

# Putting Companies in the Driver's Seat to Enhance ESG Reporting

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ESG. It's one of the fastest growing areas of investment today. Representing 1-in-4 of every dollar that is professionally managed, sustainable investing is being integrated into portfolios at 17% each year.<sup>1</sup> And yet, for all the investor interest and excitement around ESG, companies struggle to understand what information to report, how to report it, and the relevance of ESG information to investors.

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For State Street Global Advisors, we believe financially material ESG factors can impact a company's long-term performance. Our goal is not just to build ESG portfolios but also to encourage companies to focus on issues that matter while providing them with the transparency to meet those expectations. This is the only way to create sustainable markets and long-term value for investors.

To drive progress in this area, we have been engaging with hundreds of companies to understand how they disclose and incorporate ESG into their long-term strategy. And now, we've built a tool we believe will incentivize companies to make a big leap forward.

Here's how it works.

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## Addressing the ESG Data Challenge<sup>2</sup>

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Over the course of our conversations with companies in our portfolio, a few things have become clear. Investors need access to ESG data that is material, consistent, comparable and as easily available and accessible as more traditional financial data. However, many companies aren't disclosing a lot of ESG information — and when they are, it isn't always material to their industry or particularly helpful to investors.

Part of the challenge is that there is no commonly accepted framework to help companies or their investors navigate ESG materiality. For instance, while it might be nice to know what a footwear company does to strengthen community relations, understanding their supply chain management practices and how they source their materials is far more relevant for investors.

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Recognizing these challenges, in 2016 the Principles for Responsible Investing (PRI) laid out in its Blueprint the need to “drive meaningful data throughout markets” as one of its core areas of impact for signatories, who together represent more than half of the world’s professionally managed assets. PRI sees this as critical to building sustainable markets.

But making progress on ESG reporting also requires this work to be done cost effectively so that every company can be part of this new investment paradigm. Indeed, the less speculation required by a company when it comes to figuring out what to report doesn’t only mean more resources available to collect and report the information itself. More importantly, it also allows companies to manage material ESG factors as part of their day-to-day activities and incorporate them into their long-term strategy.

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## **Our Solution**

### **R-Factor™**

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To focus companies on the material ESG factors considered relevant by investors, we have developed a scoring system that leverages multiple data sources and aligns them to widely accepted, transparent materiality frameworks to generate a unique ESG score.

As one of the largest asset managers in the world, we see this not as simply a product or service — but as our responsibility to investors. And so, we call this score “R-Factor™.”

The R-Factor™ score is aligned to the materiality framework of the Sustainability Accounting Standards Board (SASB), as well as market-specific corporate governance codes.<sup>3</sup> The advantage of utilizing the SASB framework, which is supported by investors representing more than \$32T in assets, is that it focuses only on ESG factors that are likely to impact company financial performance. These factors shown by academic research to contribute to long-term returns.<sup>4</sup> Detailed standards published by SASB guide companies to disclose material ESG information which, in turn, will improve disclosure and management practices.

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## **Taking the Guesswork Out of ESG Reporting**

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R-Factor™ is the first ESG scoring system that puts companies in the driver’s seat and allows them to take the action needed to enhance their scores. It is built to address the current challenges with ESG data by removing opaqueness around ESG materiality in the scoring process.

Put simply, it takes the guesswork out of ESG reporting.

R-Factor™ not only powers our investment and client reporting capabilities — it is also fully integrated into our stewardship program. Our stewardship team is already sharing companies’ R-Factor™ scores with portfolio companies.

As companies develop infrastructure to manage ESG factors and improve their disclosure, we expect to see more meaningful ESG data driven throughout markets.

With R-Factor™, we have made it easier for smaller companies to focus their ESG efforts and report on what investors want to know. It’s particularly the small, mid-cap, and emerging market companies who stand to be the biggest beneficiaries of our ESG reporting playbook.

The world of ESG disclosure may seem complex — but with R-Factor™, companies and investors no longer have to go it alone. Together, we can forge a new standard in ESG investing and responsibly create long-term sustainable value for investors.

## Endnotes

- 01 McKinsey, "From 'why' to 'why not': Sustainable investing as the new normal", October 2017.
- 02 <https://www.ssga.com/investment-topics/environmental-social-governance/2019/03/esg-data-challenge.pdf>
- 03 "R-Factor™: Reinventing ESG Investing Through a Transparent Scoring System"
- 04 Khan, Mozaffar, George Serafeim, and Aaron Yoon. "Corporate Sustainability: First Evidence on Materiality." *Accounting Review* 91, no. 6 (November 2016).

## About State Street Global Advisors

For four decades, State Street Global Advisors has served the world's governments, institutions and financial advisors. With a rigorous, risk-aware approach built on research, analysis and market-tested experience, we build from a breadth of active and index strategies to create cost-effective solutions. As stewards, we help portfolio companies see that what is fair for people and sustainable for the planet can deliver long-term performance. And, as pioneers in index, ETF, and ESG investing, we are always inventing new ways to invest. As a result, we have become the world's third-largest asset manager with US \$2.5 trillion\* under our care.

\* AUM reflects approximately \$32.4 billion (as of December 31, 2018), with respect to which State Street Global Advisors Funds Distributors, LLC (SSGA FD) serves as marketing agent; SSGA FD and State Street Global Advisors are affiliated.

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