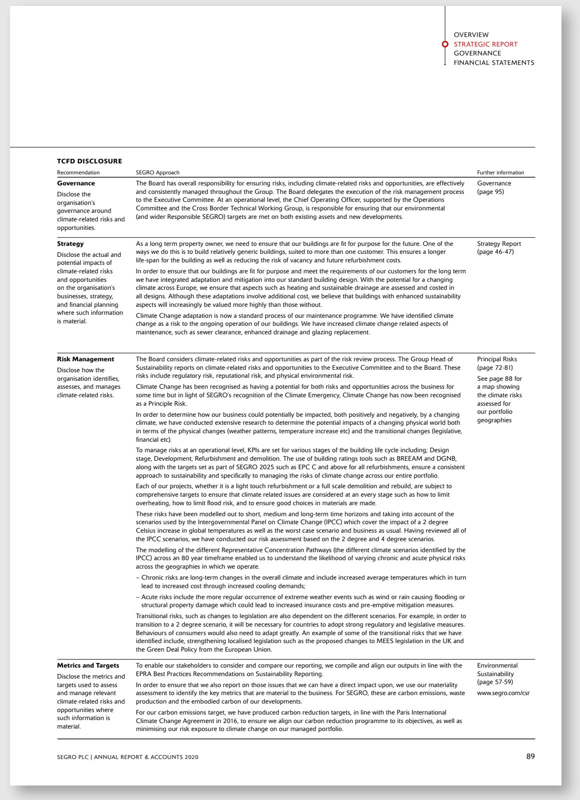
As part of its assessment of climate-related risks and opportunities, SEGRO has undertaken a climate resilience study.





SEGRO presents the TCFD disclosure in its Annual Report using an easy-to-read tabular index which shows the disclosures required for each of the four TCFD pillars next to a summary of the company's approach and actions.

Download the report here



How we can help you

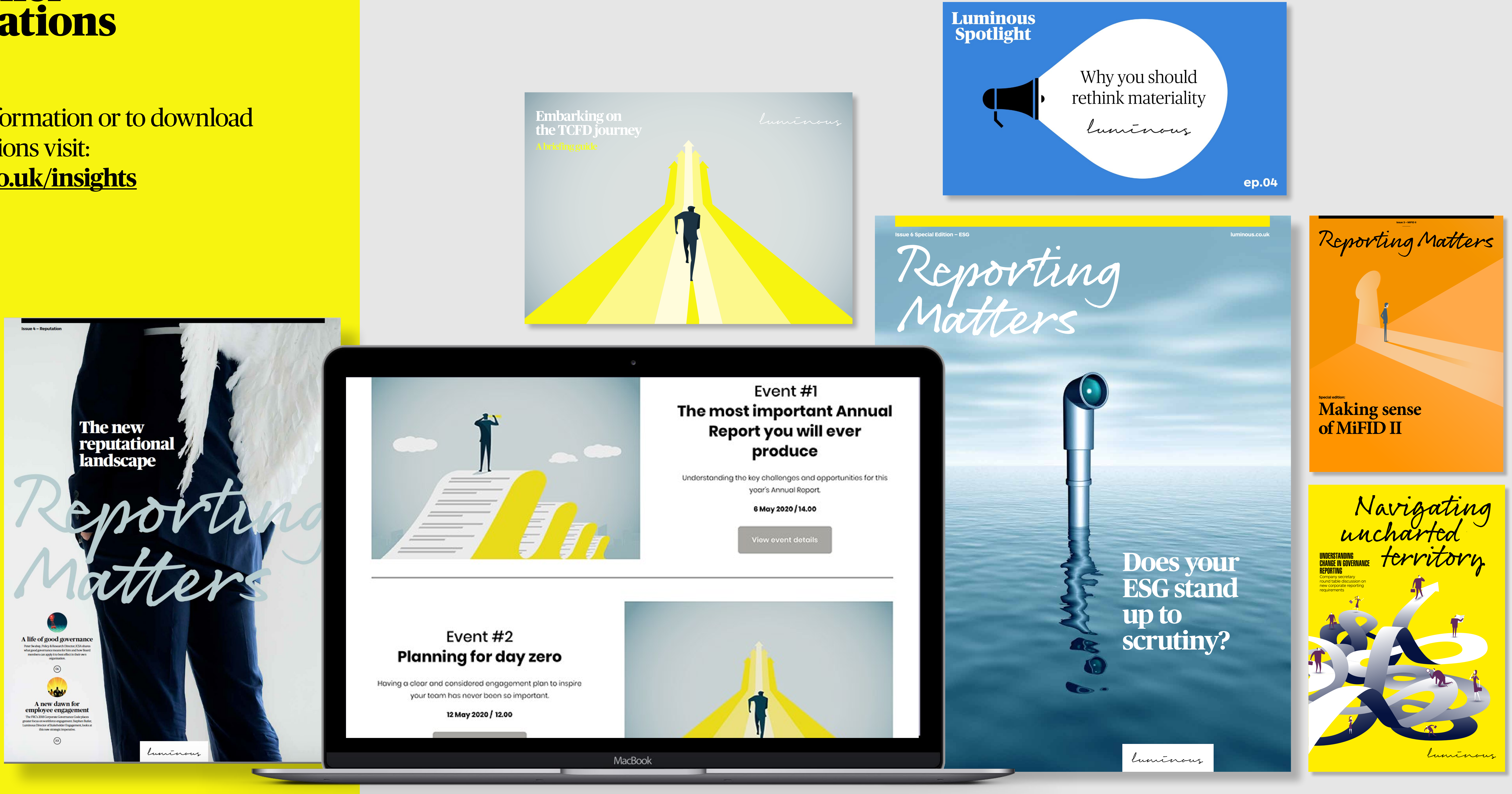
Luminous' strategy team has a deep understanding of capital markets and ESG disclosure requirements. We can help you to communicate with confidence around ESG issues and highlight your performance in a brighter way.

Our ESG services include:

- TCFD guidance and compliance
- SASB alignment and reporting
- ESG disclosure and integration
- ESG capital markets and investor events
- Board training and Executive Committee training on ESG issues
- Materiality assessment
- SDG prioritisation
- Stakeholder mapping
- Target setting
- KPI and metric development
- Reporting framework alignment

Our other publications

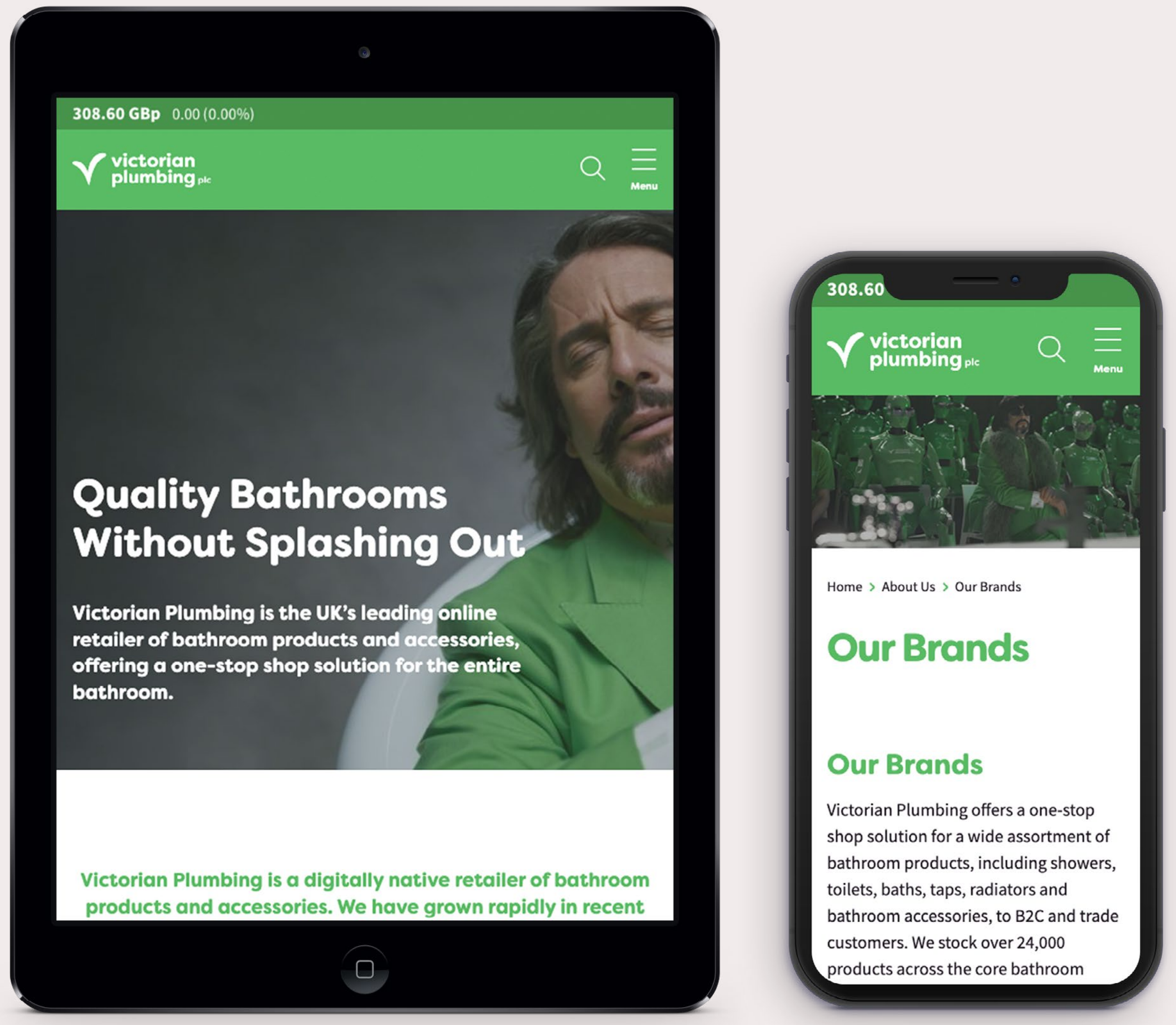
For more information or to download our publications visit:
luminous.co.uk/insights



Our recent project highlights

Telford Homes online Sustainability Report

Britvic Annual Report



Victorian Plumbing investor website

Biffa Annual Report and Sustainability Report

RGA online Annual Report

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