Q&A on Sustainability and Risk Management with Sustainalytics

Interviewer: Gareth Byatt – Director, Satarla Australia
Interviewee: Marco Sepulveda, Senior Associate, Sustainalytics

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Thank you for making the time to talk to me about the work of Sustainalytics.

I'd like to start by asking whether you could briefly describe the services of your organisation, and your key aims and objectives.

Marco: *We are a global leader in environmental social and corporate governance (ESG) research and ratings. For over 25 years, the firm has developed high-quality, innovative solutions to meet the evolving needs of global investors. Today, with 17 offices globally, Sustainalytics supports hundreds of the world's foremost investors who incorporate ESG and corporate governance insights into their investment processes.*

Gareth: What would you say are the hot topics of today and tomorrow that people who work in Sustainability and Risk departments of organisations should be focusing on? I'm thinking in particular of the strategic risks (opportunities as well as threats) that they need to be advising their Executive teams about.

Marco: *Sustainability and risk departments should be focused on measuring, managing and reporting material ESG risks for their organisations – as this information is increasingly being used by investors as a key consideration in their investment decisions.*

Sustainalytics' approach to determining ESG risk is two-dimensional. First, we quantify material exposure to ESG risks, considering company-specific business models, and then we measure how well companies are managing those material risks.

Specific examples of exposure to the most material ESG risks for the resource mining, oil & gas and utilities sectors include: carbon impact and risks of operations; non-carbon emissions, effluents and waste (think of tailings, for example); human capital; occupational health and safety; relations with local and indigenous communities; and business ethics and corporate governance (from corruption to lobbying, from fair competition to board independence and shareholders rights).

Gareth: Are you seeing an increased commitment by investors around the world to ensure their capital is allocated to businesses and enterprise that proactively demonstrates a commitment to tackle climate risk, and to achieving strategic sustainable outcomes?

Marco: *Carbon issues are clearly at the centre of public debate (for example the recent landmark court ruling in the State of NSW to block a coal mine on climate grounds). In response to the increasing appetite from investors to understand the climate risk they face in their investments, last year Sustainalytics launched our Carbon Risk Rating. The framework assesses, on the one hand, a company's carbon risk exposure based on factors such as the sectors and geographies in which it operates, its business model, past performance and financial strength. On the other hand, we analyse a company's strategy and management approach, for example governance oversight on climate risk, GHG reduction targets and use of renewable energy. The combination of these two dimensions results in our rating of a company's unmanaged carbon risk – which in our view is a forward-looking signal of how well positioned a company is to transition to a low-carbon economy.*

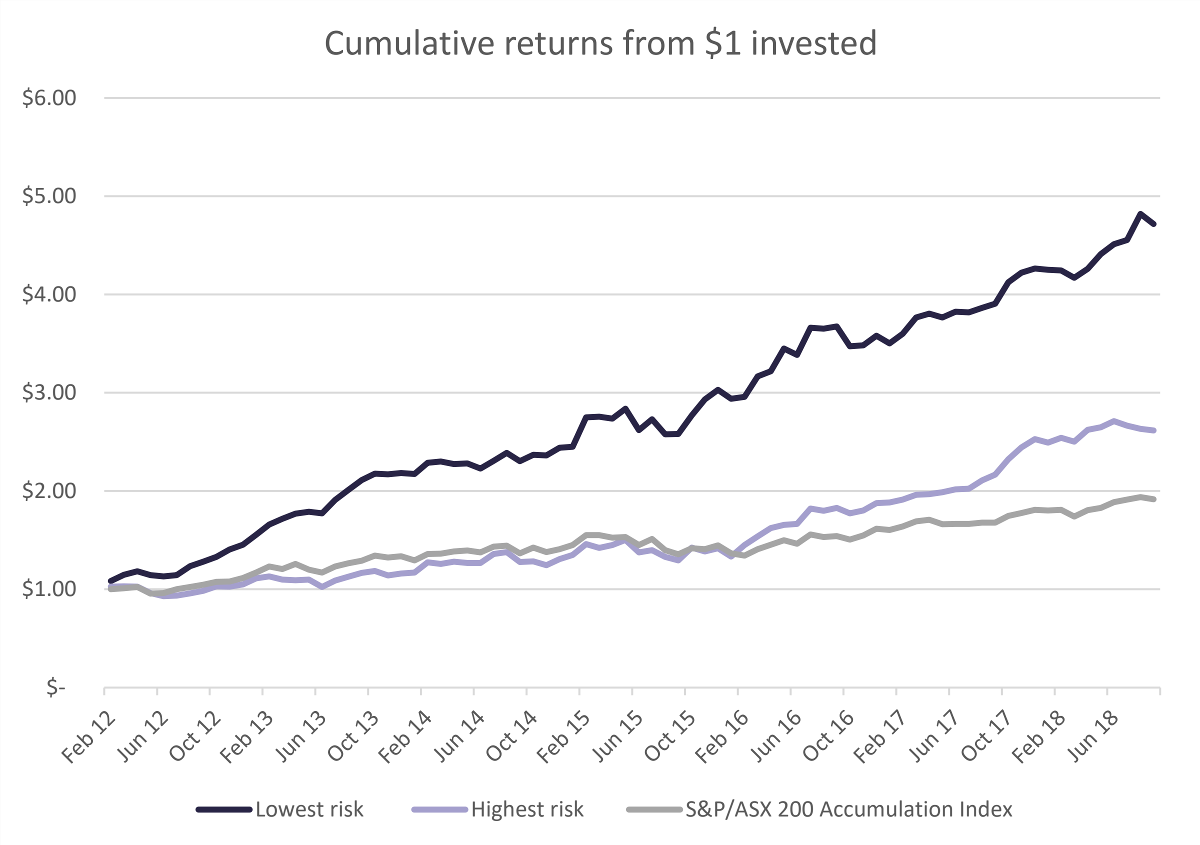
Our assessment shows that, on average, companies in the resource mining, oil & gas and utilities sectors are managing approximately 30% of their exposure to carbon risk. The average management score across these sectors is 40 out of 100, thus we note ample room for improvement and flag these companies as facing medium, high or severe carbon risk.

Gareth: Is it fair to say that investors are increasingly interested in understanding carbon exposure and risk?

Marco: *Driven by an increasing adoption of the recommendations from the Task Force on Climate-related Financial Disclosures (TCFD), we are seeing investors shift away from a carbon footprint approach, and towards a more holistic understanding of companies' carbon exposure, risk management and transition strategies – which is what Sustainalytics Carbon Risk Rating provides.*

In addition, many investors are at the forefront of climate action, and their initiatives are, in a way, a response to the current policy vacuum on energy and climate in Australia. The Investor Group on Climate Change (representing institutional investors with over AUD 2 trillion in assets under management) and the upcoming initiative to develop a Sustainable Finance Roadmap (which includes 300 participants from the financial industry) are just two examples of how investors are supporting climate action. The number of ESG related shareholder resolutions, particularly on climate change topics, is also growing.

Leading Australian Asset Manager, Platypus AM, has conducted analysis using Sustainalytics' Carbon Risk Rating data, showing that investing in Australian companies, that are rated as having lower risk in the transition to a low-carbon economy, significantly outperform both the benchmark and companies which are rated as having high carbon risks.



Further information on this report can be found in our [Sustainalytics' blog](#).

Gareth: Lastly, would you be able to share examples of how companies are responding to increasing demands from investors related to ESG and climate change?

Marco: *We see mounting interest from companies to understand how ESG rating agencies such as Sustainalytics view and assess their sustainability policies and programmes – as investors are paying increasing attention of companies' ESG performance alongside financial performance, particularly when it comes to carbon risk.*

Part of our research process is to seek feedback from companies on our analysis before publishing our reports. We do this to ensure a complete and accurate representation, particularly in the case of controversial events. The response and engagement rate to our requests is increasing, whilst also shifting from the traditional investor relations and sustainability departments, towards executive teams.

Some companies are using our ratings to drive further sustainability action and improve disclosure over time. Some are also linking their sustainability commitments to financial objectives. A great example of this is [Adelaide Airport], which signed a AUD 50 million seven-year sustainability performance linked loan with ANZ. This loan, which incentivises a borrower to further improve its performance against a set of environment, social and governance (ESG) criteria, was the first of its kind in Australia. Sustainalytics is a leader in the field of sustainability linked loans and we see this market growing exponentially.

Increasingly, companies are also seeking to use our ratings (through the purchase of an ESG license) in roadshows (debt and equity), in reporting to shareholders and stakeholders, and with suppliers and customers, in addition to a variety of other use cases. The demand for benchmarking services, as well as second-party opinions for green, social and sustainability bonds is also growing rapidly in response to the trends and drivers outlined above.

Gareth: Thank you very much for your time, Marco.

(this interview was originally published in the Risk Insight Consulting Newsletter)