Material or Not: That is the Question in ESG Reporting

Argyle

In This
Thought Piece

In this thought piece we explore the evolving concept of materiality within the world of corporate environmental, social and governance (ESG) reporting and four “types” of materiality that have emerged: financial materiality, impact materiality, double materiality and dynamic materiality.

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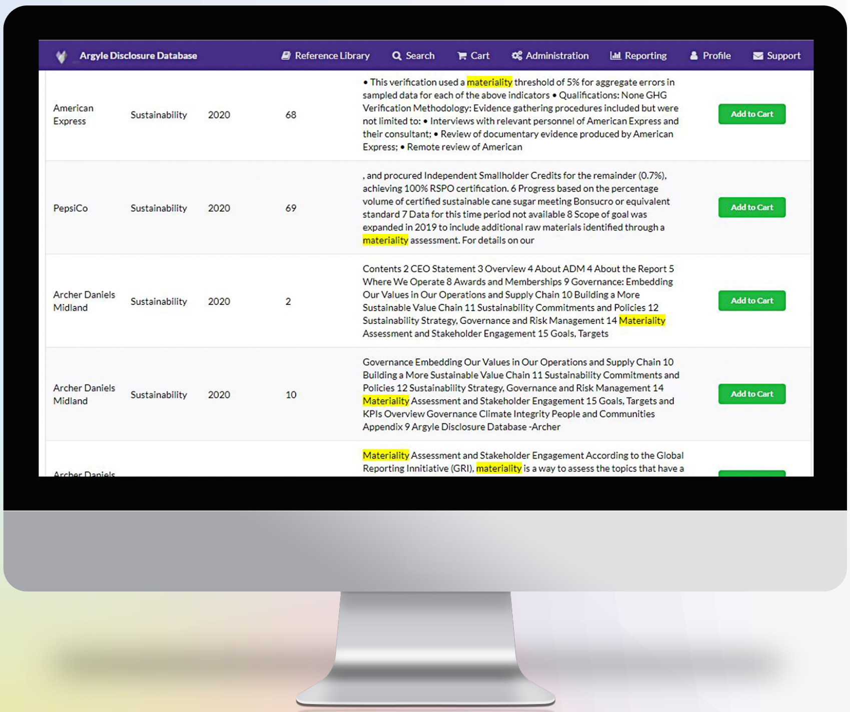

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Introduction: Material or Not, That is the Question

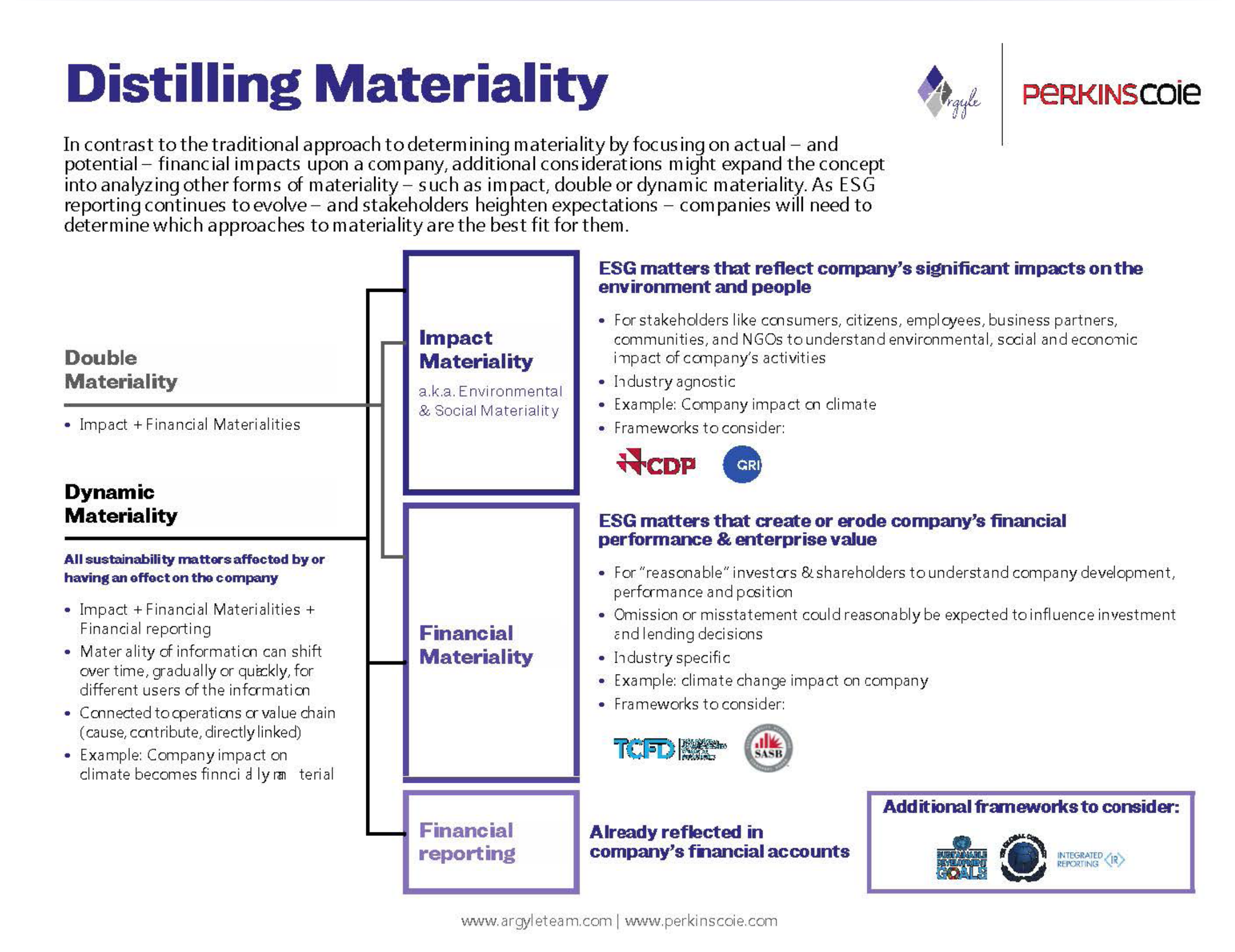
"To be or not to be," one of Shakespeare's most iconic questions, also belongs center stage in corporate environmental, social and governance (ESG) reporting – namely, whether ESG information is material and worthy of public disclosure.

From a corporate reporting standpoint, the concept of materiality is grounded in the idea that companies should disclose to investors information they need to make decisions. Through regulations, guidance and case law, U.S. securities law has defined what constitutes materiality for the purpose of filing documents with the Securities and Exchange Commission (SEC). Information is deemed "financially material" if there is a substantial likelihood that a "reasonable investor" would consider it important to their decision-making around buying or selling securities or issuing shareholder votes.[1] As the Sustainability Standards Accounting Board (SASB) explains, "...in many jurisdictions, [materiality] is the basis for determining whether a company may be exposed to fines or lawsuits for making a false or misleading statement about a material matter or for omitting information about a material matter."[2]

For decades, however, a growing number of investors, asset managers, employees, non-governmental organizations, and other stakeholders have been asking companies to go beyond SEC-mandated financial materiality in their reporting. They recognize that managing ESG risks poorly around issues like climate change, human capital and business ethics could lead to increased costs and liabilities – and that managing such risks well and innovating around them could lead to positive returns. This movement, which has gained significant momentum in recent years, has expanded the realm of what companies are considering material, especially as they strategize on long-term value creation and risk management.

1 Handy, Allison C. and Feldis, Kevin R. (July 13, 2021). *Sustainability Disclosures: What Is Material?*
2 Sustainability Accounting Standards Board (SASB). *Fundamentals of Sustainability Accounting Level I Study Guide. (March 2021). p. 66.*

Originally defined by the Global Reporting Initiative (GRI) in 2011, "impact materiality" (or "environmental and social materiality") reflects an organization's significant economic, environmental, and social impacts – even if such impacts are not (yet) financially material. In 2019, the European Commission began requiring companies to report disclosures that are doubly material in order to understand both a company's "development, performance and position" (financial materiality) and its "external impacts" (impact materiality).[3] By the end of 2020, 96% of the 250 largest companies globally (the G250) were reporting on their sustainability performance, with 73% of the G250 and 67% of the N100 (5,200 companies comprising the largest 100 firms in 52 countries) using the GRI framework and its definition of impact materiality.[4]



In the United States, debate continues in some circles around what ESG topics might be material for public disclosure and if such disclosures should be regulated. In 2021, the SEC announced it would begin analyzing the accuracy, gaps and misstatements in public company disclosures around climate risks and other ESG factors, and is set to propose rulemaking on climate risk and human capital management disclosures sometime this year.

3 European Commission. (2019). *Guidelines on reporting climate-related information*.
4 KPMG. (December 2020). *The Time Has Come: 2020 KPMG Survey of Sustainability Reporting*.

Conceptions of Materiality within the SEC

Not all SEC Commissioners agree on whether ESG information is financially material to investor decisions – or if the SEC should specify such disclosures.[5]

On the one hand, Commissioners Hester Peirce and Elad Roisman have stated that they do not think that ESG issues are financially material, nor should they be part of securities laws – unless Congress mandates their disclosure and until one set of investor ESG expectations and comparable metrics exists (as they do in financial reporting).

On the other hand, former Acting Chair Allison Herron Lee has stated that "the idea that the SEC must establish the materiality of each specific piece of information required to be disclosed in our rules is legally incorrect, historically unsupported, and inconsistent with the needs of modern investors, especially when it comes to climate and ESG."[6]

And, without using the exact term, SEC Chairman Gary Gensler explained the concept of dynamic materiality at the Principles for Responsible Investment's "Climate and Global Financial Markets" webinar in July 2021:[7]

> *"Over the decades, there's been debate about disclosure on things that, today, we consider pretty essential for shareholders. The first disclosures revolved around companies' financial performance. Then, there was investor demand for information about who runs the company. Later, investors wanted more information on how much a company's resources were dedicated to paying those executives… Of course, there was opposition to many disclosure requirements that have become so integral to our regime that it's hard to imagine investors making a decision without them. So why am I talking about climate risk? Simple: because investors are. Today, investors increasingly want to understand the climate risks of the companies whose stock they own or might buy. Large and small investors, representing literally tens of trillions of dollars, are looking for this information to determine whether to invest, sell, or make a voting decision one way or another."*

[5] Handy, Allison C. and Feldis, Kevin R. (July 13, 2021). *Sustainability Disclosures: What Is Material?*

[6] Lee, Allison Herren, U.S. Securities Exchange Commissioner and former Acting Chair. (May 24, 2021.) *Living in a Material World: Myths and Misconceptions About "Materiality."*

[7] Gensler, Gary, U.S. Securities Exchange Commissioner and Chair. (July 28, 2021.) *Prepared Remarks Before the Principles for Responsible Investment "Climate and Global Financial Markets" Webinar.* Washington, D.C.

Examples of Materiality in ESG Reports

Given the evolving nature of ESG and materiality, how have U.S. companies been disclosing ESG information that they determine is material to their business?

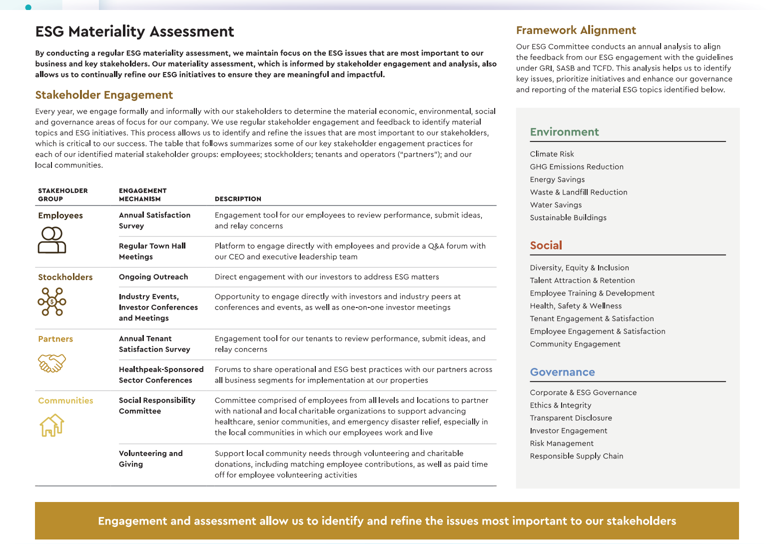
Some use tables, Venn diagrams, or other infographics to list material ESG topics grouped under the headings of environmental, social or governance and/or under the types of stakeholder groups that identified the issues as impactful.

Left to right, top to bottom: Citigroup Inc., Healthpeak Properties and Broadcom use tables or Venn diagrams in their latest ESG annual reports to show ESG issues material to their businesses and stakeholders.

Material ESG Topics*	Key Stakeholders					
	Clients and Customers	Employees	Suppliers	Communities and NGOs	Shareholders	Government and Regulators
Environmental						
Biodiversity	●			●	●	
Climate Change	●	●	●	●	●	●
Environmental Justice	●		●	●		
Operational Footprint		●	●			●
Products and Services with Environmental or Social Benefits	●		●	●	●	
Social						
Community Investment		●		●		
COVID-19	●	●	●	●	●	●
Employee Health and Well-being		●	●			●
Financial Inclusion	●			●	●	
Human Rights	●	●	●	●	●	
Racial Equity/Racial Justice	●	●	●	●		
Talent Attraction, Retention and Development		●			●	
Workforce Diversity, Inclusion and Equal Opportunity		●		●	●	
Governance						
Business Ethics	●	●	●	●	●	
Business Model Resilience	●				●	
Data Security/ Financial Product Safety	●	●	●	●	●	
ESG Governance	●	●			●	
Innovation and Digitization	●	●				
Public Policy and Regulation Reform	●			●	●	
Stakeholder Engagement	●	●	●	●	●	
Systemic Risk Management	●				●	
Transparency and Trust	●			●	●	

* For issue definitions, see next page.

Citi 2020 ESG Report



ESG Materiality Assessment

By conducting a regular ESG materiality assessment, we maintain focus on the ESG issues that are most important to our business and key stakeholders. Our materiality assessment, which is informed by stakeholder engagement and analysis, also allows us to continually refine our ESG initiatives to ensure they are meaningful and impactful.

Stakeholder Engagement

Every year, we engage formally and informally with our stakeholders to determine the material economic, environmental, social and governance areas of focus for our company. We use regular stakeholder engagement and feedback to identify material topics and ESG initiatives. This process allows us to identify and refine the issues that are most important to our stakeholders, which is critical to our success. The table that follows summarizes some of our key stakeholder engagement practices for each of our identified material stakeholder groups: employees; stockholders; tenants and operators ("partners"); and our local communities.

STAKEHOLDER GROUP	ENGAGEMENT MECHANISM	DESCRIPTION
Employees	Annual Satisfaction Survey	Engagement tool for our employees to review performance, submit ideas, and relay concerns
	Regular Town Hall Meetings	Platform to engage directly with employees and provide a Q&A forum with our CEO and executive leadership team
Stockholders	Ongoing Outreach	Direct engagement with our investors to address ESG matters
	Industry Events, Investor Conferences and Meetings	Opportunity to engage directly with investors and industry peers at conferences and events, as well as one-on-one investor meetings
Partners	Annual Tenant Satisfaction Survey	Engagement tool for our tenants to review performance, submit ideas, and relay concerns
	Healthpeak-Sponsored Sector Conferences	Forums to share operational and ESG best practices with our partners across all business segments for implementation at our properties
Communities	Social Responsibility Committee	Committee comprised of employees from all levels and locations to partner with national and local charitable organizations to support advancing healthcare, senior communities, and emergency disaster relief, especially in the local communities in which our employees work and live
	Volunteering and Giving	Support local community needs through volunteering and charitable donations, including matching employee contributions, as well as paid time off for employee volunteering activities

Framework Alignment

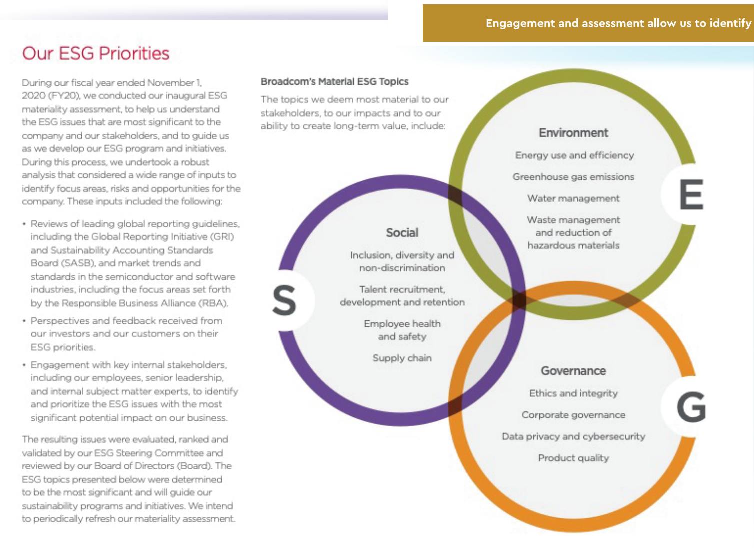
Our ESG Committee conducts an annual analysis to align the feedback from our ESG engagement with the guidelines under GRI, SASB and TCFD. This analysis helps us to identify key issues, prioritize initiatives and enhance our governance and reporting of the material ESG topics identified below.

Environment
- Climate Risk
- GHG Emissions Reduction
- Energy Savings
- Waste & Landfill Reduction
- Water Savings
- Sustainable Buildings

Social
- Diversity, Equity & Inclusion
- Talent Attraction & Retention
- Employee Training & Development
- Health, Safety & Wellness
- Tenant Engagement & Satisfaction
- Employee Engagement & Satisfaction
- Community Engagement

Governance
- Corporate & ESG Governance
- Ethics & Integrity
- Transparent Disclosure
- Investor Engagement
- Risk Management
- Responsible Supply Chain

Engagement and assessment allow us to identify and refine the issues most important to our stakeholders



Our ESG Priorities

During our fiscal year ended November 1, 2020 (FY20), we conducted our inaugural ESG materiality assessment, to help us understand the ESG issues that are most significant to the company and our stakeholders, and to guide us as we develop our ESG program and initiatives. During this process, we undertook a robust analysis that considered a wide range of inputs to identify focus areas, risks and opportunities for the company. These inputs included the following:

- Reviews of leading global reporting guidelines, including the Global Reporting Initiative (GRI) and Sustainability Accounting Standards Board (SASB), and market trends and standards in the semiconductor and software industries, including the focus areas set forth by the Responsible Business Alliance (RBA).
- Perspectives and feedback received from our investors and our customers on their ESG priorities.
- Engagement with key internal stakeholders, including our employees, senior leadership, and internal subject matter experts, to identify and prioritize the ESG issues with the most significant potential impact on our business.

The resulting issues were evaluated, ranked and validated by our ESG Steering Committee and reviewed by our Board of Directors (Board). The ESG topics presented below were determined to be the most significant and will guide our sustainability programs and initiatives. We intend to periodically refresh our materiality assessment.

Broadcom's Material ESG Topics

The topics we deem most material to our stakeholders, to our impacts and to our ability to create long-term value, include:

A growing number of companies use materiality matrices to show how ESG topics identified by the business as material compare to those identified by stakeholders. Companies then prioritize those issues that are most important to both.

Left to right, top to bottom: HPE, Walgreens Boots Alliance and ADM use matrices in their latest ESG annual reports to show ESG issues material to their businesses and stakeholders.

Some also include a brief statement to note that the term “materiality” used within the context of their ESG reporting is not the same as the concept of financial materiality used for SEC reporting purposes, while some avoid using the term altogether, especially if they have not yet conducted a materiality assessment grounded in investor and other stakeholder input.

To Thy Own Self Be True

Regardless of how companies are disclosing what they determine are their material ESG issues, what's clear is that the concept of materiality is not static. Dynamic materiality captures the idea that as external and internal factors impacting companies and their investors change over time, so too does what is material:[8]

> *"Due to factors such as emerging technologies, new knowledge, and new regulations companies adapt their products and services and entire industries evolve. These factors taken together with changing social expectations mean that what is material for an industry will change. There can also be differences at the company level within an industry due to different strategies."*

While research has shown that greenhouse gas emissions, labor practices and business ethics have constituted a steady 25% of all ESG disclosures from companies in the Russell 3000 since 2009[9], issues like employee engagement, health and safety – alongside diversity, equity and inclusion – have risen quickly in importance due to the global COVID-19 pandemic and racial justice movements. It remains key, then, for companies to stay on top of what issues are of most concern to their investors and broader stakeholders. And until securities exchange commissions like the SEC specify ESG disclosures in their financial reporting requirements, the materiality of ESG topics will continue to be up to each company individually to determine, using GRI, SASB and others for guidance.

Or, in the words of Shakespeare, when it comes to determining the materiality of ESG topics, "to thy own self be true."

[8] Eccles, Robert G. (January 17, 2020). *Dynamic Materiality And Core Materiality: A Primer For Companies And Investors.* Forbes.com.
[9] Eccles, Robert G. (January 17, 2020). *Dynamic Materiality And Core Materiality: A Primer For Companies And Investors.* Forbes.com.

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www.argyleteam.com

Argyle Company
100 Burma Rd.
Jersey City, NJ 07305
(201) 793 5400

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