ALL-PARTY PARLIAMENTARY GROUP FOR MUTUALS

BRIEFING NOTE

Environmental, social and governance standards (ESG) for investment

Increasingly, investors are concerned with the environmental, social and governance (ESG) standards of the companies they invest in. Beyond the ethical and moral arguments in favour of good behaviour, it is now clearly of value as one of the necessary tests for capital investment.

The sustainable business

ESG (environmental, social, and governance) has become the preferred terminology for capital markets when assessing the sustainability of a business.

E - environmental criteria

This includes the energy a company uses and the waste it discharges and the consequences for people and the environment as a result. 'E' encompasses carbon emissions and climate change.

S - social criteria

This addresses the relationships a company has and the reputation it fosters with people and institutions in the communities where it does business. ‘S’ also includes labour relations and diversity and inclusion.
G - governance criteria
This relates to the internal systems of practices, controls, and procedures a company adopts in its governance. ‘G’ includes compliance with the law, and relations with all internal and external stakeholders.

Source: ESG Framework, McKinsey

Measuring ESG

The growing awareness in ESG reporting is reflected in the many voluntary standards that have emerged, but the range of initiatives is confusing for both investors and companies trying to develop meaningful reports and assessments. Some ESG reporting standards offer competing alternatives, while others complement each other. Examples include:

- Global Reporting Initiative (GRI) https://www.globalreporting.org/Pages/default.aspx
- International Integrated Reporting Council (IIRC) https://integratedreporting.org
- Sustainability Accounting Standards Board (SASB) https://www.sasb.org

Many standards are industry specific and include both qualitative and quantitative disclosures.

In the IIRC's Integrated Reporting Framework, non-financial information is integrated with standard financial reporting to provide a more rounded picture of a firm's performance.

There is a global initiative to standardise some of this through 'The Corporate Reporting Dialogue' (led by former ASIC Chief Accountant of the IIRC) to seek to bring alignment to the direction, content and ongoing development of reporting frameworks, standards and related requirements.

Much of this voluntary certification has emanated from what is now accepted as established environmental standard setting, but social and governance standards are less defined, often they are loosely based on UN sustainable development goals, which sometimes feel more specific to developing countries. So, meaningful social and governance standards are still to be established, suggesting there is room for the mutual sector to innovate.

One area to look at for inspiration around certification is the development of the B Corp.

Case study: B Corporations

According to this new movement, ‘Certified B Corporations are businesses that meet the highest standards of verified social and environmental performance, public transparency, and legal accountability to balance profit and purpose.’

B Corp Certification doesn’t just evaluate a product or service; it assesses the overall positive impact of the company that stands behind it. Certified B Corporations achieve a minimum verified score on the B Impact Assessment—a rigorous assessment of a company’s impact on its workers, customers, community, and environment—and make their B Impact Report transparent on bcorporation.net. Certified B Corporations also amend their legal governing documents to require their board of directors to balance profit and purpose.

The combination of third-party validation, public transparency, and legal accountability help Certified B Corps build trust and value. B Corp Certification is administered by the non-profit B Lab.

So far, 3,358 firms in 71 countries from 150 industries have been certified.

Source: www.bcorporation.net

Co-operative and mutual business impact & ESG

As business seeks to explore how it can express its impact more positively, and to do this in a measurable way, many firms have elaborated on their business purpose as a way of expressing their good intentions. Yet they cannot escape the basic legal duty that they have to their investor shareholders. There will always be a conflict.

Co-operative and mutual business has an inherent natural advantage over such investor-owned firms in in that it has a clear and unambiguous business purpose.

Co-ops and mutuals have a different purpose from ordinary investor-owned firms. They exist to provide a service to their mutual membership, rather than focussing on capital growth for investors.

Co-operatives and Mutuals are the epitome of a sustainable business

They are established to provide a service rather than to simply grow capital value. Their business focus is naturally suited to meeting these three objectives.

As responsible, sustainable businesses, co-operatives and mutuals should always demonstrate that they meet the Social & Governance criteria as outlined above, and often seek to meet the Environmental too.

E - environmental criteria

Many co-operatives and mutuals are leaders in corporate action on the environment. Often, green energy generation businesses choose to be set up as co-ops partly for this reason. Ultimately, firms will be judged on how their business contributes individually to the sustainable development of their communities by sourcing and investing locally.

S - social criteria

Co-operatives and mutuals are by definition community businesses. Large or small, they are communities of people with a shared objective. They encourage engagement with individuals and organisations in their communities and beyond.

G - governance criteria

Co-operatives and mutuals all operate equitable, one member one vote, governance structures. Democracy and engagement are at the heart of co-operative governance and they will all operate inclusive governance structures that participate with their owner members.

Source: www.mutuo.coop

In terms of attracting external investment funding, the co-operative or mutual's business purpose is an advantage

Co-operatives and mutuals are funded by a mixture of share capital, retained profits, and debt. To appeal to any debt or equity investor, it is an advantage to be clear about what the money is to be used for. The proposition can be no clearer if the business purpose is unambiguous.

If we look at the ESG framework, we can see how any business can test itself against the criteria, and this will be the same for a mutual, except that it will be able to use its corporate status as positive indicator.

In this respect, being a co-operative or mutual per se is an upfront advantage, but only if it is visible from the outside. Co-operatives and mutuals should ensure that they are able to express their business purpose clearly and that this can be shown as a meaningful thread that runs demonstrably through the operations of the business.

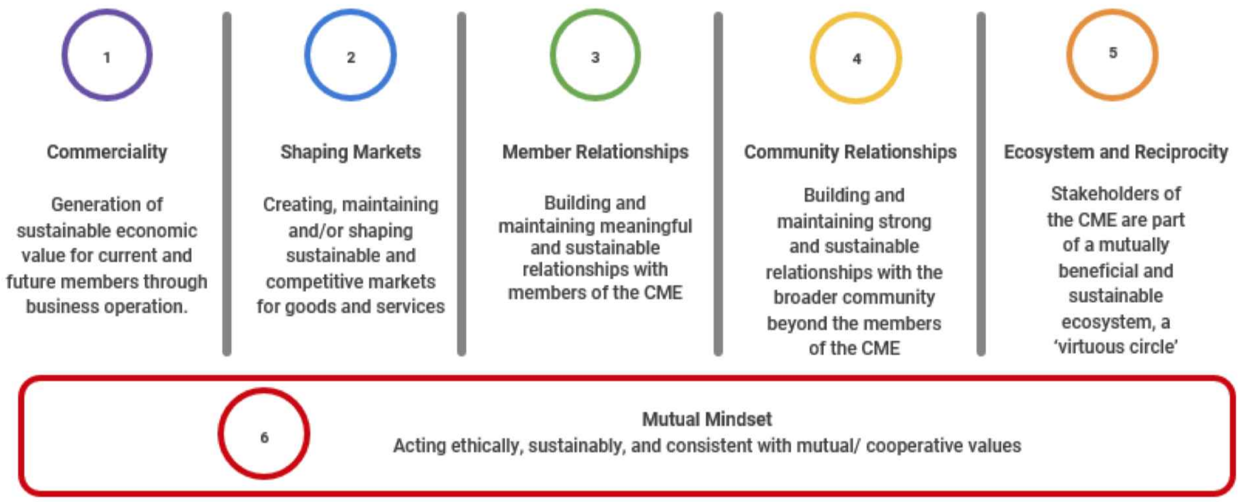
The challenge beyond this for a co-operative or mutual is to demonstrate its value as a mutual. The ground-breaking Mutual Value Measurement (MVM)[1] is a tool which firms could use to do this.

Mutual Value Measurement (MVM)

MVM provides six dimensions of mutual value which can be used to provide the test base and evidence for how an individual co-operative or mutual has an impact in its operations.

Dimensions of Mutual Value

1 Developed in Australia by Monash University and the Business Council of Co-operatives and Mutuals (BCCM)



Source: Monash University/BCCM

Co-operatives and mutuals should engage with impact investors and institutional funds to identify how MVM can be used to boost social and governance credentials for potential debt/equity investment markets.

Once co-operatives and mutuals are able to identify, measure and demonstrate their unique mutual value, they could be in a position to use their mutuality to their advantage in seeking business funding.

Investment in the social purpose of mutuals

Investment is already taking place in mutuals that are able to demonstrate their social impact. The following two examples, one from Australia and one from the UK, show how this area of investment has great potential for growth.

Case study: Australian Unity
In December 2020, Australian Unity issued the first mutual capital instruments to raise $120 million, as part of its ongoing capital management strategy. The proceeds of the offer are to be used for a range of opportunities across the

Australian Unity Group. These include pursuing near-term growth opportunities within the individual. The use of proceeds may also extend to merger and acquisition opportunities across the Australian Unity Group to increase investment in social infrastructure and to help support business consolidations in important mutual sectors such as private health insurance, banking and friendly societies.

Australian Unity Managing Director, Rohan Mead said: "Australian Unity is delighted to issue Australia's inaugural mutual capital instrument and to provide eligible investors with the opportunity to invest in Australian Unity. The Offer will support Australian Unity's ongoing and sustainable growth as it continues to provide health, wealth and care products and services that deliver both community and social value."

Australian pension fund, HESTA, committed $20 million as a cornerstone investor in Australian Unity's issuance, helping to establish a new capital source for the For-Purpose, Mutual sector in Australia. The $56 billion (AUD) industry fund made the investment through its $90 million Social Impact Investment Trust (SIIT). The SIIT aims to catalyse the development of Australia's impact investment market through developing a pipeline of investments designed to earn an appropriate market return and a measurable social impact.

Source: www.australianunity.com.au/media-centre/asx-announcements

Case study: Co-operative Group

In May 2019, in a first for a UK retailer, The Co-operative Group issued a sterling denominated Sustainability Bond, raising £300m to allocate proceeds exclusively on its work on supporting and promoting Fairtrade, including Fairtrade producers and their communities.

The move underlines the Co-op’s unique focus on a better way of doing business which delivers real benefits for members, communities and investors. The Co-op intends to allocate the net proceeds of the Sustainability Bond issuance to the costs of bringing Fairtrade products to customers, marketing and promoting Fairtrade products and wider Fairtrade movement.

The five-year Sustainability bond pays investors an annual interest of 5.125%. Raising funds through a Sustainability Bond allows the Co-op to access long-term funding at an attractive rate and enables global investors to increase their focus on investments that meet the UN’s Sustainable Development Goals and key environmental and sustainability targets.

The Co-op has developed a Sustainability Bond Framework under which any subsequent bond issuance will allow the Co-op to allocate funds to its spend on education, via its Academies Trust, alleviating water poverty, providing access to responsibly sourced products and delivering energy efficient technology to lower emissions.

Commenting on the bond Steve Murrells, CEO of the Co-op, said: “The popularity of this bond demonstrates confidence in the Co-op’s growth strategy and in particular how we’ve placed sustainability at the heart of our future plans.

“Co-op was an early pioneer of Fairtrade and now with the support of like-minded investors we can grow it further, opening up new opportunities and creating value for our members as well as producers and communities in developing countries.”

Source: www.co-operative.coop/investors/reports

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