

Breakout III: The Evolving State of ESG

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The Evolving State of ESG

Bank Compensation & Talent
Conference
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Today's Discussion

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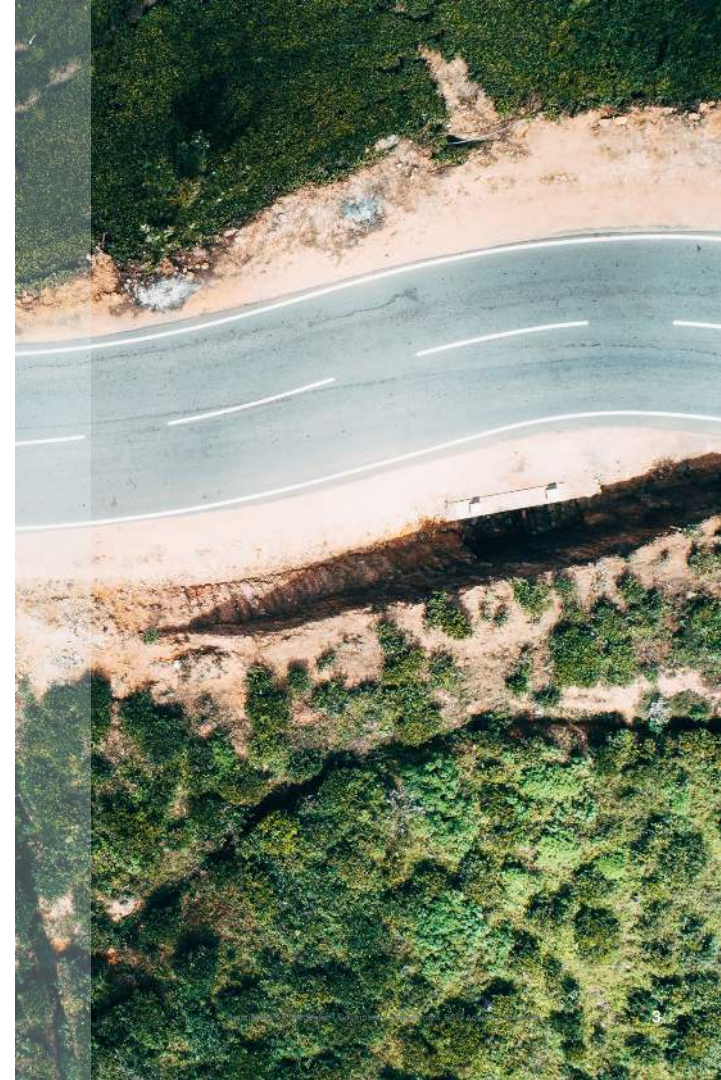
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Current ESG Context for Financial Institutions



ESG Issues

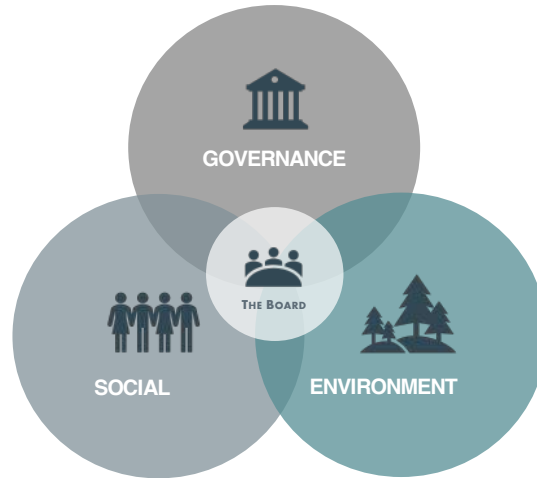
Key external stakeholders are focused on a range of risks and opportunities under the broad rubric of “ESG.” These issues and factors may seem disparate but are driven by investor views on **which ESG issues are material** and expectations **for board oversight and corporate strategy**

Human Capital

- Culture & Employee Engagement
- Diversity & Inclusion
- Employee Health & Safety
- Human Rights
- Labor Practices
- Talent Attraction & Retention

Social Capital

- Access & Affordability
- Brand Equity
- Community Relations
- Customer Privacy
- Product Quality & Safety



Corporate Governance

- Board Composition
- Executive Compensation
- Shareholder Rights
- Risk Oversight
- Business Ethics
- Competitive Behavior
- Data Security
- Supply Chain Management

Environment

- Climate Risk
- Energy Management
- GHG Emissions
- Hazardous Materials & Waste
- Product Packaging
- Water & Wastewater

Financial Sector Material ESG Factors



Financial Environment Impact



Systemic Risk Management



Data Security



Selling Practices & Product Labeling



Financial Inclusion



Human Capital Development



Incorporation of ESG Factors in Credit Analysis and Investment Management



Consumer Financial Protection



Business Ethics



Governance

ESG Growth & Growing Pains

ESG is at the forefront of financial product growth; ESG-mandated assets are projected to make up a third of global assets under management by 2025¹

Financial service companies' ESG performance is dependent on clients' ESG performance, driving broader engagement but presenting challenges navigating fiduciary duties

Many large financial service companies have made ambitious environmental pledges, leading to scrutiny around achievability



The ESG Backlash: Recent Headlines

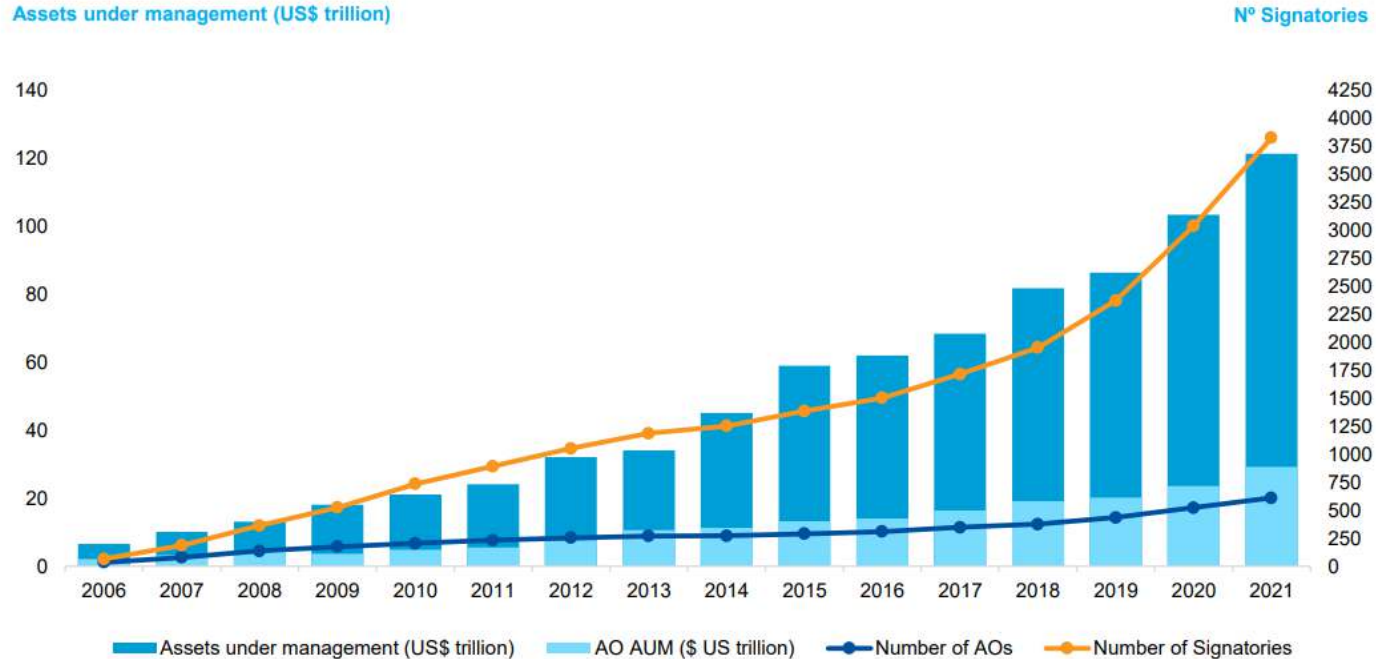
The financial sector is facing ESG criticism from investors, politicians, among others

- **AG Coalition Objects to Climate Change-Based ESG Investments** – JD Supra
- **West Virginia Punished Banks That It Says Don't Support Coal** – The New York Times
- **Banks far from hitting Paris Climate Targets, groups warn** – AP News
- **Deutsche Bank's DWS Sees More Outflows in the Second Quarter** – Bloomberg
- **Investor Scrutiny Intensifies As More Banks Link Executive Pay to Climate Goals** – S&P Global Market Intelligence
- **Ben & Jerry's Israel Fight Carries ESG Lesson for Deal Makers** – Bloomberg
- **What's Wrong With ESG Ratings** – Mondaq



Investors Driving the Rise of ESG

Principles for Responsible Investment & Assets Under Management



*Total AUM include reported AUM and AUM of new signatories provided in sign-up sheet that signed up by end of March of that year.

ESG Priorities for Financial Services Companies



Increasing transparency into how ESG risks are being considered in their various financial products/analysis



Developing tailored frameworks for assessing ESG risks across their business lines and portfolios which roll up into a centralized risk view



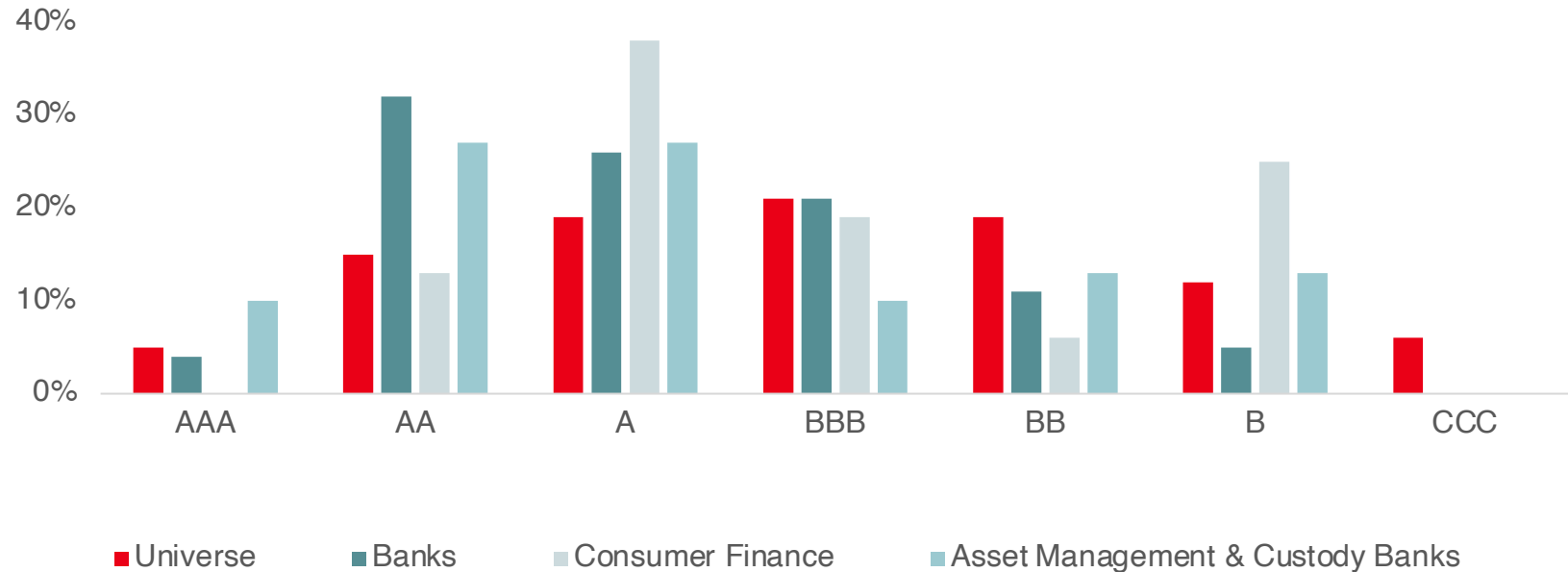
Governing cyber security at the board level and disclosing more information around risk management processes and incidents



Identifying feasible pathways to achieving net zero commitments through client climate engagement, strategic divestment, and investing in innovative green technologies

MSCI ESG Rating Distribution: Financial Sector

The financial sector is generally outperforming the MSCI ESG ratings universe mean, with banks performing the strongest in the sector



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Stakeholder ESG Considerations



Aon's Approach to ESG: Gather Stakeholder Intelligence

Understanding stakeholder agendas and influence are key to mapping the ESG journey



Companies

Need a dynamic ESG strategy to manage risks and seize opportunities in a rapidly evolving business landscape



Financial Stakeholders

Want to see companies perform amidst a changing global landscape and have a clear strategy for managing ESG risks



Regulators

Moving toward standardized ESG reporting, with a focus on climate risk transition, HCM, DEI



Colleagues

Want to work for a company that aligns with their values and provides opportunities for growth



Society

Committed to activism for companies not demonstrating a willingness to adopt ESG strategies

Our ESG solutions are tailored to respond to each unique stakeholder



The Big 3's ESG Priorities

Expectations on ESG Issues in voting guidelines; applicability differs by company size and sector

Generally, BlackRock, State Street Global Advisors & The Vanguard Group are Prioritizing 3 ESG Areas:

Board Diversity

- Reflect gender and racial diversity on the board
- Disclose board diversity characteristics

Workforce Diversity

- Disclose EEO-1 Reports
- Formalize board oversight of workforce diversity, equity, and inclusion

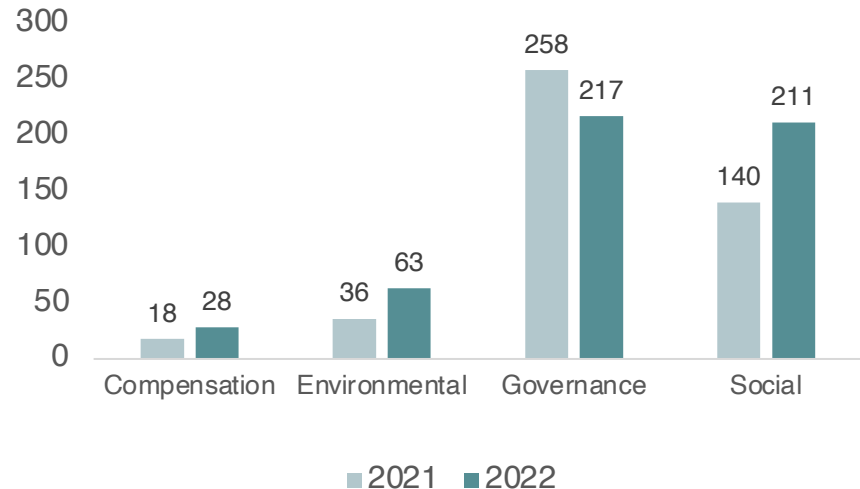
Boarder Sustainability & Climate

- Support for the TCFD framework; increasing support for SASB
- Proxy advisors are looking for board oversight of climate risk

ESG Shareholder Activism: 2022 Proxy Season

- There were approximately the same number of submitted shareholder proposals in 2022 (917) as in 2021 (903)
- Submitted environmental proposals were up 50% from last year but the number of proposals that passed is flat
- Governance proposals were down 18% from 2021
- The number of submitted human capital management proposals decreased 25 percent from 2021, but more of these proposals went to vote than the previous year

Voted ESG Proposals 2021-2022



Diversified Financial Companies: 2022 Shareholder Proposals

21 Shareholder Proposals Voted on in 2022

- 13 Governance proposals
- 4 Environmental proposals
- 4 Social proposals

1 Proposal Passed

- 7 received support above 30%
- 6 of 7 were enhancements to shareholder rights

Environmental Proposal Topics

- Strategy consistent with net zero 2050
- Report on GHG emissions targets
- Report on climate-related risks and opportunities
- Fossil-fuel lending and underwriting policy consistent with net zero 2050

Social Proposal Topics

- Report on charitable contributions
- Report on effectiveness of DEI efforts and metrics
- Board diversity policy

U.S. ESG Regulatory Update

Topic	Update
SEC Current Rule Human Capital Management Disclosure	Effective 11/9/2020 SEC requires that companies discuss human capital management in the Form 10-K based on “principles-based” disclosure
Nasdaq Current Rule Board Diversity	In August 2021, Nasdaq finalized its listing rule that would require listed companies to have at least 2 diverse directors including 1 who self-identifies as female and 1 who self-identifies as either an underrepresented minority or LGBTQ+ or explain in writing why they are not meeting these guidelines. Smaller reporting companies can meet the diversity objective with 2 female board directors. Companies will have until the later of Aug. 8, 2022, or the date the company files its proxy statement for the 2022 AGM to provide diversity data in matrix format.
SEC Proposed Rule Cybersecurity Risk Governance	In March 2022, the SEC proposed cybersecurity disclosure rules which specify how companies should disclose cybersecurity incidents as well as adequately describe risk management, governance oversight, and cybersecurity expertise of board members.
SEC Proposed Rule Climate Disclosure	In March 2022, the SEC proposed rules that would require publicly traded companies to include climate-related disclosures (including material climate risks, management systems, and emission metrics) in registration statements, Form 10-K, and Form 10-Q reports. If the rules are finalized, the earliest companies would be required to make climate-related disclosures would be FY 2023 for large accelerated filers, FY 2024 for accelerated and non-accelerated filers, and FY 2025 for smaller reporting companies.

Other Regulatory Guidance Specific to U.S. Financial Institutions:

- The OCC has issued principles for climate-related financial risks
- The FDIC has published draft principles on climate-related financial risk
- The National Credit Union Administration is expected to publish draft principles on climate-related financial risks in the next couple of years

Reputational Risk: News Media & Employee Sentiment

By understanding patterns across both internal and external stakeholders, you can better **forecast upcoming risks** and adjust your strategy to match.

Emerging Topics in News Media

Employee Engagement,
Diversity & Inclusion ⓘ

↑ 35%

increase over the last three months

Business Conduct &
Compliance ⓘ

↗ 11.8%

increase over the last three months

Innovation ⓘ

↗ 10.5%

increase over the last three months

Employee Sentiment Snapshot

Highest sentiment topics



Lowest sentiment topics



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Spotlight: Human Capital Management Strategy



Increased External Focus on Human Capital

- Institutional investors¹, shareholder activists, and the SEC are requiring increased transparency from public companies about how they are managing their human capital risks
- As the first SEC-mandated ESG-related risk disclosure, in August 2020, the SEC amended its rules to require public companies to disclose their human capital resources to the extent material
- As a result of this enhanced focus, many boards have expanded their oversight and consideration of human capital management (HCM) and Diversity, Equity and Inclusion (DEI) to encompass issues beyond executive officer hiring and compensation



Formalizing Board Oversight of ESG Topics

Regulators, institutional investors, and proxy advisors increasingly expect board accountability over material ESG issues

General ESG Duties

- May be included in the **Nominating & Governance Committee Charter** or separate standalone committees such as ESG Committees or Corporate Citizenship & Sustainability Committees
- ESG duties may also be addressed **by the full board**

Environment/Climate

- May be included in the **Audit Committee Charter**, or in separate standalone committees such as ESG Committees or Corporate Citizenship & Sustainability Committees

HCM / DEI

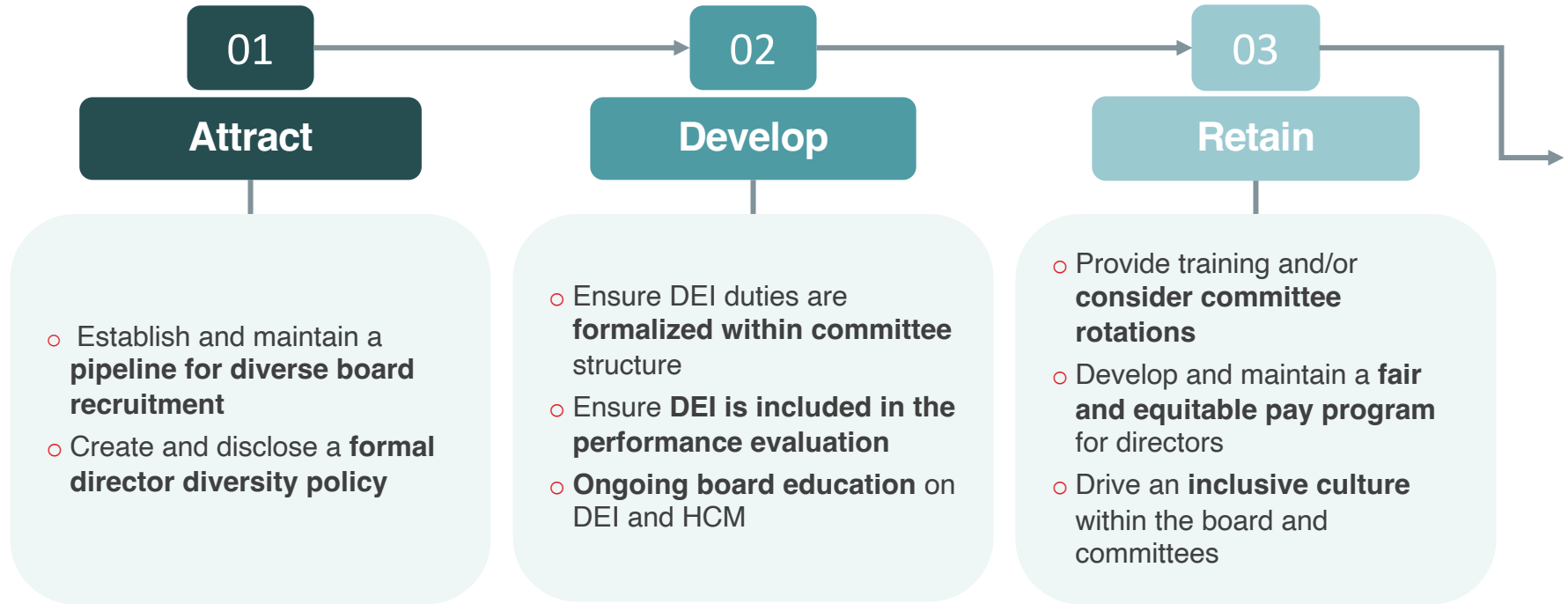
- Typically included in the **Compensation Committee Charter**

Cybersecurity

- Usually included in the **Audit Committee Charter** or separate committees such as Governance and Technology Committee

Diversity Equity and Inclusion – Board Role

Building a Holistic Perspective of DEI Initiatives Starts with the Board



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Investor Perspective: Identify gaps, opportunities, and plan of action

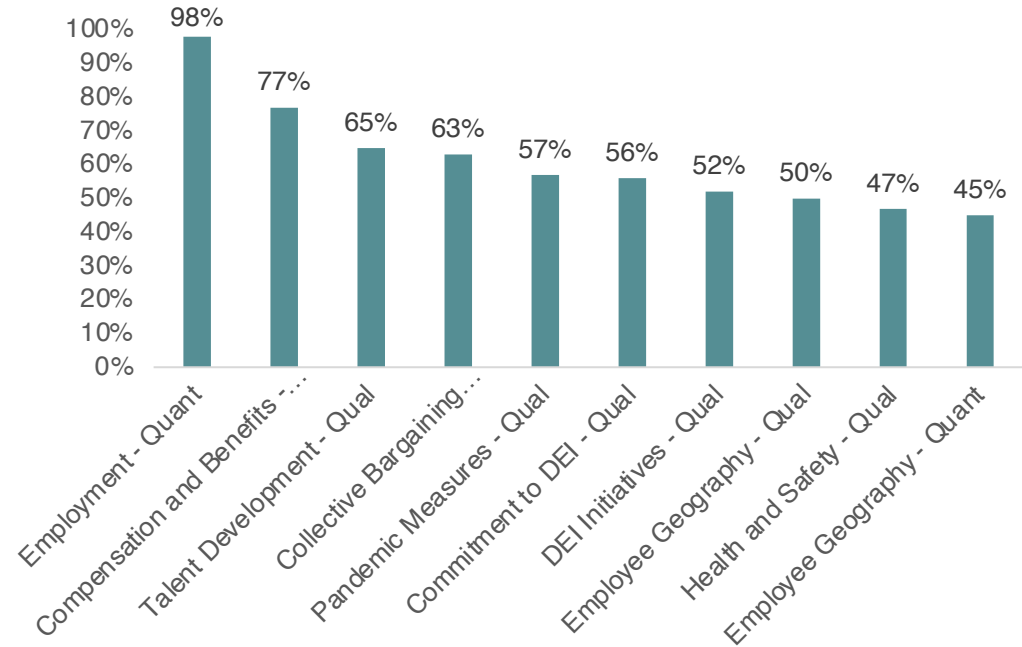
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Expanding Oversight Within the Compensation Committee

- Compensation Committees are expanding oversight duties to include broader human capital and DEI strategy. Some committees are being renamed to demonstrate the Board's commitment to broader human capital concerns.
- In 2021 10-K Human Capital Disclosures, companies included more workforce data, particularly with respect to diversity.
- Companies should consider reporting in alignment with the most prevalent categories and prepare for reporting employee gender and race/ethnicity breakdown in the next few years, if not doing so already.

Most Prevalent Categories in HCM 10-K Disclosures in Year Two

Data represents 3,026 Companies' 2021 Filings



Human Capital Management: Key Organizational Considerations

1 Organizational governance

- Board composition (diversity, skills)
- Board and management oversight, ongoing education
- DE&I metrics tracking and reporting
- Investor, underwriter, and lender expectations
- Comprehensive risk mitigation

2 People strategy

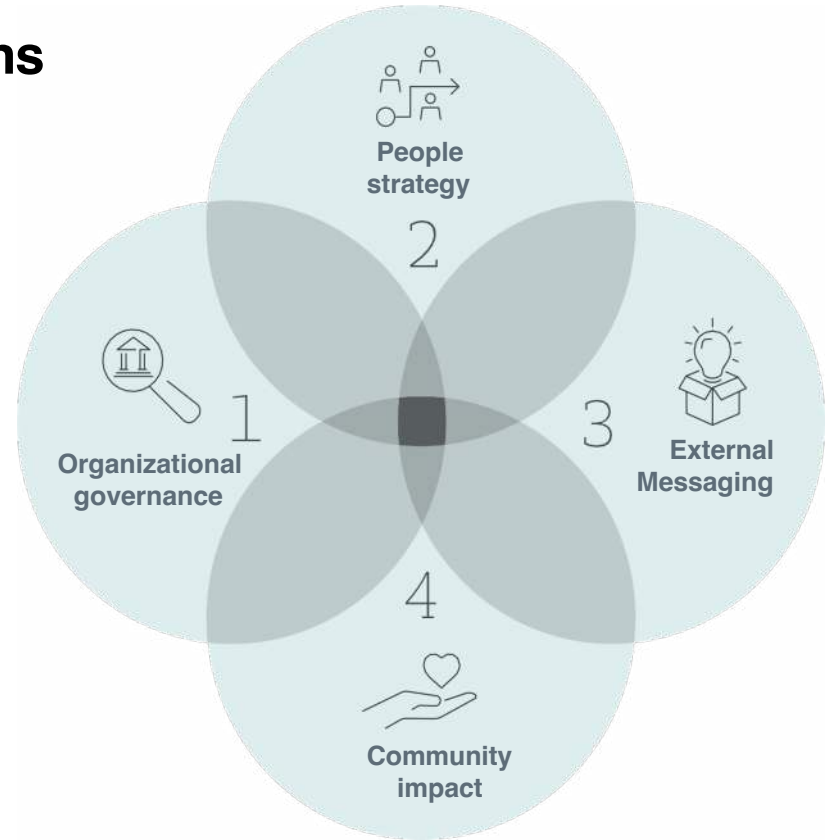
- Human capital metrics, including pay equity and talent mobility
- Talent attraction, development and retention
- Needs-based health and wellbeing benefits design

3 External Messaging

- Brand marketing and reputation
- ESG/Sustainability reporting avenues
- Alignment with ESG reporting frameworks
- Parity between consumer, employee and vendor messaging
- Careers website, public policies

4 Community impact

- Supplier diversity programs
- Corporate Social Responsibility (CSR) contributions
- Community-sourced talent pools, partnerships, and apprenticeship programs



Human Capital Management (HCM) Disclosure Strategy

- Given that “Human Capital” is considered a material ESG risk for all companies regardless of industry, companies can improve their ESG profiles by effectively handling their human capital management activities and reporting strategy across the Form 10-K, the proxy statement, corporate website, and ESG report
- Investors, regulators, employees, customers, ESG raters, and other key stakeholders are sourcing company data on their HCM oversight, practices, and metrics from all publicly available sources, such as:

Disclosure	Considerations
Form 10-K (required for all public companies) ¹	SEC requires material principles-based disclosure Companies are providing qualitative practices and limited quantitative data
DEF 14A	Board oversight/HCM metrics and executive compensation, board diversity metrics, or even company response to shareholder proposals on HCM or DEI related topics
Corporate Website	Employee demographics-including links to EEO-1 data, qualitative HCM practices
ESG/Sustainability Report	Quantitative and Qualitative (practices, goals, policies)



Wrap Up and Next Steps



Growing focus on ESG considerations by investors, employees, regulators, customers, and society are driving companies and their boards to re-evaluate their disclosures and board oversight of ESG

All companies are at different stages of their ESG journey –there is no one-size-fits-all approach

Industry sector, size, and maturity should all be key considerations in determining how to prioritize ESG

Investor approaches on ESG may also impact the company's goal setting and prioritization

While ratings can be directionally helpful, they should not be viewed as prescriptive—given their evolving methodologies and data points, they should be used as a tool to identify outliers

**Educate
Board**

**Identify
Focus
Areas**

**Compare
Practices to
Peers**

**Consider
Stakeholders**

**Inform and
Communicate**

Thank You