WHEN THINGS GO WRONG

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WE'LL BE STARTING MOMENTARILY

From Risk to Reward: The Bottom Line Benefits of DEI and ESG Implementation

David Vaillencourt
The GMP Collective

Bethany Moore
The GMP Collective

Mike Lomuto
Dao Mastery
MCBA Board Chair

Marc Ross
Needle Consultants LLC

Source: TechTarget

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ESG Regulatory Landscape - International

- **EU Sustainable Finance Disclosure Registration (SFDR)**
  - How financial market participants integrate ESG factors into investment decisions-making (increased transparency)
  - Implementation began March 2021 with various phases and deadlines extending into 2022 and beyond.
- **Task Force on Climate-Related Financial Disclosures (TCFD)**
  - Voluntary framework for companies to disclose climate-related risks and opportunities in FINANCIAL filings (Governance, Strategy, Risk Management, Metrics/Targets)
  - But many companies and countries are adopting these standards (including US and EU).
  - Deadlines vary based on individual reporting schedules and country.
  - First companies needed to report with financials FY 2023

ESG Regulatory Landscape - International

- **Corporate Sustainability Reporting Directive (CSRD)**
  - Reporting directive for all organizations listed on a regulated EU market or that reach certain thresholds regarding number of employees, financial turnover, balance sheet, etc.).
  - Complements SFDR and the EU Taxonomy; will supersede and complements the Non-Financial Reporting Directive (NFRD).
  - Double Materiality – businesses report on the effect of sustainability challenges on their own operation as well as their own impact on people and the environment.
  - Applies to all major, publicly traded companies operating in the EU, SMEs listed on the EU regulated markets, and *applies to non-EU based companies with subsidiaries in the EU*.
  - 3rd party assurance is required
  - Compliance Deadline: Reporting is done annually, with deadlines starting in 2024, rolling out into 2028 (EU subs of Non-EU companies).

ESG Regulatory Landscape – Country Specific

- US
  - **SEC Climate Disclosure Proposal** to enhance climate related disclosures for public companies covering risks, impacts, & mitigation strategies
    - Compliance schedule – deadlines will be determined upon finalization, but likely to be phased in starting with the largest companies. Final rule expected 02Q2024.
  - **SEC Human Capital Disclosure Proposal** – draft due out 2024
- UK
  - **Streamlined Energy & Carbon Reporting (SECR)**
    - Details: SECR mandates reporting on energy consumption, greenhouse gas emissions, and energy efficiency measures for large UK companies.
    - Compliance Deadline: Effective since April 2019; annual reporting required with financial filings.
  - **UK Corporate Governance Code**
    - Details: The Code sets out standards of good practice for listed companies on board leadership, remuneration, accountability, and stakeholder engagement.
    - Compliance Deadline: Ongoing compliance; companies report adherence in annual reports.

ESG Regulatory Landscape – Country Specific

- Japan
  - Japanese Stewardship Code - improve the governance of institutional investors, encouraging them to fulfill their fiduciary responsibilities
  - Japanese Corporate Governance Code - promotes transparency, accountability, and shareholder value in Japanese companies.

- France
  - France Corporate Duty of Vigilance law – only French companies/subs with at least 5,000 employees

ESG Regulatory Landscape – California

- **California Climate Disclosure Law (SB 253)**
  - Requires certain businesses (over $1B revenue) to report their GHG (all – Scope 1, 2, and 3) emissions.
  - 3rd party assurance required
  - Compliance Deadline: Regulations to be promulgated by 1/1/25; **Effective date is 1/1/26.**

- **California Greenhouse Gases: Climate-Related Financial Risk (SB 261)**
  - SB 261 requires covered entities (annual revenue over $500M) to prepare, publish and submit a climate-related financial risk report on or **before January 1, 2026**, and biennially thereafter.
  - Publish on website and file with CARB in accord with TCFD standards (unless other state standards established)
  - Penalty up to $50K per year for failure to file

- **California Voluntary Carbon Market Disclosures (Assembly Bill 1305)**
  - Entities operating in California that make claims regarding emissions, zero emissions, net zero, carbon neutral, etc.
  - Back up disclosures with evidence, measurement, science-based targets, reduction pathway, third party certified.
  - Penalties up to $500K each violation
  - **Effective January 1, 2024**

- **California Transparency in Supply Chains Act (SB 657) (2010)**
  - SB 657 requires certain companies (large retail sellers and manufacturers) to disclose efforts to eradicate slavery and human trafficking from their supply chains.
  - Compliance Deadline: Ongoing compliance; disclosures are typically made in annual reports.

- **California SB 260: Corporate Board Diversity Reporting**
  - SB 260 requires publicly held corporations headquartered in California to report board member demographics and diversity metrics.
  - Compliance Deadline: **The law took effect on January 1, 2023**.

ESG Regulatory Landscape – US States

- New York
  - **New York State Climate Leadership and Community Protection Act (CLCPA)**
    - Details: CLCPA sets ambitious targets for greenhouse gas emissions reductions and renewable energy deployment in New York State.
    - Compliance Deadline: Various deadlines set for emissions reductions and renewable energy goals, ongoing compliance required.

  - **New York Climate Risk Disclosure Act**
    - Details: The Act mandates financial institutions to assess and disclose climate-related risks in their operations and investments.
    - Compliance Deadline: Proposed legislation; compliance deadlines will be determined upon enactment.

Source: McKinsey Quarterly - Five ways that ESG creates value (Nov 2019)

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Exhibit 2

A strong environmental, social, and governance (ESG) proposition links to value creation in five essential ways.

	Strong ESG proposition (examples)	**Weak ESG proposition** (examples)
Top-line growth	Attract B2B and B2C customers with more sustainable products Achieve better access to resources through stronger community and government relations	Lose customers through poor sustainability practices (eg, human rights, supply chain) or a perception of unsustainable/unsafe products Lose access to resources (including from operational shutdowns) as a result of poor community and labor relations
Cost reductions	Lower energy consumption Reduce water intake	Generate unnecessary waste and pay correspondingly higher waste-disposal costs Expend more in packaging costs
Regulatory and legal interventions	Achieve greater strategic freedom through deregulation Earn subsidies and government support	Suffer restrictions on advertising and point of sale Incur fines, penalties, and enforcement actions
Productivity uplift	Boost employee motivation Attract talent through greater social credibility	Deal with "social stigma," which restricts talent pool Lose talent as a result of weak purpose
Investment and asset optimization	Enhance investment returns by better allocating capital for the long term (eg, more sustainable plant and equipment) Avoid investments that may not pay off because of longer-term environmental issues	Suffer stranded assets as a result of premature write-downs Fall behind competitors that have invested to be less "energy hungry"

Recent ESG Findings

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Deloitte.

Deloitte (2022) *Does a company's ESG score have a measurable impact on its market value?*: Investing to deliver better ESG performance can drive value upside for a business beyond the associated net financial costs. A company that increases its ESG score by 10 points experiences an increase of approximately 1.8x in its EV/EBITDA multiple.

Massachusetts Institute of Technology

MIT (2022) *The Economic Impact of ESG Ratings*: Stock prices in companies with ESG rating upgrades rose as high as 2.6% over two years, while those with downgrades fell as much as 3.8% over the same period.

- Downgrades have a powerful corrosive effect on stock performance, even more so than the upgrades have on boosting return.

Recent ESG Findings

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THOMSON REUTERS

Thomson Reuters (2024) *Distilling ESG drivers of enterprise value and the role of corporate boards*: Intangible assets represent more than 90% of total assets.

***Human capital as an important social issue* -** Employee engagement, satisfaction, and experience are key indicators of financial performance across a number of different financial metrics, including *return on assets, return on sales, revenue generation, market valuation, and stock performance.*

Recent ESG Findings

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- KPMG: *US ESG and Financial Value Survey* (2023)
  - Business leaders report ESG is delivering financial results today but expect greater benefits in the next 3-5 years.
  - More business leaders believe ESG improves financial performance than reduces it with significant financial benefits being realized today in M&A efficacy (41%), access to new capital (35%), and customer loyalty (34%) at the top of the list.
  - Benefits of ESG adding major value now and expected to add major financial value over the next 2-5 years respectively include attracting new customers (26% to 40%), revenue from premium pricing (25% to 37%), and risk mitigation (33% to 41%) to respondents.
  - Nearly 90% of businesses say they are feeling at least some pressure from supply chain partners to engage on ESG, while more than 80% report some pressure from employees (82%), institutional investors (81%), customers (81%) and regulators (80%).
  - Only a quarter of companies feel "very confident" meeting future ESG reporting requirements across the U.S., EU, and other international jurisdictions.

MSCI

- MSCI **(2019) – *Foundations of ESG Investing: How ESG Affects Equity Valuation, Risk, & Performance***
  - ESG information transmitted to their valuations and performance, both through their systemic risk profile (lower costs of capital and higher valuations) and their idiosyncratic risk profile (higher profitability and lower exposures to tail risks)
  - Companies with a strong ESG profile are more competitive than their peers. For instance, this competitive advantage can be due to the more efficient use of resources, better human capital development, or better innovation management.
  - In addition to this, high ESG-rated companies are typically better at developing long-term business plans and long-term incentive plans for senior management.
  - High ESG-rated companies use their competitive advantage to generate abnormal returns, which ultimately leads to higher profitability.
  - Higher profitability results in higher dividends.

Upcoming Events

Meet David Vaillencourt, CEO and Founder of The GMP Collective:

- April 9-11 – **MJUnpacked** – Atlantic City, N J
- April 13-15 – **NoCo Hemp Expo** – Estes Park, CO
- May 7-9 – **Cannabis Science Conference** – Kansas City, MO
- September – MCBA Equity Workshop Tour