

December 2020

ESG for the Energy Sector

By Varun Teja Dhara and Nandha Karthik Suresh

Environmental, Social, and Governance (ESG), or sustainable investing, have gained significant importance over the past decade in all business sectors, with investment groups viewing ESG as a critical factor for decision making. Apart from investment group communities, ESG has gathered significant interest across government bodies as they push organizations toward more sustainability in their business models.

In the European Union (EU), the European Securities and Markets Authority (ESMA) proposed several additions to existing regulations that set out how financial market participants and financial advisors must integrate ESG risks and opportunities in their processes (Collins & Sullivan, 2020). In Asia, regulators determined that increasing disclosure requirements about sustainability practices and ESG factors will increase foreign investment (Poh & Ishikawa, 2019).

While several organizations are comfortable incorporating ESG into their portfolios, there are some concerns about the transparency and quality of ESG disclosures (Bioy, 2020). There is an increased emphasis on ESG funds, thus presenting numerous opportunities for the energy sector. The energy industry has been at the forefront of ESG-related matters, with several investors in the energy sector in Canada embracing the ESG metrics to make investments.

However, without a consistent ESG reporting framework, investors are left to navigate through the seemingly ever-changing landscape of definitions. Given the challenges, complications, and impacts of ESG disclosure, the following steps are an action plan for researching the ESG related frameworks, criteria, and data for the energy sector to secure investments and analyze the projects' risks.

CERI is undertaking a step wise analysis of the key determinants that must be understood to respond to these new requirements effectively.

Stage 1 of that analysis is to understand the different frameworks in the market. The research will consider the organizations who have developed the frameworks, what criteria are present in these frameworks, and how they suggest these criteria be reported, as well as the significant differences and significant similarities in these notable frameworks. The frameworks that have gathered considerable attention in the market are GRI (Global Reporting Index), SASB (Sustainability Accounting Standards Board), TCFD (Task Force Climate-Related Financial Disclosure), CDP (Carbon Disclosure Project), IIRC (International Integrated Reporting Council), and UN SDGs (United Nations Sustainable Development Goals).

Stage 2 of the research is to understand the importance of these frameworks; who utilizes these frameworks in terms of business profiles; investing groups; governments; stock exchanges; and insurance organizations. Given the need to respond to investors' new requirements, it is important for oil and gas companies to consider how the frameworks are established and implemented. The

importance of understanding which frameworks are suitable for oil and gas companies to consider is key to securing investments domestically or foreign direct investments in projects.

Stage 3 involves investigating the framework process, gathering data, and how the data is suggested to be reported in each of the criteria, including identifying the type of data, its quality and providence, whether it is relative data or absolute data, and how the information is used and assessed in ESG reporting. Understanding the data types would help identify the frameworks' data gaps and data reporting similarities. This stage revolves around understanding the ESG rating agencies, how they work, and rate the organizations based on their ESG performance based on which framework, criteria, and data are being reported. The renowned ESG rating agencies are Sustainalytics, MSCI, Bloomberg, and FTSE Russell.

Stage 4 focuses on developing a regional analysis of the business organizations; insurance agencies; investment groups; and government organizations in Africa, Asia, North America; Europe; and South America. This regional analysis will create a roadmap to secure investments based on business activities in the region. The framework can support the justification for potential ESG related investments, analyze ESG risks, and understand the government's ESG policies.

The possible challenges that can be encountered along the pathway for research on mapping out the energy sector's action plan to navigate the ESG sector are data gathering. Given the landscape's evolving nature, the availability of adequate and useful data could prove to be a challenge. Secondly, the size of the data sample in several regions could prove challenging, given the diverse take of ESG in the different areas of the world. Thirdly, understanding the importance of each of Environment (E), Social (S), and Governance (G), whether equal importance is provided in each of the criteria in each of the respective regions.

This analysis aims to provide guidance to those organizations and companies seeking to implement their own ESG reporting frameworks, and for what purpose. This guidance will assist companies in navigating the evolving nature of the frameworks, and to focus the reporting to support the strategic objectives of the reporting organization. CERI's guidance report will be made available in mid 2021.

References

- Bioy, H. (2020, January 31). ESG Challenges and Solutions. Retrieved from Morning Star: <https://www.morningstar.co.uk/uk/news/199225/esg-challenges-and-solutions.aspx>
- Collins, S., & Sullivan, K. (2020, February 20). Advancing environmental, social, and governance investing. Retrieved from Deloitte Insights: <https://www2.deloitte.com/us/en/insights/industry/financial-services/esg-investing-performance.html#endnote-sup-5>
- Poh, J., & Ishikawa, M. (2019, June 20). China Set to Lead ESG Disclosure to Lure Foreign Investments. Retrieved from Bloomberg: <https://www.bloomberg.com/news/articles/2019-06-20/china-set-to-lead-esg-disclosures-to-lure-foreign-investments>

CERI Natural Gas Report

Editorial Committee: Allan Fogwill, Ganesh Doluweera

About CERI

CERI provides decision-makers in government, industry and other market segments with analyses of economic and environmental issues in the energy production, transportation and consumption sectors. The institute is an independent, registered charitable organization funded by government, industry, associations, academic supporters and by individual donations.

For more information about CERI, please visit our website at www.ceri.ca or contact us at info@ceri.ca.