

ISS Adds Climate Scorecard to Proxy Reports, Recognizing the Rise of Sustainable Investing

A new rating has been added to ISS' proxy reports that's focused on climate awareness. This article highlights key components of the Scorecard and its impact for issuers.

Navigating how your company is rated based on environmental, social, and governance (ESG) factors is already standard practice for many issuers. While it's likely that you are still working to understand the various existing ESG ratings, including the Environment and Social Quality Scores that first appeared last year in Institutional Shareholder Services' (ISS) proxy reports, be prepared — yet another rating is coming your way. In fact, some investors subscribing to ISS will begin to see a Climate Awareness Scorecard in certain ISS reports for upcoming annual meetings.

ISS' August 2019 Custom Climate Voting Service launch announcement included a notice stating, "in response to growing investor interest for more integrated climate-related data, ISS has introduced the new ISS Climate Awareness Scorecard, which will appear in a range of select ISS Benchmark and Specialty policy research reports." The Scorecard has recently been added to some of these reports.

Highlights of the Climate Scorecard

As described by ISS, the Scorecard "distills and harmonizes publicly available data and ISS proprietary analysis on a company's climate change-related disclosures, practices, and performance record, including its industry risk group." The Scorecard is divided into three sections:

- **Climate Risk Exposure:** Acknowledging that different industries have different exposure to climate change, this section is made up of two components:
 - Industry Climate Risk Exposure – Companies are assigned a low, medium, or high climate risk exposure based on their specific industry and business activities.
 - Incident-Based Risk Exposure – This indicates whether the company is violating the standards of the Paris Agreement or other universally accepted climate norms.
- **Climate Performance:** Current and future climate performance relies upon meeting climate targets, as well as avoiding climate-related risks. This section is also comprised of two components:

- Current Climate Performance – This portrays a company’s current direct and indirect greenhouse gas (GHG) emissions. Emission Intensity (direct GHG emissions, normalized by revenue) is contrasted with Average Peer Emission Intensity.
- Forward-Looking Climate Performance – Each company is assigned a Carbon Risk Category (Leader, Performer, Underperformer, or Laggard) and Rating (0-100 scale, where 100 is best).
- **Climate Disclosure:** This section follows the nomenclature of the Task Force on Climate-Related Financial Disclosure (TCFD) to rate a company on its disclosure across four categories — climate governance, strategy, risk management, and metrics and targets — with a classification of Standard Unmet, Partial Alignment, Meets Standard, or Exemplifies Standard.

The Scorecard draws from several of ISS’ ESG data and analysis offerings, including ISS ESG Climate Solutions, the ISS ESG Carbon Risk Rating, and ISS ESG Norm-Based Research.

The Impact for Issuers

Incorporating the Scorecard into ISS’ proxy reports is likely to increase awareness of the firm’s multiple ESG offerings. It comes as no surprise that ISS intends to capitalize on its strategic acquisitions of ESG providers over the last several years.

While some may view the continued expansion of ISS’ reach beyond traditional governance matters with cynicism, it’s clear that ISS is trying to meet the needs of its investor clients. As we observed in [our summary](#) of ISS’ annual policy survey, investors are increasingly looking at how companies assess and measure the impact of risks related to climate change, as well as the increased regulation of climate change-related disclosure. ISS later reported that 60% of investor respondents answered that “all companies should be assessing and disclosing climate-related risks and taking actions to mitigate them where possible.” The new Scorecard provides ISS’ perspective on whether and how well that is being done.

As always, it is important to put such developments into context. First, not all institutional investors subscribe to ISS, and those who do may use ISS’ materials in various ways. For example, some may only receive selected data points from ISS to consider and may seldom, if ever, review an actual ISS proxy report. Others may rely upon ISS on a more turnkey basis and view offerings like the Scorecard as an opportunity to factor climate change performance and disclosure into their analysis, where resource constraints may have precluded them from doing so in the past.

Secondly, ISS is only one of many firms providing ESG ratings, as well as data and analysis to investors and other stakeholders. While ISS ratings are visible to companies and their board members due to their prominence in proxy reports, there is nothing that conveys which ESG providers, if any, a given investor is using.

Finally, it’s important to realize that this new development is a result of market demand. Institutional investors want climate change information and analytics, so service providers are delivering it. While investors recognize that ISS and other providers each apply their particular methodology to the available data, companies must be proactive if they want to drive their own narrative on climate change and other aspects of sustainability.

Next Steps

It's imperative for companies to understand how their top investors that subscribe to ISS use information in the ISS reports. This development is also a reminder that organizations should be aware of the full scope of ESG information and the ratings their investors may be considering, regardless of whether they source it actively or passively, receive it bundled with proxy research materials, or follow ISS' proxy recommendations. Radical changes to your company's policies, practices, or disclosure may or may not be required — but the first step is understanding the range of ESG factors applicable to your company and industry, and determining which are most significant to your investors.

If you have questions about this development or other corporate governance-related topics and want to speak with one of our experts, please write to rewards-solutions@aon.com.

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