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# ALVAREZ & MARSAL ESG PRACTICE STARTS WITH RISK MITIGATION AND AIMS FOR MEASURABLE VALUE IN ESG TERMS

Companies, investors and government entities around the world turn to **Alvarez & Marsal** (A&M) for leadership, action and results. Privately held since its founding in 1983, A&M is a leading global professional services firm that provides advisory, business performance improvement and turnaround management services. When conventional approaches are not enough to create transformation and drive change, clients seek the company's deep expertise and ability to deliver practical solutions to their unique problems. With over 5,400 people across four continents in over 25 countries, A&M delivers tangible results for corporates, boards, private equity firms, law firms and government agencies facing complex challenges. Senior leaders, and their teams, leverage A&M's restructuring heritage to help companies act decisively, catapult growth and accelerate results. A&M is has experienced operators, world-class consultants, former regulators and industry authorities with a shared commitment to telling clients what's really needed for turning change into a strategic business asset, managing risk and unlocking value at every stage of growth.

***Julie Hertzberg, Managing Director/Practice Lead.*** *Ms. Hertzberg has more than 20 years of experience across sectors including global financial services, broadcasting, consumer services and energy, among others. She has performed extensive work with Board and C-Suite members across industries. She oversees A&M's ESG Services and Case Management Services groups, where she leads a diverse team helping clients solve challenges and maximize value. Ms. Hertzberg also sits on the Executive Committee for the North American Restructuring Practice. During her tenure at A&M, she has been a champion of the company's diversity and inclusion initiatives and has been a forceful advocate with clients in emphasizing the unique opportunity that restructurings and turnarounds create in strengthening holistic stakeholder communications and engagement. She serves as Immediate Past President of* ***INSOL International****, a 10,000 member-driven global insolvency and restructuring organization in over 100 countries.*

***Rich Goode, Managing Director.*** *Mr. Goode has over 25 years of business experience and over dozen years of experience supporting companies in creating ESG strategies, identifying and leveraging opportunities and mitigating ESG risk. He has extensive experience with greenhouse gas emissions, regulatory compliance, ESG strategies, sustainable supply chain, new product launches, enterprise risk and startup management, and C-Suite relationships. He has served some of the world's largest companies and financial services firms on a variety of sustainability and ESG issues. He previously served as Managing Director for Environmental, Social and Governance and Climate Change Practice with* ***EY****. He helped build the practice and identified, hired and led a team that helped companies develop innovative strategies to create new opportunities and reduce ESG risk using GRI, SASB, TCFD and the WEF frameworks. During his time there, Verdantix ranked the practice #1 Sustainability Advisory*

***Vic Svec, Managing Director.*** *Mr. Svec has more than three decades of corporate experience in Investor Relations, Social Responsibility/ESG and Corporate Communications with Fortune 500 companies and global category leaders in Energy, Consumer Products and Recreation. Hi assists clients on driving tangible improvements in ESG with companies operating within the Specialty Chemicals, Natural Resource and Infrastructure industries. His work has brought significant recognition including: Measurably increasing company ESG ratings by 60%; Number-one honors for Small/Mid-Cap Companies in the Metals/Mining Sector by Institutional Investor Magazine in 2019; Chairing a global industry initiative to align leading companies around responsible ESG principles; and Directing social responsibility activities that were recognized by a first-in-sector social responsibility honors by Fortune's Most Admired Companies ranking in 2006 and the Platt's Global Energy Awards in 2013.*

**EBJ: When did A&M developed its ESG Service Practice? Why did it make sense for a company like yours and in which ways does it complement other services that you provide?**

A&M: We announced the start of our comprehensive ESG Services practice on March 15, 2021. Prior to this, several of A&M's practice groups provided advisory services across a range of ESG related value indicators for companies and funds. To ensure complete end-to-end ESG consulting advice, A&M's ESG Services team builds off these existing core practices to create maximum value enhancement for clients. ESG is a company's license to operate. To omit the impact of a company's decision-making on its ESG profile either means the company isn't fully managing risk or is missing opportunity, something not acceptable to any client or its stakeholders.

**EBJ: Tell us about the ESG services that you offer and how are they unique?**

A&M: Our approach to ESG goes far beyond risk mitigation – we look to not only protect value but create it for the benefit of our clients and their stakeholders. We drive meaningful value by simplifying the ESG landscape through targeted analysis, effective solutions and practical integration for companies and organizations. A&M ESG Services brings together extensive corporate and consulting experience to identify gaps and build opportunities, while leveraging a global team of specialized professionals across multiple disciplines to drive further execution and achieve deep sustainable results.

**EBJ: In which ways are companies integrating ESG during the due diligence stage of an acquisition? What should an acquiring company look for?**

A&M: Just 18 months ago, performing ESG due diligence was the exception, not the rule, when considering an acquisition. Now the inverse is true. More importantly, the role of ESG in the diligence process has fundamentally changed in that deals are now being stopped or multiples changed due to discoveries at this phase. ESG due diligence is so important because it looks for both risks and opportunities that are not immediately obvious when conducting more traditional financial due diligence. An example of this is when conducting ESG diligence of a metals company, the acquiring firm found that the target company had a culture of harassment, a toxic work environment and had numerous lawsuits pending. In addition, popular online employee forums rated the company as one of the worst places to work and cautioned minority employees against working there for their own safety. This information was taken into consideration by the acquiring company and it drastically reduced the selling price. This goes to show that looking at acquisitions through an ESG lens can uncover hidden risks or opportunities that the traditional diligence process may not reveal.

**EBJ: Which type of private equity firms are investing in companies with higher ESG ratings? How are private equity firms looking at ESG and what other ESG trends have you noticed within private equity?**

A&M: Private equity firms are still seeking out the best value – however, ESG diligence is helping private equity firms uncover value by looking for hidden risk and opportunity that can potentially affect valuation multiples. In addition to ESG due diligence, leading private equity firms are incorporating ESG criteria into their investment process. We see some firms simply performing what is called a "negative screening" which means screening certain investments out based on the industry, and other firms incorporate "positive screening" where they actively look for companies to invest that may be involved in developing low carbon solutions or promoting diversity and inclusion.

Increasingly, leading PE firms are incorporating more than one tool when it comes to using ESG in their acquisition process – like ESG due diligence, input from ESG ratings agencies and custom investment criteria that appeals to their particular LPs. Finally, and most importantly, more and more private equity firms are assisting their portfolio companies improve their ESG presence. From simple statements around climate, diversity and governance policies and codes of conduct all the way to full-fledged ESG reports, the bar for portfolio companies keeps rising when it comes to meeting market and investor expectations.

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**EBJ: How are companies using ESG to increase their overall company value when trying to sell the company or when trying to raise more capital?**

A&M: Bank of America Merrill Lynch has noted that ESG leaders can sell for as much as a 20% valuation premium over their laggard counterparts. And we're finding portfolio decisions increasingly being made on behalf of ESG. Company A, for instance, decides to sell off an out-of-ESG-favor division, bring cash in the door, raise the multiple of the remaining company and invest in higher-growth opportunities. Such ESG arbitrage opportunities are increasingly being explored.

For expanding access to capital markets, companies are rightly viewing ESG as a gating issue that didn't exist a few years ago. We recently worked with a small company that was raising substantial funding to make more acquisitions. They realized they didn't have an ESG presence but had to be credible for the upcoming funding. We worked with them to quickly articulate what was a good set of policies and practices that hadn't been cogently stitched together, and they noted they were "10 times better prepared" than they otherwise would have been for the successful fund raise.

**EBJ: What regulations and initiatives are affecting or influencing the ESG market in the United States?**

A&M: The most-watched ESG area for U.S. regulations is through the **Securities and Exchange Commission**, which is evaluating enhanced disclosures around ESG for publicly listed companies. Keep in mind that anything material to share-

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holders is already required to be disclosed, so these would be enhanced disclosures and are likely to center on major ESG focus areas such as climate change and diversity, equity and inclusion.

The other carefully watched area is in the **Department of Labor**'s definition of a fiduciary's role in considering ESG considerations in, for example, pension investments. The prior Administration had ruled that fiduciaries must only take into account monetary considerations, while many observers believe that the current Administration will be more expansive in allowing for broader ESG considerations by pension fund managers.

Increased regulation in this area is likely, but will be evolving for many decades to come. Keep in mind that the first major environmental law – the Clean Air Act – turned 50 last year, and we continue to refine what clean air means.

**EBJ: What type of data must be aggregated for ESG reporting and how can companies set up a system to acquire high quality data?**

A&M: This question really targets some of the biggest challenges when evaluating a company's ESG profile. Data touching upon a company's environmental, social and governance footprint encompasses almost all divisions within an organization – legal, supply chain, human resources, etc and is entirely reliant on self-reporting what details a company may choose to disclose (or not disclose). Most frustrating to external constituents is the lack of one standardized reporting framework or a way to fully validate the veracity of the information being disclosed.

Companies exploring the most compelling way to promote transparency will complete a gap assessment aligned against key elements across a variety of frameworks like TCFD, MSCI, and SASB and use the output of this analysis to establish a starting point ESG disclosure. Within this process, it is critical a company build an internal reporting infrastructure which ties each question to the data or document substantiating the response and to tie this to the individuals within the company responsible for providing the response. This can be accomplished within a SharePoint data site or a more robust external reporting program specifically geared toward ESG reporting as more and more technology offerings become available. Regardless of which path is chose, transparency and data integrity provide the foundation and credibility necessary for a company to maximize the benefit of its disclosures across the entire stakeholder base.

**EBJ: What are the main elements of a Climate-Related Financial Disclosure? Which governments, entities or investors are requiring them?**

A&M: Several years ago, the Financial Stability Board, along with the Bank of England and Bloomberg, rolled out what is called the Task Force for Climate-Related Financial Disclosure (TCFD). The idea behind the TCFD is that investors have a right to know whether the companies they invest in face undue risk or opportunities from climate-related impacts – both physical and market-related impacts. An example of a market-related impact would be the shift to electrification of vehicles or the introduction of a carbon tax. If those risks are indeed material to the company, then they should be managed and reported to investors like any other risk and disclosed in the mainstream financial statements.

The TCFD asks companies to undertake a scenario analysis, examining the range of potential impacts to their business strategy should different climate-related outcomes occur. For example, what would happen to a steel company if a $30/ton carbon tax were levied? Or what would happen to an agricultural company if there were extreme, persistent drought in their growing region? This thoughtful exercise is designed to both make executives aware of the potential impacts that climate can have on their business and act now to ward off the worst of those effects.

The TCFD also guides companies on a useful disclosure framework which includes reporting on these elements:

- ***Governance:*** In short, describe who in the organization has responsibility for identifying and managing climate risk. Ideally this is at very senior levels.
- ***Strategy:*** Disclose the actual and potential impacts of climate related risks (or opportunities – remember, not all risk is bad!) on the organization's business strategy.
- ***Risk Management:*** Detail how the company manages these newly identified climate-related risks.

## *A&M ESG Service Offerings*

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| **Gap Analysis**<br>Conduct a comprehensive review of industry benchmarking activities to determine key areas of tangible risk and opportunity | **Ratings Improvement**<br>Identify the highest-impact disclosures and performance metrics to improve ESG disclosures and scoring with raters and rankers | **Materiality Assessments**<br>Evaluate ESG topics most material to a company and its key stakeholders and develop a tailored materiality matrix |
| **Sustainability Strategy**<br>We simplify the complex ESG landscape to create value and meet the needs of stakeholders such as investors, employees and regulators | **Investor Positioning**<br>Leverage a company's ESG position to create opportunities, improve valuation, expand access to capital and garner proxy support | **Stakeholder Engagement**<br>We build ESG into your organizational narrative and create communications approaches to reach your most important stakeholders |
| **Advancing Social Purpose**<br>We help companies explain in clear and compelling terms why their business, products and services are in the broad interest of society | **Knowledge Hub**<br>As thought leaders, we share ESG fundamentals and keep our clients apprised of meaningful news, trends and updates | **Reporting Capabilities**<br>Advise on best practices in disclosure to align with reporting frameworks and highlight priorities, performance and commitments |
| **PE Fund Consulting**<br>Working at both the PE and Portco level to evaluate hot spots, identify key ESG issues and assist with potential target investments | **"Virtual CSO"**<br>Provide end-to-end ESG solutions as an outsourced Chief Sustainability Officer and develop full suite of ESG program | **Perception Studies**<br>We customize interviews with stakeholders to assess company sentiment and gain insight into views on approach and performance |

- ***Metrics and targets:*** Describe the metrics and targets used to assess and manage climate risks and opportunities.

While this may seem daunting, it is actually a very useful exercise for all companies to undertake simply to better understand whether there are hidden risks to manage or opportunities to exploit due to a changing climate and on the transition to a low-carbon economy.

The United Kingdom is the first G-20 nation requiring publicly listed companies to disclose climate-related risks and opportunities using the TCFD framework starting next year. The United States Securities and Exchange Commission is currently examining whether and how publicly listed companies should disclose climate related risks. Many companies are undertaking TCFD scenario analysis and proactively reporting on the results using the recommended framework not due to regulations, but simply due to investor demand.

**EBJ: In which ways are lenders utilizing ESG data to determine credit risks?**

A&M: Lenders are laser-focused around ESG, and incorporate many of the same filters that equity funds employ – negative screening to compensate for risk in certain industries, "best in breed" analyses to reward good performers. ESG leaders have been shown to enjoy a cost of debt as much as 200 basis points lower than ESG laggards. Green bonds for specific projects or particularly strong ESG borrowers have been receiving enormous fund inflows. And any company can work with its banks to establish sustainability-linked bonds or loans that offer lower coupon rates so long as certain standards are met.

**EBJ: What about insurers?**

A&M: Insurers are all about managing risks, of course, and contrary to a short-term-owning hedge fund, an insurer might have a 20- or 30-year relationship with a company. Black swan events are likely to occur over these time frames. A company that is savvy on evaluating and managing its collection of ESG risks is likely to be more attractive to insurers. Interestingly, Allianz research of more than 6,000 companies over 12 years demonstrated that ESG parameters were "significant early warning indicators" to identify firms that pose excess risks. ◻

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