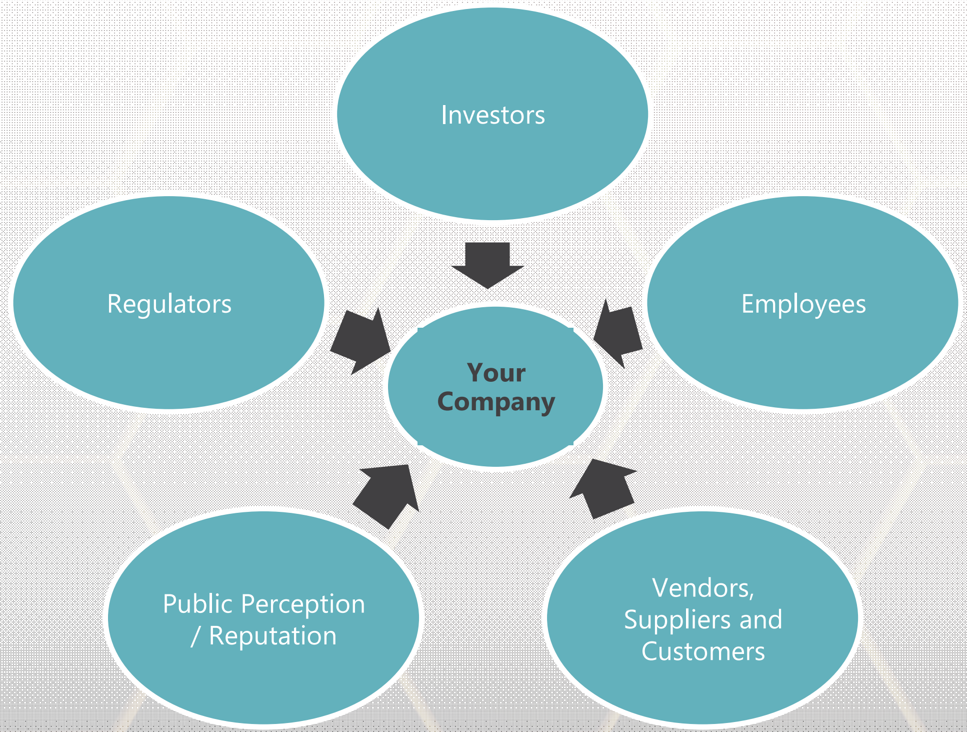
How Private and Public Companies can Navigate the ABC's of ESG in a Dynamic Environment

June 20, 2023

Starting on the same page:

What is ESG? Where did it come from? Why is it important?

All the Buzz



ESG encompasses a range of risks and opportunities not historically considered when analyzing financial performance

Environmental

Resource usage, management, and impact of climate on industry and vice versa.

Examples
Greenhouse gas emissions, resource management, air quality

Social

Social and human capital issues that have societal impacts and risks,
including workforce management concerns.

Examples
Human rights, community impacts, workforce diversity, health and safety

Governance

Leadership and governance matters that pertain to legal and ethical obligations of the company.

Examples
Business ethics, board diversity, ESG oversight, shareholder rights

Use of voluntary frameworks can be helpful in determining what and how to communicate

Key distinctions between frameworks:

- GRI is the broadest of the frameworks, focusing on ***materiality across all stakeholders***
- SASB prioritizes ***financial materiality*** in its framework and provides sector-specific guidance for reporting
- TCFD focuses on ***climate-related risk*** and is structured around four pillars: governance, strategy, risk management, and metrics/targets

GRI

SUSTAINABILITY ACCOUNTING STANDARDS BOARD SASB

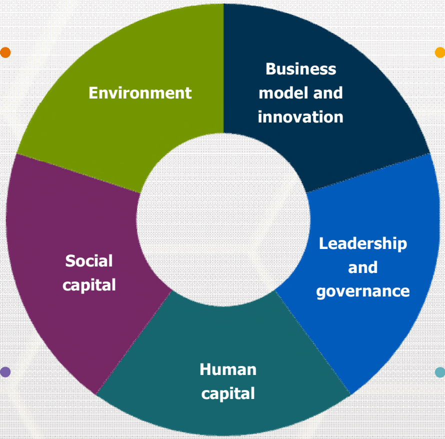
TCFD TASK FORCE ON CLIMATE-RELATED FINANCIAL DISCLOSURES

SASB and TCFD further solidify as primary expectation of institutional investors

Material ESG concerns vary by industry and market, not a single approach

Lennox International used the SASB materiality framework to help prioritize which ESG issues were most pressing for them

Not all issues are relevant for every company. Framework helps clarify material concerns.



Environment

- GHG Emissions
- Air Quality
- **Energy Management**
- Water & Wastewater Management
- **Waste & Hazardous Materials Management**
- Ecological Impacts

Business model and innovation

- **Business Ethics**
- Competitive Behavior
- Management of the Legal & Regulatory Environment
- Critical Incident Risk Management
- Systemic Risk Management

Social capital

- Human Rights & Community Relations
- Customer Privacy
- Data Security
- Access & Affordability
- **Product Quality & Safety**
- Customer Welfare
- Selling Practices & Product Labeling

Human capital

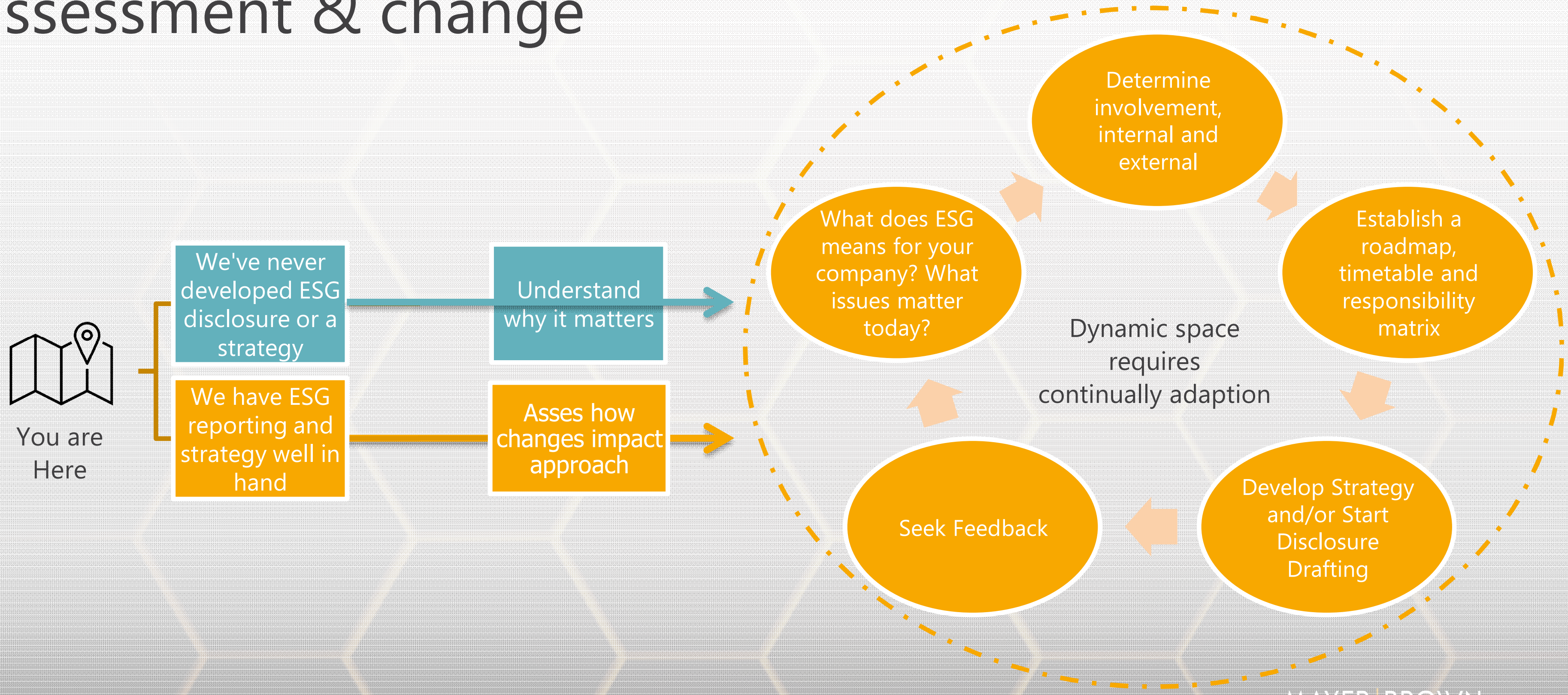
- Labor Practices
- **Employee Health & Safety**
- Employee Engagement, Diversity & Inclusion

Leadership and governance

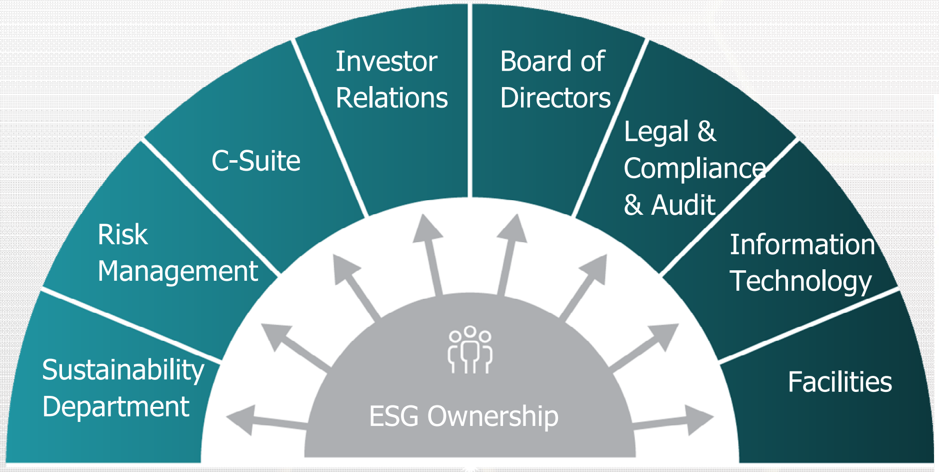
- **Product Design & Lifecycle Management**
- Business Model Resilience
- Supply Chain Management
- **Materials Sourcing & Efficiency**
- Physical Impacts of Climate Change

Bold items relate to material ESG concerns for Lennox International

Managing ESG requires a continuous process of assessment & change

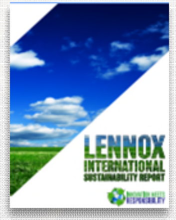


ESG is not owned by one function but spans multiple, requiring coordination



Advancing your management and board's ESG literacy, enable them to effectively oversee the ESG matters within their purview and prepare corporate leaders to discuss ESG topics with their investors, employees, clients and other stakeholders.

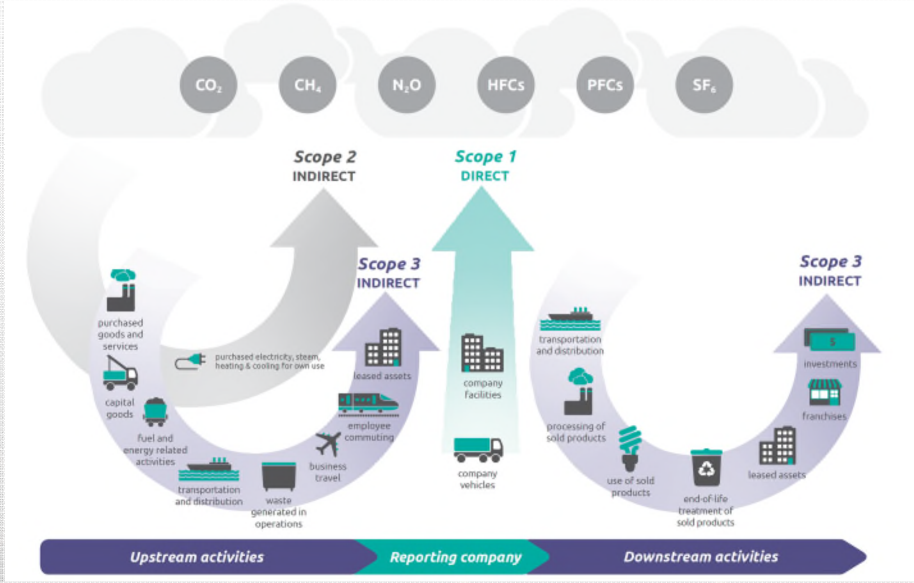
How Lennox International matured its approach and reporting over time

	2019	2020	2021	2022
				
	• Philanthropy & Community focused	• Investor Lens • SASB and TCFD	• Investor Lens (with CSA and CDP focus) • SASB and TCFD	• Investor Lens (with CSA and CDP focus) • SASB and TCFD • ESG Data Tear Sheet
S&P Global CSA Score Improvement	-	13 (11th percentile)	44 (80th percentile)	55 (92nd percentile)

Notable Climate Progress

- Conducted an initial climate scenario analysis
- Refined calculation of Scope 3 emissions and modelled out Scope 3 emissions to target year
- Set science-based targets for Scope 1, 2, and 3 emissions

Climate change related reporting will be required for SEC registrants



Source: https://www.epa.gov/climateleadership/scope-1-and-scope-2-inventory-guidance

SEC Draft Rule Components

Emissions:

- **Scope 1 and Scope 2:** Required for all registrants
- **Scope 3:** required if material, or if emissions target or goal covers Scope 3, possible greater specifics for financial sector companies

- **Disaggregated Climate-Related Financial Metrics**
- **Aligned reporting with TCFD**

Registrant type	Non-scope 3	Scope 3	Attestation, scope 1 & 2
Large accelerated filer	2023	2024	Limited – 2024 Reasonable – 2026
Accelerated filer	2024	2025	Limited – 2025 Reasonable – 2027
Nonaccelerated filer	2024	2025	Not required

Appendix

SEC climate-related disclosure rule proposal

EMISSIONS DISCLOSURES

- **Scope 1 and Scope 2:** Companies would be required to disclose direct GHG emissions (Scope 1) and indirect GHG emissions from purchased electricity and other forms of energy (Scope 2)
- **Scope 3:** Companies would also be required to disclose indirect emissions from upstream and downstream activities in a registrant's value chain (Scope 3), if material, or if the registrant has set a GHG emissions target or goal that includes Scope 3 emissions
  - SEC did not propose a quantitative materiality threshold for Scope 3

METHODOLOGIES

- **GHG Protocol:** SEC expects that most issuers will elect to utilize the GHG Protocol for reporting and calculating emissions, though this is not required
  - Provides flexibility to adapt to new and emerging approaches, such as industry-specific methodologies
- **Financial Sector:** SEC acknowledges the use of Partnership for Carbon Accounting Financials (PCAF) framework within financial sector and specifically references this methodology as it relates to Scope 3 emissions

DISCLOSURE REQUIREMENTS

- **Disaggregated Climate-Related Financial Metrics:** Proposed rules would require companies to also provide certain disaggregated climate-related financial metrics across three categories: financial impact metrics, expenditure metrics, and financial estimates and assumptions.
- **Climate Goals:** Companies with climate goals, such as net zero by 2050, would need to disclose how the commitment would impact financial estimates and assumptions, such as estimated useful life, fair value measurements, and depreciation expense

Timeline:

- Expected to finalized October 2023
- Timeline for implementation may shift
- Specifics are still pending

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Other notable SEC ESG-related rulemaking

Cybersecurity Rule Proposal

Material Incidence Reporting (within 4 days)
- When the incident was discovered, scope of it, description and whether it is ongoing;
- Impact & remediation
- Reported within 4 days of discover

Governance, Risk Management & Strategy
- Cybersecurity strategy and governance practices
- BOD & executive expertise on cybersecurity
- Cybersecurity risk management

Timeline:
- Final rule **expected in October 2023**
- Specifics and timeline may shift

Human Capital Management (expectations)

Expected Structure:
- Line-item disclosure focused on specific workforce metrics
- Standard workforce metrics disclosed for each filing company

Possible Components:
- Workforce composition: # of fulltime, part-time and contingent workers
- Workplace cost: wages, benefits, etc..
- Workplace stability: turnover rates
- Workforce diversity: gender and race/ethnicity at different levels of seniority

Timeline:

Draft rule **expected in Fall 2023**

Consolidated reporting standards influence regulatory requirements

Alignment of standards are clarifying what should be included in reporting, making it easier for regulators to enact requirements and for existing disclosures to adhere to new regulations

GRI Empowering Sustainable Decisions

GSSB

The **Global Sustainability Standards Board** is responsible for setting globally accepted standards for sustainability reporting. In doing so, they oversee the development of the **GRI** and collaborate with various organizations, including the **IFRS** and the **EFRAG** (who are responsible for the **CSRD**).

TCFD SASB CDSB IR

ISSB

The **International Sustainability Standards Board** was formed under the **IFRS** to develop standards for a global baseline of sustainability disclosures, building upon past reporting initiatives

HKEX 香港交易所

Exchanges including expectations
The Hong Kong exchange requires ESG disclosure informed by GRI

CSRD

The EU **Corporate Sustainability Reporting Directive**, replacing the NRFD, came into effect 2023 and will require companies operating in the EU to report against the standards in **2025** (reporting on **FY24**)

Climate Rule

The **US SEC** Climate Rule is requiring listed companies to disclose certain climate-related information (such as GHG emissions and climate risks and impacts). The proposed rules are expected to be final in the beginning of **Q4 2023**.

2020-2022
Rapid framework and standards consolidation & alignment

2023-2024
New standards come into effect

2024-2025:
Regulatory requirements come into effect, **referencing** the established frameworks and standards

Setting a course for ESG preparedness: A practical guide for small and midcap companies

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To begin the process of formulating an ESG reporting strategy, begin by examining the 'why', 'what', and 'who' is driving your decision to provide disclosure.

Where to Start

WHERE TO START

To begin the process of formulating an ESG reporting strategy, begin by examining the '**why**', '**what**', and '**who**' is driving your decision to provide disclosure.

WHY: In light of growing interest amongst a variety of stakeholders, including large institutional investors, to see ESG reporting in place for more companies, consider your company's rationale for beginning this journey. Consider framing questions like, are you pursuing robust ESG reporting in response to investor demand or client or customer feedback? What are your peers doing? What are your direct competitors focused on? What is your industry trending towards when it comes to environmental, social and governance matters? What information are your investors responding to or requesting from you? What questions are you fielding from clients or customers on ESG specifically? This grounding can help focus the narrative on the relative audience(s).

WHAT: In the beginning stages of an ESG reporting strategy figuring out key logistics will be important. Consider what investor-preferred reporting frameworks you'd like to include/work towards and begin to look at what issues are material to your industry. You can work with an external advisor to dig into specific investor preferences to help focus your report priorities and goals. Discuss internally and with external partners the timeline for publishing. Consider keeping a running list of metrics that peer companies track in their ESG reports, and then review this material with your newly formed ESG Committee. Are these metrics also relevant to your company, and is it possible to track them on an ongoing basis? At this stage consider the report's format, will it be hosted on a webpage or a standalone PDF?

Georgeson recently interviewed 20 top institutional investors in the US, UK and Europe representing \$30.5 trillion in AUM to discuss their ESG positions and methods. Learn more about investors' ESG priorities here. **2022 Global Institutional Investor ESG insights (georgeson.com)**

WHO: As you begin to formulate your reporting plan, line up key internal and external team members. It's also important at this stage to break down the silos of E, S, and G and discuss the interconnectedness of these matters. Consider the role of the different departments that will need to provide relevant data and metrics to support your report. ESG is not the sole domain of any one department, while one department may lead it's typical that there will be both cross-functional collaboration as well as engagement at multiple levels. Discuss with the board their involvement in the reporting process, and develop disclosure around the Board of Directors' s ESG oversight. As you look outside of your company, consider involving an investor relations and ESG advisory firm.

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What to Consider

We've outlined four key areas of the reporting process:

1 Guiding questions to focus your report and define data collection scope

When beginning to outline your inaugural or enhanced ESG report, consider developing a set of questions to guide your data collection scope. What ESG-related issues are most impactful to your industry? Do you have data to provide a baseline or roadmap to improvement? What ESG reporting topics and data points are trending in your industry? Consider discussing with your internal team and advisors, what investor-preferred reporting frameworks you want to develop for your report (Example: **TCFD, SASB, GRI**). Host internal stakeholder interviews to uncover possible areas for data collection and disclosure. Ask your executive team how they would like to be involved in the reporting process.

2 Data collection

ESG reporting-related data collection may feel like a colossal task for your company, but certainly an essential component of the process. To start, coordinating and compiling existing and updated disclosures can be helpful. Discuss with relevant departments if they have responded to any data-seeking surveys and how you can utilize that information, where relevant (example: CDP). Given pending SEC disclosure requirements, compounded by the fact that many large investors use ESG data for investment and voting decision-making purposes, you could consider involving your internal audit team, as you would with drafting your proxy statement. Looking into the future, when your ESG report becomes available and related data included in your SEC filings, you will begin to receive requests from investors and rating agencies to fill out ESG surveys. It's important to know this in advance of publishing your report in order to allow your internal team and external advisors time to develop an effective plan to memorialize ESG-related data and conduct routine updates to prepare for inbound inquiries in the future. Data collection maintenance will be key to continually developing effective ESG disclosure, and ultimately help demonstrate ESG-related achievements over time.

3 Report drafting

Once the data is collected, finding the most compelling way to relay this information as succinctly and simply as possible to all stakeholders is essential. While involved in the process, investor relations professionals are not typically writing the initial draft of the ESG report. The report is often written by operational individuals on your ESG Committee, or can be developed by a member of your external advisory team. Once sections of the report have been drafted, your external advisory team, including investor relations and your ESG advisory group, will review the material, streamline as necessary and weigh in on the terminology used, data provided and examples offered. How will the investor community react to the goals and metrics listed in your report? Can the information you provided be tracked from the outside and correlated to financial performance? Based on the feedback investor relations provides, continue to refine the report's content. Hedge some of your risks by thinking through the potential questions investors may have regarding the report's content, and proactively answer these questions in the text before the questions are ever asked.

4 Market outreach and response

Once the report is ready for publishing, ensuring the investment community and ESG rating agencies know the report is available is key. One important step in garnering attention for your ESG report is to issue a press release announcing that the report has been published. Investor relations can help craft the text of the release, including messaging core pieces of the analysis while at the same time leaving enough at bay to encourage investors to read the full report. Other key communications tools include preparing your management and Board of Directors for inbound inquires and developing an effective ESG web presence.

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Biographies

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Jen Carlson's corporate and securities practice focuses on capital markets transactions, public company disclosure, and corporate governance matters. Jen's robust transactional practice is equally balanced between representing companies and underwriters in a variety of capital markets and finance transactions, including debt and equity offerings, liability management transactions, and corporate venture capital investments. Jen has extensive experience advising companies on SEC disclosures, stock exchange compliance, fiduciary duties, and corporate governance matters. Jen regularly counsels both domestic companies and foreign private issuers on SEC reporting requirements, including ongoing rulemaking related to climate change, cybersecurity, human capital, and insider trading. Her extensive knowledge of SEC regulations and state corporate law, combined with years of experience advising clients in times of opportunity and crises, make her a trusted advisor to executive officers and boards of directors.

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Kilian Moote is a Managing Director within Georgeson's ESG advisory practice, where he advises clients on developing and implementing effective strategies that align with investors' expectations. Kilian has 15 years of experience working with executives and investors on sustainability, including leading the development of the ESG supply chain rating tool KnowTheChain. Prior to joining Georgeson, Kilian developed and managed strategies on human and labor rights, as well as public policy for the private foundation Humanity United. He has deep expertise on responsible supply chain management, having previously taught an MBA course at the University of San Francisco. As a leading expert on social and human capital issues he's frequently called on to provide guidance. He is currently advising The Investment Integration Project and involved in an effort to enhance SASB's human capital management standard

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Betty Ungerman is Vice President, Deputy General Counsel and Chief Ethics & Compliance Officer of Lennox International Inc. (NYSE LII), a leading global provider of climate-control solutions in the heating, air conditioning and refrigeration markets, with approximately 11,000 employees. Betty is also President of the recently established LII LENNOX Foundation, a private charitable foundation, set up to increase employee and stakeholder engagement and the positive impact that Lennox employees make in the communities where we live and work. Betty spearheaded LII's ESG program and published their first ESG report in December 2020 and then again in 2021 and 2022. She also leads the Ethics & Compliance Office and Global Trade Compliance activities.

Additional Resources

FREE WRITINGS + Perspectives

OUR FREE WRITINGS & PERSPECTIVES BLOG PROVIDES NEWS AND VIEWS ON SECURITIES REGULATION AND CAPITAL FORMATION.

The blog provides up-to-the-minute information regarding securities law developments and commentary on developments relating to private placements, IPOs, and other securities topics.

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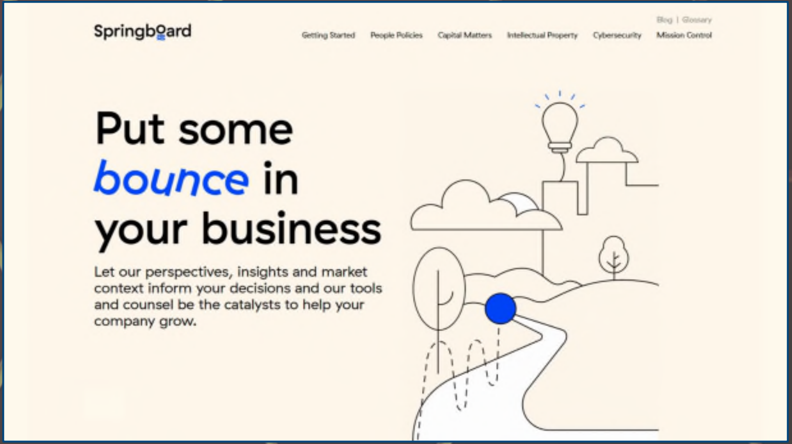

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