KPMG

Utilities and ESG

How utilities can turn ESG reporting into a strategic advantage

KPMG IMPACT

Institutional investors, ratings agencies, and consumers want better reporting on corporate environmental, social, and governance (ESG) performance. Allison Herren Lee, acting chair of the U.S. Securities and Exchange Commission, is even making the case for a mandatory ESG reporting framework. Few industries feel the pressure more than utilities, which are essential to decarbonization efforts and highly exposed to climate-related risks, from violent storms and flooding to forest fires.

Public or investor-owned utilities, especially the largest operators, have been filing voluntary ESG disclosures for several years. More recently, under pressure from investors, many are going beyond completing the standard industry frameworks, such as those provided by the Edison Electric Institute and American Gas Association, among others, to report on disclosure requirements set by the Sustainability Accounting Standards Board (SASB) and Financial Stability Board Task Force on Climate-related Financial Disclosures (TCFD). Sempra Energy, for example, explained that it prepared its most recent ESG report:

"…in accordance with the GRI Standards: core option. We also disclose information using the Sustainability Accounting Standards Board standards, the Task Force on Climate-related Financial Disclosures guidelines and the Edison Electric Institute and American Gas Association combined ESG template."

Yet, many smaller utilities are still learning the ropes of ESG reporting. And, for all the effort utilities put into ESG reporting, most still treat filing as another needed compliance action. But certain progressive utilities are using ESG reporting to inform decisions about strategy, investments, and risk management. The best run, most responsible utilities will translate ESG goals into concrete plans for decarbonization and performance improvement, while managing physical and transition risks as governments around the world promote policies to accelerate the transition to a low-carbon global economy.

In this brief paper, we discuss the challenges and opportunities of ESG reporting and provide a practical analysis of the major reporting regimes. Our goal is to help utilities embrace the spirit of ESG as they master the intricacies of reporting; use ESG to build alignment with the full array of stakeholders, from investors and ratings agencies to employees, customers and communities; and drive business performance.

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[1] Aaron Nicodemus, Biden's SEC set to require disclosure of ESG, climate change risk, Compliance Week, December 2, 2020

[2] Sempra Energy Corporate Sustainability Report, Sempra.com

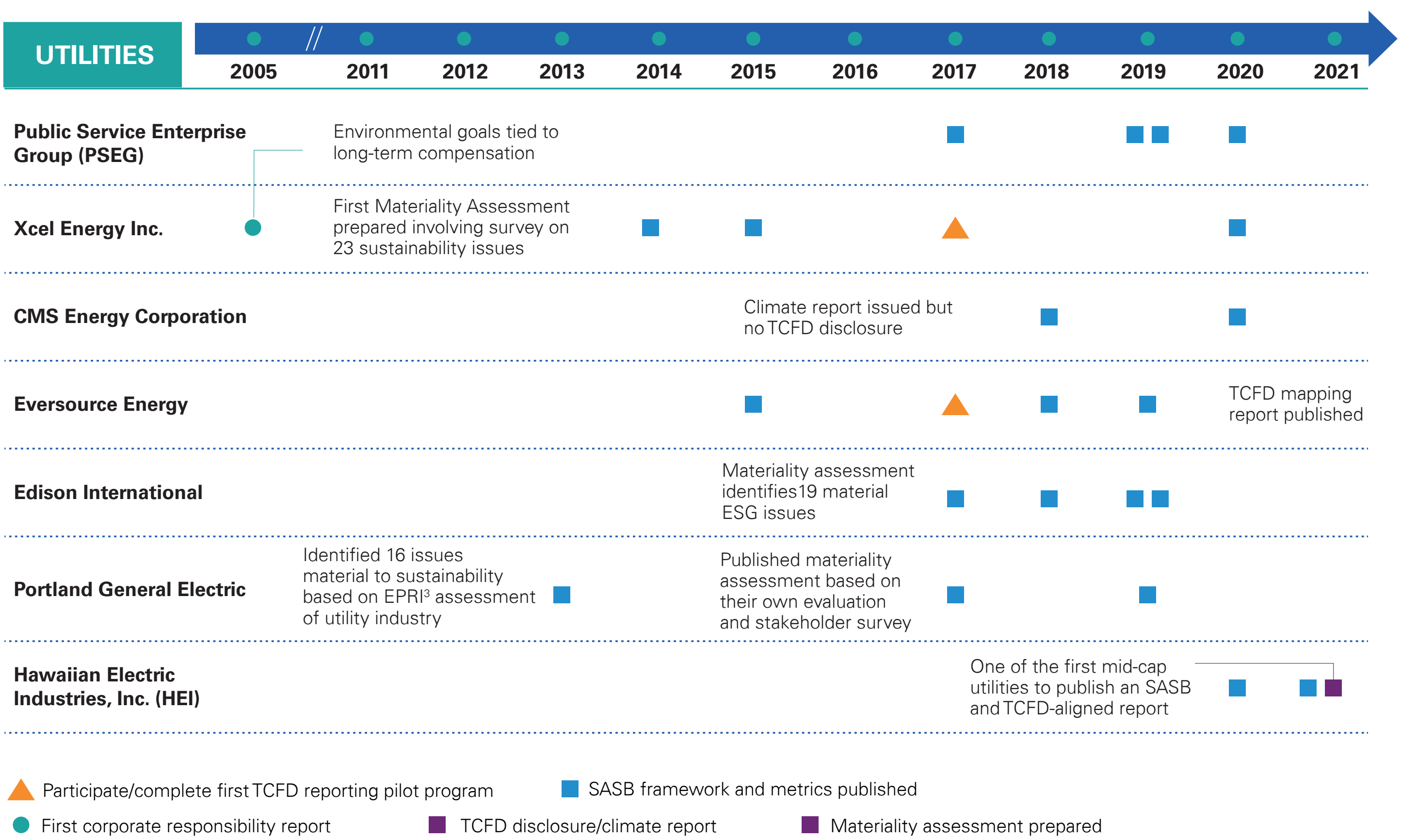
Navigating the ESG disclosure process

The ESG disclosure process is the first step in building a comprehensive ESG strategy because it helps a company identify gaps between its aims and accomplishments. To be useful and credible, reporting should address material ESG matters and not merely extract or extrapolate from historic ESG data.

We focus here on materiality statements and the increasingly popular SASB and TCFD reporting frameworks. Some utilities may want to consider other options depending on the preferences of their investors and stakeholders, such as standards set by the Global Reporting Initiative (GRI), International Integrate Reporting Framework (IIRF) and Carbon Disclosure Project (CDP).

We help utilities navigate this complex and changing landscape, develop key performance indicators (KPIs) to measure progress, and build alignment on ESG issues with key stakeholders. We also help them create proper governance and risk-management processes and develop execution strategies to integrate ESG into the entire organization, from daily operations to long-term planning.

Exhibit 1. How ESG reporting has evolved at major utilities



[3] EPRI – Electric Power Research Institute

Materiality assessments

In a materiality assessment, a company identifies and explores the full range of ESG issues that could affect the business or its internal or external stakeholders and aligns the output with reporting standards. This process helps companies define their ESG roadmap. In preparing materiality assessments, here are three pitfalls to avoid:

1. **Insufficient engagement with a broad range of stakeholders.** ESG efforts affect a wide range of stakeholders: community members, investors, regulators, and customers (Exhibit 2). Broad engagement on ESG issues has never been more important. A June 2020 Pew Research Center survey found that 63 percent of Americans see the effects of climate change in their communities, 65 percent said the government is doing too little to reduce the effects of climate change, and 79 percent want the country to prioritize developing alternative energy sources.[4]

Exhibit 2. ESG requires broad stakeholder engagement

	In-person meetings or phone calls	Open houses or townhall meetings	Ethics & compliance helpline	Website content	Corporate sustainability report	Facility tours	Surveys	Print or social media
Customers	✓	✓	✓	✓			✓	✓
Communities	✓	✓	✓	✓	✓	✓	✓	✓
Employees	✓	✓	✓	✓	✓	✓	✓	✓
Investors & shareholders	✓	✓	✓	✓	✓	✓	✓	✓
Regulators, elected officials, community leaders	✓	✓	✓	✓	✓	✓		✓
Suppliers, contractors, business partners	✓	✓	✓	✓	✓	✓	✓	✓

2. **Failing to build consensus among the senior executives and board members** who will be responsible for developing and executing ESG strategy. A targeted stakeholder engagement approach includes interviews, workshops, and facilitated education sessions to gain buy-in from senior leaders across the company—critical in integrating ESG strategy throughout the business.

3. **Failing to translate ESG priorities into reporting strategy and corporate policies and practices.** A well-articulated process highlights areas that require more risk management and corporate attention while helping to articulate a unique corporate narrative that should carry through future reporting.

ESG reporting that feeds into strategy begins with the engagement process, during which management can craft a unique corporate narrative. In articulating the stakeholder engagement process, for example, utilities should describe how it weighs the concerns of external stakeholders against business needs, which ESG issues are most important, and the company's ESG narrative, including potential gaps specific to the business. Every ESG disclosure should identify the key initiatives and KPIs the business will rely on to deliver on its priorities. Other leading practices include defining the company's top ESG issues and explaining the lessons learned in the materiality assessment process.

[4] "Two-Thirds of Americans Think Government Should Do More on Climate," Pew Research Center, June 23, 2020

SASB and TCFD reporting

While ESG reporting is generally voluntary, most leading utilities follow SASB and TCFD standards. SASB attempts to establish industry-specific standards for the disclosure of material ESG metrics and context, while the TCFD provides a framework to disclose climate-related risks and opportunities through existing reporting processes in four categories: governance, strategy, risk management and metrics, and KPIs. We reviewed 19 recent utility SASB- and TCFD-aligned disclosures to understand the trends and challenges.

Many firms recognize that they need a more robust ESG governance policy, and a few have created stand-alone "sustainability committees" to connect business strategy with the most current views on climate-related issues and other stakeholder interests.

Strategy remains the least robust disclosure area in utilities' ESG reporting—few firms consider their selected scenarios in the planning process or quantify the outcomes of these scenarios, for example. In our review of 19 TCFD-aligned disclosures, we found that only six included any quantitative results of scenario analyses, and only nine disclosed both transition and physical risks. Eight said senior management was responsible for identifying and assessing climate-related risks and opportunities; 11 identified enterprise risk management (ERM) as the responsible body. Despite these limitations, some common themes in climate risks and opportunities are emerging in disclosures (Exhibit 3).

Exhibit 3. Common themes in climate risks and opportunities (TCFD reporting)

Climate-related risks

Transition Risk

Policy and legal
- Increased pricing of GHG emissions
- Enhanced emissions reporting obligations
- Federal and state environmental laws
- Exposure to litigation

Technology
- Substitution of existing products and services with lower-emissions options
- Unsuccessful investment in new technologies
- Costs to transition to lower-emissions technology
- Reliability

Market
- Changing customer behavior
- Uncertainty in market signals
- Increased cost of raw materials
- Availability of capital

Reputation
- Customer satisfaction
- Stigmatization of sector
- Increased stakeholder concern or negative stakeholder feedback

Physical Risk

Acute
- Increased severity of extreme weather events
- Wildfires

Chronic
- Changes in precipitation patterns and extreme variability in weather patterns
- Rising temperatures
- Rising sea levels
- Droughts

Climate-related opportunities

Resource efficiency
- Use of more efficient modes of transport
- Use of more efficient production and distribution processes
- Move to more efficient building
- Reduced water usage and consumption

Energy source
- Use of lower-emission sources of energy
- Use of supportive policy incentives
- Use of new technologies (solar, energy storage, etc.)
- Shift toward decentralized energy generation

Products and services
- Renewable energy products
- Electric vehicles
- Development of climate adaptation and insurance solutions
- Ability to diversify business activities

Markets
- Access to new markets
- Use of public-sector incentives
- Access to new assets and locations needing insurance coverage

Resilience
- Participation in renewable energy programs and adaptation of energy efficiency measures
- Resource substitute/ diversification
- Advance grid intelligence and security

The SASB framework is ideal for identifying, managing, and communicating financially material sustainability information to investors, but even within a single framework, results are widely inconsistent. While most utilities now disclose medium- and long-term carbon reduction targets and report generation portfolio and emission intensities, for example, they do not report consistent metrics related to climate-related risks and opportunities.

As climate risk grows, utilities will need to integrate ESG considerations into the ERM processes. Investor-owned utilities in California, a bellwether jurisdiction, are now required to incorporate a risk assessment mitigation phase (RAMP) to identify and describe the top risks facing the utility and the controls and mitigations considered by the utility to treat the risk. Utilities in California, Oregon, Washington, Idaho, and Colorado are now adjusting wildfire practices as wildfire seasons get longer. The overall trend is clear: across the U.S. and around the world, utilities will need to better articulate and justify their actions and spending related to aging assets, evolving customer requirements, and climate change.

Finding a way forward

We expect reporting practices to ultimately coalesce around a single set of standards and become more comparable. Until then, ESG standards will vary significantly and comparability within subsectors will be limited. In our view, the ideal metrics will be those that help key stakeholders understand how a utility will measure ESG progress consistently and transparently and translate insights into action and performance improvement, irrespective of the selected disclosure framework.

Even while reporting standards and expectations remain fluid, every utility should aim to show continuous improvement in both reporting and operations. Utilities can no longer risk having others tell their ESG story or cast their efforts as disingenuous greenwashing—they need to take the lead and control both the message and the reality of ESG performance. In short, no utility can afford to be on the wrong side of this powerful global trend.

How KPMG IMPACT can help

With its deep industry-specific global sustainability knowledge, experience, and insight, KPMG helps utilities navigate the evolving ESG landscape. We offer guidance on metrics selection, help utilities assess potential impact and performance in a range of climate scenarios, and craft a compelling narrative for priority stakeholders (institutional investors, ratings agencies, customers, communities, employees, and potential recruits). We also help utilities develop sustainable, repeatable analyses and reporting processes, including well-established approaches to data collection and integrity and pressure testing forward-looking metrics such as anticipated reductions in greenhouse gas emissions. In one case, we were approached by a utility that was being pressed by a major shareholder to improve its ESG performance and reporting. A KPMG team worked with the client to publish its first SASB framework and helped assess its climate risk for TCFD reporting (Exhibit 4).

Exhibit 4. How KPMG helped a utility upgrade its ESG reporting transparency

Rapid assessment	Real partnership	Results driven
— Reviewed the relevant ESG frameworks and those used by industry peers to establish metrics relevant to client operations (and explain exclusion of immaterial metrics) — Identified metrics compliant with SASB guidance or explained gaps and omissions — Reviewed the process and documentation behind in-scope metrics and developed a strategy to close process gaps	— Conducted working sessions with the executive team of the utility to develop and refine the ESG metrics and framework to help identify potential key initiatives to support the overall ESG narrative — Aligned the executive team of the utility on a list of prioritized initiatives and a strategic transformation roadmap. Assisted in translating the metrics and initiatives into a logical roadmap	— Supported the development of the utility's first consolidated materiality assessment to build executive consensus and key messaging for future disclosure documents — Developed the utility's first SASB disclosure, which included all subsidiaries — Produced utility's first TCFD-aligned disclosure

We also help companies integrate ESG considerations into ERM processes to bolster long-term resiliency by aligning ESG issues with top risks to identify and quantify potential gaps. The results of this analysis help clients prepare to withstand and rapidly recover from strategic, operational, enterprise, and climate-related disruptions.[5]

Our services include ESG strategy, ESG risk management, and ESG operationalization (i.e., decarbonization), including renewables development and the circular economy, which enable utilities to understand and adapt to changes in the business landscape by developing responsible and sustainable strategies, business models, operating models, and investments.

[5] See our previous paper, *From managing risk to building resilience.*

About KPMG IMPACT
KPMG IMPACT helps achieve your ESG imperatives. It is a holistic ESG solution that paves a clear path to sustainable business while driving measurable growth today. Our extensive services and capabilities focus on priority issues, such as climate change, sustainable finance, and reporting, with a wide range of data-driven solutions and deep industry expertise. Find out how we can simplify your ESG journey. **Sign up for ESG Alerts at http://visit.kpmg.us/IMPACT.**

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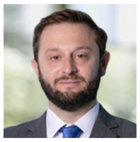
The KPMG Global Energy Institute (GEI) is a worldwide knowledge-sharing forum on current and emerging industry issues. Launched in 2007, the GEI interacts with over 43,000 members through multiple media channels, including audio and video webcasts, publications and white papers, podcasts, events, and quarterly newsletters. Subscribe today to begin receiving valuable insights covering critical business topics and industry issues by visiting **https://institutes.kpmg.us/global-energy.html**.

Contact us

Arun Mani
Principal, Advisory
T: +1 832-648-8513
E: arunmani@kpmg.com



Matthew Broida
Director, Advisory
T: +1 614-202-3369
E:mbroida@kpmg.com

Courtney Ackerman
Associate, Advisory
T: +1 312-665-4152
E:courtneyackerman@kpmg.com

kpmg.com/socialmedia

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