Measuring, Managing, and Reporting What Matters - The State of ESG

Tim Williams

An introduction - what language are we speaking?

Environment, social and governance, or 'ESG,' performance, is where sustainability and capital markets converge.

In Australia, climate change - and carbon risk - is an accepted reality. The current review of the ASX corporate governance principles will likely entail new disclosure requirements for all listed companies around material business risk. Finally the United Nations Principles for Responsible Investment are driving ESG performance into investment analysis and decision-making right across the investment supply chain.

This paper sets out the major drivers and initiatives globally which mean that 2007 is the year ESG moves centre-stage for investment markets.

ESG is a convenient shorthand for a profound rethinking of corporate performance and value within companies - and ultimately within society more generally - which is here to stay, and which requires a response from companies, analysts, asset managers and asset owners.

This is a broad agenda which extends across the role of Boards and directors' duties; corporate accountability and disclosure; risk management; corporate responsibility and 'doing the right thing' as well as major trends in financial accounting. It includes the tension between value and values; on what is right, and what represents appropriate corporate behaviour - and on financial outcomes and shareholder returns.

These concepts and frameworks might seem strange bedfellows, but there is a common theme - the simple recognition that the value drivers within business extend well beyond those captured within traditional financial accounting and reporting. Environmental, social, and governance performance, including reputation, stakeholder relationships and other intangibles, are all fundamentally linked to shareholder returns.

The language is problematic because we do not yet have a framework for describing this new world-view. But however it is framed - in terms of ESG, or material risk, sustainability, intangible value, intellectual capital, or non-financial performance, it follows that the investment process should take into account as fully as possible all of these value drivers.

There are two aspects to this. This requires, on the one hand, active ownership and engagement by investors over the long term to help protect and enhance the value of investments. Secondly the whole investment supply chain needs the capacity to 'measure, manage and report what matters.' Value drivers are distributed along a spectrum from the more easily measured, like employee turnover and commitment or greenhouse gas emissions to the more intangible and abstract. For example social licence to operate and reputation may be hard to measure, but unquestionably they also matter. ESG is specifically about the *investment-ready* data and analytics which mean these non-traditional drivers of business performance can be built into the investment process.

Part 1: The evolution of ESG

ESG performance is a strategic business agenda

Major risk issues like climate change, drought, the war for talent, reputation and so on are the new business priorities. Within business this agenda is typically still framed around risk management or sustainability and corporate responsibility. The broader arguments are around the roles and responsibilities of companies, when there has been a profound shift in power from civil society and government to business, in an increasingly connected, borderless world society; all coupled with a pervasive cynicism in public institutions and business alike. In short, the goal-posts for business have shifted.

There will always be a moral dimension to the ESG agenda for companies. There should be, because at the heart of this is the interdependence of business, society and the natural environment. An 'enlightened self-interest' response means accepting accountability for the externalities of business activities that impact the public and stakeholder interests, and being concerned with the principles of right and wrong and conforming to expected standards of behaviour.

McKinsey recently[1] set out that almost half of the US executives surveyed believed they and their peers should play a much greater leadership role in publicly shaping debate and addressing major public policy issues. And more recently, McKinsey's public opinion research is pointing to a new Zeitgeist - that the Friedman ideology of shareholder value is essentially bankrupt. Simply stated, there are now higher public expectations of business morality - unenlightened self-interest is bad; enlightened self-interest is good.

Alongside this, it is also clear that businesses need more than financial capital to prosper - they also need human, physical and social capital. A harder-edged strategic agenda is emerging which recognises that ESG factors directly affect business strategy. 'Extended performance management' is one term to describe the strategic management of these resources.[2] From this perspective, the main organisational value-drivers in the 21st Century are managing relationships, business infrastructure, systems and processes, and employee skills and competencies.

---

[1] McKinsey Quarterly online: CEOs as Public Leaders, January 2007. See also: When Social Issues become Strategic; What is the Business of Business? www.mckinseyquarterly.com

[2] The Society for knowledge Economics: New Pathways to Prosperity www.ske.org.au

regnan

This perspective was recognised locally by the Business Council of Australia (BCA) in its submission to the 2005 Parliamentary Joint Committee (PJC) Inquiry into corporate responsibility. The BCA identified the strategic aspects of ESG performance in terms of:

- employee recruitment, motivation and retention;
- learning and innovation;
- reputation management;
- risk profile and risk management;
- competitiveness and market positioning;
- operational efficiency;
- investor relations and access to capital; and
- licence to operate.

More recently influential Harvard Business School strategist Michel Porter has put his seal of approval on the strategic nature of ESG performance, by emphasising the interdependence of business and society. His blueprint for management action is to focus activity on the intersection of two dimensions: the social and environmental influences on a company's competitiveness; and the social and environmental impacts of the company's whole value chain.[3]

Overall, increasingly it is accepted that management needs to understand the true drivers of long term shareholder value, and then measure, manage and report on this material performance.

ESG metrics are critical for Board oversight

Boards have long been at the centre of the convergence of the corporate governance and corporate responsibility agendas because of their oversight role, but more profoundly ESG performance is central to a company director's oversight of company performance, strategy and governance.

The 2004 Deloitte report, In the Dark, emphasised the dearth of metrics at a Board's disposal covering the true risk and value drivers of a business -'vital signs' like customer satisfaction, employee commitment, environment and reputation risk, innovation and so on. The updated 2007 survey[4] more explicitly sets out how leading Boards are linking strong financial performance to non-financial drivers.

[3] Harvard Business Review: Strategy & Society, Michael Porter and Mark Kramer; December 2006. www.hbr.org

4 Deloitte Touche Tohmatsu 2007: In the dark II: what many boards and executives STILL don't know about the health of their businesses. http://www.deloitte.com

The picture that emerges is that:

- Existing performance measurement frameworks are inadequate. Seventy eight percent of respondents said financial indicators alone do not adequately capture their companies' strengths and weaknesses;
- ESG metrics are the equal of, or even more compelling than, financial predictors of long term performance; and
- Significantly, 87% percent of respondents at the larger companies said the market is similarly emphasing non-financial performance measures.

Locally, the two recent Federal Government inquiries (PJC and CAMAC) into corporate responsibility and directors' duties, the ASX Corporate Governance Council review and the deepening acceptance of climate change have further broadened the Board mandate for the oversight of corporate performance.

In short, Boards have a new landscape to navigate:

- Understanding the shifting issues environment, the new expectations on business; and a statutory and regulatory environment which continues to evolve;
- Directors' duties which have been reformulated in the minds of the public, if not in law;
- New expectations on board performance from regulators and asset owners and managers;
- Oversight of meaningful environment, social and governance performance metrics, reporting and assurance;
- New critical areas of required expertise like climate change and carbon risk;
- Principles-based decision making - and coping with moral dilemmas, where issues are rarely straightforward or clear-cut.

The engagement by active investors together with ESG metrics are central to performing this broadened oversight role.

Filling the black hole in financial accounting

Directors, shareholders and other stakeholders need the appropriate information to fully assess and value a company's performance. Whilst financial statements are still the mainstay of valuation and investment decision-making, their shortcomings are increasingly apparent.

Accounting conventions do not embrace ESG considerations, so these value drivers are too often overlooked or undervalued by management and the market. This as much limits the ability of management and boards to properly allocate resources, as investors to fully value company performance. This is when the proportion of a company's total market value that exceeds its book value increased from 40% in the early 1980s to over 80% by the late 1990s.[5]

[5] Intangible Assets and Value Creation, New York John Wiley, 2003.

Double-entry book keeping was invented in the 14^{th} Century - and financial accounts are very much grounded in a prior manufacturing era, even when in 2005, service-based industries accounted for 68 percent of global GDP and in Australia employed 73 per cent of the workforce.[6]

It is a curious anomaly that accounting standards cannot see much of the value the stock market sees in a company. Intangibles and other leading indicators have no place on a traditional P&L and balance sheet even though one can argue that business drivers are ultimately all non-financial. After all, the bottom line is just that - downstream of the countless drivers that contribute to the P&L.

Changes to the treatment of intangible assets under the International Financial Reporting Standards (IFRS) have complicated the picture by introducing new strictures on the intangibles which can be recognised on the balance sheet, whilst fundamentally missing the point by excluding intangibles, which almost by definition, are hard to value.

Against this background, in 2006 the heads of the Big Six accounting firms acknowledged that financial reporting must be now updated for our post-industrial, knowledge-based society.

Closer to home, earlier this year the Australian Institute of Chartered Accountants disbanded the Institute's TBL (Triple Bottom Line) Special Interest Group, signalling a mainstreaming of ESG reporting within what is termed broad-based business reporting. 'Extended Performance Reporting' is the emerging umbrella term used to cover the various attempts to capture and report on intangible and other performance not fully captured within financial reporting.[7]

In search of alpha: ESG analytics and valuation

The capital markets are equally concerned with identifying the real value drivers within business. Intuitively, ESG performance is inherently value-adding, and this has been demonstrated by the collective outperformance of companies selected on this basis - for example for the Dow Jones Sustainability Index, or local portfolio analysis research by Goldman Sachs JB Were or AMP Capital Investors.[8] This kind of analysis may look for an investment signal for share price performance, reported earnings reliability, or in terms of a risk control.

Recent landmark surveys by Mercer Investment Consulting[9] have shown that the majority of institutional investors believe that ESG factors are material to investment performance. And equities analysts are also on the case.

[6] Society for Knowledge Economics

[7] Institute of Chartered Accountants 2005: Extended Performance Reporting: An Overview of Techniques; Professor Wai Fong Chua University of NSW.

[8] AMP Capital Investors 2005: Financial Payback from environmental and social factors.

[9] Mercer Investment Consulting: 2005 and 2006 Fearless Forecast. www.merceric.com/riforecast

But there are challenges to mainstreaming ESG performance within conventional analysis and valuation[10] - for example the number and diversity of dimensions which might matter; and the investment performance implications of each. This is when it is not easy to isolate the role of any specific factor, ESG or otherwise, as a driver of financial performance, or in particular, as a driver of the share price.[11]

Sell-side analysts already assess ESG performance, but largely on an ad-hoc and qualitative basis, or else it is consigned to a 'quality of management' catch-all. To move forward they are looking for replicable causal relationships between ESG drivers and financial outcomes - an exploitable alpha signal[12]. In particular they need data which fits their existing valuation models.

Systematically building multiple factors into current valuation models remains a significant challenge, although ESG performance clearly can be understood in terms of impacting on risk and growth rates within traditional discounted cash flow analysis. Ratio analysis, Economic Value Added, option pricing and rule of thumb type techniques can also be used.[13]

Institutional investors up the ante

Increasingly, investors recognise the importance of ESG performance in ensuring business success over the long term. Massive growth in pension funds globally has elevated the long term perspective on investment market performance. Their growing resources have prompted a sophisticated understanding of their own role in investment market dynamics, and their fiduciary responsibility to take an active interest in their investments. Beyond this the definitive 2005 analysis from UNEP-FI and Freshfields set out how the integration of ESG performance is clearly permissible, and arguably required - in all of the largest capital markets jurisdictions.[14]

ESG-related investing has a long history, which has progressed from negative screening to positive screening or best in class approaches. And a large part of the response is active ownership and engagement to help protect and enhance the value of investments.

---

[10] For example see reports by the UN Global Compact (Who Cares Wins;) or the UNEP Finance Initiative (Show me the Money: Linking Environmental, Social and Governance Issues to Company Value.

[11] USS Universities Superannuation Scheme Limited 2006: Enhanced Analytics for a New Generation of Investor.

[12] Goldman Sachs JB Were August 2005: Corporate Governance Investing.

[13] The SD Effect: Translating Sustainable Development into Financial Valuation Measures: Yachnin & Associates, Sustainable investment Group Ltd and Corporate Knights Inc: 2006.

[14] UNEP-FI 2005: A legal framework for the integration of environmental, social and governance issues into institutional investment.

Universal ownership and investing for the long haul

Superannuation funds are a major force behind the drive for better governance. Today, many Australian superannuation funds invest portfolios exceeding $1 billion in S&P/ASX200 companies and have growth rates of around 30% per annum. This combined with a bias to diversification as a risk-management strategy, means many of the larger superannuation funds are - or soon will be - permanent shareowners of *every* S&P/ASX200 company.

At the same time they recognise some of the challenges posed by the dynamics of financial market - namely that while some of their service providers have investment horizons extending no more than a couple of years (and in one survey, traders indicated "long term" could mean as little as ten minutes,) their members require sustained performance, across the market, over a period of many decades. Their investments typically include a suite of fund managers, investment styles and analysts - portfolios that effectively span the index.

This gives super and pension funds a distinct different perspective on risk. If you're invested across the index, you consider market risks as well as stock risks. Not just out- or under-performance versus a benchmark, but the performance of the benchmark itself. Similarly, if you own stocks for decades instead of buying and selling within months, days or minutes, it is reasonable to be interested in the long term prosperity, as well as the short term profitability of a company. Indeed it is the fiduciary responsibility of superannuation and pension funds to ensure long term value is protected.

Getting involved

Superannuation and pension funds have begun to act on their commitment and their ability to pursue the interests of their members, even co-ordinating across borders where appropriate.

In 2001, ARIA (then PSS and CSS Boards) initiated Australia's first ESG engagement mandate, interfacing with S&P/ASX200 companies. This $3 billion engagement mandate grew to $9 billion by 2007, with ARIA joined by the Catholic Superannuation Fund, the Northern Territory Government Public Authorities Superannuation Scheme, VicSuper and the Emergency Service's Superannuation Scheme. Operated by BT Financial Group's Governance Advisory Service (GAS), this engagement mandate covered the full spectrum of ESG issues with public position papers issued in relation to such governance concerns as:

- Audit governance
- Environmental risk disclosure
- Workplace heath & safety
- Conflict of interest
- Ethical business practices, and
- Director share trading

During the year to June 2006, the BT GAS mandate engaged some 67 separate S&P/ASX200 companies via 87 company engagements. Two-thirds of this engagement occurred on a face-to-face basis. Eleven ESG concerns were raised during this process.

Separately, 12 funds, including six major Australian super funds took legal action in Delaware's Court of Chancery in 2004, demanding News Corp abide by an agreement it made with the Australian Council of Superannuation Investors (ACSI) regarding shareholders' rights to vote on any extension to 'poison pill' (shareholder rights) arrangements. At issue was not the poison pill's merit, but rather the right of shareholders to vote on its extension.

The Delaware Chancery Court found that "the board's power - which is that of an agent's with regard to its principal - derives from the shareholders." On one level this would appear to be no more than stating the obvious. On another, this appears to present in a new light shareholder proposals and the value of shareholder engagement as part of corporate governance activities.

Significantly this action involved the support of Australian, Dutch, UK and United States pension funds, who convened, proposed and implemented a course of action very swiftly. Each powerful in their own right, investors that are willing and able to co-ordinate their efforts are a formidable force.

Part 2: the State of Play - landmark developments in ESG

The beginning of true ESG

Voting, screening, engagement, class actions and collaborative initiatives underpin the more systematic assessment of ESG value drivers into financial analysis, investment decision-making and active ownership. To achieve this, asset managers and owners need investment-ready data and analytics and portfolio analysis tools - and the marketplace has developed rapidly.

The UN Principles for Responsible Investment (UNPRI) project has been fundamental to this maturing view of the role of investment institutions. It has institutional investors worth US $8 trillion among its 180 signatories.[15] Among other things, signatories agree to seek appropriate disclosure on ESG issues by the entities in which they invest, and to incorporate ESG issues into investment analysis and decision-making. Australian signatories include ARIA (formerly the PSS & CSS), BT Financial Group, CARE Super, Catholic Superannuation Fund, CBUS, Christian Super, HESTA, Local Super, Portfolio Partners, Statewide Superannuation Trust, VicSuper and Vision Super.

Shareowners are finding novel ways to address their ESG information needs. Institutional investors worth US $2.4 trillion[16] are collaborating via the Enhanced Analytics Initiative, (EAI) allocating brokerage to mainstream analysts that take ESG performance into account. Three Australian superfunds - UniSuper, HESTA and VicSuper are local members. These critical initiatives - UNPRI and EAI - are now formally aligned.

Climate change is a major risk for corporations and hence has significant investment implications. Various investor-led initiatives seek to understand these implications and request climate change related investment-relevant disclosure from companies.

The Carbon Disclosure Project[17] (CDP) is the largest global investor coalition, comprising 284 institutional investors with assets of $41 trillion under management - more than one third of total global invested assets. The CDP is a clearing house for climate change ESG data and reporting from more than 1,000 large corporations. The project is in its fifth, 'CDP5' iteration, with over 2,400 FTSE500, S&P/ASX 100 companies targeted.

The Institutional Investors Group on Climate Change[18] (IIGCC) is a forum for collaboration between pension funds and other institutional investors on issues related to climate change.

---

[15] UNPRI media release January 2007 www.unpri.org

[16] EAI media release 24 May 2007 www.enhancedanalytics.com

[17] www.cdproject.net/

[18] www.iigcc.org/

Locally, the Investor Group on Climate Change Australia/New Zealand (IGCC) represents Australian and New Zealand investors with total funds under management of over $225 billion.[19] The IGCC specifically works to build the impacts of climate change into investment analysis and decision making.

With a broader mandate, the Society of Knowledge Economics is a local but globally significant initiative kicked off in 2003. Today the group brings together accountants (CPA Australia, Ernst & Young, PricewaterhouseCoopers, The Institute of Actuaries of Australia, and Trowbridge Deloitte;) government (Federal Department of Finance and Administration and NSW Department of Lands;) academics (Macquarie Graduate School of Management, University of NSW and the University of Sydney;) and major corporates, including Microsoft and Westpac. The aim is open up the issue of intangibles for a national debate and position it on the national economic agenda.

A maturing market for ESG data and analytics

Globally there is a maturing market for ESG data and analytics from both mainstream brokers and non-broker specialists. The EAI regularly reviews broker ESG research. To date, the comprehensive integration of ESG factors into investment valuation remains limited and research is concentrated on the ESG performance dimensions which are more easily operationalised and/or where the investment signal is more explicit - for example carbon-related research. In comparison, other ESG areas like intellectual and human capital and innovation, and corporate governance, are under-researched.

Specialist ESG research is developing rapidly. The trends include:

- A shift from SRI-type language and activity and sector screening to, in effect, endeavouring to ‘measure what matters;’
- A shift from ad-hoc or intuitive measures to robust conceptual models, both in terms of the validity of the measures used, and the multivariate or other modelling of the links to enhanced returns - the investment signal;
- Recognising that ESG data has to be meaningful and applicable to diverse users, making available raw data and weightings as well as aggregated data or ratings;
- A shift from annual assessments towards more real-time data.

A light touch from regulators - so far

Given that ESG performance is increasingly understood as meaningful and/or material, there have been various legal and regulatory initiatives to drive better disclosure. Developments in the US (Sarbanes Oxley) and Australian (the Corporate law Economic Reform Program) have focused on financial integrity and disclosure, but European initiatives have been more specifically ESG-focused.

One of the most significant regulatory responses around ESG has been the UK’s Operating and Financial Review (OFR.) UK companies were required to prepare and disclose an OFR as part of their annual accounts.

---

[19] www.igcc.org.au

Whilst subsequently dropped as a requirement, the idea is to provide a balanced and comprehensive analysis of the business, which is both retrospective and future-focused. The key disclosures are the directors' views on corporate strategy and the positive and negative value drivers, including ESG performance, to the extent that they have a material bearing on the current or future financial performance of the business.

Much of the OFR intent was transferred into the UK Accounting Standards Board (ASB) Reporting Statement of best practice on the OFR.[20]

The UK Companies Act 2006 is on the horizon and sets out new requirements for directors. They will need to demonstrate they have paid attention to: the long term consequences of decision-making; the interests of employees; business relationships with suppliers, customers and others; the impact of the company on the community and the environment; and reputational impacts.

The Act incorporates the requirements of the EU Accounts Modernisation Directive which requires all large and medium-sized quoted and unquoted companies within EU to produce a Business Review in their directors' report.

The Business Review includes the key material reporting requirements and performance indicators that are necessary to monitor business performance and risks, including on environmental and employee issues 'to the extent necessary for an understanding of the development, performance or position of the business of the company.'

South Africa has been progressive in this space. Framed as integrated sustainability reporting, and following on from the King Report on Corporate Governance for South Africa 2002 ('King II',) listed companies, banks, financial and insurance companies and many public sector organisations are obliged to report ESG performance at least annually, in terms of the 'nature and extent of social transformation;' ethics; safety, health and environment; and human capital performance.

Under legislation passed in 2001 as part of the Nouvelles Régulations Économiques, larger French listed companies are required to make numerous detailed social and environmental disclosures, largely based on GRI indicators. In Austria, the University Organisation and Studies Act 2002 requires all state universities to make a public intellectual capital statement, covering human, structural and relational capital.

Closer to home, the ASX Corporate Governance Council Principles of Good Corporate Governance are currently under review. Significant revisions are expected which, starting in 2008, are likely to require listed companies to consider ESG performance and disclosure as part of a broadened conception of 'material business risk.'

---

[20] Accounting Standards Board: A Review of Narrative Reporting by UK Listed Companies in 2006.

ESG metrics and analysis are also part of a broader landscape of conceptual and operational frameworks which seek to more fully capture 'value' from the corporate to the societal level. A vast array of principles, guidelines and frameworks[21] are available globally to assist companies to better measure and report on ESG performance, although most are not framed in investment terms. The most relevant focus on a company's strategic positioning and the key ESG factors which impact on that.

From 2002 onwards the International Accounting Standards Board (IASB) has been looking at the role of standards or guidance for a management commentary within financial reports. In its 2005 discussion paper[22] the IASB acknowledged that "financial statements alone are not sufficient to enable users to make economic decisions, because they do not provide all the information that users may need to make economic decisions since they largely portray the financial effects of past events and do not necessarily provide non-financial information." In line with other initiatives, the focus is "the main trends and factors that are likely to affect the entity's future development, performance and position."

In a similar vein, the American Institute of Certified Public Accountants is behind the Enhanced Business Reporting Consortium,[23] a not for profit aiming for international consensus on ESG indicators and guidelines for voluntary disclosure across opportunities, risks, strategies and plans, and about the quality, sustainability and variability of cash flows and earnings. A public exposure draft of the proposed framework was released in 2005.

Numerous sustainability frameworks are also part of this landscape - the OECD Guidelines for Multinational Enterprises, the UN Global Compact and Global Reporting Initiative (GRI) and Keizai Doyukai (Japan Association of Corporate Executives) and Nippon Keidanren (Japanese Business Federation) guidelines in Japan. Amongst these, the G3 update of the GRI framework is significant because it is designed to better meet the specific ESG requirements of investors, through building in a materiality component; revisions to indicators, and a new strategy and analysis disclosure which sets out the context for performance data, and should improve reporting comparability and quality.

Finally also relevant are the intellectual capital frameworks which include the Austrian Universities Organisations and Studies Act (above;) the Danish Guidelines on Intellectual Capital Reporting; the German Guideline on Intellectual Capital Statements; and the Japanese Intellectual Based Management. Of these, the MERITUM (Measuring Intangibles to Understand and Improve Innovation Management) Guidelines are significant - an EU initiative on measuring and disclosing intangibles as a driver of future expected earnings.

The key disclosures are the organisation's main objectives and strategy and the critical intangibles to reach those objectives; a summary of intangible resources and a range of financial and non-financial measures for these resources. Each measure must be: comparable; reliable; truthful; verifiable; and feasible. The guidelines are used by numerous European organisations.

---

[21] For an overview see: UNEP/KPMG 2006: Carrots and Sticks for Starters: Current trends and approaches in Voluntary and Mandatory Standards for Sustainability Reporting.

[22] Management Commentary http://www.iasb.org

[23] http://www.ebr360.org/

Part 3: What next for ESG?

It is clear that ESG performance is now part of the investment landscape, given the converging interests of management, boards and institutional investors. What are the likely future directions in the ESG space?

1. Companies will need to incorporate ESG performance into strategy, performance assessment, operational management and reporting. They can expect to field questions about ESG performance from the mainstream financial community - which typically will mean a step change in how they communicate this performance.

2. The valuation black hole will see major attention. It is currently the market failure undermining the whole sustainability agenda. Current empirical research shows an association between ESG performance and shareholder returns. The question remains as to exactly what is going on. The stage is set for more systematic analysis; more valid measures; and better conceptual and predictive models for valuation and the investment signal. Importantly ESG performance pertains to financial outcomes and hence investment returns over both the long short and short term. The consideration of a short term investment signal has been neglected - and is an opportunity.

   There is some consensus around the various dimensions of ESG performance; for example the broad categories of strategy, ethics, environmental performance, human capital management and so on. But the power of systematic analysis will be to drill down and identify associations between the multiple underlying parameters to identify new bundles of performance. This has the potential to give insights and new ways of thinking about how value really is generated within modern organisations. ESG analysis also has the potential to show up the inadequacies of traditional valuation models.

3. The materiality of ESG data has implications for its treatment and dissemination. Over time ESG data will be understood as market sensitive.

4. For asset owners, light touch regulation places an additional burden to express their views and indicate what they want to know. As in so many areas of company disclosure, this will not work unless it is part of a dialogue - a conversation between the company and its owner. Owners need to be ready to engage in that dialogue and highlight cases of both good and bad practice.

5. There will be a shakeout in the plethora of available ESG frameworks. Over time we can expect convergence and alignment between principles, operational management and reporting frameworks. One example is the prominence of the GRI framework. Already there is a formalised relationship between the GRI and Global Compact; via its G3 update, GRI is attempting to more directly meet the needs of investors; and specialist ESG analysts are providing data and analytics based on GRI indicators.

6. Finally over the longer term, accounting frameworks will evolve to encompass a more holistic conception of performance and value. Understanding the materiality of ESG performance is itself only a stepping stone to frameworks which assess the totality of business endeavour. Whilst this remains a huge challenge, the 2006 statement from the Big Six CEOs is a step forward. The professionals at the heart of the current regime have become proponents for the next.