



THE LONG ROAD TO Standardized Environmental Reporting



Blaine Townsend, CIMA®, CIMC® | April 2019

*“It’s not easy being green.”
— Kermit the Frog*

Beyond Political Parties: Environmental Issues are Investor Issues

Fifty years ago this January, there was a blowout on a Union Oil rig in the Santa Barbara channel. For nearly two weeks the oil kept coming. It soon blighted, clogged, choked and tarred the Central California coast as far south as Ventura and as far north as the Channel Islands. At the time, it was the United States' worst oil spill in history and a seminal moment in this country's environmental movement. In the aftermath, activists marched down Wall Street to create the first Earth Day, and a more bi-partisan Washington created the Environmental Protection Agency and passed a succession of the world's strongest environmental laws.

Half a century later, U.S. environmental policy is no longer at the vanguard of the world, and Washington, D.C. sits beneath a partisan frost so thick that glaciers are melting faster. It remains to be seen whether a resuscitation of a "green new deal" will change the policy debate. Today, investors on Wall Street are more likely to address risks of the carbon-based world than policy makers. In fact, those investor concerns are spreading like an oil slick. In response, there have been a series of public and private efforts to provide Wall Street much more reliable environmental data.

The progress stands to reason. Disasters, man-made or natural, often serve as a fulcrum for change that can shock the status quo. The stock market crash in 1929, for example, led to the standardization of financial reporting and the creation of the Securities and Exchange Commission (SEC). The impetus to better reporting on environmental risk continues to play out in real time. The Santa Barbara spill was surpassed by the spill of the Exxon Valdez in Prudhoe Bay Alaska in 1989, and then by British Petroleum's Deepwater Horizon explosion and spill in the Gulf of Mexico in 1999. There was then a decade of stronger and stronger storms and fires with damage so catastrophic that the *Insurance Journal* reported in June of 2013 "...climate change threatens the insurability of catastrophe."

Climate and Environmental Reporting in Investor Analytics

"The river rose all day, the river rose all night
Some people got lost in the flood
Some people got away alright"

— *Louisiana 1927*, Randy Newman

In the wake of the Valdez spill, an organization called CERES catalyzed an ambitious union. Comprised of large institutional investors like the California Public Employees' Retirement System (CalPERS), environmental non-governmental organizations (NGOs) and the social investing community, CERES made the first organized push in

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North America for environmental reporting by publicly traded companies. By the time of the Deepwater Horizon explosion, the CERES-inspired Global Reporting Initiative (GRI) exported the concept worldwide.¹

While public debate on climate science simmered during the 1990s and 2000s, the steady drumbeat for better environmental reporting grew louder. At some point, the capital markets reached a tipping point in the perception that man-made emissions posed a serious risk for long-term investments. In the minds of many large institutional investors, environmental issues had become bottom-line issues. They began to demand more accurate environmental reporting and the research vendors started to respond. By the time Hurricane Maria hit Puerto Rico in 2017, even the Bloomberg Terminal (the ubiquitous tool of Wall Street) was providing a trove of data on the environmental performance of publicly traded companies. Large players in financial services like MSCI, Dow Jones and Morningstar had also made sustainability research a core part of their offering. The 2010s saw a staggering growth in the

level of environmental- and climate-related data that worked its way into investment analytics.

It was a long and iterative journey. At the public policy level, environmental reporting received a strong push from global bodies like the United Nations Environment Programme (UNEP) and the United Nations Global Compact. Within the professional, non-for-profit and academic ranks, scores of socially-minded investors, NGOs, think tanks and large public pension funds were working to overcome the challenge of quantifying the risks posed by climate change. These efforts helped fuel the growth of the movement toward environmental, social and governance (ESG) analysis in investing and strategic planning around climate change at the corporate and public policy level.

ESG Reporting in Investor Analytics

The ESG framework has now become one of the fastest and most widespread trends in investing. To bridge the gap between ESG and traditional investment analytics, it was imperative to create a

framework to identify the most relevant data and sort out how it could be standardized among industries, geographies and market capitalizations. By necessity, there were really two kinds of environmental reporting which evolved side by side to get the markets closer to real standardization.

VOLUNTARY REPORTING

The first type of environmental reporting relied heavily on voluntary self-reporting by companies and the development of sustainability rating systems by various stakeholders and data providers. Why was this necessary? Because environmental issues could potentially have a huge impact on long-term investment results, and there was inadequate required environmental disclosure.

Perhaps the best example of this was an effort that began in 1999 by Dow Jones and asset man-

ager RobecoSAM. RobecoSAM sent assessments directly to the 2,500 largest S&P firms.² The data collected served as the basis for some of the first sustainability-focused indices by Dow Jones. Another was the more narrowly-focused Carbon Disclosure Project (CDP). The CDP questionnaire, also sent directly to large companies, was designed to provide investors data on a company's exposure to climate change, carbon and water risk. Launched in 2000, 20% of the world's emissions are reported through CDP today. CDP provides discernable information on emissions to investors and serves as the basis for some 6,000 companies, 500 cities and 100 states to set targets and reduce emissions.³ Without these baseline targets, reducing emissions is extremely difficult.

The Task Force on Climate-related Financial Disclosure (TCFD) is a more recent example.⁴ Com-

REPORTING INITIATIVES

	Year Founded	Type	Audience	Form of Report	Focus
Carbon Disclosure Project (CDP)	2000	Reporting and rating	Investors and other stakeholders	CDP questionnaire	Provide investors with climate change, water and carbon data
Dow Jones Sustainability Index (DJSI)	1999	Rating	Investors	RobecoSAM questionnaire	Evaluate the sustainability performance of the largest 2,500 S&P firms through a family of indices
Global Initiative for Sustainability Ratings (GISR)	2011	Rating	Investors and other stakeholders	Center of Ratings Excellence (CORE) program	Steward an ESG ratings standard to accelerate the contribution of organizations worldwide to sustainable development
Global Reporting Initiative (GRI)	1997	Reporting	Broad set of stakeholders	Sustainability report	Empower sustainable decisions through established standards and a global, multi-stakeholder network
International Integrated Reporting Council (IIRC)	2010	Reporting	Providers of financial capital	Integrated annual report or standalone report	Establish integrated reporting and thinking within mainstream business practice for both public and private sectors
Sustainability Accounting Standards Board (SASB)	2012	Reporting	Investors in U.S. public companies	SEC 10-K, 20-F filings	Establish and improve industry-specific metrics for investors in the U.S.

Source: Deloitte, "Sustainability disclosure: Getting ahead of the curve", 2016.

prised of 32 members representing different economic sectors among the G20 (nineteen nations and the European Union), the TCFD set out to identify voluntary climate-related disclosures to help investors allocate their capital and help lenders, insurers and underwriters better evaluate their risks and exposures over the short-, medium- and long-term.

EARLY-STAGES OF REPORTING STANDARDS

The second aspect of environmental disclosures was built on these voluntary efforts but focused on drawing a link between value creation and financial materiality. For example, in 2013 the International Integrated Reporting Council (IIRC) was created by a global group of regulators, investors, accountants and companies to create a sustainability framework that includes both financial and non-financial information.⁵ By 2016, the GRI had nearly two decades under its belt and was able to launch its latest iteration, “G4”, the first global standards for sustainability. These standards were designed to help business and stakeholders make more informed decisions about climate-related practices.

In the United States, perhaps the most impactful development to standardized reporting was the official launch of the Sustainable Accounting Standards Board (SASB) in 2018. SASB aspires to create a unified standard of what public companies should report and how it should be reported. SASB will give U.S. investors and companies a much better set of industry-specific metrics to measure and improve sustainability performance.

In November of 2018, SASB launched the set of 77 codified standards, providing a complete set of global, industry-specific standards which identify financially material sustainability metrics for a typical company in an industry. SASB created a “materiality map” to help investors and companies identify which key performance indicators on sustainability issues have the greatest chance to affect financial performance. With a standard set of benchmarks, companies can disclose the same information, and investors and companies can compare sustainability performance through an objective lens.

The absence of standards (and complexity of issues) makes environmental reporting a bigger challenge than financial reporting. For example, in the United States the combination of SEC rules and U.S. Generally Accepted Accounting Principles (G.A.A.P.), created a standard framework in which financial information gets accounted for and reported. G.A.A.P. standards provided a framework for investors to gauge a company’s profitability. Even allowing for the alchemy involved in defining “profit”, the rules are fairly well understood and comparisons between companies and industries are possible.

The idea of a similar system and set of standards to gauge “sustainability” is a bit more daunting. Where the dollar can represent a uniform measure that can be applied across the board in financial accounting, the inputs or outputs to gauge materiality on environmental issues is not as clear cut. For example, something as basic as energy consumption is not even measured around the world in a uniform fashion. There is also an issue of the burden of reporting on small and mid-sized companies versus their larger peers. Some of the most sophisticated vendors providing ESG data to the market have started to use machine learning to predict the environmental impact of smaller companies based on what their larger industry peers have reported. The ability to attain accurate measures of comparison is one of the steepest challenges for environmental reporting.

Aiding the movement to standardize reporting is the evolution of securities listing requirements around the world. The SEC first offered a glimpse of where climate change might fit into required disclosures in 2010. At the time, SEC Chairman Mary Shapiro said, “a company must disclose the significant risks that it faces, whether those risks are due to increased competition or severe weather.”⁶ Obviously, more required disclosures on sustainability issues will help create a quicker path to standardized information.

This is the goal of the Sustainable Stock Exchange (SSE) initiative which has been incubated by several U.N. initiatives, including the United Nations Conference on Trade and Development, the UNEP Financial Initiative, the UN Global Compact and the Principles for Responsible Investing (PRI).

The SSE aims to align capital market information and decisions with public policy goals on sustainability through research, consensus building and technical assistance. The SSE brings together investors and regulators with the stock exchanges themselves to encourage reporting frameworks that could promote green finance (green bonds for example) and reporting disclosures aligned with sustainability issues. To date, there are over 40 exchanges around the world that voluntarily recommend sustainability disclosures, seven of which are now writing disclosure rules specifically on ESG issues. This includes the London Stock Exchange, but neither the New York Stock Exchange nor the NASDAQ have published specific guidelines on ESG reporting.⁷

The line between the Union Oil spill in Santa Barbara 50 years ago and the burgeoning movement for environmental reporting today might not be

perfectly straight. But you don't have to squint to see it. Union Oil became Unocal in 1983 and was eventually acquired by Chevron Corporation in 2005. On February 7th, 2019, Chevron released a voluntary environmental report — 50 years to the day after a \$1.3 billion lawsuit was filed against Union Oil for the spill. The report, *An Update to Climate Change Resilience: a framework for decision making*,⁸ included climate related disclosures and the acknowledgement that “Chevron recognizes climate change is a growing area of interest for our investors and stakeholders.”⁹

The report substantiates the investor argument that environmental risk is financially material. It is a near certainty it will not take another 50 years for environmental reporting to become standardized and on par with financial reporting. Hopefully, it won't take another major oil spill to speed up the process.

“How do we measure nuclear waste?
Electric cars and solar TV
Organic food — the things that we need
And if you still don't understand
The information is at your hands”

— *I Had a Dream I Was Falling Through a Hole in the Ozone Layer*,
Deee-Lite

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Endnotes

- 1 <https://www.globalreporting.org/Pages/default.aspx>
- 2 <https://eu.spindices.com/indices/equity/dow-jones-sustainability-world-index>
- 3 <https://www.cdp.net/en/info/about-us>
- 4 <https://www.fsb-tcfd.org/>
- 5 <http://integratedreporting.org/>
- 6 <https://www.sec.gov/news/speech/2010/spch012710mls-climate.htm>
- 7 http://www.sseinitiative.org/esg_guidance/
- 8 <https://www.chevron.com/stories/climate-change-press-release>
- 9 <https://www.chevron.com/-/media/shared-media/documents/update-to-climate-change-resilience.pdf>

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Blaine serves as a Senior Vice President and the Director of Bailard Wealth Management’s Sustainable, Responsible and Impact Investing (SRII) group. Blaine is on both Bailard’s fundamental and SRII investment committees, conducts social research, oversees corporate engagement efforts and maintains client relationships.

Blaine began researching and writing about corporate social responsibility in the late 1980s. He started his career in Socially Responsible Investing in 1991 at the Muir Investment Trust, the nation’s first environmentally screened bond fund. In 1996, he opened the California office for Trillium Asset Management, which he led for thirteen years. While at Trillium, Blaine managed socially responsible and sustainably focused portfolios, served on the firm’s investment committee and worked on corporate engagement efforts on a host of social and environmental issues from deforestation to media reform. Blaine also led the effort to create the “Joan Bavaria Awards for Building Sustainability in the Capital Markets”, which are presented each year at the Ceres annual conference and was part of the working group that created OpenMic to address net neutrality and media reform. In 2009, he joined Nelson Capital Management, where he was a partner and a senior portfolio manager. He also served on the firm’s leadership team and investment committee. Blaine chaired the company’s corporate engagement committee and was on the Extraction-Free and Animal-Welfare model teams. Blaine joined Bailard in 2016.

Blaine holds a BA from the University of California, Berkeley and CIMA® and CIMC® credentials. His writings on social investing have appeared in numerous publications including the *San Francisco Chronicle*, *Houston Chronicle*, *San Jose Mercury News* and London’s *Environmental Finance* magazine. Blaine has three children in college and lives with his wife and two dogs in Mill Valley, California. He has an eclectic taste in music and is an avid sports fan.

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