LEVELLING THE PLAYING FIELD ON SUSTAINABILITY RISK
Michelle Edkins

One of the challenges of indexed investing for investors seeking to fulfil their stewardship responsibilities is that their equity benchmarks include companies with a poor performance track record – on financial returns, as well as on environmental, social and governance (ESG) practices. As most indexed investors are by nature long-term, ESG practices are a focus because they have considerable potential to affect performance over time. Sound practices in relation to the material environmental and social aspects of a company’s business can be signal of operational excellence and management quality.

ESG risks constitute seven of the top 10 most concerning global risks in the World Economic Forum’s annual Global Risks Report. But they are difficult for investors to incorporate into investment analysis and stewardship activities, as we do not yet have the complete, consistent and comparable data required to accurately measure how companies are managing them.

If BlackRock wants to compare the financial performance of, say, the telecoms companies in Singapore, the US and Spain we can rely on a set of widely understood international accounting standards. If we also want to compare the carbon dependency, employee turnover levels or the number of independent directors of those companies, it is either impossible due to lack of disclosure or requires so many assumptions and extrapolations that the output is nigh on meaningless.

Market-led solutions need more support

This problem is not new. BlackRock and bodies such as US non-profit Ceres, which advocates for sustainability leadership by companies and investors, have worked for many years to encourage better corporate reporting. We prefer practitioner-led solutions as they garner buy-in by all those affected by a change in approach. Many large companies have led by example, and a growing number of companies now participate in initiatives such as CDP and GRI. However, the level of ESG disclosure is neither broad-based nor consistent enough to meet investor needs.

The practitioner-led, market-based solution needs more support from a wider base of market players as there is evidence that voluntary regimes are stalling while many regulatory responses are piecemeal. We are seeing more interest from investors, including our clients, in ESG integration and index providers are responding with new benchmarks.
BlackRock, as a long-term, fiduciary investor, holding over 14,000 securities in companies across many markets and sectors, is using the ESG data that is available to benchmark, analyse and value the companies that we invest in on behalf of clients. For the companies we invest in through indexed portfolios, this data is an important input into our engagement or stewardship work. But the data is patchy.

To achieve critical mass we need more market participants, particularly those with some soft law authority such as the stock exchanges, to require ESG disclosure.

**Meeting investor demand**

Why the stock exchanges? Because they are in a position to collaborate with their global peers to establish consistent guidance and structures across markets.

To that end, investors, including BlackRock, have been working with Ceres to develop recommendations for the integration of sustainability disclosure requirements into stock exchange listing rules. Last year, this led to Ceres’ [Investor Listing Standards Proposal](#) and, in turn, the UN’s ‘[Model Guidance on Reporting ESG Information to Investors](#)’. Both provide potential foundation stones for a consistent global regime on ESG disclosure standards.

During this work, we have seen progress. The stock exchanges of South Africa and Australia already have listing rules on ESG reporting, and Hong Kong, Singapore, and Malaysia have all recently proposed progressive rules on sustainability reporting. But we need more exchanges to follow suit and to collaborate with their peers so that we don’t have a patchwork of 100 different ESG reporting regimes.

**Companies, investors and stock exchanges agree**

Companies, investors and stock exchanges all see the benefits of a more strategic approach that provides consistent standards of disclosure by companies globally of the most material ESG factors.

Some worry that companies will list elsewhere if a stock exchange brings in additional rules on ESG reporting. Conversely, we hear time and again from companies how challenging it is for them to respond to multiple ESG reporting regimes and that they would welcome rules and guidance to standardize reporting and reduce ‘survey fatigue’.

As shareholders, we too are concerned about too many surveys and the potential for different representations of the same data to cause confusion. We want to level the playing field to make the data that is reported more useful and to encourage reporting by companies that aren’t due to the lack of direction.
And the majority of stock exchanges themselves support this initiative. A 2012 survey for example, found that 76% of stock exchanges agreed they have a responsibility to encourage better corporate disclosure on sustainability, while a third agreed that voluntary initiatives alone would not be adequate. This implies that leadership on the part of the exchanges and their regulators would be welcomed.

**An opportunity for leadership**

This week in Doha, the trade and policy association for global exchanges—the World Federation of Exchanges—will hold its General Assembly and Annual Meeting. I hope that they will take that opportunity to look in-depth at the issue of ESG disclosure listing rules, and commit to helping investors deal with an important information challenge.

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