



ESG Factors, Rating Firms and Third-Party Validation

Nicolai Lundy

Director of Education & Partnerships

NIRI Chicago: Navigating the Brave New World of ESG

May 10, 2019

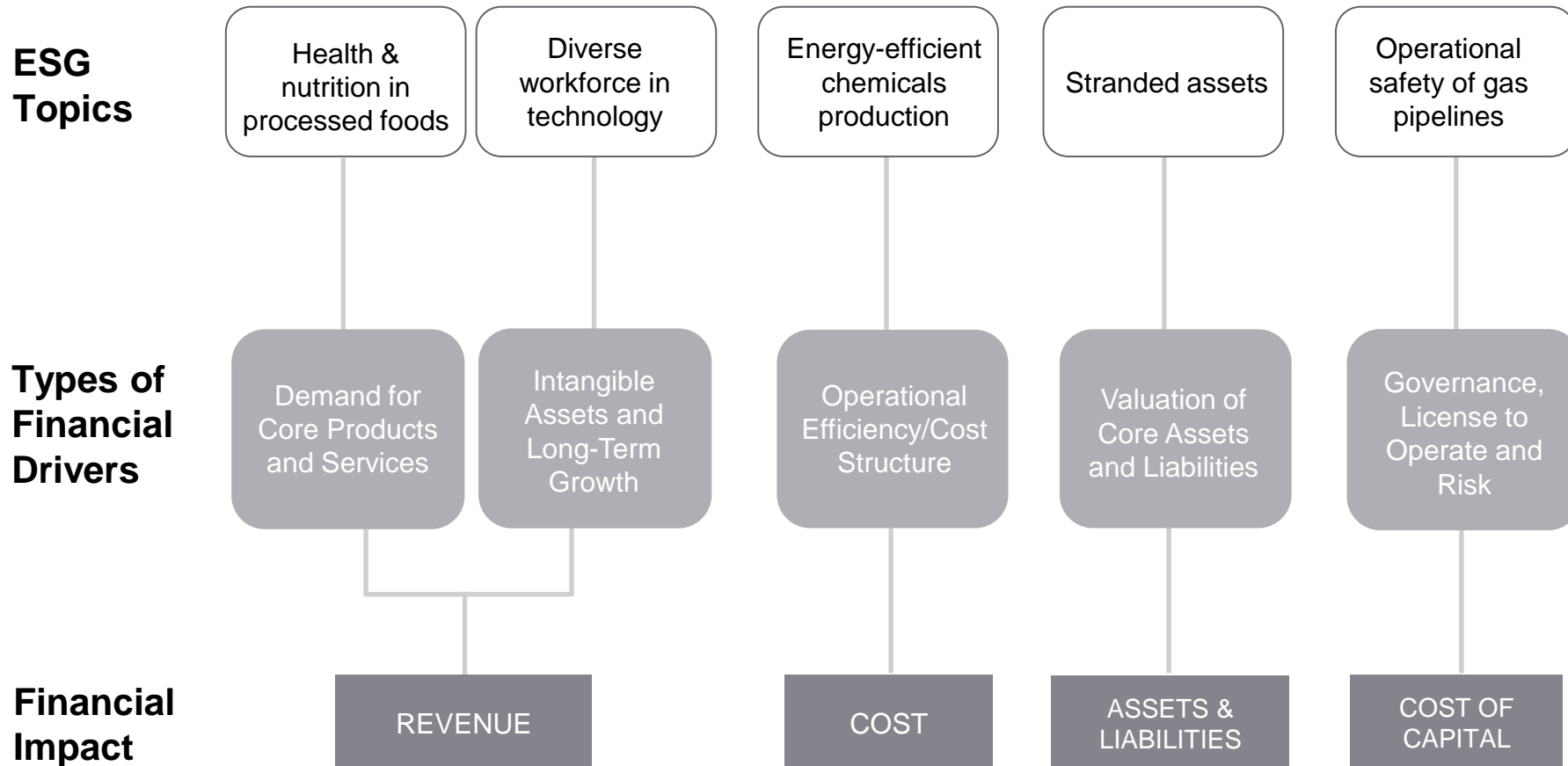


Discussion Topics

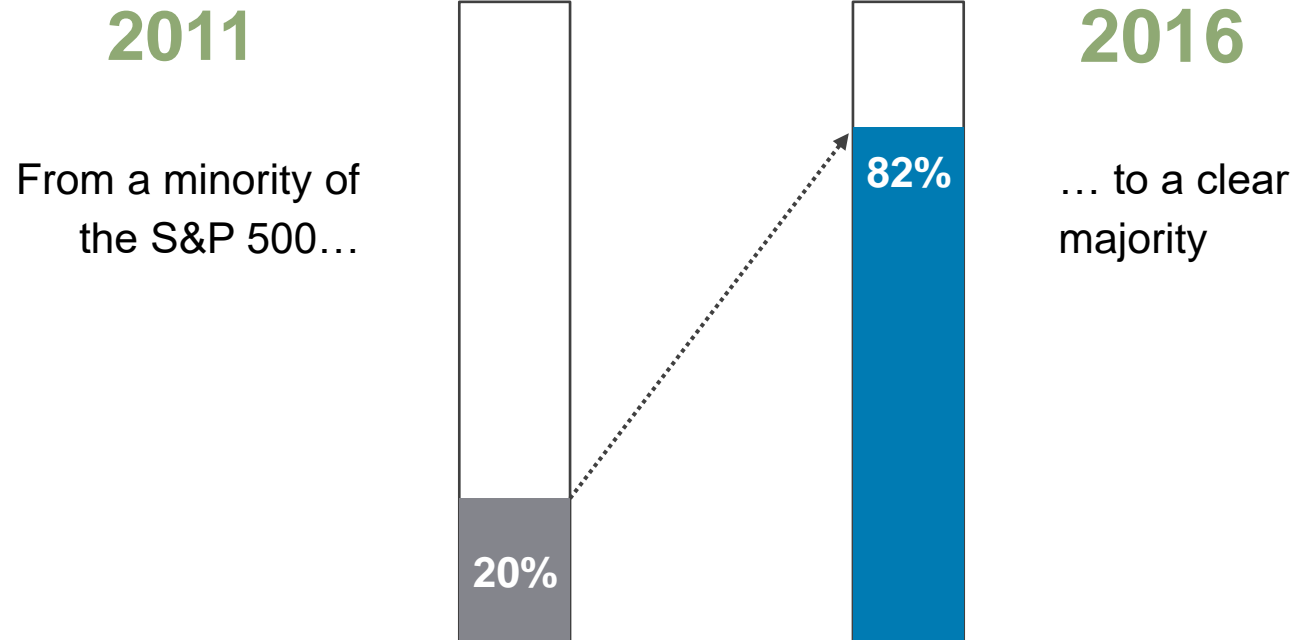
- 1** The Materiality of ESG
- 2** Overview of Data Providers and ESG Ratings Firms
- 3** Disclosure Standards to Guide Investor Communications
- 4** What IROs Can Do Next

Today's ESG is Unlike Historical Corporate Social Responsibility

ESG focuses on financial performance, not corporate citizenship



The Rapid Rise in CSR Reporting...



...Gave Researchers New Data Sets to Study

As the Field Evolves, the Financial Impact of ESG Gets Clearer

“I’ve never seen anything as effective as ESG characteristics when it comes to anticipating future earnings and volatility of U.S. corporations.”

SAVITA SUBRAMANIAN
HEAD OF U.S. EQUITY AND
QUANTITATIVE STRATEGY, BOFA
MERRILL LYNCH GLOBAL RESEARCH

The best signal we’ve found for fundamental risk

Prior to our work on ESG, we found scant evidence of fundamental measures reliably predicting earnings quality. If anything, high quality stocks based on measures like ROE or earnings volatility tended to deteriorate in quality, and low quality stocks tended to improve just on the principle of mean reversion (Table 1, Table 2, Table 3).

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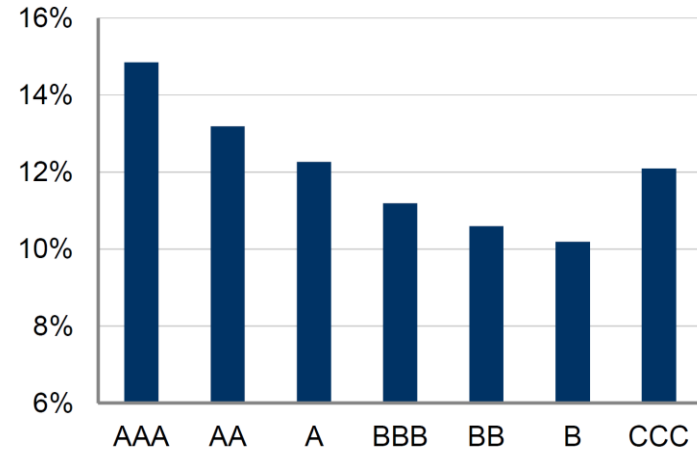
Table 4: Subsequent five-year median change in EPS volatility by overall ESG percentile ranks

Overall ESG Rank (from worst to best)	Median change in EPS volatility over next 5 years (%)
1st to 20th percentile (worst)	92%
21st to 40th percentile	64%
41st to 60th percentile	65%
61st to 80th percentile	37%
81st to 100th percentile (best)	32%

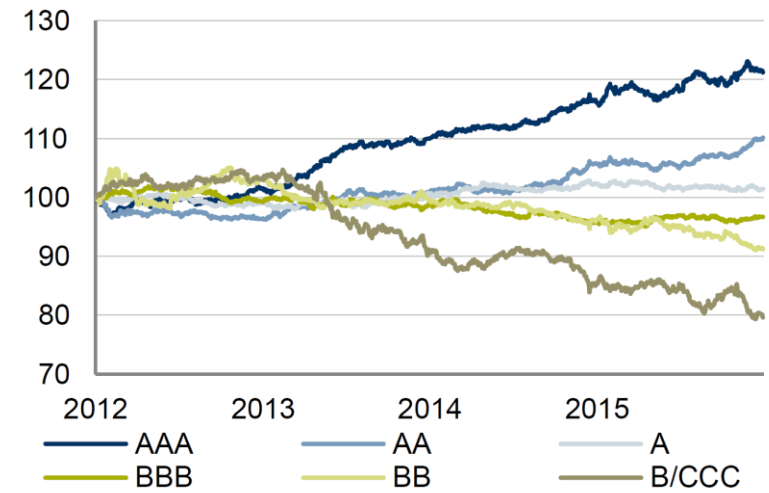
Source: BofA Merrill Lynch US Equity & Quant Strategy based on Thomson Reuters data

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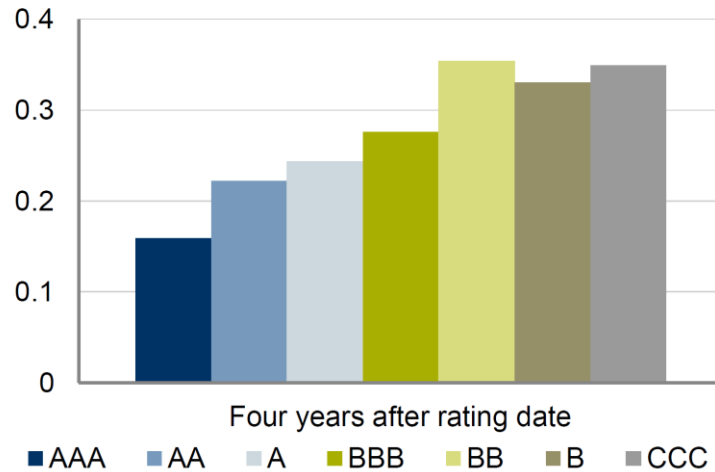
High ESG-rated companies have higher RoE



Relative performance per rating



Stability in ROCE four years after rating date



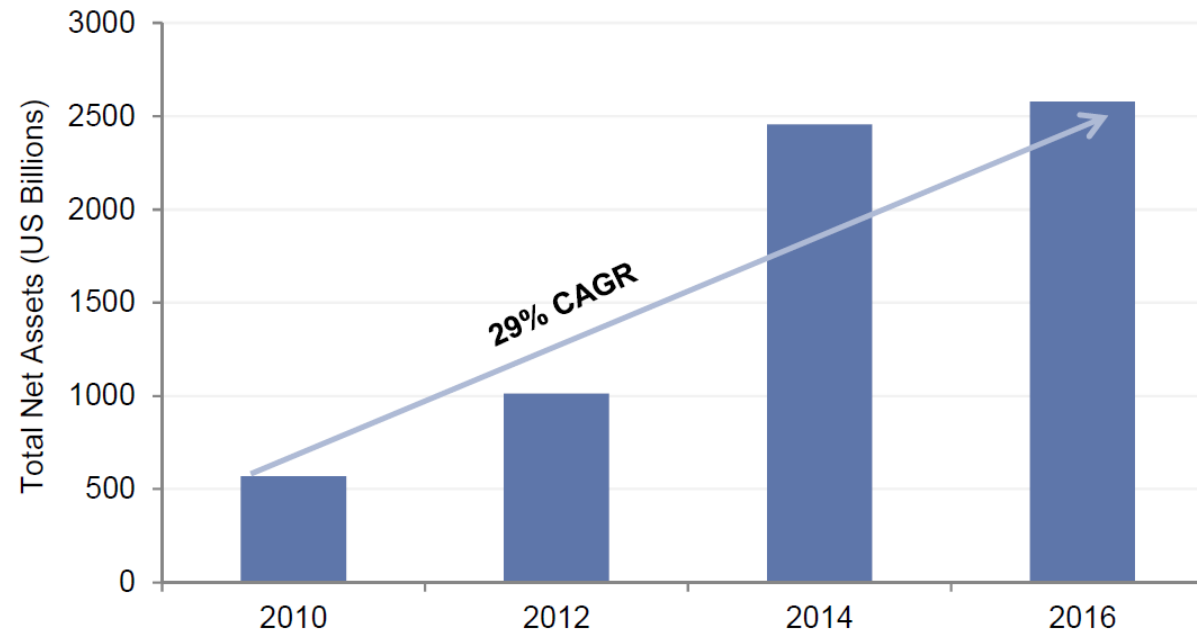
Source (all three charts): MSCI ESG Research, FactSet and Nordea Markets



As the Research Has Proliferated, Inflows Have Followed

Exhibit 32: Funds incorporating ESG in the US have grown 4.5x over 2010 levels

Investment assets incorporating ESG in the US (2010-2016), including mutual funds, variable annuities, closed-end funds, ETFs, alternative investment funds and other pooled products



The PM's Guide to the ESG Revolution, Goldman Sachs Asset Management, 2017

As Inflows Grew, a Host of Data Firms Entered the Fray

Data & Ratings Firms

- Company-level Ratings
- Proprietary KPIs
- Proprietary Materiality Framework



But Most Sustainability Reports Haven't Been Prepared for Investors

2015 JetBlue Report

ENVIRONMENTAL SUSTAINABILITY

We depend on natural resources and a healthy environment to keep our business running smoothly. Natural resources are essential for us to fly, and tourism relies on having beautiful, natural and preserved destinations for our customers to visit. Therefore we take an active approach to shrinking our greenhouse gas (GHG) footprint, reducing pollution and waste.

CLIMATE CHANGE — CHANGING OUR IMPACT

It's important to have a frank discussion about climate change and our business. Like other fossil fuel-based forms of transportation, planes and ground equipment release carbon dioxide (CO₂) into the atmosphere, which traps heat in the form of a GHG. JetBlue is focused on minimizing our impact by shrinking our carbon footprint.

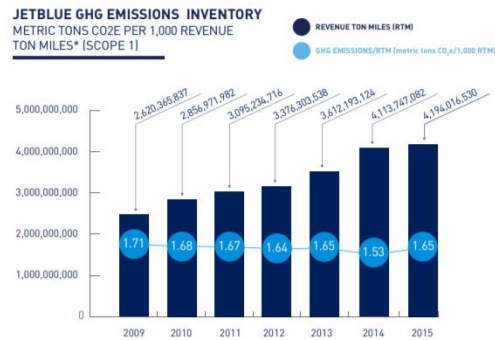
A changing planet creates unpredictable weather patterns, contributes to sea level rise and affects ecosystems, for example, by bleaching coral reefs, a tourist attraction critical to the Caribbean. These changes could impact our operations and harm our communities and customers.

MEASURING OUR PROGRESS

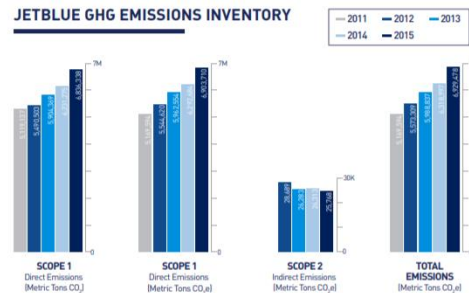
To track our progress and stay on course, we measure the emissions of our aircraft

and operations using conversion factors from the Climate Registry. In addition to CO₂, we track other heat-trapping gases such as methane through a standard CO₂e conversion factor, which puts other GHGs in terms equivalent to the warming impact of CO₂.

To better understand how efficiently we use energy resources, we normalize our emissions using revenue ton miles (RTM), a common airline efficiency metric that looks at weight in tons of customers and cargo multiplied by miles flown. Since 2009, we have reduced our Scope 1 emissions intensity ratio by 3.7 percent.



*Revenue ton miles = weight in tons of revenue traffic transported (customers and cargo) multiplied by miles flown.



CLIMATE CHANGE at 36,000 ft

I've been a pilot for the past 32 years — 16 of them in the Air Force.

I've flown the smallest bush planes in Alaska and been the captain of wide-bodies.

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I made myself a promise a long time ago to always be a force pushing sustainable practices wherever I could. It's one of the big reasons I'm here at JetBlue.

And now research tells us that jet fuel can be made safely out of biomass. The only question is how much can we make how fast?

Those powerful experiences created a sincere, uncompromising desire to do everything I can to decrease my own environmental impact and the impact of the business I work for.

Based off a true story.

<https://www.jetblue.com/p/JetBlueResponsibilityReport2015.pdf>



As a Result, Investors Are Dissatisfied With ESG Reporting

	<u>% Investors Dissatisfied</u>
Disclosure of ESG-related risk/opportunity that could affect business models	93%
Ease of comparing peer companies based on ESG data disclosed	92%

Sources: EY, *Is your non-financial performance revealing the true value of your business*, 2017; PwC, *Sustainability Goes Mainstream*, May 2014; *ESG Pulse*, 2016.



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Investor Needs



Investor confidence in the quality of the ESG information received from issuers



Issuer Reporting

Issuer confidence in the quality of the ESG information reported



Sources: EY, *Is your non-financial performance revealing the true value of your business*, 2017; PwC, *Sustainability Goes Mainstream*, May 2014; *ESG Pulse*, 2016.



CSR Was Not Geared to Investors, So Ratings Are All Over the Map

Figure 1
**ESG Scores are Different
Across Providers**
(Cross Sectional Correlation
for Constituents of the MSCI
World Index, June 30, 2017)

	Sustainalytics	MSCI	RobecoSAM	Bloomberg ESG
Sustainalytics	1	0.53	0.76	0.66
MSCI		1	0.48	0.47
RobecoSAM			1	0.68
Bloomberg ESG				1

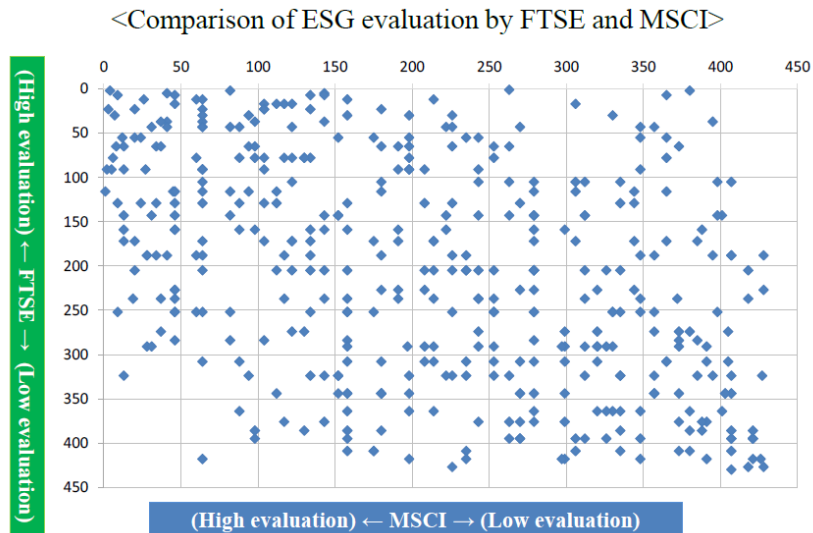
The ESG Data Challenge, SSGA, March 2019

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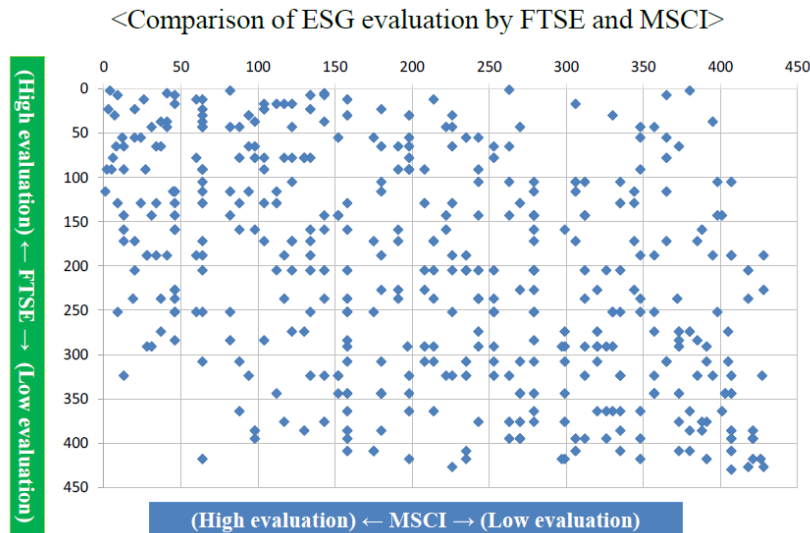
Results of ESG Index Selection, GPIF, July 2017

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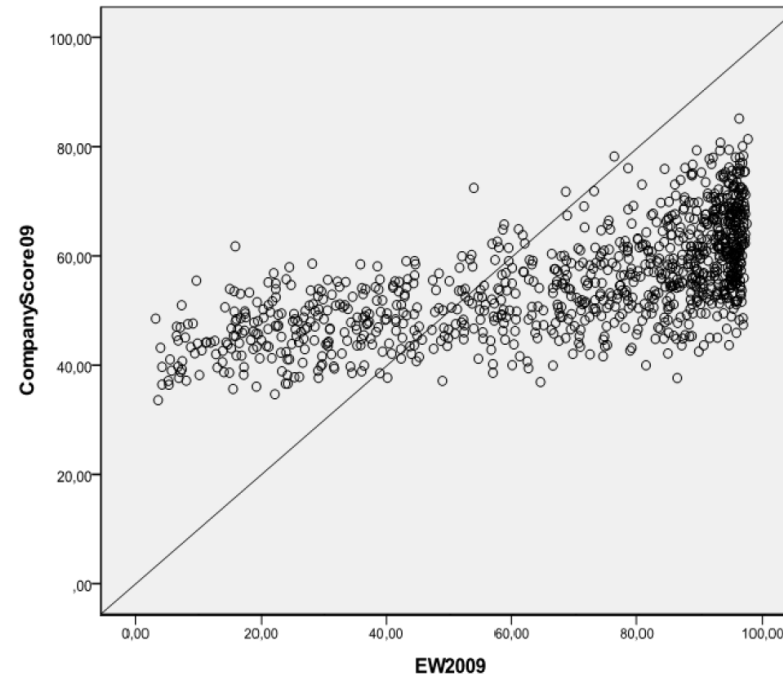
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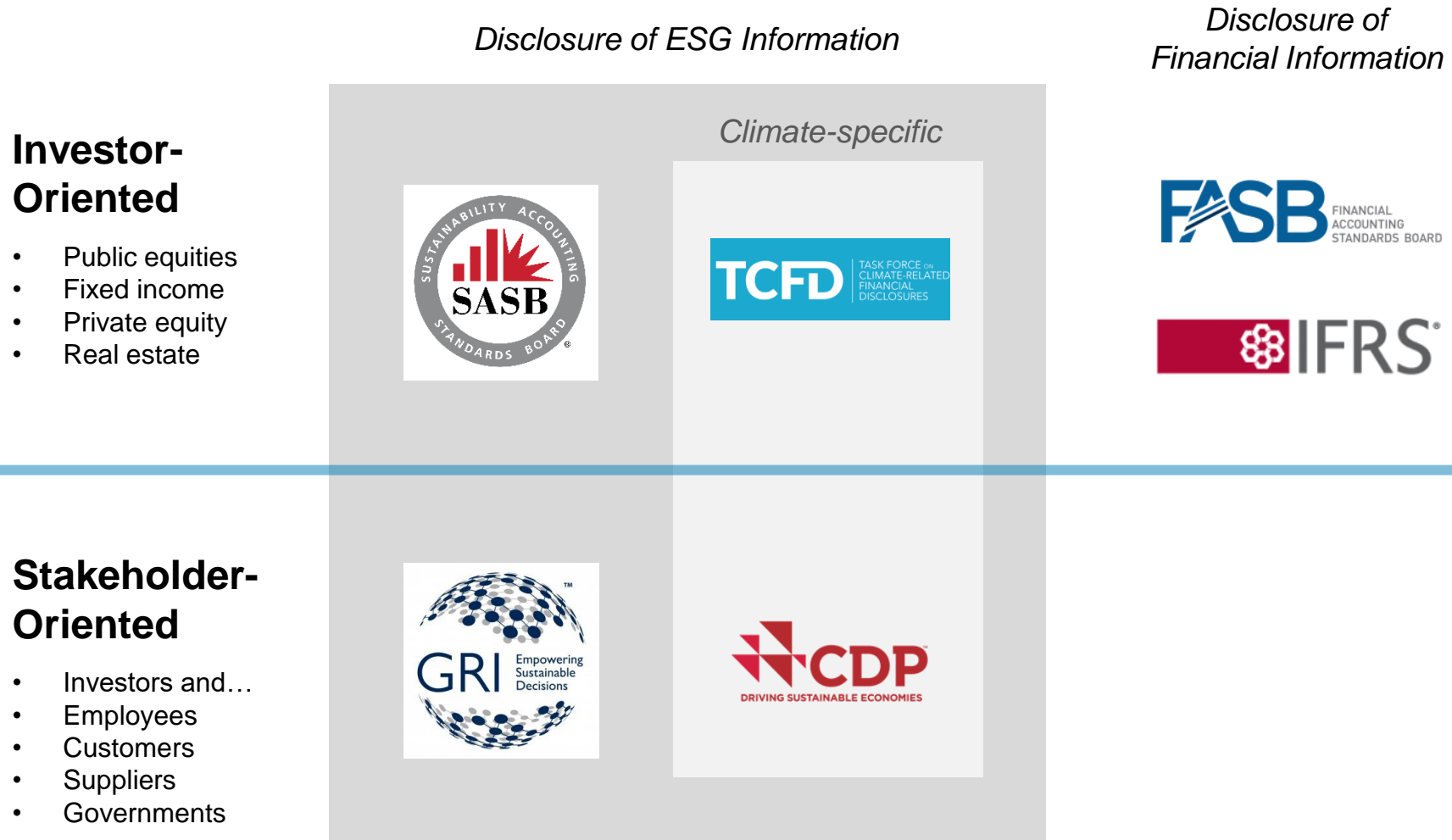
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How Robust Are CSR Benchmarks? Comparing ASSET4 with Sustainalytics, Tilburg University, October 2018

ESG Disclosure Guidance Differs From Ratings, With Distinct Goals

Unlike data firms, disclosure standards don't rate companies, have transparent KPIs



SASB – Sustainability Accounting Standards Board

Independent, non-profit standards-setting organization for ESG information



SASB connects businesses and investors on the financial impacts of sustainability



77 industry-specific disclosure standards

Used by companies and investors globally



A Focus on Business Issues That are Related to E, S, and G

Each industry is analyzed on 26 issues, but only a handful are material to an industry

Environment

- GHG Emissions
- Air Quality
- Energy Management
- Water & Wastewater Management
- Waste & Hazardous Materials Management
- Ecological Impacts

Leadership & Governance

- Business Ethics
- Competitive Behavior
- Management of the Legal & Regulatory Environment
- Critical Incident Risk Management
- Systemic Risk Management



Business Model & Innovation

- Product Design & Lifecycle Management
- Business Model Resilience
- Supply Chain Management
- Materials Sourcing & Efficiency
- Physical Impacts of Climate Change

Social Capital

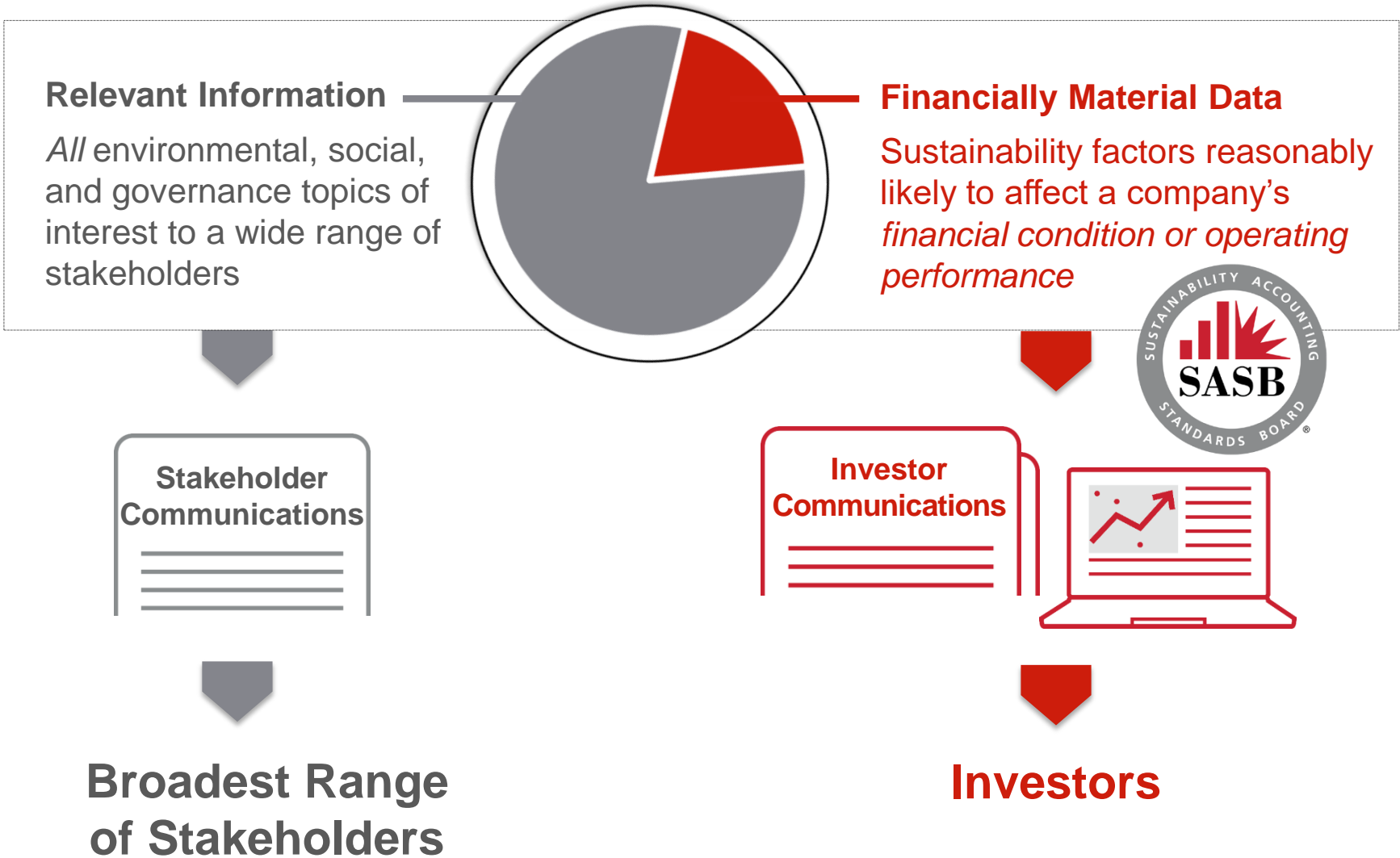
- Human Rights & Community Relations
- Customer Privacy
- Data Security
- Access & Affordability
- Product Quality & Safety
- Customer Welfare
- Selling Practices & Product Labeling

Human Capital

- Labor Practices
- Employee Health & Safety
- Employee Engagement, Diversity & Inclusion

Investor-oriented & Stakeholder-oriented ESG Data is Complementary

Different sustainability information to specific audiences for specific purposes



With a Focus on Materiality, Leading Investors Support SASB

SASB’s Investor Advisory Group includes 41 firms with over \$32 trillion AUM, represented by **senior investment professionals**

Participants include:



Head of Due Diligence for the Chief Investment Officer



Senior Vice President and Head of Fundamental Equities



Vice-Chairman



Global Head of Credit Research



Co-Head, Equity Division



Executive Vice President & Chief Investment Officer, Global Head of Beta Solutions



Managing Director and Global Head of Institutional Client Strategy



President and Chief Investment Officer, Wells Capital Management



Co-Head and Chief Investment Officer, Solutions & Multi-Asset Group



For Companies, SASB Standards Represent a Limited Set of KPIs

Each standard is industry-specific & focused on materiality – just 6 topics, 13 metrics

One of the 77 industry-specific standards: Automobiles industry



Topic	Accounting Metric
Product Safety	Percentage of vehicle models rated by NCAP programs with an overall 5-star safety rating, by region
	Number of safety-related defect complaints, percentage investigated
	Number of vehicles recalled
Labor Practices	Percentage of active workforce covered under collective bargaining agreements
	(1) Number of work stoppages and (2) total days idle
Fuel Economy & Use-phase Emissions	Sales-weighted average passenger fleet fuel economy, by region
	Number of (1) zero emission vehicles (ZEV), (2) hybrid vehicles, and (3) plug-in hybrid vehicles sold
	Discussion of strategy for managing fleet fuel economy and emissions risks and opportunities
Materials Sourcing	Description of the management of risks associated with the use of critical materials
Materials Efficiency & Recycling	Total amount of waste from manufacturing, percentage recycled
	Weight of end-of-life material recovered, percentage recycled
	Average recyclability of vehicles sold



Even Without SASB Disclosures, Investors Are Evaluating with SASB

Research studies point to the value of SASB's materiality framework

Harvard Business School and Russell Investments find that performance on material ESG issues identified by SASB is a better predictor of return than traditional ESG issues

		Differences in four-factor alphas (High – Low Quintile Performance)		
		SASB-based ESG issues	Immaterial ESG issues	Total ESG issues
 <p>HARVARD BUSINESS SCHOOL</p> <p>“Corporate Sustainability: First Evidence on Materiality”¹</p>	MSCI KLD Data (1991-2013)	4.18%	3.37%	2.93%
	 <p>Russell Investments</p> <p>“Materiality Matters”²</p>	Sustainalytics Data (2012-2017)	1.19%	0.30%

Sources:

1. Mozaffar Khan, George Serafeim, and Aaron Yoon, *The Accounting Review*, Vol. 91, No. 6, Nov. 9, 2016. Results for value-weighted portfolios of firms scoring at the bottom and top quintiles of the total, material, and immaterial sustainability indexes.
2. Emily Steinbarth, Scott Bennett, Russell Investment Management Ltd., Feb. 2018. Differences in the four-factor alphas of high and low portfolios formed on the basis of Material and Immaterial Sustainability Issues.

Case Study: From Stakeholder-based Reporting

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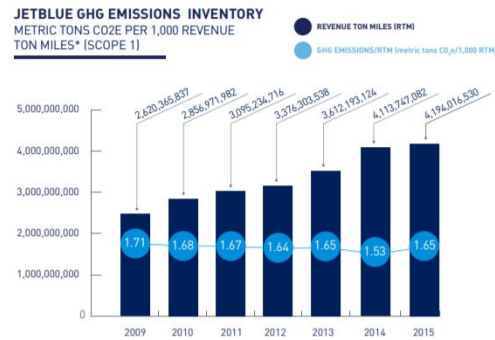
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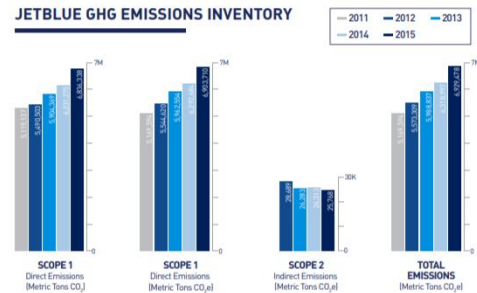
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Case Study: To Investor-based Reporting

2017 JetBlue Report – SASB

Sustainability Disclosure Topics and Accounting Metrics

Topic	SASB Code	Metric	2017 Performance	2016 Performance	Page
Environmental Footprint of Fuel Use	TR0201-01	Gross global Scope 1 emissions	7,809,488 MT CO ₂ e	7,484,799 MT CO ₂ e	4
	TR0201-02	Description of long-term strategy or plan to manage Scope 1 emissions	2017 Report, page 6	2016 Report, page 4	6
	TR0201-03	Total fuel consumed	112.8 million gigajoules	108.2 million gigajoules	11
	TR0201-04	Notional amount of fuel hedged	Removed from SASB October 2017 Airlines Exposure Draft	47 million gallons, 2016	
Labor Relations	TR0201-05	Percentage of active workforce covered under collective-bargaining agreements	0	0	14
	TR0201-06	Number and duration of strikes and lockouts	0	0	16
Competitive Behavior	TR0201-07	Amount of legal and regulatory fines and settlements associated with anti-competitive practices	0	0	17
Accidents & Safety Management	TR0201-08	Description of implementation and outcomes of Safety Management System	2017 Report, page 19	2016 Report, page 16	19
	TR0201-09	Number of accidents	2	2	24
	TR0201-10	Number of governmental enforcement actions of aviation safety regulations	0	0	24
Customer Welfare	TA05-11-01 (optional disclosure)	American Customer Satisfaction Index Airline Ranking	1 st place	1 st place	25

Environmental Footprint of Fuel Use

JetBlue's primary sustainability priority — and greatest financial opportunity — is reducing and managing carbon (CO₂) emissions.

Jet fuel is one of the largest components of JetBlue's cost structure and the biggest contributor to our greenhouse gas emissions (GHG). Anything we can do to reduce the amount of fuel consumed is a win-win proposition for our bottom line and environmental risk exposure. Our emissions reduction strategy is based on 1) limiting the absolute amount of jet fuel used; 2) offsetting certain CO₂ emissions; and 3) increasing the proportion of more environmentally friendly renewable jet fuel in our fuel mix.

SASB Disclosure TR0201-01: Gross global Scope 1 emissions

JetBlue's total Scope 1 GHG emissions in 2017 were 7,809,488 MT CO₂e. Scope 1 emissions are defined by the World Resources Institute and the World Business Council on Sustainable Development as direct emissions of GHGs from stationary or mobile sources that include but are not limited to equipment, production facilities, office buildings, and transportation (i.e. trucks, trains, ships, airplanes, buses, and cars).

Emissions	Amount (Metric Tonnes) 2017	Amount (Metric Tonnes) 2016
Carbon Dioxide	7,733,276	7,417,431
Methane	14	11
Nitrous Oxide	76,198	67,357

Scope 1 emissions for JetBlue come from the burning of jet fuel in our aircraft, along with diesel fuel consumed by ground equipment. We do not currently track hydrofluorocarbons, perfluorocarbons, or sulfur hexafluoride associated with our Scope 1 emissions.

Change in Scope 1 emissions

In 2017, JetBlue's gross Scope 1 emissions increased by 324,689 metric tonnes, or 4.34% compared to the previous year, due to increased passenger volume. Available seat miles increased by 4.45% in 2017.

Gross global Scope 2 emissions

Scope 2 GHG emissions, reported here for the first time, were 26,521 MT CO₂e in 2017. Information about JetBlue's Scope 2 emissions in 2017 can be found on page 42-43.

<http://blueir.investproductions.com/~media/Files/J/Jetblue-IR-V2/Annual-Reports/jetblue-sasb-tcf-d-2017.pdf>



What to Do as an IRO?

- How do you get management on board?
 - Bust legacy thinking with research on ESG as an investment signal
 - Highlight net inflows for ESG funds
 - Talk to your largest shareholders
 - Do they care about ESG?
 - What data do they want to see?
 - Point to your peers
- Start with defining your audience and purpose for ESG reporting
 - Investor and/or stakeholder?
- Be deliberate about responding to surveys and raters – **own your story!**
 - Asset managers are increasingly developing their own scores, not leaving it to the ratings firms on their own
- Ok to start small – the market recognizes ESG reporting evolves over time



**Accounting for a
Sustainable Future**