GLOBAL

Sustainability Q & A

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R&C: Could you provide an overview of the rising importance of sustainability? To what extent is this issue becoming a key agenda item for companies?

Marks: Sustainability has been a critical focus for companies and investors alike, especially of late. For example, sustainable funds or other investment vehicles that market an awareness of ESG issues have experienced record inflows of capital in 2020. This trend is notable against the backdrop of the global recession and market volatility. The idea that creating value for investors and shareholders need not come at the expense of other stakeholders is no longer novel. Indeed, in the longer run, investments in companies and products that are sustainable may be both more resilient and more successful in attracting risk capital.

Public policy has also historically been a key driver for sustainability efforts. As a result, sustainability is becoming central to the way businesses plan for the future of their operations and strategy – whether the emphasis on sustainability is being driven internally or in response to external pressures. Companies are now finding opportunities to attract capital, bolster innovation and improve financial performance as a result of their sustainability efforts.

R&C: To what extent are investors growing increasingly interested in companies' sustainability efforts? Are there growing calls for increased reporting on sustainability performance?

Marks: Sustainability reporting is certainly garnering increased attention from investors and other stakeholders. Any inconsistency in the standards against which sustainability efforts and programmes are compared makes it challenging for investors to be able to interpret this information effectively. As investors take sustainability issues more seriously, we will likely see increased emphasis on reporting and verification so that investors can have greater confidence that corporate or fund investments are actually aligned with sustainability goals.

> **"Investors, and thus companies, will increasingly focus on sustainability and ESG considerations in the wake of the pandemic."**

For instance, the US Securities and Exchange Commission (SEC) issued a request for comment in March 2020 under the so-called Names Rule – rule 35d-1 under the Investment Company Act of 1940 – noting that many investment funds use ESG terms in their names or state sustainability as an investment strategy without substantively deploying sufficient capital in line with those terms. According to the SEC, the number of funds, excluding unit investment trusts, including the terms 'ESG,' 'clean,' 'environmental,' 'impact,' 'responsible,' 'social,' or 'sustainable' in their names increased from 65 as of 31 December 2007 to 291 as of 31 December 2019.

Similarly, at the urging of US senator Bob Menendez of New Jersey, the US Treasury Inspector General for Tax Administration issued a report in April 2020 that found fossil fuel companies may have improperly claimed nearly $1B in clean air tax credits under Section 45Q of the Internal Revenue Code. The tax credits were made available to companies to trap, sequester and store carbon emissions, preventing them from entering the atmosphere, but the recipients may not have complied with the Environmental Protection Agency's (EPA's) monitoring, reporting, and verification (MRV) requirements. In another example, in the project finance space, scrutiny of sustainability performance and other ESG metrics is no longer limited to development finance institutions.

An important consideration for both equity investors and lenders, especially institutional investors providing long-term financing for operating projects, is not just the availability of sustainability reporting, but the extent to which this information is useful more broadly in benchmarking and value creation analyses. I would expect to see activist investors, including large public pension funds, and government agencies alike, take a heightened interest in reporting and verification to combat 'greenwashing' by corporations or investment fund managers.

R&C: What considerations should companies take into account when drawing up a roadmap to embed sustainability into their agenda?

Marks: Companies can approach sustainability issues on two levels. The first step is to review products and processes to see how sustainable practices align with the company's commercial goals, from flexible and resilient supply chains to branding and customer expectations, always with an eye on costs, return on capital and productivity. Next, at a deeper level, senior company management should instill sustainability into the firm's culture, inviting employees, customers and suppliers to innovate and collaborate toward meeting those goals and to create transparent ways to measure and reward success.

From my perspective, the most important consideration in preparing any strategy is to ensure that the approach is long term and able to withstand the tests of the fluctuating market. Investors expect companies to demonstrate that sustainability is more than a buzzword used in marketing materials. The key question to consider is, how will this figure into our strategy three, five, 10 years down the line? I would also urge companies to consider the sources they are consulting and the voices at the table when preparing an agenda for the business's sustainability efforts – that is, who are the right stakeholders to engage in these conversations, and what efforts really move the needle in substance with more than a one-off headline?

R&C: In your opinion, what are the implications of the COVID-19 pandemic for companies' long-term sustainability plans?

Marks: Sustainability means maintaining current living standards without jeopardizing the quality of life for future generations. That definition applies to the environment and also to social equity. So, in a sense, the pandemic has been a sort of stress test revealing vulnerabilities and inequities in systems and institutions. To the extent that the pandemic and resulting economic strain present companies, investors and lenders with an opportunity to reevaluate the viability of long-term strategies, including with respect to sustainability, these challenges can lead to better outcomes.

We are seeing, without a doubt, increased pressure on companies to reduce their financial losses, which may at first appear to be at odds in the short term with investments in sustainability. However, I would expect investors and consumers to reward companies that commit to sustainability in the years to come. We know that focusing on sustainability has a tremendous potential to spur innovation – now is the time to tap into that innovation to address unprecedented challenges to companies' long-term financial health and to make them more resilient in every respect.

R&C: What sustainability strategies should companies look to deploy in the COVID-19 era as part of their recovery and growth? What advice would you offer on revisiting their business model, capturing opportunities and managing risks to shape a sustainable future?

Marks: Sometimes external shocks are a valuable wakeup call, spurring renewed attention to both risks and opportunities. I would advise companies to remember that sustainability is not limited to checking compliance boxes. For so many of us, the pandemic has been an opportunity to reset and re-evaluate priorities, and the same should be true for every business as we plan for a post-COVID-19 future.

> "ESG considerations continue to be significant."

Risk management is becoming more valued, and appropriately so. Managing risk in the face of uncertainty presents challenges for valuations, liquidity and investment. Those challenges can be met with coordinated action, vigilance and creativity. As just a small example, many companies are experimenting with new ways of connecting with employees and customers digitally, given social distancing, which results in less wasted time and energy than was previously spent travelling and commuting. Those new tools will likely survive the pandemic, with resulting cost savings, increased workforce flexibility and environmental benefits. We have yet to see how companies will respond to the acceleration of trends in office space utilization and working from home, transportation and communications networks, e-commerce, digital networking, and cyber security wrought by the pandemic and the economic and public policy responses to it.

R&C: What frameworks, ratings and standards can companies utilize to ensure coherent, consistent and comparable sustainability reporting?

Marks: A challenge of sustainability reporting is that the frameworks of analysis are numerous and varied. Information provided to investors is of limited significance if data collected and weighted using standardized metrics is not readily available to enable companies, investors and lenders to effectively compare performance. I would urge companies to consider which frameworks are most widely accepted in their space, and which rubrics their investors and other sources of capital are most likely to be familiar with.
Compliance with the Equator Principles framework is a baseline in global debt finance, and there are a number of other standards that companies may wish to consider, among them the GRI Standards, the SASB framework and the United Nations Sustainable Development Goals (SDGs), to name a few. Reporting should facilitate comparisons both between companies and within each company over time, quantitatively and qualitatively, and as measured against stated sustainability goals or metrics. Investors should also pay attention to the bigger picture. Company policies may have unintended consequences or impacts – positive or negative – for other parties along the value chain. Sustainability goals should not be analyzed in a vacuum but rather in the context of larger systemic impacts.

R&C: Going forward, to what extent do you believe sustainability will be a core focus as companies rebound from the COVID-19 pandemic? What are your long-term predictions for this trend?

Marks: I would expect sustainability and ESG considerations to continue to be a significant focus for companies and investors alike in the wake of the COVID-19 pandemic. Many sustainable industries are also more resilient. As impacts of global climate change become more apparent – in extreme heat and severe weather events, droughts and sea-level rise – businesses that emphasize both sustainability and resilience should hold more promise for investors for the foreseeable future.

Market trends emerging in 2020 so far illustrate that sustainability has remained a focus for investors. In many ways, the pandemic provides a test case for how to deal with a crisis. Some industry segments will naturally benefit more than others. For example, historically, we have seen that renewable energy provides stable cash flows and predictable returns and is a sustainable sector that should see significant growth in the long term despite economic volatility. Adjusting to the current challenging economic environment while bolstering long term sustainability and resilience may, in fact, be complementary goals.