

**Hughes Hubbard & Reed**



How To ESG:  
A Resource Guide  
for Establishing  
an ESG Program  
for your Company



Hughes Hubbard & Reed LLP • A New York Limited Liability Partnership  
One Battery Park Plaza • New York, New York 10004-1482 • +1 (212) 837-6000

**Attorney advertising.** This advisory is for informational purposes only and is not intended as legal advice.  
Readers are advised that prior results do not guarantee a similar outcome.  
No aspect of this advertisement has been approved by the Supreme Court of New Jersey.

# Acknowledgements

We hope you find this toolkit informative and useful. The book is the product of collaboration across many practices at Hughes Hubbard & Reed. We could not have completed it without the generous efforts of many members of our ESG Practice, whom we wish to thank and acknowledge below. The editors wish to offer special thanks to Valerie Cahan, Stephen Fowler, and Ashley Hodges, without whose dedication, skills, and enthusiasm during the most challenging stages of the project we would not have been able to fulfill our ambitions. We appreciate the encouragement and resources offered to us by The Conference Board ESG Center and the rich insights available through their excellent programs and publications. We all are also grateful for the unflagging support of Leigh Woodworth, of our Marketing & Business Development team, whose experience and management skills kept this train on the rails and headed always in the right direction. Final thanks also to Kim Martin Korda and the design team at Hughes Hubbard, for helping us polish up our final drafts and make them ready for public release.

**Alexandra Poe**  
Editor-in-Chief

alexandra.poe@hugheshubbard.com

**Andrew F. Fowler**  
Editor

andrew.fowler@hugheshubbard.com

**Bryan Sillaman**  
Editor

bryan.sillaman@hugheshubbard.com

---

**Principal Authors** Andrew F. Fowler, Laura Perkins, Alexandra Poe, Bryan Sillaman

**Contributors** Arnaldo Bernardi, M. Shams Billah, Valerie Cahan, George Cortina, Stephen Fowler, Federico Goudie, Steven Greene, Ashley Hodges, Javad Husain, Ernesto Lappe, Sergon Sancar, Taylor Skaggs, Nicolas Tollet.

**With the assistance of** Talia Helfrick, Ismail Houdi, Win Jordan, Richard Silverberg.

# Foreword

*"[T]he challenge is in the moment; the time is always now."*

—James Baldwin

Capital has an impact. Invest in something, and you're giving it fuel to grow and an expression of confidence. Divest, and you signal a reversal of sentiment or lack of confidence in a company's prospects. Investment, divestment, exercising shareholder rights, and setting loan terms have long been guided solely by traditional financial analysis. Over the last twenty years or more, an idea has been germinating: there may be factors not included in traditional financial analysis that can have a meaningful financial impact on a company's prospects. Coverage of this topic often focuses on the value judgments inherent in caring about the environment and our communities, but other views simply posit that environmental, social and governance (ESG) risk is simply investment risk. Many investors around the world have long been focused on factors like climate change, the finiteness of natural resources, the value of diversity in leadership, and the impact of systemic social or economic justice. These early adopters launched initiatives to identify the information needed to assess these sorts of risks and opportunities to the companies in which they invest.

The scientific urgency of climate change, in particular, has driven these once liminal questions into the limelight. In 2021, years of stolid criticism of ExxonMobil's intransigence on the climate crisis were washed away in a historic proxy contest. Shareholders, led by tiny, activist hedge fund, Engine No. 1, elected three of their nominees to the Board, seeking more earnest leadership in service of sound, science-based strategies for the fossil fuel giant, because the shareholders believed that to be the more financially sound choice. Momentum toward values-aligned conduct can also be credited in the incredibly swift pace of private sector actions to isolate Russia economically, in reaction to its current invasion of Ukraine. Even President Biden's recent executive order directing the Treasury Secretary and all federal agencies to advance United States policy and preparedness around the risks and opportunities of cryptocurrency was motivated, in part, by the importance of financial inclusion to the national interest.

Many of the topics discussed are objects in motion, complex to begin with, sensitive to changing circumstances, and subject to laws that are still evolving. This book is a creature of its time. It is meant to address issues in establishing an ESG Program in the present moment. For the most part, we tried not to dwell on issues that were of the moment thirty, ten, five, or even two years ago. The circumstances prevailing now are what matter most to personnel charged with creating a company's ESG program, so we endeavor to provide a chart for the road ahead, not the one in the rearview mirror. This involved making choices like focusing on existing SEC guidance on corporate financial disclosures, even as we note the new, headline-making rule proposal on this subject released in March 2022, which may yet undergo many shifts and changes before it becomes law.

At the same time, this book addresses the prevailing expectations of regulators and investors that companies ready themselves to move beyond policy to action, to calibrate action to the true nature of problems and opportunities, to move beyond boilerplate to customized disclosures and science-based targets, to engage a wider set of voices, and to be steadfast and nimble in execution. We aim to give guidance, support, resources, and encouragement to companies in this crucial stage of transformation.

**Alexandra Poe**

Editor-in-Chief

# Table of Contents

<b>DEFINING ESG FOR YOUR FIRM.</b> . . . . .	<b>1</b>
1.1 Frameworks for Disclosure . . . . .	2
1.2 Benchmarking ESG Practices . . . . .	8
<b>ESTABLISHING THE ESG RESPONSE TEAM AND THEIR REMIT</b> . . . . .	<b>12</b>
2.1 The Goal Setters. . . . .	14
2.2 The Program Developers. . . . .	14
2.3 The Inside Consultants . . . . .	15
2.4 The Outside Consultants. . . . .	16
2.5 The Government . . . . .	20
2.6 The Peer Group. . . . .	20
2.7 The Compliance Team . . . . .	21
<b>REGULATIONS AND FORESEEABLE DEVELOPMENTS</b> . . . . .	<b>22</b>
3.1 European Union. . . . .	23
3.2 United States . . . . .	29
3.3 United Kingdom. . . . .	36
3.4 Asia. . . . .	37
3.5 Africa . . . . .	40
3.6 Australia – New Zealand . . . . .	43
3.7 Latin America . . . . .	45
<b>ESG FOR LENDERS AND BORROWERS</b> . . . . .	<b>49</b>
4.1 Overview of Sustainability-Linked Loans and Green Loans Guidance . . . . .	50
4.2 Gender Lens Loans: A Useful Guide to ESG Lending . . . . .	54
4.3 Values-Based Finance: A Case Study of Islamic Finance . . . . .	56
<b>ESG FOR OPERATING COMPANIES</b> . . . . .	<b>62</b>
5.1 Public Company Financial Disclosures . . . . .	63
5.2 Stakeholder Capitalism . . . . .	71
5.3 Shareholder Activism . . . . .	76
5.4 Public vs. Private Companies. . . . .	79

<b>ESG FOR FUNDS AND ADVISERS.</b>	<b>81</b>
6.1 Use of ESG Considerations in Investment Practices	82
6.2 Applicable Law and Regulation	83
6.3 Additional Disclosure Guidelines	88
6.4 Measuring Impact.	95
6.5 Qualified Benefit Plans/Fiduciary Duty	96
<b>TOPICS YOUR ESG PROGRAM MAY COVER</b>	<b>99</b>
7.1 Net Zero and Carbon Reduction Pledges	100
7.2 Nature-Related Disclosures: Beyond Climate	105
7.3 Diversity, Equity, and Inclusion	112
7.4 Duty of Care and Anti-Slavery	116
<b>ESG INVESTIGATIONS AND ENFORCEMENT</b>	<b>119</b>
8.1 When the Need for Investigation Arises	120
8.2 Conducting the Investigation	121
8.3 Remediation.	128
<b>*Glossary of ESG-Related Terms</b>	<b>129</b>
<b>*ESG Toolkit Index of Organizations</b>	<b>133</b>



1

## **Defining ESG for Your Firm**

# Defining ESG For Your Firm

## 1.1 FRAMEWORKS FOR DISCLOSURE

---

*“The pace of evolution of the ESG reporting landscape over the last 12 months against the backdrop of a global pandemic has been dizzying, even to the most seasoned pundit. . . . [W]e have once again seen a dramatic increase in companies reporting against the Task Force on Climate-related Financial Disclosure Recommendations (TCFD) in 2020-21. However, the vast majority continue to produce a standalone TCFD report, failing to integrate the risks and opportunities into their general-purpose reporting . . . The alphabet soup of reporting frameworks, standards and approaches has often been blamed for companies not telling one story or even reporting in the first place.”—Mardi McBrien, Executive Director, Climate Disclosure Standards Board, Foreword to World Business Council for Sustainable Development, Reporting Matters, at 6 (2021).*

When companies address their ESG disclosure practices, they must first determine what to disclose and how and where to disclose it. These determinations are complicated by the fact that the United States has not yet adopted new securities laws or regulations specifically mandating climate risk disclosures by operating companies, although new rules were proposed in the first half of 2022.<sup>1</sup> At the same time, companies that also have primary or affiliated operations or reporting obligations in Europe, the UK, or other jurisdictions are already subject to new regulations, in particular the EU Taxonomy Directive and the EU Sustainable Financial Disclosure Regulation (“SFDR”). Companies are also confronted by investor expectations that disclosures be meaningful and consistent across companies and even industries, an expectation that has given rise to the “alphabet soup” of private sector disclosure frameworks.

### Private Sector Frameworks

It is fair to say that the effort to create a common framework for ESG goal-setting and disclosures started with the publication of the United Nations’ Principles for Responsible Investment in 2006, primarily targeted at promoting and supporting investors’ concerns, and its seventeen Sustainable Development Goals, finally adopted by all UN Member States in 2015. On the heels of that, institutional investors and capital markets analysts from both sides of the Atlantic Ocean launched the Task Force on Climate-related Financial Disclosures (“TCFD”), also in 2015, to apply pressure to issuers to develop disclosure practices that investors believe are needed to keep markets healthy, including full and fair climate-related risk disclosure. Framework publishing and standard setting exploded from there.

---

<sup>1</sup> See Chapters 3.2—United States, 5.1—Public Company Financial Disclosures, and 6.2—Applicable Law and Regulation.

Many organizations launched efforts to offer guidance to companies on how to evaluate their ESG risks, goals, and performance, seeking to provide some standardization so that market participants could compare apples to apples.<sup>2</sup> Many of these publishers are listed and their work described in the Glossary of Terms and Index of Organizations at the end of this book.

Over time, so many organizations published frameworks for analyzing or ranking a company's progress towards ESG objectives that the pendulum is swinging the other way. Framework publishers themselves acknowledged the unwieldiness of so many competing standards, and began convening and converging to bring an excess of taxonomies into alignment with one another. In September 2020, for example, five principal framework publishers, the Sustainability Accounting Standards Board ("SASB"), International Integrated Reporting Council ("IIRC"), Global Reporting Initiative ("GRI"), Climate Disclosure Standards Board ("CDSB"), and Carbon Disclosure Project ("CDP"), issued a joint Statement of Intent to work together to find alignment and to distinguish financially material sustainability information from other relevant information, such as the external economic, environmental, and social impacts of a company's business operations.<sup>3</sup> That same month, the World Economic Forum International Business Council and the four major global accounting firms released a report, "Measuring Stakeholder Capitalism: Towards Common Metrics and Consistent Reporting of Sustainable Value Creation."<sup>4</sup> In June 2021, SASB and IIRC announced their merger, forming the Value Reporting Foundation to pursue alignment of two of the most influential U.S. and non-U.S. reporting standards.<sup>5</sup>

The EU Regulatory Authority, in passing the EU Taxonomy Regulation, delayed endorsing any published framework until further study and convergence efforts can be concluded. Along those lines, at COP26 in November 2021, IFRS Foundation launched the ISSB, consolidating several smaller organizations and their technical and financial reporting frameworks, into unified international sustainability reporting standards.<sup>6</sup> IFRS Foundation recently announced the appointment of former Danone chairman and corporate ESG pioneer, Emmanuel Faber, to lead the effort.

---

2 See generally Minji Xie & Anke Schrader, Sustainability Reporting Is Hard – Will It Get Easier in the Future?, CONFERENCE BOARD (Aug. 2021), <https://www.conference-board.org/topics/ESG-reporting/sustainability-reporting-is-hard-will-it-get-easier>, & <https://www.conference-board.org/topics/ESG-reporting/sustainability-reporting-is-hard-will-it-get-easier-appendix-A> (reviewing harmonization efforts around sustainability reporting).

3 *Statement of Intent to Work Together Towards Comprehensive Corporate Reporting*, [VALUE REPORTING FOUND]. (Sept. 2020), <https://29kjwb3armds2g3gj4lq2sx1-wpengine.netdna-ssl.com/wp-content/uploads/Statement-of-Intent-to-Work-Together-Towards-Comprehensive-Corporate-Reporting.pdf>.

4 WORLD ECONOMIC FORUM, MEASURING STAKEHOLDER CAPITALISM TOWARDS COMMON METRICS AND CONSISTENT REPORTING OF SUSTAINABLE VALUE CREATION (Sept. 2020), [https://www3.weforum.org/docs/WEF\\_IBC\\_Measuring\\_Stakeholder\\_Capitalism\\_Report\\_2020.pdf](https://www3.weforum.org/docs/WEF_IBC_Measuring_Stakeholder_Capitalism_Report_2020.pdf).

5 Janine Guillot, *Welcome Remarks from the CEO*, VALUE REPORTING FOUNDATION (June 16, 2021), <https://www.valuereportingfoundation.org/news/welcome-remarks-from-the-ceo/>.

6 The IFRS Foundation will also complete consolidation of the CDSB and the Value Reporting Foundation (which houses the Integrated Reporting Framework and the SASB Standards) by June 2022. Press Release, Value Reporting Foundation, IFRS Foundation Announces International Sustainability Standards Board (Nov. 3, 2021), <https://www.valuereportingfoundation.org/news/ifrs-foundation-announcement/>.

Issuers' efforts at ESG reporting and disclosure generally start by surveying the voluntary and regulatory frameworks to discern applicability, utility, and overlap. Issuers will note that stakeholders in U.S. operating companies were heard during the recent proxy seasons both endorsing and critiquing published frameworks. First, some of the most influential U.S. institutional investors endorsed frameworks put forward by TCFD, SASB, and Principles for Responsible Investment.<sup>7</sup> Shortcomings of each framework quickly emerged, such as complaints that SASB's industry-specific standards pose questions on topics not applicable to certain companies, whose "performance" may then be downgraded for having nothing to say on those topics. Investors and other stakeholders also realized that rigid adherence to the broad frameworks resulted in massive reports that were difficult to digest, and may prevent an issuer from focusing on the challenges and opportunities material to its specific circumstances. Investors benefit from consistency across issuers but, at the same time, wish to avoid approaches that produce too much information and too little intelligence.<sup>8</sup> Looking ahead, companies can expect investors and other stakeholders will want reporting that is shorter, more focused, more timely, and more incisive in tying ESG efforts to value creation, the achievement of science-based targets on climate-risk mitigation, and other customized strategic goals.<sup>9</sup>

For issuers, the emergence of ESG ratings agencies and data collection and reporting by framework publishers further complicates the landscape. Companies that do not report into these facilities risk the inference that the company is not attending to climate risk or other ESG matters. Companies that do report add complexity to their reporting efforts, in that such reporting must also be aligned with their disclosures in regulated reports and other voluntary corporate social responsibility ("CSR") and sustainability reports. As a result, issuers are choosing to be more selective, disclosing which monitors they report to and why they chose not to report to others.

## Government Frameworks

**The United States.** U.S. public companies reporting on ESG issues currently may disclose ESG matters in offering documents, financial statements, or proxy statements (together, "regulated reports") or in separate, voluntary sustainability reports. U.S. law governing regulated reports requires complete and accurate disclosure, free from material omissions, of all information that is material to a company's financial and operational risks

---

7 See, e.g., Barbara Novick et al., *Towards a Common Language for Sustainable Investment*, BLACKROCK (Jan. 2020), <https://www.blackrock.com/corporate/literature/whitepaper/viewpoint-towards-a-common-language-for-sustainable-investing-january-2020.pdf>; Cyrus Taraporevala, *CEO's Letter on Our 2020 Proxy Voting Agenda*, STATE STREET GLOBAL ADVISORS (Jan. 28, 2020), <https://www.ssga.com/us/en/institutional/ic/insights/informing-better-decisions-with-esg>; Investment Stewardship 2019 Annual Report, VANGUARD (Aug. 29, 2019), [https://www.wlrk.com/files/2019/Vanguard\\_2019\\_Annual\\_Report\\_Investment\\_Stewardship.pdf](https://www.wlrk.com/files/2019/Vanguard_2019_Annual_Report_Investment_Stewardship.pdf); Sustainability Accounting Standards Board, *The State of Disclosure 2017*, VALUE REPORTING FOUNDATION (Dec. 1, 2017), <https://www.sasb.org/knowledge-hub/state-of-disclosure-2017/>; Letter from Cynthia A. Williams & Jill E. Fisch to Brent J. Fields, Secretary, SEC (Oct. 1, 2018), <https://www.sec.gov/rules/petitions/2018/petn4-730.pdf> (enclosing a petition for rulemaking to the SEC on standardized disclosure related to environmental, social, and governance ESG issues, signed by investors and organizations representing more than \$5 trillion in assets under management).

8 See THE CONFERENCE BOARD, ESG CENTER, <https://www.conference-board.org/us/environmental-social-governance> (last visited Jan. 4, 2022).

9 See, e.g., *Recommendation of the SEC Investor Advisory Committee Relating to ESG Disclosure*, SEC (May 21, 2020), <https://www.sec.gov/spotlight/investor-advisory-committee-2012/esg-disclosure.pdf>.

and results. Much has been written on the subject of determining what is material, from the basic principle that materiality is in the eye of the ordinary investor<sup>10</sup> to the challenge of mathematical determinations of materiality based on company assets, income and liabilities.<sup>11</sup>

With two exceptions—human capital<sup>12</sup> and board diversity<sup>13</sup>—U.S. lawmakers and regulators have not mandated any specific topics to cover, so companies must educate themselves about ESG topics, and decide which, if any, will be addressed, and where and how to address them. Companies have historically been slow to volunteer disclosure in regulated reports because of the liability for misleading statements and omissions, which is heightened in the context of rapidly evolving science, industry standards, and investor expectations.

Two developments may change all that and encourage companies to do more on climate risk-related disclosures. First, investor expectations about these disclosures have advanced rapidly. In the last 24 months, imperatives have shifted from expecting that companies will have assessed relevant risks and developed policies to address them to an expectation that companies will have adopted science-based targets for emissions reductions and started acting to achieve them. Investors have growing data sets to consult, from private sector disclosure frameworks to watchdog reports and ratings agency releases that rank individual company progress toward Net Zero 2050 and other climate risk mitigation goals.<sup>14</sup> As investors focus on company progress from policy setting to action, this may affect company assessments about what is, in fact, material to investors.

---

10 The Supreme Court has articulated the standard of materiality, stating that something is material if there is “a substantial likelihood that the disclosure of the omitted fact would have been viewed by the reasonable investor as having significantly altered the ‘total mix’ of information made available.” *Basic Inc. v. Levinson*, 485 U.S. 224, 231-32 (1988) (quoting *TSC Industries, Inc. v. Northway, Inc.*, 426 U.S. 438, 449 (1976)). The SEC has adopted a similar definition of materiality in the context of financial statements, providing that “[a] matter is ‘material’ if there is a substantial likelihood that a reasonable person would consider it important. . . . The omission or misstatement of an item . . . is material if, in the light of surrounding circumstances, the magnitude of the item is such that it is probable that the judgment of a reasonable person relying upon the report would have been changed or influenced by the inclusion or correction of the item.” SEC Staff Accounting Bulletin No. 99, 64 Fed. Reg. 45150 (Aug. 12, 1999).

11 While no standard mathematical formula is universally accepted, accounting and auditing firms regularly assist clients with such evaluations on a case-by-case basis.

12 Modernization of Regulation S-K Items 101, 103, and 105, Securities Act Release No. 10825, Exchange Act Release No. 89670, 85 Fed. Reg. 63726 (Oct. 8, 2020) (to be codified at 17 C.F.R. pts. 229, 239, and 240) (amendment to Rule 101(c) in Regulation SK, mandating financial statement disclosure about a company’s human capital). Even this development leaves the actual content of such disclosure unclear as “human capital” is not defined, and the aspects of human capital to be addressed are not stipulated in detail. See Ganesh M. Pandit, *First Look at the Human Capital Disclosures on Form 10-K: Analyzing the SEC Mandate and Comparing it to SASB and EU Standards*, CPA J. (Aug./Sept. 2021), <https://www.cpajournal.com/2021/10/27/first-look-at-the-human-capital-disclosures-on-form-10-k/>. For further discussion, see Chapter 3.2—United States, SEC Regulation of Social and Governance Disclosures.

13 The new requirement affects Nasdaq-listed issuers. Rules adopted in August 2021 will require a listed company to disclose, in a specific matrix format, whether or not its board of directors is diverse. A Nasdaq-listed company whose board does not include at least one woman and one person who is either an under-represented minority or a member of the LGBTQ+ community also must disclose why board composition is not diverse. For further discussion, see Chapter 3.2—United States, SEC Regulation of Social and Governance Disclosures.

14 See, e.g., SCIENCE BASED TARGETS, <https://sciencebasedtargets.org/> (last visited Feb. 14, 2022); CLIMATE ACTION TRACKER, <https://climateactiontracker.org/> (last visited Feb. 14, 2022); CERES ROADMAP 2030, <https://roadmap2030.ceres.org> (last visited Feb. 14, 2022); UN ENVIRONMENT PROGRAMME FIN. INITIATIVE, TARGET SETTING PROTOCOL (2d ed. 2022), <https://www.unepfi.org/wordpress/wp-content/uploads/2022/01/NZAOA-Target-Setting-Protocol-Second-Edition.pdf>.

Second, on March 21, 2022, the SEC published a long-awaited rule proposal that would amend public filing disclosure requirements to enhance and standardize climate-related disclosures.<sup>15</sup> The proposed rules substantially endorse the TCFD framework for reporting companies. While there are already significant headwinds confronting the proposed rules' adoption, from legal challenges to the SEC's authority to the proposed rules' length and complexity, their publication demonstrates the Commission's intentions, which, in turn, may add teeth to the SEC guidance already in effect. See Chapters 3.2—United States and 5.1—Public Company Financial Disclosures for further discussion of the Climate Disclosure Rule Proposal.

The SEC first addressed climate-related disclosure in regulated reports in 2010, stating that climate-related risks were no different than any other risks, and must be disclosed if the issuer deems them to be material or necessary to make other required statements, in light of the circumstances under which they were made, not misleading.<sup>16</sup> The 2010 Guidance flagged examples of climate-related topics, including the physical effects of climate change (such as flood risk to real estate assets, facilities, and capital equipment); legislative and regulatory developments (such as the long-running debate over whether a policy shift toward carbon caps would result in write-downs for oil companies with stranded assets); and business and market impacts (such as decline in consumer demand for products perceived to harm the climate, or increases in insurance premiums for assets at risk).<sup>17</sup>

By 2021, the admonishments of the 2010 Guidance and the SEC efforts to enforce them were seen as inadequate, and the advanced understanding of climate risk as a scientific reality demanded that issuers revisit their determinations of materiality. New executive orders instructed federal agencies to consider the climate crisis and adapt their policies. In addition, developments in law and policy in Europe, the UK and other jurisdictions required companies with international operations to fulfill new reporting obligations. Accordingly, the SEC Division of Corporate Finance published its Sample Letter to Companies Regarding Climate Change Disclosures, offering issuers insight into the SEC Staff's expectations for climate-related disclosures.<sup>18</sup> Issuers are now obliged to consider material effects of each topic in the 2021 Guidance on the company's business, financial condition, and results of operations.

---

<sup>15</sup> The Enhancement and Standardization of Climate-Related Disclosures for Investors, Securities Act Release No. 11042, Exchange Act Release No. 94478, 87 Fed. Reg. 21334 (Apr. 11, 2022) (proposed Mar. 21, 2022) (to be codified at 17 C.F.R. pts. 210, 229, 232, 239, and 249) (the "Climate Disclosure Rule Proposal").

<sup>16</sup> Commission Guidance Regarding Disclosure Related to Climate Change, Securities Act Release No. 9106, Exchange Act Release No. 61469, Financial Reporting Release No. 82, 75 Fed. Reg. 6289 (Feb. 8, 2010) (the "2010 Guidance").

<sup>17</sup> For example, many insurance companies are phasing out coverage for coal-related businesses or limiting insurance for business in communities repeatedly threatened by wildfires. Esther Mobley, *California announces changes to ease the thorny problem of fire insurance for vintners, farmers*, S.F. CHRONICLE (Oct. 12, 2021), <https://www.sfchronicle.com/food/article/Winemakers-and-farmers-should-be-able-to-get-16527875.php>; Lauren Hirsch, *Large Insurers Are Hatching a Plan to Take Down Coal*, N.Y. TIMES (Nov. 21, 2021), <https://www.nytimes.com/2021/11/23/business/dealbook/insurance-companies-coal.html>.

<sup>18</sup> *Sample Letter to Companies Regarding Climate Change Disclosures*, DIV. OF CORP. FIN. SEC (Sept. 22, 2021), <https://www.sec.gov/corpfin/sample-letter-climate-change-disclosures> (the "2021 Guidance").

The 2021 Guidance notes that the SEC Staff, in reviewing required reports, will focus on discrepancies between statements made in required reports versus those made in voluntary sustainability or CSR reports, and risk factors such as potential operational and compliance burdens of policy and regulatory changes and climate change-related litigation risks. The SEC Staff expects the MD&A section of financial reports to address material pending and existing climate change-related legislation, regulations, and international accords; material past and future capital expenditures on climate-related projects; indirect consequences of climate-related regulation or business trends, *e.g.*, on demand, competition, and reputational risk; and physical effects of climate change, including extreme weather events, costs of insurance against climate risks, and effect on local agricultural capacity. Although the 2021 Guidance does not specifically call out supply chain costs and disruptions in general, it is reasonable to expect interest in this topic in light of headline-making disruptions across industries and the country. Issuers should also quantify any material increase in compliance costs and disclose the purchase or sale of carbon credits or offsets. The 2021 Guidance does not constitute an exhaustive list of topics the SEC Staff may comment on, and issuers may consider it by analogy in assessing disclosure on other ESG related topics.

**The European Union and UK.** Europe and the UK’s regulations include frameworks in some cases, and/or embrace private sector frameworks such as TCFD. For further discussion, see Chapters 3.1—European Union, 3.3—United Kingdom, and 6.2—Applicable Law and Regulation.

## Action Plan

In light of the proliferation of disclosure frameworks, and until such time as they may converge or align their requirements, a reporting company can take these steps:

- Determine which frameworks are obligatory (such as U.S. required reports, EU required reports, and reporting required in other jurisdictions), and reporting required under a voluntary framework the company has contractually agreed to follow, if any (“total required reports”).
- Determine the disclosure standard in each of the total required reports, such as financial materiality or other dual or dynamic materiality test.
- If not among the company’s total required reports, become familiar at least with SASB/IIRC, TCFD and GRI frameworks, as these are the most widely-embraced frameworks. Research the availability of guidance or analysis on disclosure standards addressed specifically to your industry.
- Determine what topics are material or otherwise reportable for the company to disclose in total required reports.

- Create a centralized or coordinated review function to promote consistency across disclosure documents, including those required by regulation, voluntary disclosures such as sustainability or CSR reports, websites, marketing materials, and responses to requests for proposals.
- Establish a role for personnel in ESG compliance and/or corporate compliance to assure disclosures are consistent with the company's ESG and corporate compliance programs, as applicable.
- Consider use of disclaimers to disclose why the company chose not to report to certain framework publishers or progress monitors or, if reporting without completing all items, why certain items are inapplicable.
- Establish a monitoring and testing capability for claims that are capable of confirmation by testing outcomes or progress.
- Establish a procedure to keep executive leadership and the board informed, involved, and accountable for disclosure practices.

## 1.2 BENCHMARKING ESG PRACTICES

---

"At the end of 2021, more than 2,200 companies covering over a third of global economy market capitalization were working with the SBTi – a rate of more than 110 new companies per month."

—Science Based Targets Initiative, 2021 Annual Report<sup>19</sup>

After a company has decided, generally, what to address in its ESG program, it faces the question "what's next?" Industry benchmarks and peer studies are useful for answering this question. These tools help companies decide how to set strategy, pursue goals, identify weaknesses, close gaps, measure progress, and publicize the company's progress to stakeholders.<sup>20</sup> This is where the rubber is hitting the road at the date of publication of this toolkit. Concerned stakeholders expect companies to be moving beyond strategy-setting exercises and policy development to measurable progress toward ESG Program goals, especially, but not exclusively, with regard to greenhouse gas (GHG) emissions.

---

<sup>19</sup> SCIENCE BASED TARGETS, SCIENCE-BASED NET-ZERO SCALING URGENT CORPORATE CLIMATE ACTION WORLDWIDE: SCIENCE BASED TARGETS INITIATIVE ANNUAL PROGRESS REPORT, 2021, 6 (June 2022), <https://sciencebasedtargets.org/resources/files/SBTiProgressReport2021.pdf>

<sup>20</sup> According to an April 2021 survey of ESG and communications executives, the Conference Board Found that the number one reason behind companies' decision to use sustainability reporting frameworks was to "Inform/guide sustainability strategy." See *Navigating Sustainability Reporting Frameworks: A Practical Guide*, CONFERENCE BOARD (Dec. 1, 2021), <https://www.conference-board.org/pdfdownload.cfm?masterProductID=38219/>.

Several organizations have developed (or are developing) industry-specific resources to help companies set and achieve concrete targets.

- As discussed in Chapter 1.1—Frameworks for Disclosure, SASB has focused on industry-specific standards, using its own Sustainable Industry Classification System (SICS) to group companies based on sustainability profiles rather than financial and market characteristics.<sup>21</sup> SASB’s framework includes sustainability accounting standards for 77 different industries within 11 different sectors: Consumer Goods, Extractives & Minerals Processing, Financials, Food & Beverage, Health Care, Infrastructure, Renewable Resources & Alternative Energy, Resource Transformation, Services, Technology & Communications, and Transportation.<sup>22</sup> In line with its sector-based approach, SASB has a number of tools available for investors and companies seeking to benchmark their ESG programs, including case studies from the perspective of companies (<https://www.sasb.org/company-use/case-studies/>) and investors (<https://www.sasb.org/investor-use/case-studies/>).
- Similarly, GRI has begun to develop industry-specific standards for 40 prioritized sectors.<sup>23</sup> The GRI Sector Program is intended “to focus sustainability reporting issues that matter most from a sustainable development perspective, leading to a stronger foundation for sustainable decision-making.”<sup>24</sup> GRI’s Sector Standards for the oil and gas (<https://www.globalreporting.org/standards/standards-development/sector-standard-for-oil-and-gas/>) and coal sectors are both now available for public use (<https://www.globalreporting.org/standards/standards-development/sector-standard-for-coal/>). Forthcoming Sector Standards include the standards for agriculture, aquaculture, and fishing, which is open to public comment (<https://www.globalreporting.org/standards/standards-development/sector-standard-project-for-agriculture-aquaculture-and-fishing/>), and a Sector Standard for mining (<https://www.globalreporting.org/standards/standards-development/sector-standard-project-for-mining/>), which is currently under development.

---

21 VALUE REPORTING FOUNDATION, FIND YOUR INDUSTRY, <https://www.sasb.org/find-your-industry/> (last visited July 5, 2022).

22 SASB’S SUSTAINABLE INDUSTRY CLASSIFICATION SYSTEM (SICS®), <https://www.sasb.org/wp-content/uploads/2018/11/SICS-Industry-List.pdf>; See *Navigating Sustainability Reporting Frameworks: A Practical Guide*, CONFERENCE BOARD (Dec. 1, 2021), <https://www.conference-board.org/pdfdownload.cfm?masterProductID=38219/>.

23 GSSB, GRI SECTOR PROGRAM—REVISED LIST OF PRIORITIZED SECTORS 3 (Nov. 19, 2020), <https://www.globalreporting.org/media/mqznr5mz/gri-sector-program-list-of-prioritized-sectors.pdf>.

24 GSSB, GRI SECTOR PROGRAM 2 (Feb. 7, 2019), [https://globalreporting.org/media/cqxldusf/gri\\_sector\\_program\\_description.pdf](https://globalreporting.org/media/cqxldusf/gri_sector_program_description.pdf).

- o The Science Base Targets Initiative (SBTi) is a multi-organizational<sup>25</sup> initiative to develop targets “for companies and financial institutions to reduce GHG emissions, helping prevent the worst impacts of climate change and future-proof business growth” consistent with the attainment of the targets in the Paris Accord.<sup>26</sup> SBTi asks companies to commit to a process by which they develop, submit, communicate, and disclose science-based GHG emissions targets (“SBTs”).<sup>27</sup>
- o To assist companies achieve these goals, SBTi has developed a comprehensive series of tools to assist companies set individualized SBTs, including a near term target-setting guide (<https://sciencebasedtargets.org/resources/files/SBTi-How-To-Guide.pdf>) and a comprehensive SBT manual (<https://sciencebasedtargets.org/resources/legacy/2017/04/SBTi-manual.pdf>).
- o SBTi also has a target validation procedure for Small and Medium-Sized Enterprises (SMEs) (<http://form.jotform.co/targets/sme-target-validation>).
- o SBTi has also developed sector-specific guidance documents for the following industries: apparel and footwear, aviation, chemicals, information and communication technology (ICT), and transport. Additional sector-specific guidance and methods for the following additional industries is in progress: aluminum, buildings, cement, chemicals, forests, land and agriculture, steel, oil, and gas (<https://sciencebasedtargets.org/sectors>).
- o Case studies include: Coca-Cola, Klöckner & Co, AstraZeneca, Pfizer, Procter & Gamble, Sony, Tesco, and Wipro (<https://sciencebasedtargets.org/companies-taking-action/case-studies>).

---

25 SBTi is a partnership among CDP (formerly the Carbon Disclosure Project), World Resources Institute (“WRI”), the World Wide Fund for Nature (“WWF”), and the United Nations Global Compact (“UN Global Compact”). It is worth noting that SBTi receives significant funding from corporations and corporate foundations and has been criticized for having a conflict of interest as a result. SBTi maintains a conflict of interest policy and can expect continued scrutiny of the integrity of its evaluations of corporate goal-setting and progress.

26 *What is the Science Based Targets Initiative (SBTi)?*, SCIENCE BASED TARGETS, <https://sciencebasedtargets.org/faqs#what-are-science-based-targets> (last visited July 5, 2022).

27 *How it Works*, SCIENCE BASED TARGETS, <https://sciencebasedtargets.org/how-it-works> (last visited July 5, 2022).

- o SBTi also publishes field-building work on measurement, reporting, and verification of SBTs, and is developing ways to increase engagement among companies in Asia, Latin America, and Africa.
- o A complete set of SBTi's resources is available at <https://sciencebasedtargets.org/resources/?tab=develop#resource>.
- Climate Action 100+ is an initiative coordinated by five regional investor networks: the Asia Investor Group on Climate Change (AIGCC), Ceres, Investor Group on Climate Change (IGCC), Institutional Investors Group on Climate Change (IIGCC), and Principles for Responsible Investment.<sup>28</sup> The group's Net-Zero Company Benchmark "assesses the performance of focus companies against the initiative's three high-level goals: emissions reduction, governance, and disclosure."<sup>29</sup> Company assessments include two broad types of indicators: "Disclosure Framework Indicators" which evaluate the adequacy of corporate disclosure, and "Alignment Assessments" which evaluate the alignment of company actions with the Paris Agreement goals.<sup>30</sup> Currently, the project includes 166 focus companies which account for up to 80 percent of corporate industrial greenhouse gas emissions.<sup>31</sup>
  - o Full data sets for the Net-Zero Company Benchmark including individual assessments for each of the current 166 focus companies are available on the Climate Action 100+ website (<https://www.climateaction100.org/whos-involved/companies/>).

---

28 *About Climate Action 100+*, CLIMATE ACTION 100+, <https://www.climateaction100.org/about/> (last visited July 5, 2022).

29 *Net Zero Company Benchmark*, CLIMATE ACTION 100+, <https://www.climateaction100.org/net-zero-company-benchmark/> (last visited July 5, 2022).

30 *Net Zero Company Benchmark: Structure and Methodologies*, CLIMATE ACTION 100+, <https://www.climateaction100.org/net-zero-company-benchmark/methodology/> (last visited July 5, 2022).

31 *Companies*, CLIMATE ACTION 100+, <https://www.climateaction100.org/whos-involved/companies/> (last visited July 5, 2022).



# 2

## **Establishing the ESG Response Team and Their Remit**

# Establishing the ESG Response Team and Their Remit

One of the first steps in launching an ESG Program is identifying the people who will build the program. Choices made in staffing the ESG Response Team will reflect the company’s existing values and influence outcomes. Accordingly, it is important to assemble an ESG Response Team that is forward-looking and reflects the company’s aspirations.

An ESG Response Team should include employees of multiple seniorities, be functionally diverse, and be culturally inclusive. Functional diversity comes from staffing the ESG Response Team with employees from different functions within the company and with varying roles within those functions. Cultural inclusion comes from engaging persons of different racial, ethnic, and religious backgrounds, differently abled persons, as well as people with varied sexual orientations and gender identities, in a way that is reflective of the company and its stakeholders.

This chapter describes an approach to building the ESG Response Team for relatively large companies, but it may be adapted for smaller ones where personnel may wear more than one hat. We describe the proposed members of the ESG Response Team using functional terms and titles, and expect each company will use its own nomenclature for individuals or groups that will be members of its own ESG Response Team.

If your company has an internal sustainability steering committee, which functions are represented on the committee?

	All N=104	US n=48	Europe n=49
Business units	57 %	54 %	57 %
Human resources	54	63	49
Communications	51	60	39
Supply chain / procurement	49	52	47
Finance	42	46	43
Legal	41	<b>56</b>	<b>29</b>
Strategy	38	48	27
Investor relations	38	48	27
Public affairs/government relations	37	38	35
Marketing	35	<b>50</b>	<b>16</b>
R&D/product development/engineering	35	38	31
CEO	26	19	33
Country/region leadership	22	21	24
Other	20	19	24

Source: The Conference Board, Organizing for Success in Corporate Sustainability (November 03, 2021)  
 Note: Figures shown are the percentage of respondents who selected each function. Bold indicates at least half of respondents selected that function.  
 \*All\* column also includes responses from Asia-Pacific which are not shown.

## 2.1 THE GOAL SETTERS

---

The first step in assembling your ESG Response Team is to select a team of “Goal Setters.” The value of identifying this group as “Goal Setters,” rather than “leaders,” is to encourage leadership at all levels of the ESG Response Team.

The remit of the Goal Setters is to identify the company’s initial and ostensible priorities based on the company’s business, operations, aspirations, commitments, and applicable law. The Goal Setters also determine how to build out the optimal ESG Response Team. The value in identifying the Goal Setters’ priorities as initial and ostensible is to embrace the likelihood that the company’s ESG priorities will be refined, or that new priorities will emerge, as a byproduct of the ESG Response Team’s work over time.

The Goal Setters should be a group of people whose collective familiarity with company operations is comprehensive and whose seniority conveys accountability for company conduct. It should include at least one person with accountability in each of the following areas: company financial and regulatory disclosures, operations, risk management, investor relations, sales and marketing, and human capital management. Companies that have a chief sustainability officer (“CSO”) should include that person as a Goal Setter. Companies that have a chief scientist should consider including that officer as a Goal Setter. The Goal Setters should have the CSO or an adjunct officer appointed to coordinate the work of the other teams comprising the entire ESG Response Team.

Some companies will find it useful to kick off this process with an educational program for the Goal Setters addressing the state of play in corporate ESG Program development, both generally and in your company’s industry, and introducing the breadth of potential topics your company’s ESG Program may address.

## 2.2 THE PROGRAM DEVELOPERS

---

In addition to the Goal Setters, the ESG Response Team should have among its membership representatives from each business unit or area of operations affected by the ESG Program goals or essential to their achievement. One can think of these individuals as the Program Developers; people who translate the company’s ESG priorities into practice. The company should assemble Program Developers in each area of operations with a view to including people with enough authority to drive timely attention and efforts to the Program Developers’ remit; people representing many facets of the operations area; people representing diverse voices in the operations area; and people representing different levels of seniority. The Program Developers should include a wide variety of employees to avoid an “ivory tower” ESG Program that is impractical, disconnected from lived realities, and for which personnel do not feel ownership and accountability.

The remit of the Program Developers is to assess each business unit’s existing policies, procedures, practices, and processes (together, “practices”) and determine how those practices relate to the achievement of the ESG Program goals. This might include, for example, breaking down larger goals into discrete component goals relevant to each area of operations; determining if existing practices promote or impede goal achievement; developing, communicating, and driving adoption of any recommended changes to the practices necessary to promote goal achievement; establishing a method and assigning responsibility for measuring progress toward goal achievement; and communicating upward any recommendations for fine-tuning or expanding company goals to better cover or relate to company risks and operations.

In some areas of operations, Program Developers may need resources to include input from external stakeholders such as suppliers, customers, and the community. In larger companies, it may be useful, efficient, or even necessary to connect the Program Developers of related business units to share information and resources.

Companies will need to consider the types of educational, level-setting, and empowerment resources they need to support the Program Developers’ responsibilities and goals.

## 2.3 THE INSIDE CONSULTANTS

---

As part of their process, the Program Developers should get input from various stakeholders and advisors. First are the company’s own employees. Establishing effective practices to achieve a company’s ESG Program goals will require input from employees within each Program Developer’s business unit as well as other parts of the business that interact with those business units, such as internal clients, risk managers, ethics and compliance personnel, product developers, salespeople, and other related or supporting functions. As a result, thinking of your own employees as “Inside Consultants”—i.e. the keepers of useful information—may help foster communications that do not occur during day-to-day operations, and contribute to employee buy-in of the company’s ESG Program goals.<sup>1</sup>

For example, Inside Consultants can identify the incentives that exist within the company and help assess whether those incentives are aligned to produce desired conduct.<sup>2</sup> Changes to practices should seek to align monetary and other incentives with ESG Program goals.

---

<sup>1</sup> See Thomas Singer, *Practical Guide 2: Telling Your Sustainability Story Authentically and Effectively*, CONF. BD, 4 (Aug. 12, 2021), <https://www.conference-board.org/topics/ESG-reporting/Telling-Your-Sustainability-Story-Practical-Guide-2> (noting the importance of input and engagement with employees, and making sure that a company’s sustainability story should not feel like a directive from above).

<sup>2</sup> There are many examples of situations where well-intended corporate incentive programs, particularly sales incentives, skewed human behavior and led to bad outcomes. In a regulatory investigation, the government will often expect the company to have reviewed its incentive structures and mitigated any risks they created. See e.g., Andris A. Zoltners *et al.*, *Wells Fargo and the Slippery Slope of Sales Incentives*, Harv. Bus. Rev. (Sept. 20, 2016), <https://hbr.org/2016/09/wells-fargo-and-the-slippery-slope-of-sales-incentives>.

## 2.4 THE OUTSIDE CONSULTANTS

---

There are several groups of people outside the company whose input Program Developers may also require in building a successful ESG Program. These “Outside Consultants” include independent third parties with special expertise as well as other external stakeholders who have an interest in the success of the company’s ESG Program. These Outside Consultants may include paid experts, investors, customers, lenders, and the communities of which the company is a member.

**Outside Experts and Independence.** As noted above, engaging internal personnel familiar with the company’s circumstances is more likely to produce workable ESG implementation plans. However, companies may need help from outside experts to develop information or assessments that are unavailable or impractical to develop internally or that require independence. Discrete areas in which input from paid outsiders is helpful may include gathering scientific data, peer performance data, or internal data (if internal processes are likely to be biased or otherwise flawed).

**Suppliers.** A company will generally need the input and cooperation of its suppliers to achieve its ESG Program goals. At a minimum, regulators, customers, and investors increasingly expect that companies require their suppliers to have meaningful ESG Programs, and that companies avoid suppliers whose practices are adverse to the company’s ESG Program goals or violate the law. Notably, greenhouse gas (GHG) emissions Scope 3 compliance calls for companies to have their supply chains in alignment with their carbon emissions goals.<sup>3</sup> Additionally, a proposed February 23, 2022 EU directive on “Corporate Sustainability Due Diligence” would require companies to implement sustainability due diligence on their value chains and require that a company’s directors oversee its implementation.<sup>4</sup> However, suppliers may be able to help companies develop solutions to avoid or to remediate undesirable supply chain issues. As a result, companies should ensure that their suppliers are informed about their ESG Program goals and, in particular, any intended changes to company practices with enough lead time for the supplier to make its own changes that support the company’s goals and timelines.

**Customers.** Customers and consumers are also driving the elevation of ESG concerns. Consumers are more interested than ever in topics like fair labor conditions, fair wages, recycled content, recyclability after use, product health and safety, organic and regenerative agriculture, avoidance of human and animal rights abuses, and a company’s record for diversity and inclusion.<sup>5</sup>

---

3 See *infra* Glossary.

4 See Press Release, European Commission, Just and sustainable economy: Commission lays down rules for companies to respect human rights and environment in global value chains (Feb. 23, 2022), [https://ec.europa.eu/commission/presscorner/detail/en/ip\\_22\\_1145](https://ec.europa.eu/commission/presscorner/detail/en/ip_22_1145); Proposal for a Directive of the European Parliament and of the Council on Corporate Sustainability Due Diligence and Amending Directive (EU) 2019/1937, COM (2022) 71 final (Feb. 23, 2022), <https://eur-lex.europa.eu/legal-content/EN/TXT/?uri=CELEX%3A52022PC0071>.

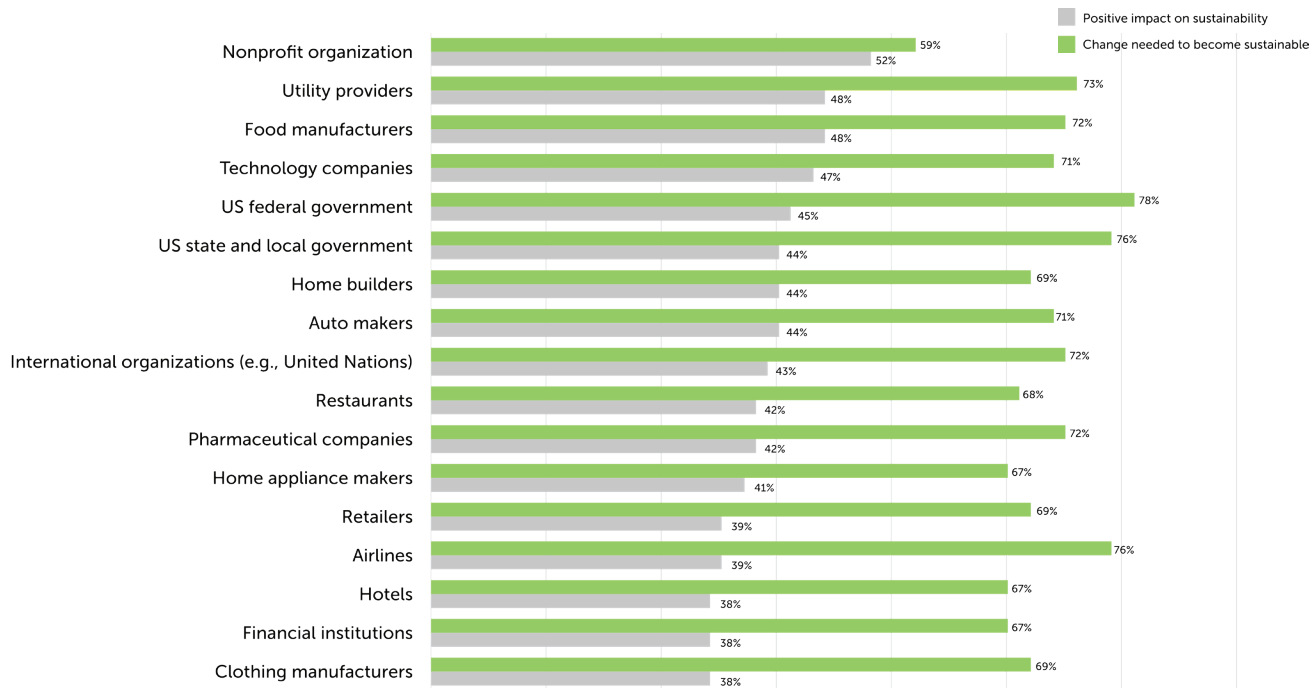
5 See generally Denise Dahloff, *US Consumers Want Business to Do More on Sustainability*, CONFERENCE BOARD (Feb. 8, 2022), <https://www.conference-board.org/topics/consumers-attitudes-sustainability/US-consumers-sustainability>; see also Denise Dahloff, *Sustainability Features That Sway US Consumers Are Changing*, CONF. BD. (Apr. 17, 2022), <https://www.conference-board.org/topics/consumers-attitudes-sustainability/perceptions-sustainability-efforts>.

## Survey findings: Perceptions of business impact on sustainability

### US consumers see the need for more change even among leaders of sustainability

Q: To what degree do you believe each of the following types of organizations are making a positive impact on sustainability? Very much, quite a bit, just a little, not at all

Q: How much do the following industries need to change to become sustainable? Very significantly, somewhat significantly, not too significantly, not significantly at all



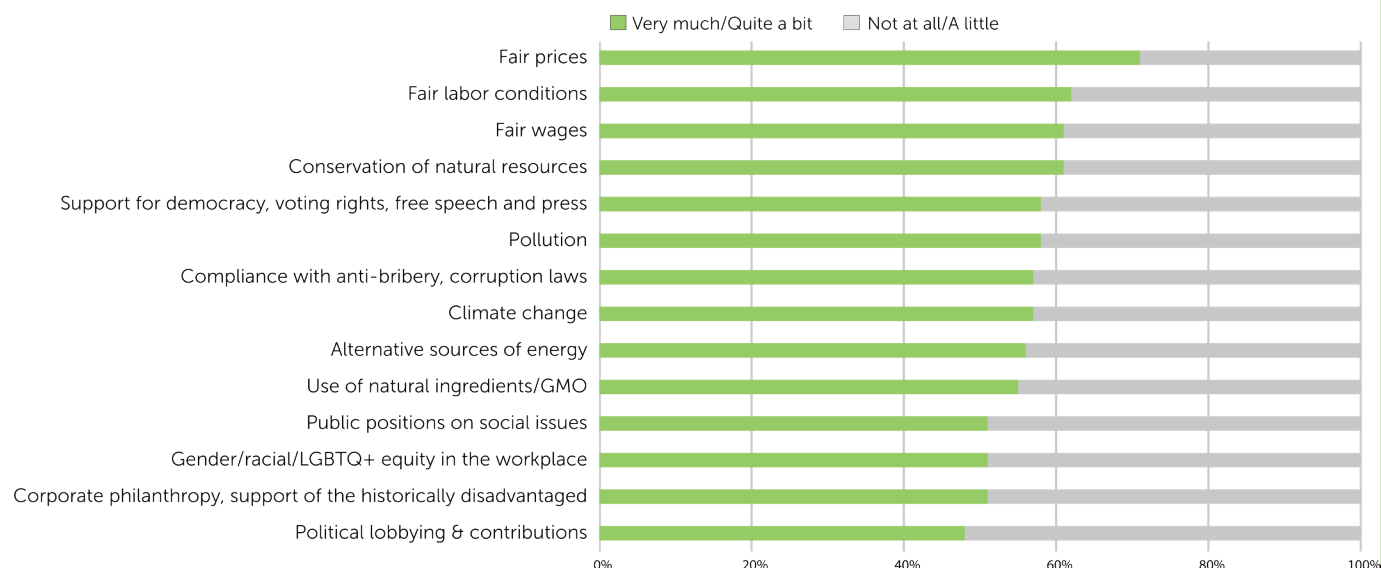
Source: The Conference Board + Harris Poll Sustainability Insights

Source: The Conference Board, US Consumers Want Business to Do More on Sustainability (February 8, 2022).

Companies should, however, refrain from advertising or marketing that misrepresents or overstates their ESG practices. Sometimes called “greenwashing” or “virtue signaling,” these practices involve companies representing their products as promoting fashionable ESG goals, while ignoring—or, worse, obfuscating—the full array of its ESG considerations associated with such products, particularly those that the public cannot easily understand.

## Fair prices, wages and labor conditions motivate consumers most to buy sustainable products

Q: To what degree would information about a brand's actions on the following issues influence the brands you buy?



Note: 1,923 US adults surveyed

Source: The Conference Board + Harris Poll Sustainability Insights

Source: The Conference Board, Sustainability Features That Sway US Consumers Are Changing (April 17, 2022).

**B2B Customers.** Many companies are part of other businesses' supply chains. A business customer likely has its own, and evolving, ESG Program. Companies' ability to assure their practices support their B2B customers' ESG objectives—and that their B2B customers are aware of this support—is increasingly important as suppliers seek to retain (and create value for) their customers. Prominent trends in this area are B2B customers seeking to include in their own ESG reporting assessments of their suppliers' GHG emissions, fair labor practices, diversity and inclusion practices, and whether their suppliers pay a living wage.

**Investors.** Investors have driven ESG concerns into the mainstream, from the earliest days of socially responsible/impact investing, to the launch of the Task Force on Climate-related Financial Disclosures (TCFD), to the messages driven home by the 2021 proxy season (during which 29% of environmental proposals passed and a little hedge fund called Engine No. 1 forced three ESG-focused directors onto Exxon's board).<sup>6</sup> Recent trends in investor activism include the appearance of new or occasional activist investor groups, companies encountering scenarios with multiple activist groups (sometimes with conflicting goals), and large scale funds

6 See Merel Spierings & Paul Washington, *Environmental Proposals*, CONF. BD. (Feb. 14, 2022), <https://www.conference-board.org/topics/tags.cfm?parent=shareholder-voting&child=environmental-proposals-brief-3>; Jennifer Hiller & Svea Herbst-Bayliss, *Engine No. 1 extends gains with a third seat on Exxon board*, REUTERS (June 2, 2021, 8:03 PM), <https://www.reuters.com/business/energy/engine-no-1-win-third-seat-exxon-board-based-preliminary-results-2021-06-02/>.

supporting ESG priorities.<sup>7</sup> Accordingly, the ESG Response Team should include a role tasked with gathering the views and, where appropriate, direct inputs from the company's investors. This may include surveys, monitoring investor comments on social media or the company's website, using data analysis, and soliciting comments during in-person or virtual meetings. For example, one emerging theme is that encyclopedic disclosures are not helpful to investors. Instead, investors value data published according to public frameworks which provide consistency and comparability across companies; actionable, plain-English disclosures in digestible portions with useful context; and the company's views on how its ESG efforts fit into value creation.<sup>8</sup>

**Lenders.** Lenders are in some ways similar to both customers and investors. Like a B2B customer, a lender is likely to have its own ESG Program, and may seek to provide financing in a way that supports the lender's ESG Program goals or at least has enough transparency to determine whether the loan it provides has pro-ESG characteristics or not.<sup>9</sup> Like investors, lenders may be sensitive to the borrower's ESG risk when deciding on the terms of the loan, or even the decision whether to lend money at all.

**Community.** Every company is part of the geographic community or communities where it does business. Companies should consider how they engage with local residents, community organizations, and governments, and seek to improve upon philanthropic or CSR efforts where they simply "parachute in" to support causes in episodic ways. Instead, companies should seek a deeper understanding of community needs and opportunities to collaborate with stakeholders in a way that aligns the company's ESG Program to the ongoing ESG objectives of the community.<sup>10</sup> Additionally, ensuring that all company personnel understand the company's values and ESG efforts turns every employee into a potential ambassador who can speak to the company's contributions and values.

---

7 See *ESG Alert: Shareholder Activism Returns to Prepandemic Levels, with New Players, Issues, and Impact*, CONF. BD. (July 9, 2021), <https://www.conference-board.org/contenthub/publicationContentHub.cfm?parent=esg-newsletters-alerts&child=esg-alert-july-9-2021>.

8 See Jaakko Kooroshy & Felix Fouret, *Corporate Climate Action: Through a Glass Darkly*, CLIMATE ACTION 100+ (May 4, 2021), <https://www.climateaction100.org/news/corporate-climate-action-through-a-glass-darkly/>; see also *ESG Alert: Shareholder Activism Returns to Prepandemic Levels, with New Players, Issues, and Impact*, *supra* note 7; Paul Washington et al., *Governance Watch: The New Era of Shareholder Activism*, CONF. BD. (June 28, 2021), <https://www.conference-board.org/webcast/ondemand/shareholder-activism>.

9 See, e.g., Christof Innig et al., *Retooling the bank for sustainable lending*, ACCENTURE (Oct. 21, 2021), <https://www.accenture.com/us-en/insights/banking/sustainable-lending>.

10 See Robert Schwarz, *How Companies Can Make an Enduring Difference in American Cities*, CONF. BD. (June 24, 2021), <https://www.conference-board.org/topics/corporate-social-impact-practices/how-companies-can-make-an-enduring-difference-in-cities>.

## 2.5 THE GOVERNMENT

---

There must be a role on a company's ESG Response Team for engaging with all relevant government entities—local, national, and supranational. Engagement with government is a broad concept encompassing contribution to the development of laws and regulations through government relations (and, if applicable, the public comment process), as well as compliance with laws and regulations as they are adopted. This will vary widely, country to country. In the United States, the consensus is that, as of 2022, the private sector, driven by investor and customer demand rather than new regulations, is ahead of government with respect to recognizing the need for companies to adopt comprehensive ESG programs. U.S. regulators, tasked by executive orders to align their activities with Net Zero 2050 goals,<sup>11</sup> are wrestling with how to promulgate policies, rules, and guidance in the context of a private sector that is already in motion toward ESG implementation.<sup>12</sup> EU regulators, on the other hand, have already adopted new regulatory schemes, whose goal is to speed corporate action on both climate and other ESG concerns.<sup>13</sup> China, Singapore, Japan, and Canada are similarly expected to announce ESG regulations in the near future.

Companies that operate across borders may find value in helping regulators in early-acting countries adopt positions that are practical and effective, and comply with directives and laws that are already in place, while encouraging other jurisdictions to regulate in a manner that will not impede the company's ongoing ESG efforts or present conflicts with other applicable laws.

## 2.6 THE PEER GROUP

---

Other companies in a firm's peer group are also an important reference point. There are an increasing number of resources that log and analyze ESG data by industry or sector. These tools (see Chapter 1.2—Benchmarks) facilitate evaluation of peer companies for investors, consumers, regulators, and the general public.<sup>14</sup> These resources are also valuable to companies themselves as they benchmark against their peer firms and pursue solutions to spur their respective industries to advance Net Zero 2050 and other ESG Program goals. The ESG Response Team should have a role responsible for networking with peer companies, relevant innovators, and publishers of peer comparison data.

---

<sup>11</sup> See Exec. Order No. 14008, 86 Fed. Reg. 7619 (Jan. 27, 2021) ("The Climate Crisis Order"); Exec. Order No. 14030, 86 Fed. Reg. 27967 (May 20, 2021) ("Climate Related Financial Risk"); Exec. Order No. 14057, 86 Fed. Reg. 70,935 (Dec. 8, 2021) ("Catalyzing Clean Energy Industries"); see also Exec. Order No. 13990, 86 Fed. Reg. 7037 (Jan. 20, 2021) ("Protecting Public Health and the Environment and Restoring Science To Tackle the Climate Crisis"); Exec. Order No. 14027, 86 Fed. Reg. 25947 (May 7, 2021) ("Establishment of the Climate Change Support Office").

<sup>12</sup> On March 21, 2022, the U.S. SEC issued for public comment a rule proposal that would require disclosures regarding climate-related information in various filings. See *SEC Proposes Rules to Enhance and Standardize Climate-Related Disclosures for Investors*, SEC (Mar. 21, 2022), <https://www.sec.gov/news/press-release/2022-46>.

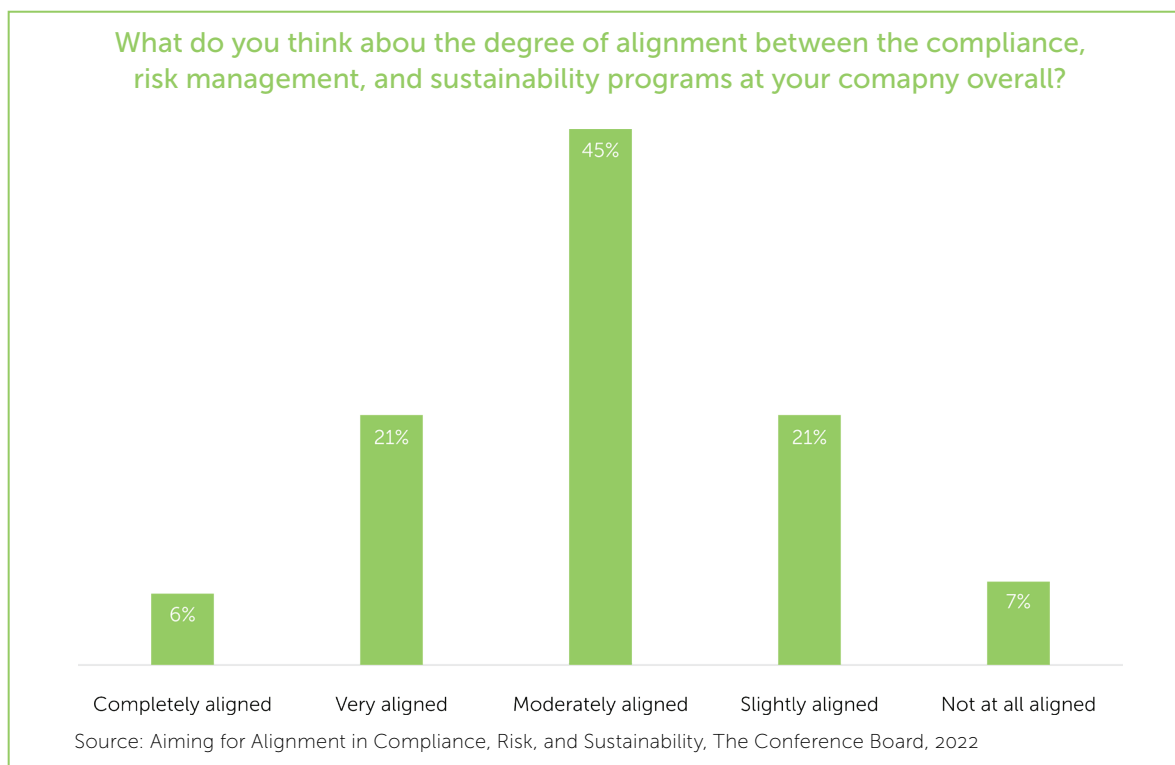
<sup>13</sup> See *Is the EU Clearing the Path toward More Effective Sustainability Reporting?*, CONF. BD. (Apr. 2021), <https://www.conference-board.org/pdfdownload.cfm?masterProductID=27273>.

<sup>14</sup> See *supra* Chapter 1.1—Frameworks and Beyond Frameworks.

## 2.7 THE COMPLIANCE TEAM

Last, but not least, the ESG Response Team should coordinate with the company's corporate compliance team. There are many similarities in the exercise of developing, launching, socializing, monitoring, and enforcing a company's ESG Program to the corresponding work done for the company's corporate compliance program.<sup>15</sup> For some companies, implementing the ESG Program, in whole or in part, may best fall to the corporate compliance department where many relevant skill sets reside. In others, where the ESG Response Team may feature its own ESG compliance function (or a dedicated liaison to corporate compliance), the corporate compliance team should at least be a significant resource for the ESG Response Team. Many ESG concerns, such as child labor, human slavery, and financial statement disclosures, are already governed by law and, therefore, already addressed by the corporate compliance program; coordination can prevent duplication.

However, the idea that ESG concerns are solely the burden of a dedicated CSR team is obsolete.<sup>16</sup> As with other types of corporate compliance, it is important that everyone within a company understands that ESG compliance happens not just within the ESG compliance team but throughout the organization's business units and support functions. The ESG compliance team can keep records, contribute to improving practices, promote understanding, guide employees of other units on how to conduct business consistent with the ESG Program, and support management's role in oversight and policy development, but successful development and implementation of a company's ESG program requires the commitment of the company's business units.<sup>17</sup>



Source: The Conference Board, Aiming for Alignment in Compliance, Risk, and Sustainability (May 17, 2022).

<sup>15</sup> See Merel Spierings, *Aiming for Alignment in Compliance, Risk, and Sustainability*, CONF. BD. (May 17, 2022), <https://www.conference-board.org/publications/aiming-for-alignment-in-compliance-risk-sustainability>.

<sup>16</sup> *Id.* at 6.

<sup>17</sup> See *infra* Chapter 8—ESG Investigations Considerations.



# 3

## **Regulations and Foreseeable Developments**

# Regulations and Foreseeable Developments

## 3.1 EUROPEAN UNION

---

### Introduction

In recent years, the European Union (“EU”) has adopted a series of directives aimed at increasing companies’ and financial firms’ public disclosures on the ESG impact of their activities and products. In addition, these directives establish common standards for making and assessing ESG disclosures across EU member states. Collectively, these directives are designed to aid EU member states in meeting EU sustainability objectives and to increase transparency in a marketplace where ESG impact is increasingly used to market products and services.

Key recent ESG-focused directives in the EU include the Taxonomy Regulation, the Sustainable Finance Disclosure Regulation, and the Non-Financial Reporting Directive. Additionally, a Corporate Sustainability Reporting Directive has been proposed to bolster the Non-Financial Reporting Directive, and a new Corporate Sustainability Due Diligence Directive has been proposed to establish harmonized ESG due diligence requirements.

### EU Taxonomy Regulation (June 2020)<sup>1</sup>

The EU Taxonomy for Sustainable Activities (the “EU Taxonomy Regulation”) entered into force in July 2021. The EU Taxonomy Regulation aims to prevent “greenwashing” or misrepresentations to the public about the extent to which certain economic activities are sustainable or environmentally friendly.

Fundamentally, the EU Taxonomy Regulation establishes common criteria for determining whether an economic activity by a company can be claimed to be environmentally sustainable, and applies to the following:

- financial products or corporate bonds that are made available as environmentally sustainable;
- financial market participants that make available financial products;<sup>2</sup>

---

<sup>1</sup> Commission Regulation 2020/852, 2022 O.J. (L 198/13) (EU), <https://eur-lex.europa.eu/legal-content/EN/TXT/?uri=celex:32020R0852> (the “EU Taxonomy Regulation”).

<sup>2</sup> A financial product includes certain managed portfolios, alternative investment funds (“AIF”), an insurance-based investment product (“IBIP”), a pension product, a pension scheme, an undertaking for collective investment in transferrable securities (“UCITS”), or a pan-European personal pension product (“PEPP”).

- certain undertakings which are subject to the obligation to publish a non-financial statement or consolidated non-financial statement.

Under the EU Taxonomy Regulation, an economic activity can be claimed by a company to be environmentally sustainable if it meets four key requirements:

1. it contributes substantially to at least one of the following six environmental objectives set out in the Taxonomy Regulation: (i) climate change mitigation, (ii) climate change adaptation, (iii) the sustainable use and protection of water and marine resources, (iv) the transition to a circular economy, (v) pollution prevention and control, and (vi) the protection and restoration of biodiversity and ecosystems;
2. it complies with technical screening criteria established in accordance with the Taxonomy Regulation relating to these six environmental objectives;
3. it does not significantly harm any of the environmental objectives set out in the Taxonomy Regulation; and
4. it complies with certain minimum safeguards established in the Taxonomy Regulation, which require companies undertaking to carry out an economic activity to do so in alignment with OECD Guidelines for Multinational Enterprises and the UN Guiding Principles on Business and Human Rights.

The EU Taxonomy Regulation was directly applicable in all EU member states when it entered into force. Accordingly, EU member states were not required to pass any implementing legislation.

Delegated Acts<sup>3</sup> are adopted by the European Commission under the EU Taxonomy Regulation, and include specific and well-defined criteria for what amounts to a substantial contribution to each of the environmental objectives set out in the Taxonomy Regulation, as well as standards for what amounts to significant harm to the environmental objectives. Additionally, the Taxonomy Regulation provides for certain circumstances where an economic activity can be claimed as contributing substantially to an environmental objective by directly enabling *other* activities to make a substantial contribution to an objective. A Delegated Act adopted by the European Commission on March 9, 2022 would permit natural gas and nuclear energy to be treated as sustainable under the Taxonomy Regulation, which generated significant debate and protest from certain EU countries who viewed such activities as detrimental to the Union's long-term environmental objectives.

---

<sup>3</sup> Delegated Acts are non-legislative acts adopted by the European Commission that serve to amend or supplement the nonessential elements of the legislation. See Treaty on the Functioning of the European Union art. 290, Mar. 25, 1957. <https://eur-lex.europa.eu/legal-content/EN/TXT/?uri=celex%3A12016ME%2FTXT>.

Enforcement will play a key role in ensuring the Taxonomy Regulation is effective, and under the Regulation EU member states must establish effective, proportionate, and dissuasive measures and penalties for violations. Although the Taxonomy Regulation does not cover all large multinational companies or non-EU organizations, the Taxonomy Regulation does apply to non-EU financial market participants who provide financial products in the EU. Large companies that do not do business in the EU are nevertheless well-advised to familiarize themselves with the framework, as it may serve as an important model for other jurisdictions as they begin to develop similar frameworks to meet sustainability goals.

## **EU Sustainable Finance Disclosure Regulation (March 2021)<sup>4</sup>**

The EU's regulation on sustainability-related disclosures in the financial services sector (the "Sustainable Finance Disclosure Regulation" or "SFDR") became applicable on 10 March 2021. Under the SFDR, financial market participants<sup>5</sup>—which include those who create and sell financial products as well as financial advisers<sup>6</sup>—are required to make certain sustainability disclosures to investors regarding their approaches to the integration of sustainability risks and the consideration of adverse sustainability impacts. The regulation harmonizes requirements across EU member states, and aims to reduce distortion of competition due to differences in disclosure standards.

Under the SFDR, sustainability factors include:

- environmental,
- social and employee matters,
- respect for human rights, and
- anti-corruption and anti-bribery matters.

Given that sustainability factors overlap with regulated areas, financial market participants subject to the SFDR should take special care to coordinate with their corporate compliance departments when fulfilling obligations under the SFDR. Among other things, the interplay between SFDR, the Taxonomy Regulation, and other disclosure obligations regarding financial product and/or investment risk will require particular coordination and harmonization.

---

<sup>4</sup> Commission Regulation 2019/2088, 2019 O.J. (L 317/1) (EU), <https://eur-lex.europa.eu/legal-content/EN/TXT/?uri=celex%3A32019R2088>.

<sup>5</sup> "Financial market participants" include insurance undertakings that make available an IBIP, investment firms that provide portfolio management, institutions for occupational retirement provision ("IORP"), manufacturers of pension products, AIF managers, PEPP providers, managers of certain qualifying venture capital funds, managers of certain qualifying social entrepreneurship funds, management companies of UCITS, or credit institutions which provide portfolio management.

<sup>6</sup> "Financial adviser" as used in the SFDR correlates to the U.S. term "investment adviser" and not to "financial adviser" as commonly used in the U.S. to refer to securities brokers that offer investment products and related advice.

Under the SFDR, financial market participants are required to make certain sustainability-related disclosures on their websites and in their pre-contractual disclosures and periodic reports:

**Websites:** Among the types of information that must be disclosed on financial firms' websites are:

- Information related to principal adverse impacts of financial market participants' investment decisions on sustainability factors, and pre-contractual disclosures and due diligence policies for those adverse impacts.
- Information on remuneration policies and how they are consistent with integrating sustainability risks.
- Information related to the environmental or social characteristics or the sustainable investment objective of financial products that purport to have these characteristics or objectives, and the associated pre-contractual disclosures required for such products.

All information published on the financial firm's website must be up-to-date (with clear explanations for any amendments).

**Pre-contractual Disclosures:** In addition to pre-contractual disclosures on principal adverse impacts and environmental, social, or sustainable objectives of financial products, financial firms should make pre-contractual disclosures on how sustainability risks are integrated into their investment decisions or investment or insurance advice, as well as information on the likely impacts of sustainability risks on the returns of the financial products they provide or manage. In cases where financial firms do not deem sustainability risks to be relevant, financial firms must provide a clear and concise explanation as to why they are not relevant in their pre-contractual disclosures.

**Periodic Reports:** For financial products that have environmental or social characteristics or a sustainable investment objective, the extent to which the social characteristics are met or the sustainability impact must be described in periodic reports.

The SFDR's disclosure requirements differentiate between (i) general disclosures regarding sustainability risks and impacts (Article 6); (ii) disclosures relating to financial products that include certain environmental or social characteristics (so called "Article 8" funds/products); and (iii) disclosures relating to financial products that have a defined sustainability objective (so-called "Article 9" funds/products). For Article 8 and Article 9 funds that also align with the Taxonomy environmental objectives, the percentage of such alignment must also be stated.

Under the SFDR, financial firms have the option of using, where appropriate, information in management reports and non-financial statements for the purposes of the SFDR and other ESG non-financial reporting regulations.

It is important to note that the SFDR does not prevent individual EU member states from having more stringent provisions on climate change and sustainability policies and disclosures for financial firms headquartered in their respective jurisdictions.

The European Commission has clarified in a Q&A on the SFDR that non-EU alternative investment fund managers are financial market participants subject the SFDR when they enter the market of an EU member state through a national private placement regime. In addition, EU financial market participants that have analogous operations in the United States should note that this EU regulation imposes discrete disclosure obligations and is not dependent on a subjective assessment of materiality. U.S. entities making disclosures under SFDR should then consider whether having made such disclosures abroad affects their assessment of the need to make similar disclosures to U.S. customers and clients.

### **EU Non-Financial Reporting Directive (NFRD) (December 2016/January 2017)<sup>7</sup> and EU Corporate Sustainability Reporting Directive (CSRD) (proposed in April 2021)<sup>8</sup>**

Currently, under the EU Non-Financial Reporting Directive (NFRD), large “public-interest entities” with over 500 employees must publish information related to environmental matters, social matters and treatment of employees, respect for human rights, anti-corruption and bribery, and diversity (age, gender, and educational and professional background) on company boards. Public-interest entities are companies with securities listed on EU regulated markets, banks, and companies designated by member states as public-interest entities because of their significant public relevance due to the nature of their business, their size, or the number of their employees.

With these requirements in mind, the European Commission also has published (1) non-mandatory guidelines for helping companies disclose environmental and social information (2017) and (2) guidelines for reporting climate-related information (2019), which supplement existing applicable guidelines on non-financial reporting.

To further bolster the NFRD, the European Commission adopted a proposal for a Corporate Sustainability Reporting Directive (CSRD) in April 2021. The directive would amend the existing NFRD and, among other things, extend its scope to all large companies and most companies listed on regulated markets. As a result, approximately 49,000 companies would be required to report under the CSRD, compared to the approximately 11,600 companies that report under the NFRD. The CSRD would also introduce more detailed requirements to report how sustainability issues impact companies’ businesses and how their businesses impact people and the environment. Companies subject to the directive would be required to report according to mandatory EU reporting standards. As a result, significantly more companies in the EU would be required to adhere to comprehensive EU sustainability reporting standards.

---

7 Council Directive 2014/95, 2014 O.J. (L330/1) (EU), <https://eur-lex.europa.eu/legal-content/EN/TXT/?uri=CELEX:32014L0095>.

8 *Proposal for a Directive of the European Parliament and of the Council Amending Directive 2013/34/EU, Directive 2004/109/EC, Directive 2006/43/EC and Regulation (EU) No 537/2014, as regards corporate sustainability reporting*, COM (2021) 189 final (Apr. 21, 2021), <https://eur-lex.europa.eu/legal-content/EN/TXT/?uri=CELEX%3A52021PC0189>.

The CSRD aims to harmonize and simplify sustainability reporting for companies that are currently faced with the challenge of trying to adhere to various sustainability reporting standards and frameworks. The CSRD also aims to reduce systemic risk to the economy, increase accountability, and improve the allocation of capital to businesses that address social, health, and environmental problems. Under the CSRD, reported information must be audited, disclosed in a machine-readable format, and published in the company's management reports. The first set of standards specifying all sustainability information that companies should report would be adopted by October 2022, and the directive would apply to financial years starting on or after January 1, 2023.

## **EU Corporate Sustainability Due Diligence Directive (proposal adopted February 2022)<sup>9</sup>**

On 23 February 2022, the European Commission adopted a proposal for a Corporate Sustainability Due Diligence Directive ("CSDDD"). Under the CSDDD, companies would have a duty to conduct diligence to identify, eliminate, prevent, mitigate, and account for the company's negative impacts on human rights and the environment. Additionally, directors would have duties under the CSDDD, including (1) the duty to establish and oversee the implementation of the due diligence processes, as well as their integration into the company's strategy and (2) the requirement to take into account human rights, climate change, and environmental consequences of their decisions when fulfilling their duty to act in the best interest of the company. The CSDDD would initially apply to companies with over 500 employees and worldwide net turnover of over €150 million. Two years later, it would also apply to other companies in certain high-impact sectors (e.g., textiles, agriculture, extraction of minerals) that have over 250 employees and worldwide net turnover of over €40 million. Among other objectives, the CSDDD aims to harmonize due diligence requirements across member states, increase corporate accountability for adverse impacts, and improve corporate governance practices.

Under the CSDDD, member states would designate an authority to oversee the compliance of companies with these obligations, including through the issuance of sanctions, including fines and compliance orders. Member states would also be required to ensure that victims could receive compensation for damages from compliance failures. Director duties would be enforced through member states' existing laws.

---

9 *Proposal for a Directive of the European Parliament and of the Council on Corporate Sustainability Due Diligence and Amending Directive (EU) 2019/1937*, COM (2022) 71 final (Feb. 23, 2022), <https://eur-lex.europa.eu/legal-content/EN/TXT/?uri=CELEX%3A52022PC0071>.

## 3.2 UNITED STATES

---

### SEC Regulation of Environmental and Climate-Related Disclosures

"Investors representing literally tens of trillions of dollars of assets under management are looking for consistent, comparable, decision-useful information to determine whether to invest, sell, or make a proxy vote one way or another." SEC Chairman Gary Gensler, Prepared Remarks at London City Week, June 23, 2021

*"To date, Congress has not granted authority to the SEC to address ESG issues for the purpose of promoting goals unrelated to the federal securities laws. . . . Wading into controversial issues, whether directly or indirectly through a third-party standard setter, would consume our limited resources and impede our ability to carry out our given mission of protecting investors and the integrity of the capital markets."* SEC Commissioner Hester Peirce, Prepared Remarks before the Brookings Institution, July 21, 2021

U.S. federal securities law is a complex, rules-based system, embodied across several statutes, implemented through extensive rule-making, interpreted by agency guidance, and constructed around a unifying principle. The unifying principle is that issuers of securities and securities investment advisers must not be allowed to mislead investors, meaning that they must provide disclosure that is complete and accurate in all respects that are material to investors' decisions buy or sell securities or to vote or exercise other rights and privileges of securities owners. It is often described as a disclosure-based system, designed to promote the integrity of information as the principal support for fairness in a free market.

For more than a decade, it was the SEC's view that no new rulemaking was needed to address issuer and investment adviser disclosures about climate and other ESG related matters. Existing rules around materiality and avoidance of misleading statements (and omissions) under the principal existing statutes were thought to be sufficient to elicit and govern appropriate conduct in this area. Investors disagreed. As climate science advanced, investors became increasingly unsatisfied with the quality and quantity of climate-related risk disclosure in company financial statements and other public filings. Taking matters into their own hands, investors across the G20 joined the UK's Financial Stability Board in its launch of the TCFD in December 2015 to give the market guidance on exactly what climate-related disclosures investors consider material. For U.S. investors, private market efforts seemed to be the only path forward.

Meanwhile, the SEC wrestled with its duty and authority to mandate ESG disclosure specifically. It had already published some guidance on climate disclosure in 2010,<sup>10</sup> without much effect on actual corporate disclosure practices. There were two principles that were generally agreed. First, any ESG related information that concerns disclosure items required to be discussed in documents like financial statements, proxy statements, and prospectuses, and that is material to investors, must be disclosed.<sup>11</sup> That is to say, ESG related information is not exempt from existing disclosure obligations, even where its inclusion is not specifically mandated. Second, statements about an issuer's ESG practices or impacts, or about an adviser's ESG objectives, practices, or results, must be materially accurate and complete.

On March 21, 2022, the SEC published a long-awaited rule proposal amending public filing disclosure requirements to enhance and standardize climate-related disclosures (the "Climate Disclosure Rule Proposal").<sup>12</sup> There are already significant headwinds to the Climate Disclosure Rule Proposal, from legal challenges to the Proposal's length and complexity. It remains to be seen whether the Climate Disclosure Rule Proposal will bring closure to long-running debates or extend them.

The SEC has also been forthcoming with guidance for investment advisers and funds, covered in Chapter 6—ESG for Funds and Advisers.

One can expect significant public comment to the Climate Disclosure Rule Proposal before adoption, and further uncertainty arising from legal challenges to the SEC's authority to adopt such rules. We provide below an executive summary of the new proposal, but first we discuss the U.S. regulatory guidance currently in place.

**Current Effective Guidance.** Until the Climate Disclosure Rule Proposal is finalized and adopted, operating companies have two principal sources of guidance on which to rely. On February 2, 2010, the SEC provided guidance to public companies regarding existing disclosure requirements as they apply to climate-change matters (the "2010 Guidance"). The 2010 Guidance clarified how then-existing SEC rules required reporting companies to disclose four separate climate change matters:

1. The impact of climate change legislation and regulation;
2. The impact of international climate change accords;
3. The physical impacts of climate change; and
4. The indirect consequences of climate change regulation or business trends.

---

<sup>10</sup> Commission Guidance Regarding Disclosure Related to Climate Change, Securities Act Release No. 9106, Exchange Act Release No. 61469, Financial Reporting Release No. 82, 75 Fed. Reg. 6289 (Feb. 8, 2010).

<sup>11</sup> *Id.*; Management's Discussion and Analysis, Selected Financial Data, and Supplementary Financial Information, Securities Act Release No. 10890, Exchange Act Release No. 90459, Investment Company Act Release No. 34100, 86 Fed. Reg. 2080 (Jan. 11, 2021) (to be codified at 17 C.F.R. pts. 210, 229, 230, 239, 240, and 249).

<sup>12</sup> The Enhancement and Standardization of Climate-Related Disclosures for Investors, Securities Act Release No. 11042, Exchange Act Release No. 94478, 87 Fed. Reg. 21334 (Apr. 11, 2022) (proposed Mar. 21, 2022) (to be codified at 17 C.F.R. pts. 210, 229, 232, 239, and 249).

While the 2010 Guidance was a first step in the right direction, its impact faded over time. After its release, SEC staff issued very few comment letters to focus reporting companies on climate-related disclosures. According to a 2018 Government Accountability Office report (the “GAO Report”),<sup>13</sup> out of more than 86,000 comment letters sent by the SEC from 2010 to 2017, only thirty-nine letters concerned climate-related disclosures.<sup>14</sup> In a 2012 report to Congress, the SEC staff reported that they did not find any notable year-to-year changes in the disclosures reviewed from the year before the 2010 Guidance to the following year.<sup>15</sup> The 2010 Guidance did not have the force and focus of new rulemaking and, without substantial enforcement effort behind it, produced little new or meaningful disclosure over the following decade.<sup>16</sup>

On February 24, 2021, then-Acting Chair of the SEC, Allison Herren Lee, directed the Division of Corporation Finance to enhance its focus on climate-related disclosure in public company filings by reviewing “the extent to which public companies address the topics identified in the 2010 Guidance, assess compliance with disclosure obligations under the federal securities laws, engage with public companies on these issues, and absorb critical lessons on how the market is currently managing climate-related risks.”<sup>17</sup>

The outcome of this directive arrived in September 2021, when the SEC’s Division of Corporation Finance published its Sample Letter to Companies Regarding Climate Change Disclosures.<sup>18</sup> With its greater focus and implications of enforcement, the 2021 Guidance provides public reporting companies a practical tool to evaluate the need for ESG disclosures, the quality of their ESG disclosures, and a way to identify gaps and shortcomings that could lead to investigation or enforcement action if not addressed.

For a detailed discussion of the 2010 Guidance and the 2021 Guidance, see Chapter 5—ESG for Operating Companies.

**The Climate Disclosure Rule Proposal.** The Climate Disclosure Rule Proposal seeks to promote greater consistency, comparability, quantity and quality of climate risk-related disclosures. It reaches from specific data on greenhouse gas (“GHG”) emissions to narrative disclosure about conceptual matters like governance, strategy, and risk management. Registrants may also disclose climate-related opportunities, presumably subject to forward-looking statement disclaimers. The new rules are likely to have knock-on effects on private companies, as public registrants will seek to gather data from private companies that are their suppliers or customers. Public financial institutions will also be affected by the proposed guidelines for disclosure of finance emissions. It may take years for the new disclosure practices to become analyzable and actionable, as reporting companies, investors, and data analytic services become sharper at expressing, evaluating, and operationalizing

---

13 U.S. GOV’T ACCOUNTABILITY OFFICE, GAO-18-188, CLIMATE-RELATED RISKS: SEC HAS TAKEN STEPS TO CLARIFY DISCLOSURE (2018), <https://www.gao.gov/assets/gao-18-188.pdf>.

14 *Id.* at 14.

15 *Id.* at 15.

16 *See id.* at 15-16.

17 Allison Herren Lee, *Statement on the Review of Climate-Related Disclosure*, SEC (Feb. 24, 2021), <https://www.sec.gov/news/public-statement/lee-statement-review-climate-related-disclosure>.

18 *Sample Letter to Companies Regarding Climate Change Disclosures*, DIV. OF CORP. FIN., SEC (Sept. 22, 2021), <https://www.sec.gov/corpfin/sample-letter-climate-change-disclosures>.

the availability of the new information proposed to be collected. The Climate Disclosure Rule Proposal also reveals the SEC's acknowledgment of the value of consistent reporting standards, particularly those published by the Task Force on Climate-Related Financial Disclosures (TCFD), and in doing so, is likely to accelerate the work of organizations focused on aligning the excess of frameworks and reporting standards at large in the world today.

The Climate Disclosure Rule Proposal is discussed further in Chapter 5.1—Public Company Financial Disclosures, and an excellent summary of the Climate Disclosure Rule Proposal contents can be found at <https://www.bluedotcapital.co/insights-sec-climate-disclosures>.

### **State Regulation—California Climate Corporate Accountability Act**

There is also the potential for disclosure mandates by the states, particularly if the federal government is slow to finalize new rules. For example, in January 2022, the California state Senate adopted S.B. 260, the California Climate Corporate Accountability Act,<sup>19</sup> which, if enacted, may become the first law in the United States requiring companies with more than \$1 billion in revenue that are doing business in California to disclose GHG emissions. It is estimated that this will affect over 5,000 companies, and is not limited to companies domiciled in California. Covered companies would have to disclose Scope 1 and Scope 2 emissions, as well as indirect emissions from sources or activities not controlled by the company [(consistent with Scope 3)], such as employee commuting, business travel, supply chain, and waste and water usage. Emissions would be required to be confirmed by a third-party auditor approved by the California Air Resources Board, which will, in turn, use the data to monitor and promote statewide climate objectives, including by making recommendations for emission reductions consistent with the Science Based Targets Initiative (SBTi) to maintain temperatures at not more than 1.5 degrees Celsius above pre-industrial levels.

---

<sup>19</sup> S.B. 260, 2021-2022 Leg., Reg. Sess. (Cal. 2021), [https://leginfo.legislature.ca.gov/faces/billNavClient.xhtml?bill\\_id=202120220SB260](https://leginfo.legislature.ca.gov/faces/billNavClient.xhtml?bill_id=202120220SB260).

## SEC Regulation of Social and Governance Disclosures

The SEC is also considering disclosures on matters beyond climate change. In early 2021, then-Acting Chairman Lee announced that the SEC will be “working toward a comprehensive ESG disclosure framework” and would pursue initiatives such as “offering guidance on human capital disclosure to encourage the reporting of specific metrics like workforce diversity, and considering more specific guidance or rule-making on board diversity.”<sup>20</sup> Human capital management disclosure rules adopted in August 2020<sup>21</sup> have reportedly yielded limited and irregular new information, as further discussed below. Larry Fink, Chairman at BlackRock, arguably the world’s most powerful shareholder, recently noted that “[n]o relationship has been changed more by the [COVID] pandemic than the one between employers and employees. . . . Companies expected workers to come to the office five days a week. Mental health was rarely discussed in the workplace. And wages for those on low and middle incomes barely grew. That world is gone. . . . [T]he pandemic also shone a light on issues like racial equity, childcare, and mental health. . . . At BlackRock, we want to understand how this trend is impacting your industry and your company.”<sup>22</sup>

The 2020 amendments to Reg S-K, among other things, amended Item 101(c)’s non-exclusive list of disclosure items to include a description of the registrant’s human capital resources to the extent such disclosures would be material to an understanding of the registrant’s business as a whole.<sup>23</sup> Beyond mentioning the number of persons employed and any measures or objectives the company focuses on in managing its business, “human capital resources” was not defined, giving registrants flexibility to apply the requirement as it might evolve over time in the context of their firm or industry. The adopting release offered only that each company’s disclosure “must be tailored to its unique business, workforce, and facts and circumstances.” It allowed that disclosures may include measures or objectives that address the development, attraction, and retention of personnel but also that each registrant has broad discretion as to the aspects of human capital resources it will address.

Since the human capital disclosure rule was adopted, many initial filings included barely more than the number of employees and statements reflecting the quality of the company’s relationship with its workforce. One review of amended filings<sup>24</sup> suggests that the SEC staff’s comments may have focused on breaking down total employees by categories such as full-time versus part-time; steps taken to identify, recruit, or retain employees; diversity and inclusion efforts; whether employees are represented by labor unions, are covered by collective bargaining agreements, or have engaged in material work stoppages; employee benefits and incentives; social impact and social justice initiatives; impact of and response to the COVID-19 epidemic; employee safety measures; diversity statistics; core values; employee training and development programs; and use of employee engagement surveys.

---

20 Allison Herren Lee, *A Climate for Change: Meeting Investor Demand for Climate and ESG Information at the SEC*, SEC (Mar. 15, 2021), <https://www.sec.gov/news/speech/lee-climate-change>.

21 Larry Fink, Chairman and Chief Executive Officer, BlackRock, *Larry Fink’s 2022 Letter to CEOs: The Power of Capitalism*, BLACKROCK (Jan. 18, 2022), <https://www.blackrock.com/corporate/investor-relations/larry-fink-ceo-letter>.

22 *Id.*

23 Modernization of Regulation S-K Items 101, 103, and 105, Securities Act Release No. 10825, Exchange Act Release No. 89670, 85 Fed. Reg. 63726 (Oct. 8, 2020) (to be codified at 17 C.F.R. pts. 229, 239, and 240).

24 Grant Hauss & Jay Knight, *A Survey of Recent SEC Comment Letters on Human Capital Disclosures*, JDSUPRA (Aug. 2, 2021),

Also, on August 6, 2021, the Commission approved a Nasdaq rule creating greater transparency about diversity on company boards.<sup>25</sup> The Nasdaq board diversity rule will require listed companies to disclose board-level diversity statistics using a standardized board matrix and to have, or explain why they do not have, at least two diverse directors, including one who self-identifies as female and one who self-identifies as either a member of an underrepresented minority or as LGBTQ+. Companies that opt to explain their approach to board composition can do so in the company's proxy statement or information statement (or, if none is filed, on the company's Form 10-K or 20-F), or on the company's website. Companies must file their initial board matrix by the later of August 8, 2022 or the date the company files its 2022 proxy. For companies listed prior to August 6, 2021, the two-diverse-director standard will not apply until August 6, 2025 or 2026; from August 7, 2023 until then, the diversity standard is to have a single diverse director or otherwise an explanation. There is some flexibility for smaller listed companies and foreign issuers, who may meet the diversity objective with two female directors or, in case of boards with five or fewer directors, by including only one diverse director.

## Other SEC Actions

In addition to the items discussed above, the SEC has taken the following ESG-related actions:

1. announced the formation of the Climate and ESG Task Force, aimed at developing initiatives to proactively identify ESG-related misconduct and coordinate the effective use of division resources;<sup>26</sup>
2. issued a risk alert on ESG investing to investment advisers and funds, urging them to address deficiencies in their ESG-related disclosures, policies, and records;<sup>27</sup>
3. included ESG disclosures and related practices in its list of 2021 and 2022 SEC Exam Priorities;<sup>28</sup>
4. proposed changes to Form N-PX to make proxy voting data more transparent;<sup>29</sup>

---

<https://www.jdsupra.com/legalnews/a-survey-of-recent-sec-comment-letters-6744972/>.

<sup>25</sup> Self-Regulatory Organizations; The Nasdaq Stock Market LLC; Order Approving Proposed Rule Changes, as Modified by Amendments No. 1, To Adopt Listing Rules Related to Board Diversity and To Offer Certain Listed Companies Access to a Complimentary Board Recruiting Service, Exchange Act Release No. 92590, 86 Fed. Reg. 44424 (Aug. 12, 2021). Notably, a similar set of California laws requiring corporations with a principal executive office in California to have one or more directors from underrepresented communities were recently declared unconstitutional. *Crest v. Padilla*, No. 19STCV27561 (Cal. Super. Ct. May 13, 2022); *Crest v. Padilla*, No. 20STCV37513, 2022 LEXIS 5531 (Cal. Super. Ct. Apr. 1, 2022).

<sup>26</sup> Press Release, SEC, SEC Announces Enforcement Task Force Focused on Climate and ESG Issues (Mar. 4, 2021), <https://www.sec.gov/news/press-release/2021-42>.

<sup>27</sup> *The Division of Examinations' Review of ESG Investing*, DIV. OF EXAMINATIONS, SEC (Apr. 9, 2021), <https://www.sec.gov/files/esg-risk-alert.pdf>. See Chapter 6.3—Additional Disclosure Guidelines for further discussion of the SEC Risk Alert on ESG investing.

<sup>28</sup> SEC, 2021 EXAMINATION PRIORITIES, DIVISION OF EXAMINATIONS (2021), <https://www.sec.gov/files/2021-exam-priorities.pdf>; SEC, 2022 EXAMINATION PRIORITIES, DIVISION OF EXAMINATIONS (2022), <https://www.sec.gov/files/2022-exam-priorities.pdf>. See Chapter 6.2—Applicable Law and Regulation for further discussion of recent SEC Examination Priorities.

<sup>29</sup> Enhanced Reporting of Proxy Votes by Registered Management Investment Companies; Reporting of Executive Compensation Votes by Institutional Investment Managers, Exchange Act Release No. 93169, Investment Company Act Release No. 34389, 86 Fed. Reg. 57478 (Oct. 15, 2021) (proposed Sept. 29, 2021) (to be codified at 17 CFR pts. 232, 240, 249, 270, and 274). See Chapter 6.2—Applicable Law and Regulation for further discussion of proposed amendments to proxy voting rules.

5. postponed the effectiveness of a 2019 rule that may inhibit the effectiveness of proxy advisors;<sup>30</sup>
6. addressed the role of ratings agencies in providing useful ESG assessments to the markets in its annual report on nationally recognized statistical rating organizations;<sup>31</sup>
7. brought [several] enforcement cases; and
8. established a website that highlights SEC's actions in the field and provides ESG-related investing information.<sup>32</sup>

## Legislative Action

Before the SEC's new Climate Disclosure Rule Proposal, Congress floated a few legislative proposals. The ESG Disclosure Simplification Act<sup>33</sup> would require annual proxy statements to include "a clear description of the views of the issuer about the link between ESG metrics and the long-term business strategy of the issuer and a description of any process the issuer uses to determine the impact of ESG metrics on the long-term business strategy of the issuer." The draft legislation would direct the SEC to require issuers "to disclose environmental, social, and governance metrics" in any filing that requires audited financial statements, and to define "ESG metrics," with specific authority to "incorporate any internationally recognized, independent, multi-stakeholder environmental, social, and governance disclosure standards" in that definition. Potential liability for ESG disclosures would be significant under the draft bill in that the metrics adopted would be made material *per se*. "It is the sense of Congress that ESG metrics, as such term is defined by the Commission . . . are de facto material for purposes of disclosures under the Securities Exchange Act of 1934 and the Securities Act of 1933." Another less ambitious, proposed bill is the Climate Risk Disclosure Act,<sup>34</sup> which would direct the SEC to require an issuer of securities to annually disclose information regarding climate change-related risks posed to the issuer, including an issuer's strategies and actions to mitigate these risks, as well as the issuers' direct and indirect greenhouse-gas emissions and fossil fuel-related assets. Publication of the Climate Disclosure Rule Proposal may have mooted these legislative efforts. However, if there are successful legal challenges to the SEC's authority to adopt the new proposal, federal legislation may become necessary to pave the way for final rules.

---

30 Gary Gensler, *Statement on the application of the proxy rules to proxy voting advice*, SEC (June 1, 2021), <https://www.sec.gov/news/public-statement/gensler-proxy-2021-06-01>.

31 *Staff Report on Nationally Recognized Statistical Rating Organizations*, OFFICE OF CREDIT RATINGS, SEC (January 2022), <https://www.sec.gov/files/2022-ocr-staff-report.pdf>.

32 SEC RESPONSE TO CLIMATE AND ESG RISKS AND OPPORTUNITIES, <https://www.sec.gov/sec-response-climate-and-esg-risks-and-opportunities> (last visited June 29, 2022).

33 Corporate Governance Improvement and Investor Protection Act, H.R. 1187, 117th Cong. (2021).

34 Climate Risk Disclosure Act of 2021, H.R. 2570, 117th Cong. (2021).

## Other Agencies and the Executive Branch

President Biden rejoined the Paris Climate Agreement on his first day on the job and, in April 2021, hosted the Leaders' Climate Summit, in which he pledged to reduce GHG emissions by up to 52 percent, relative to the level of 2005, by 2030. There have also been numerous Executive Orders tasking federal agencies to consider how climate science and treaties should shape agency policy and conduct going forward.<sup>35</sup> These early actions clearly set the tone for President Biden's administration, including the SEC. See Chapter 6.5—Qualified Benefit Plans/Fiduciary Duty for further discussion of the Executive Orders.

Other ESG-related actions by the Biden administration's financial units include the establishment of a climate risk unit by the Commodity Futures Trading Commission (CFTC),<sup>36</sup> the creation of climate-related committees by the Federal Reserve,<sup>37</sup> and the release of a staff educational paper on the intersection of ESG matters with financial accounting standards by the Financial Accounting Standards Board (FASB).<sup>38</sup>

## 3.3 UNITED KINGDOM

---

In the United Kingdom, the Companies (Strategic Report) (Climate-related Financial Disclosure) Regulations 2022 and the Limited Liability Partnerships (Climate-related Financial Disclosure) Regulations 2022 came into force on April 6, 2022. The first set of regulations amends the Companies Act 2006 and applies to companies that are publicly traded, as well as banking and insurance companies.<sup>39</sup> The regulations also apply to companies with over 500 employees and with either securities admitted on the Alternative Investment Market, or with a turnover of £500 million or whose parent company has a turnover of over £500 million. The second set of regulations amends the Limited Liability Partnerships (Accounts and Audit) (Application of Companies Act 2006) Regulations 2008 and applies to large non-traded or banking Limited Liability Partnerships ("LLPs") which have more than 500 employees and turnover of more than £500 million. The second set of regulations also applies to traded and banking LLPs with more than 500 employees.

Companies and LLPs subject to the regulations are required to include in their strategic reports a non-financial and sustainability information statement that contains climate-related financial disclosures. These climate-related financial disclosures must include:

---

<sup>35</sup> *E.g.*, Exec. Order No. 13990, 86 Fed. Reg. 7037 (Jan. 20, 2021) ("Protecting Public Health and the Environment and Restoring Science to Tackle the Climate Crisis").

<sup>36</sup> Press Release, CFTC, CFTC Acting Chairman Behnam Establishes New Climate Risk Unit (Mar. 17, 2021), <https://www.cftc.gov/PressRoom/PressReleases/8368-21>.

<sup>37</sup> Lael Brainard, Governor, Board of Governors of the Federal Reserve System, Financial Stability Implications of Climate Change, Speech at the "Transform Tomorrow Today" Ceres 2021 Conference (Mar. 23, 2021), <https://www.federalreserve.gov/newsevents/speech/brainard20210323a.htm>.

<sup>38</sup> FIN. ACCOUNTING STANDARDS BOARD, INTERSECTION OF ENVIRONMENTAL, SOCIAL, AND GOVERNANCES MATTERS WITH FIN. ACCOUNTING STANDARDS (Mar. 19, 2021), [https://www.fasb.org/Page/ShowPdf?path=FASB\\_Staff\\_ESG\\_Educational\\_Paper\\_FINAL.pdf&title=FASB%20Staff%20Educational%20Paper-Intersection%20of%20Environmental](https://www.fasb.org/Page/ShowPdf?path=FASB_Staff_ESG_Educational_Paper_FINAL.pdf&title=FASB%20Staff%20Educational%20Paper-Intersection%20of%20Environmental).

<sup>39</sup> The regulations apply to authorized insurance companies as well as to companies carrying on insurance business which in each case satisfy various conditions, including that of having more than 500 employees.

- descriptions of governance arrangements and processes for identifying, assessing and managing climate-related risks and opportunities, and how such processes are integrated into the company's or LLP's overall risk management process; and
- the principal climate-related risks and opportunities for the company or LLP and the potential impacts of these risks and opportunities on the company or LLP.

Additionally, companies and LLPs subject to the regulations must analyze the resilience of their business model and strategy to different climate-related scenarios and the targets and key performance indicators used to assess progress against climate-related risks and opportunities.

The regulations allow directors of a company or members of an LLP to omit the climate-related financial disclosures in whole or in part where they reasonably believe that they are not necessary for an understanding of the company's business. The strategic report must articulate an explanation for this belief.

These regulations make the UK the first G20 country to require its largest businesses to make climate-related disclosures that are aligned with Taskforce on Climate-related Financial Disclosures (TCFD) recommendations.<sup>40</sup>

### 3.4 ASIA

---

Throughout Asia, countries are taking steps to further integrate ESG considerations into their laws, economic and financial policies, and listing requirements. A selection of these developments is contained within this section.

#### China

China has taken a number of steps to revise its laws and regulations on the environment, introducing provisions dedicated to additional disclosure of environmental issues and compliance with environmental requirements. These include the Environmental Protection Law, the Air Pollution Prevention and Control Law, and the Water Pollution Prevention and Control Law. Even prior to recent ESG and clean energy initiatives, these efforts have been a way to combat dangerous levels of pollution, particularly within some of China's largest cities. Beginning in 2017, a policy was issued by the China Securities Regulatory Commission to require certain companies to disclose information on their environmental pollution and discharge. In 2019, the Shanghai Stock Exchange added a section specifically on social responsibility to its listing rules, including disclosure requirements for companies on environmental protection as well as product safety.

---

40 It should be noted that New Zealand passed similar laws in October 2021, but the requirements are not expected to become mandatory until financial years beginning in 2023.

In December 2021, China's Ministry of Ecology and Environment issued the Measures for the Administration of Legal Disclosure of Enterprise Environmental Information (the "Measures"), in order to standardize ESG reporting requirements for companies with a high environmental impact and which receive a high level of public attention. The Measures require companies to submit an annual report detailing environmental information, such as emissions of carbon and pollutants, pollution control facilities, as well as history of environmental violations. Companies subject to the Measures are also required to use specific standardized terminology based on specific guidance for legal disclosure of enterprise environmental information issued by the Ministry of Ecology and Environment. These Measures entered into force in February 2022.

On a different front, in April 2021, the People's Bank of China, the National Development and Reform Commission, the China Securities Regulatory Commission and other authorities collectively published a notice on issuing the green bond-endorsed projects catalogue that would unify the standards for green bonds in China.

## **Japan**

Japan has taken significant steps to develop an ESG-focused regulatory agenda. In December 2020, the Japanese Financial Services Agency (the "FSA") established the "Expert Panel on Sustainable Finance," which issued a formal report in June 2021 titled "Building A Financial System that Supports a Sustainable Society." The report identifies certain priorities, including the enhancement of corporate ESG disclosures, including sustainability and climate-related disclosures. Other areas discussed in the report include the role of institutional investors (asset manager, pension funds), improvements to ESG-related bond exchange platforms, and the role of financial institutions in supporting clients in the transition to a de-carbonized economy managing climate-related risks. In August 2021, the FSA issued its 2021 policy statement, providing the FSA's policy priorities between July 2021 and June 2022. With respect to ESG priorities, the FSA's policy statement included most of the recommendations described in the report prepared by the Expert Panel in June 2021.

The Japanese Corporate Governance Code was also revised in 2021, requiring listed companies to disclose their sustainability efforts. These new requirements apply to corporate governance reports issued following general shareholder meetings that take place after April 2022. Companies listed on the Prime Market of the Tokyo Stock Exchange will be required to collect and analyze data on the impact of climate change-related risks and opportunities on their business activities and profits, and will have to enhance the quality and quantity of disclosure in accordance with the Task Force on Climate-related Financial Disclosures (TCFD) recommendations or an equivalent framework.

## **Singapore**

Since June 2016, companies listed on the Singapore Exchange have been required to disclose annual sustainability reports.

In December 2021, the Singapore Exchange published a roadmap for issuers to provide climate-related disclosures (based on TCFD recommendations), according to which all issuers must provide climate reporting on a “comply or explain” basis in their sustainability reports. The roadmap also provides for an obligation for directors to undergo training on sustainability.

The new Singapore Exchange climate-related reporting rules will apply to issuers in the industries identified by TCFD as most affected by climate change and the transition to a lower-carbon economy. The regulation enters into force in different stages depending on economic sector. The new reporting rules will be applicable from the financial year commencing 2022 for companies in the financial, agriculture, food and forest products sectors. The new reporting rules will gradually extend to energy industries, materials, and building industries as well as transportation industries. The Singapore Exchange also recommends a list of 27 standardized core ESG metrics for issuers to use in their sustainability reporting.

## Hong Kong

In July 2020, the Hong Kong Stock Exchange (“HKEX”) introduced new ESG reporting requirements (mandatory disclosure rules and “comply or explain” rules) for listed companies. Under the ESG mandatory disclosure rules, HKEX-listed companies are required to provide a statement from the board which includes (i) a disclosure of the board’s oversight of ESG topics; (ii) an explanation of the board’s strategy and management of ESG matters and the process followed to evaluate and manage ESG topics; and (iii) how the board monitors the progress of ESG matters.

Under the “comply or explain” provisions, listed companies are required to disclose main ESG issues (environmental and social issues) which have impacted or may impact both the company and the company’s disclosure of practices used to identify environmental and social risks in its supply chain.

In August 2021, the Securities and Futures Commission of Hong Kong (“SFC”) adopted amendments to the Fund Manager Code of Conduct and issued a related Circular to Licensed Corporations which imposes requirements on fund managers to take climate-related risks into consideration in their investment and risk management processes, and subsequently make related disclosures. The concerned companies will be SFC-regulated asset management entities that manage collective investment schemes with investment discretion, and requirements differ for large fund managers above a certain threshold.

The SFC’s requirements will become effective according to different transition periods. The first deadlines for Large Funds Managers are August 2022, when they will have to be compliant with the baseline requirements, and November 2022 when they will have to be compliant with the enhanced standards.

## India

In May 2021, the Securities and Exchange Board of India introduced new ESG reporting requirements for the top 10,000 listed companies. This Business Responsibility and Sustainability Report will be mandatory for financial year 2023. The format is based on the nine interdependent and non-divisible principles stipulated in the National Guidelines on Responsible Business Conduct. These include principles related to (i) ethical, accountable and transparent governance; (ii) sustainability and safety; (iii) employees' well-being, including in the value chain; (iv) respect of all stakeholders' interests; (v) respect and promotion of human rights; (vi) environmental protection; (vii) responsible and transparent engagement in influencing public and regulatory policy; (viii) inclusive growth and equitable development; (ix) engagement with consumers.

## 3.5 AFRICA

---

Across Africa, several countries are progressively implementing ESG considerations into their economic and financial regulations. Some of those developments are highlighted in this section.

### South Africa

As of today, entities in South Africa are not legally mandated to explicitly provide ESG disclosures or reporting. However, the King IV Report on Corporate Governance for South Africa (2016),<sup>41</sup> prepared by the Institute of Directors of Southern Africa, enshrines recommendations for all South African companies and organizations to consider regarding ESG. The King IV Report sets out 17 principles, practices and outcomes which serve as the benchmark for corporate governance in South Africa, and introduces an “apply and explain” regime. Johannesburg Stock Exchange (“JSE”)-listed companies are required by the JSE to report annually their progress in complying with the King IV Report principles.

More recently, at the end of 2021, the JSE issued two Disclosure Guidance Consultation Papers—the JSE Sustainability Disclosure Guidance<sup>42</sup> and the JSE Climate Change Disclosure Guidance<sup>43</sup>—as voluntary guidance tools that may be used by listed companies. The JSE Sustainability Disclosure Guidance is aligned with the Global Reporting Initiative (GRI) Sustainability Reporting Standards, the TCFD recommendations, and the International Integrated Reporting Council's (IIRC) International Framework.

---

41 INSTITUTE OF DIRECTORS OF SOUTHERN AFRICA, KING IV REPORT ON CORPORATE GOVERNANCE FOR SOUTH AFRICA (2016), [https://cdn.ymaws.com/www.iodsa.co.za/resource/collection/684B68A7-B768-465C-8214-E3A007F15A5A/IoDSA\\_King\\_IV\\_Report\\_-\\_WebVersion.pdf](https://cdn.ymaws.com/www.iodsa.co.za/resource/collection/684B68A7-B768-465C-8214-E3A007F15A5A/IoDSA_King_IV_Report_-_WebVersion.pdf)

42 JSE SUSTAINABILITY DISCLOSURE GUIDANCE (2021), [https://www.jse.co.za/sites/default/files/media/documents//JSE%20Sustainability%20Disclosure%20Guidance%202021\\_SPS.pdf](https://www.jse.co.za/sites/default/files/media/documents//JSE%20Sustainability%20Disclosure%20Guidance%202021_SPS.pdf) (last visited July 5, 2022)

43 *Id.*

These tools have several objectives: to assist local companies to better understand ESG and global sustainability criteria, to increase and improve the quality of information available on sustainability and ESG in order to encourage informed investment, to address South Africa's specific sustainability challenges, and to improve sustainability performance and accountability. The JSE Climate Change Disclosure Guidance clarifies current global best practices in climate-related disclosures and provides a step-by-step guide for issuers.

## Morocco

Since February 2019,<sup>44</sup> companies listed on the Moroccan Capital Market have been required to disclose in their annual financial report an "Environment, Social and Governance" section. This is intended to inform the public about the impact of the company's activities on the environment, its relations with employees and external stakeholders, and its governance.

According to Article 2.59 of the Circular issued by the Moroccan Capital Markets Authority in 2019, the ESG report must contain general and specific information. For example, in the environmental section, the issuer must present all activities that may have an impact on the environment, describe its related policy, and present any litigation or lawsuits relating to environmental issues.

Therefore, until recently, few Moroccan companies integrated corporate social responsibility ("CSR") in their annual financial reports.<sup>45</sup> The new reporting requirement now broadens the scope of companies affected by this obligation.

## Tunisia

Since the adoption of Law No. 2018-35 in June 2018,<sup>46</sup> companies have been encouraged to allocate funds in order to promote CSR practices in local regions for a better coexistence between companies and their social environment. The law encourages both public and private sector companies to finance projects within the scope of CSR, such as projects allowing the development of youth employability and the evolution of the green economy.

---

44 MOROCCAN CAPITAL MARKETS AUTHORITY, CIRCULAR NO. 03/19 (Feb. 20, 2019), [https://www.ammc.ma/sites/default/files/Circulaire%2003\\_19%20relative%20aux%20op%C3%A9rations%20et%20informations%20financi%C3%A8res.pdf](https://www.ammc.ma/sites/default/files/Circulaire%2003_19%20relative%20aux%20op%C3%A9rations%20et%20informations%20financi%C3%A8res.pdf)

45 Asmaa Loudni, *Sociétés Cotées, une Adaptation Réussie aux Nouvelles Exigences de la RSE*, LA NOUVELLE TRIBUNE (Nov. 19, 2021), <https://lnt.ma/societes-cotees-une-adaptation-reussie-aux-nouvelles-exigences-de-la-rse/>

46 Loi n° 2018-35 du 11 juin 2018 (Tunis.), relative à la responsabilité sociétale des entreprises.

More recently, in December 2021, the Tunis Stock Exchange published a specific Guidance on ESG reporting.<sup>47</sup> The Guidance is intended for directors, managers, and executives of companies listed on the Tunis Stock Exchange to convince them of the usefulness of ESG for themselves, for the company, and for the community. This Guidance provides a number of indicators for a progressive approach to extra-financial reporting on ESG considerations. It is notably inspired by the Global Reporting Initiative standards, the recommendations of the World Federation of Exchanges, and the 17 Sustainable Development Goals adopted by the United Nations.

## Nigeria

The Nigerian Code of Corporate Governance (“NCCG”)<sup>48</sup> was adopted in 2018. The NCCG applies to all public enterprises, private enterprises that are holding companies of public enterprises or other regulated entities, concessionary or privatized enterprises, and regulated private enterprises. It sets forth 28 broad corporate governance principles with recommended practices under each principle. Regarding methods aligned with the adopted “Governance” principles, principle 26 of the NCCG specifically requires companies to provide adequate attention to sustainability issues, including environmental, social, occupational, and community health and safety issues. In order to meet this requirement, the Code suggests that companies adopt policies and practices regarding the social, ethical, safety, working conditions, health, environmental and anti-corruption responsibilities of the company.

At the end of 2018, the Nigerian Stock Exchange (“NSE”) published its Sustainability Disclosure Guidelines,<sup>49</sup> whose requirements have been effective since January 2019. Entities listed on the NSE are required to adopt sustainability reporting and encouraged to consider internationally accepted standards such as the GRI standards. In preparing their reports, Nigerian companies must consider four main elements: (i) the current status of the company’s structure, governance, economic opportunities, and the environmental and social impacts of its activities, (ii) the scope of its reporting, both geographically and in terms of its internal organization and how it addresses the entire value chain, (iii) the major sustainability issues they face and how they are identified and managed, and finally (iv) the identification of stakeholders and how the company has addressed their expectations and interests.

---

47 FIN. MARKET COUNSEL & STOCK EXCHANGE OF TUNISIA, VOTRE GUIDE DU REPORTING ENVIRONNEMENTAL, SOCIAL ET DE GOUVERNANCE – ESG (Dec. 2021), <https://sseinitiative.org/wp-content/uploads/2021/12/Tunis-Stock-Exchange-ESG-reporting-guidance.pdf>.

48 FIN. REPORTING COUNCIL OF NIGERIA, NIGERIAN CODE OF CORPORATE GOVERNANCE (2018), [https://ecgi.global/sites/default/files/codes/documents/nccg\\_2018.pdf](https://ecgi.global/sites/default/files/codes/documents/nccg_2018.pdf)

49 NIGERIAN STOCK EXCHANGE, SUSTAINABILITY DISCLOSURE GUIDELINES (2018), <https://www.incsr.org/wp-content/uploads/2018/12/Sustainability-Disclosure-Guidelines.pdf>.

## Kenya

Since the adoption of the Nairobi Securities Exchange (“NaSE”) ESG Disclosures Guidance Manual in November 2021,<sup>50</sup> NaSE-listed companies are required to publicly report on their ESG performance. At least once a year, those companies will have to issue an integrated report on these issues or a separate sustainability report. In particular, this reporting will be required for the proposed mandatory ESG disclosures in order to allow for comparability and consistency of such disclosures. However, companies subject to this new obligation have one year, until November 2022, to meet the legal requirements, while they familiarize themselves with the ESG reporting methods described in the guidance.

## West African Monetary Union (WAMU)

On March 27, 2020, the General Secretariat of the Regional Council for Public Savings and Financial Markets (CREPMF) issued Circular No. 01/CREPMF/2020<sup>51</sup> regarding the establishment of a guide for the issuance of green, social and sustainable bonds on the regional financial market of the WAMU.

The purpose of this guide is to encourage regional financial market operators to promote the use of capital markets to finance projects that address the region’s environmental, social, and sustainable development needs and thus help expand the investment ecosystem. In addition, this guide also aims at promoting the development of the green bond market in the WAMU zone, notably by attracting new national and international investors willing to invest in projects with high environmental and/or social impact. Therefore, it is intended for anyone wishing to issue green bonds in WAMU.

## 3.6 AUSTRALIA – NEW ZEALAND

---

### Australia

In Australia, companies are not subject to compulsory general ESG reporting, and so broad-based ESG reporting remains voluntary. However, as a general rule, listed companies are required, pursuant to the Corporations Act (2001, section 299A), to provide any information that members of the entity would reasonably need to make an assessment of an entity’s operations, financial position and business strategies. Such reporting could include discussion regarding ESG risks that a company is facing and that could have an impact on the information disclosed and on the company’s performance.

---

50 NAIROBI SECURITIES EXCHANGE ESG DISCLOSURES GUIDANCE MANUAL (Nov. 2021), <https://sseinitiative.org/wp-content/uploads/2021/12/NSE-ESG-Disclosures-Guidance.pdf>.

51 WEST AFRICAN MONETARY UNION, REGIONAL COUNCIL OF PUBLIC FUNDS AND FIN. MARKETS, Circular n°01/CREPMF/2020 (Mar. 20, 2020), [http://www.crepmf.org/Wwwcrepmf/Reglementation/pdf/Circulaires/CIR\\_PJ\\_2020\\_0001.pdf](http://www.crepmf.org/Wwwcrepmf/Reglementation/pdf/Circulaires/CIR_PJ_2020_0001.pdf).

In addition, Australia has introduced, at the federal level, mandatory reporting obligations for medium-to-large companies on specific ESG areas under specific acts, which include:

- *The National Greenhouse and Energy Reporting Act (2007)*, which provides a national framework and requires certain Australian companies (meeting specific thresholds) to report on greenhouse gas emissions, emissions removal or reduction projects, and energy consumption and production.
- *The Commonwealth Modern Slavery Act (2018)* entered into force in January 2019 and established a national modern slavery reporting requirement. The reporting requirement applies to large businesses and other entities in the Australian market with annual consolidated revenue of at least AUD\$100 million. Entities subject to the obligation are required to prepare annual statements, in order to identify and address their modern slavery risks, and maintain responsible and transparent supply chains. “Modern slavery” includes major violations of human rights and serious crimes which include, *inter alia*, trafficking in persons, slavery, forced labor or the worst forms of child labor. According to the Australian Parliament, there is a high risk that Australian businesses are exposed to modern slavery risks and that Australian goods and services are tainted by modern slavery.
- *The Commonwealth Workplace Gender Equality Act (2012)*, which requires private sector organizations with 100 or more employees to file an annual report to the Workplace Gender Equality Agency. The reporting questionnaire covers several operational aspects of workplace gender equality, including (i) policies and strategies; (ii) action on gender equality; (iii) employee work/life balance; and (iv) employee support (e.g., paid parental leave, support for careers, sex-based harassment and discrimination, and family or domestic violence).

## **New Zealand**

In October 2021, New Zealand passed the Financial Sector (Climate-related Disclosures and Other Matters) Amendment Act 2021 (FSAA), which provides uniform and broader non-financial reporting requirements targeting around 200 large financial organizations with a high level of public accountability. Such organizations (which include large publicly listed companies, insurers, banks, non-bank deposit takers and investment managers) will gradually be required to comply with these reporting obligations for financial years beginning in 2023. The reporting obligations are modeled on the TCFD recommendations. In accordance with the FSAA, the External Reporting Board (XRB) of New Zealand was tasked with developing reporting standards to support the new reporting regime. Under the FSAA, following the first reporting year, elements of the disclosures will be required to have independent assurance.

## 3.7 LATIN AMERICA

---

### Introduction

Over the last several years there has been a notable increase in ESG debt issuances in Latin America. While there were only 14 offerings worth \$6.5 billion in 2019, that number ballooned to \$22 billion in 2020, and grew even further in 2021 to \$32 billion, when the region had 36 debt issuances. These debt issuances, and ESG policies generally, have been an important tool to counteract the negative effects of several of the regional economies that are heavily reliant on extractive industries and agricultural and mining commodities. As described below, ESG policies adopted by different countries across the region have helped address these challenges, and have provided tangible benefits to better the welfare of those in the region. As a result, ESG-related investments and programs are expected to become more popular throughout the region.

### Brazil

Brazil has been one of the leaders in ESG initiatives in Latin America. In 2018, an offering of social-impact bonds financed Programa Vivenda, which subsidizes loans to low-income communities to pay for renovations and improvements in thousands of homes. Brazilian governmental organizations have also played a key role in promoting ESG programs in the country. The Brazilian National Monetary Council passed a resolution in 2018 to require pension fund managers to consider ESG risks in their investment decisions.<sup>52</sup> This resolution enhanced disclosure requirements to promote ESG considerations.

Brazilian President Jair Bolsonaro's views and policies presented obstacles to furthering sustainable development. Amazon deforestation has accelerated during his term, reaching a fifteen-year high in 2021.<sup>53</sup> This led many European investment firms and banks that had projects in Brazil to threaten divestment from companies and government bonds if there was not a change in these practices. Despite the challenges from the Bolsonaro administration, and with the push from investors in the country, the largest economy in Latin America has become home to the largest ESG programs in the region, and this can be expected to grow.

---

<sup>52</sup> BRAZILIAN MONETARY AUTHORITY APPROVES NEW ESG REQUIREMENTS IN THE INVESTMENT RULES OF OCCUPATIONAL PENSION FUNDS, UN ENVIRONMENTAL PROGRAMME FIN. INITIATIVE (July 10, 2018), <https://www.unepfi.org/news/industries/investment/brazilian-monetary-authority-approves-new-esg-requirements/>.

<sup>53</sup> Diana Roy, *Deforestation of Brazil's Amazon Has Reached a Record High. What's Being Done?*, COUNCIL ON FOREIGN RELATIONS (Mar. 17, 2022), <https://www.cfr.org/in-brief/deforestation-brazils-amazon-has-reached-record-high-whats-being-done>.

In 2020, Suzano, one of the largest pulp and paper producers in the world, issued \$750 million in sustainability-linked bonds with the sustainability targets of reducing carbon emissions by 11% by 2025, with a penalty of a 0.25% step-up in the interest rate if targets were not met. Suzano followed this in 2021 with \$1 billion and \$500 million in sustainability-linked bonds. The bonds took aim at reducing water consumption by 15% by 2026 and increasing the percentage of women in senior management positions to 30% by 2025, subject to a 0.15% penalty if the issuer fails to meet the water consumption goal and a 0.10% penalty if it fails to meet the diversity goal. In 2021, Klabin, another pulp and paper producer, issued \$500 million in sustainability-linked bonds with targets to reduce water consumption, increase recycling materials, and reintroduce endangered species in forest areas. Also, in 2021, Natura, a large Brazilian cosmetics manufacturer, issued \$1 billion in sustainability-linked bonds with targets of reducing greenhouse gas emissions.

In September 2021, the Central Bank of Brazil released its first “Report on Social, Environmental and Climate-related Risks and Opportunities.”<sup>54</sup> This report highlighted the impact of ESG programs in the country. Additionally, the Brazilian Securities and Exchange Commission has proposed new disclosure requirements to increase transparency for ESG investors.

## Mexico

Latin America’s second largest economy is home to the first sovereign bond in the world linked to the sustainability development goals set by the United Nations. In 2020, this novel bond issued by Mexico raised over \$889 million. The bond was incredibly popular and more than six times oversubscribed. The proceeds of this bond are allocated to finance ESG-related programs in cities across the country to tackle low literacy rates and poor health services, and provide utility services, including clean water and electricity, in homes. Also, in 2020, Patrimonio Autónomo Montes de Maria issued a \$209 million bond, the first tied to an infrastructure project in the region, and guaranteed by the U.S. International Development Finance Corporation.

Organizations throughout the country have also been proponents of ESG programs. Mexico’s pension fund regulator has issued rules for pension managers to incorporate sustainability criteria and look to ESG investments in managing pension portfolios.<sup>55</sup> The Mexican stock exchange has also created exchange-traded funds that track ESG indices and bonds.

---

54 BANCO CENTRAL DO BRASIL, REPORT ON SOCIAL, ENVIRONMENTAL AND CLIMATE-RELATED RISKS AND OPPORTUNITIES (2021), [bcb.gov.br/en/publications/report-risk-opportunity](https://www.bcb.gov.br/en/publications/report-risk-opportunity).

55 Amy Guthrie, *ESG Matters Take Center Stage in Latin America as Region Eyes Sustainability*, LAW.COM (Feb. 3, 2022),

[https://www.law.com/international-edition/2022/02/03/esg-matters-take-center-stage-in-latin-america-as-region-eyes-sustainability/#:~:text=Environmental%2C%20social%20and%20governance%20\(ESG\)%20issues%20are%20taking%20center,to%20create%20meaningful%20ESG%20policies](https://www.law.com/international-edition/2022/02/03/esg-matters-take-center-stage-in-latin-america-as-region-eyes-sustainability/#:~:text=Environmental%2C%20social%20and%20governance%20(ESG)%20issues%20are%20taking%20center,to%20create%20meaningful%20ESG%20policies).

These developments come at a time when Mexico's government has sought to increase the role of state-owned companies at the expense of private investment, particularly in the energy sector. ESG programs and developments in Mexico are expected to grow in the coming years despite these changes in government policy.

## Chile

Chile is another one of the leaders in ESG bond issuances in the region. In 2020, Chile issued green bonds in the region, generating \$1.5 billion and €1.65 billion in European markets to fund green and social projects. The government has also been a proponent of ESG investments, and has created incentives for related projects. In 2021, similar to other countries in the region, the Superintendent of Pensions now requires Chile's retirement plans to incorporate ESG risks and investments into their portfolios.<sup>56</sup> Recently, Chile has issued an additional \$2 billion in sustainability-linked bonds tied to the Paris Agreement on climate, raising the total amount of ESG-related bond issuances over the past three years to about \$33 billion.<sup>57</sup>

## Colombia

Colombia's government has played a leading role in promoting ESG investments in the region. The Colombian National Council on Economic and Social Policy has enacted laws and advanced policies to promote new sources of sustainable economic growth. Furthering these developments, in 2021 Colombia's Financial Superintendency adopted Circular 007, requiring all Colombian institutional investors to discuss how ESG factors were evaluated when making investment decisions in their mandated disclosures.<sup>58</sup> The Financial Superintendency has also issued best practices for the issuance of green bonds in the country. Colombia's interest in ESG and sustainable development is notable, as the country issued the first gender-focused social bond with incentives in a deal worth \$100 million in August 2020.<sup>59</sup> The funds from the bond were earmarked to be used to finance women entrepreneurs and purchase social interest houses by women in Colombia.

---

<sup>56</sup> Fatima Meneses & Steven Hyland Jr., Ph.D., *Private Pension Plans in Latin America and Sustainable Finance*, PRESS FREE (Sept. 8, 2021), <https://thepressfree.com/private-pension-plans-in-latin-america-and-sustainable-finance/>.

<sup>57</sup> Ryan Jeffrey Sy, *World's first sovereign sustainability linked bond issued by Chile*, SP GLOBAL (Mar. 4, 2022), <https://www.spglobal.com/marketintelligence/en/news-insights/latest-news-headlines/world-s-1st-sovereign-sustainability-linked-bond-issued-by-chile-69226229>.

<sup>58</sup> CIRCULAR EXTERNA 007 DE SUPERINTENDENCIA FINANCIERA (Apr. 26 2021), <https://vlex.com.co/vid/866596373>.

<sup>59</sup> Gema Sacristán & Sandra Reyes, *Colombia Leads the Gender Bond Market in Latin America & the Caribbean*, IDB INVEST (Mar. 17, 2022), <https://idbinvest.org/en/blog/gender/colombia-leads-gender-bond-market-latin-america-caribbean>.

## Paraguay

Paraguay has had a strong commitment to promoting ESG policies in the country, particularly in matters related to climate change. The country's Itaipú hydroelectric plant has been instrumental in allowing Paraguay to establish a clean and renewable energy supply. In 2021, Paraguay incorporated the Sustainable Development Goals bonds in its national regulation to help finance projects with green, social or sustainable goals, becoming the first country in Latin America to do so.<sup>60</sup> Additionally, Paraguay has announced that ESG-related projects will be included in the national budget. The government will also work on providing guidelines for green financing that are national priorities in 2022, and in developing a fiscal policy aimed at creating incentives to mitigate climate change.

## Perú

Private pension funds constitute the largest institutional investors in Latin America, with over \$900 billion in assets under management. As has been noted, several regulators in countries throughout the region have used private pension funds as a way to promote ESG programs and investments. Peru is no exception. In 2020, the Chartered Financial Analyst (CFA) Institute announced that Prima AFP became the first pension fund in Perú to comply with the CFA Asset Manager Code. The Asset Manager Code outlines a number of ethical and professional responsibilities for organizations that manage assets. Prima AFP manages the funds of 2.3 million people, or about 31% of the market in the country. Regulators have also proposed that pension funds adopt ESG standards in their investment policies.

## Conclusion

ESG and sustainable development programs are growing in Latin America. IDB Invest, the private-sector arm of the Inter-American Development Bank, is currently planning to issue \$2 billion in sustainable bonds in 2022. As countries throughout the region continue to promote and issue guidance on ESG policies, investment is expected to grow. Recent developments, as described herein, show the interest investors and countries have in ESG-related projects. Latin America is expected to see increased activity in ESG as countries and institutional investors continue to promote these practices as a means of providing critical financing, while placing sustainable development at the forefront.

---

60 Silvia Morimoto, Paraguay first to adopt SDG bonds in its national regulation, UN DEVELOPMENT PROGRAMME (Apr. 15, 2021), <https://www.undp.org/blog/paraguay-first-adopt-sdg-bonds-its-national-regulation>.



# 4

## **ESG for Lenders and Borrowers**

# ESG for Lenders and Borrowers

## 4.1 OVERVIEW OF SUSTAINABILITY-LINKED LOANS AND GREEN LOANS GUIDANCE

---

Like the finance community generally, both lenders and borrowers have become more and more focused on ESG considerations in recent years, and we expect this trend to continue.

On March 20, 2019 the Loan Market Association (“LMA”), Loan Syndications and Trading Association (“LSTA”) and Asia Pacific Loan Market Association (“APLMA”) published their Sustainability-Linked Loan Principles (“SLLPs”), which were further updated in May 2021. The SLLPs establish a voluntary framework for the design and negotiation of sustainability-linked loans (“SLLs”). SLLs are loans that have certain terms (including interest rate margins and commitment or facility fees) tied to environmental sustainability performance targets of the borrower (e.g., increased use of renewable energy, reduction in greenhouse gas emissions, improvements in energy efficiency rating of buildings owned or leased by the borrower, and increases in the use of verified sustainable raw materials) as well as social standards (e.g., reduction in workplace injuries, increase of gender diversity in senior management, and increased purchasing from businesses with racially-diverse owners).

Similarly, the LMA, LSTA and APLMA published the Green Loan Principles (“GLPs”) in 2018 (and updated said GLPs in 2021). The GLPs comprise four key components that determine whether or not a loan can be considered “green.” These components are (1) use of proceeds (e.g., renewable energy and energy efficiency projects, pollution prevention projects, among others), (2) process for project evaluation and selection (i.e., the green standard or certification by which the borrower will select and evaluate a project), (3) management of proceeds (i.e., proceeds kept in a designated account or otherwise tracked with internal governance procedures monitoring the allocation of funds), and (4) reporting (e.g., qualitative and quantitative performance indicators, up-to-date information on the use of proceeds).

The most common method of encouraging borrowers to improve their ESG performance is through pricing incentives using the SLLPs and key performance indicators, whereby borrowers are rewarded (or penalized) with interest rate margin and fee reductions (or increases) depending on their ability to meet or exceed certain sustainability performance targets relating to ESG factors. The SLLPs establish model sustainability performance targets that borrowers and lenders can adapt to suit a particular company or industry. Typically, the margin and fee adjustments are quite modest (usually plus or minus 2.5 basis points), though there has been a trend in recent years to increase the margin and fee penalties and rewards to as high as 15 basis points to add some teeth to the SLLPs (discussed below).

## Recent Developments in the ESG Market

The focus on net-zero emissions goals on the international stage has led to a rapid rise in ESG debt financings (both loans and bonds), with such ESG financings exceeding \$1.6 trillion in 2021.<sup>1</sup> Similarly, SLLP mechanics relating to ESG factors are increasingly appearing in the loan and bond markets. In addition, the key performance indicators, which initially focused on greenhouse gas emissions, have evolved to include more social and governance goals, such as female representation at the management or board levels. There is guidance for addressing social goals in finance in the Social Loan Principles published by the LMA, LSTA and APLMA in April 2021.

Typically, SLLs will include two to four key performance indicators with targets to be achieved over a five- to six-year period, with pricing incentives ranging from plus or minus 2.5 basis points to 15 basis points.<sup>2</sup> The higher pricing adjustments are typically tied to more complex structures where all of the key performance indicator targets rather than the individual key performance indicator goals must be achieved.<sup>3</sup> Meanwhile, the small pricing adjustments have led to criticism that SLLs and green loans are merely symbolic gestures made by borrowers, as the penalties for a failure to meet the metrics are relatively insignificant.<sup>4</sup> There has been movement (particularly in the European Union) to standardize and regulate the terms and requirements of green loans and SLLs given the large increase of loan origination in the ESG market and the lack of comparable and reliable data across various SLLs and green loans.

## Examples of Recent Public SLL Financings

- Covanta Holding Corporation (“Covanta”), a waste management services company, entered into an ESG credit agreement on November 30, 2021 with two key performance indicators focused on (1) sustainably processed waste and (2) waste recycled or reused, whereby all waste managed (whether processed or recycled/reused) by Covanta must meet the waste management hierarchy established by the United States Environmental Protection Agency and the European Union. The incentive adjustment for each is plus or minus<sup>5</sup> 12.5 basis points to the applicable interest rate.

---

1 *Sustainable Debt Issuance Breezed Past \$1.6 Trillion in 2021*, BLOOMBERGNEF (Jan. 12, 2022), <https://about.bnef.com/blog/sustainable-debt-issuance-breezed-past-1-6-trillion-in-2021/>.

2 The key performance indicators are the specified criteria against which the borrower’s performance is measured, whereas the sustainability performance targets are the threshold values (relating to the key performance indicators) that the borrower must meet in order to receive their margin credit.

3 EUROPEAN LEVERAGED FIN. ASSOCIATION, *THE EMERGENCE OF ESG PROVISIONS IN LEVERAGED FIN. TRANSACTIONS* (Jul. 7, 2021), <https://elfainvestors.com/wp-content/uploads/2021/07/ELFA-Insights-17-The-Emergence-of-ESG-Provisions-in-Leveraged-Finance-Transactions.pdf>.

4 Michael Tobin & Davide Scigliuzzo, *Wall Street’s ESG Loans Charge Corporate America Little for Missed Goals*, BLOOMBERG (Sept. 8, 2021), <https://www.bloomberg.com/news/articles/2021-09-08/esg-financing-comes-with-few-penalties-for-missing-goals#:~:text=About%2040%25%20of%20the%20borrowers,swing%20of%2010%20basis%20points.>

- Occidental Petroleum Corporation (“Occidental”) entered into an ESG credit agreement on December 10, 2021 with one key performance indicator focused on the percentage reduction (or increase) in greenhouse gas emissions produced from assets operated by Occidental. The credit agreement provides for the key performance indicator metrics to be reviewed by a third-party sustainability assurance provider, and the incentive adjustment to the applicable interest rate is no more than plus or minus 4 basis points, and the incentive adjustment to the facility fee is no more than plus or minus 1 basis point.

## Representative Recent ESG Transaction

As an example, we recently acted for the administrative agent and a co-sustainability structuring agent in the refinancing of a \$250 million revolving credit facility for a public utility company. As part of the refinancing process, the revolving credit facility was layered with SLL mechanics, including one social key performance indicator and one environmental key performance indicator. For the social indicator, the revolving credit agreement included a workplace safety metric (based on the number of incidents reportable to the Occupational Safety and Health Administration (“OSHA”)),<sup>6</sup> whereby the borrower would be awarded with a 2.50 basis points decrease in the applicable interest rate margin as well as a 0.50 basis point decrease to the commitment fee (on the unused amount of the revolving commitments) if workplace injuries were kept below a certain target of reportable OSHA incidents per year (set at 90% of the three-year average of reportable OSHA incidents for the borrower). Conversely, if the number of reportable OSHA incidents exceeded a threshold amount (such threshold set to 110% of the reportable OSHA incident three-year average), the borrower would receive a 2.50 basis points increase to the applicable interest rate margin and a 0.50 basis points increase to the commitment fee.

---

5 An ESG loan will have a band of performance outcomes around an average. For example, if company gas emissions averaged 0.75 units per year over the last few years, the ESG loan will set a target (*i.e.*, gas emission reduced to 0.50 units per year), which will result in a decrease of 12.5 basis points in the applicable margin, and a threshold (*i.e.*, gas emission increased to 1.0 units per year), which will result in an increase in 12.5 basis points to the applicable margin, and if the company falls between 0.50 and 1.0, then no change in margin occurs.

6 Notably, the SLL market for OSHA incident-linked KPIs generally excludes COVID-19 related incidents, as those cases are not generally considered the type of workplace safety that the KPI metric was intended to capture. This illustrates the adaptable and flexible nature of the various KPI metrics.

For the environmental indicator, a renewable-energy metric was included whereby the borrower is rewarded (or penalized) 2.50 basis points with respect to the applicable interest rate margin and 0.50 basis points with respect to the commitment fee if the borrower meets the target renewable energy production metric (that is, whether the megawatts generation capacity from biothermal, hydroelectric, solar and other renewable energy sources meets the target projection, which is 110% of the expected renewable generation capacity of the borrower, assuming expected renewable generation growth of 10% per year) or falls below the threshold (which is 90% of the expected renewable generation capacity). For both key performance indicators, if the borrower falls within the 90% to 110% target/threshold window, there would be no change to the interest rate margin or commitment fee.

The borrower is required to deliver an annual pricing certificate to the administrative agent under the revolving credit facility, which certificate will contain the quantitative information (based on an annual key performance indicator report prepared by the borrower) needed to determine whether the borrower achieved, or failed to achieve, the applicable key performance indicator thresholds and targets for the previous fiscal year. If the borrower fails to deliver the annual pricing certificate when required, the pricing increases will be implemented until the pricing certificate is delivered and a final determination is made.

The social metric was implemented by the borrower to demonstrate the borrower's dedication to improve workplace safety (along with other company-wide initiatives), and the environmental metric was implemented to help reduce carbon emissions by at least 80% by 2035 in support of the 2015 Paris Agreement and to increase its power generation based on renewable energy to meet its goal of 70% renewable energy generation by 2035.

## Further Considerations

For investors, funds, public and private companies, banks and others considering how to be more active in the sustainable finance market, these recent developments present a broad range of options for increasingly sophisticated, bespoke solutions to meet desired objectives. Significantly, SLLs add direct commercial incentives by way of decreased debt financing costs for borrowers that meet their negotiated targets (and increased financing costs for failure to meet the pre-set SLL indicators). In some cases, investors and participants in the SLL market will look for the borrower to use the savings from meeting its key performance indicator targets by investing such savings at least partially in further ESG-focused initiatives.<sup>7</sup>

---

7 See EUROPEAN LEVERAGED FIN. ASSOCIATION, THE EMERGENCE OF ESG PROVISIONS IN LEVERAGED FIN. TRANSACTIONS (Jul. 7, 2021), <https://elfainvestors.com/wp-content/uploads/2021/07/ELFA-Insights-17-The-Emergence-of-ESG-Provisions-in-Leveraged-Finance-Transactions.pdf>.

Deciding what qualifies as “green,” “social” or “sustainable” remains a key consideration, as does ensuring ongoing transparency and compliance with relevant sustainability commitments. While most market standards remain voluntary, borrowers need to consider the reputational risks of non-compliance, and carefully track trends which may change (and increase) market expectations. As sustainable finance continues to develop and diversify at a rapid pace, it is important for all market participants to monitor the evolution of market regulations, standards, practices and perceptions with counsel in the ESG space.

## 4.2 GENDER LENS LOANS: A USEFUL GUIDE TO ESG LENDING

---

Lenders and borrowers are increasingly interested in incorporating ESG values in loan terms, but the opportunities and challenges are not obvious. A 2021 report<sup>8</sup> on creating loans that prioritize gender considerations, *i.e.*, using a gender lens, is useful beyond the gender lens category.<sup>9</sup> The Report explores this detail, providing insight on loan terms and mechanisms that work and the hidden pitfalls of approaches that might otherwise have appeared attractive.

The Report’s value is significant because it is based on several years of actual lending, monitoring, and results from Calvert, one of the global pioneers in ESG investing, plus 20 other leading-edge participants in this space. The approaches to incorporating gender lens considerations into loan terms are also easily analogized to other ESG objectives that loan negotiation and documentation might address, such as key performance metrics, among others. As banks and non-bank lenders seek to improve loan performance and the ESG profile of their loan portfolios, references like the Report provide real guidance for adding value, reducing risk, and avoiding unintended consequences.

### Overview

The Report observes that lenders have many influences that may lead to including gender lens considerations into lending practices, from outside investors to changing internal dynamics. In every aspect of drafting gender lens considerations into deal terms, lenders and borrowers will want to strike a balance between accountability for the impact and flexibility for the business. The investors who shared their experience for the Report identified the need for greater uniformity in best practices as the greatest challenge in expanding gender lens investing programs, particularly because sharing of practices or creating a common framework for gender lens loan documents can facilitate collaboration and syndication among lenders.

---

8 Leigh Moran, *Gender Lens Investing: Legal Perspectives How Investors Incorporate Gender Considerations Into Deal Documentation*, CALVERT IMPACT CAPITAL (Mar. 25, 2021), <https://calvertimpactcapital.org/resources/gender-lens-investing-legal-perspectives> (the “Report”).

9 For more on what gender lens considerations are, see Leigh Moran, *Just Good Investing: Why gender matters to your portfolio and what you can do about it*, CALVERT IMPACT CAPITAL (Dec. 5, 2018), <https://calvertimpactcapital.org/resources/just-good-investing> (discussing how to incorporate gender into investment strategies with examples of performance reporting and a due diligence framework).

## Documentation

**Loan Agreements.** In the ESG context, recitals can be useful to state intentions. While sometimes a formal exercise, stating intentions is of real value where investors include philanthropies obligated to demonstrate to the IRS that investments align with a mission or are program-related. Meanwhile, disbursement mechanisms that are dependent on progress indicators may prove less useful than parties expect, especially where the desired impacts can only be achieved over longer time periods than practical disbursement intervals or loan renewals allow. Representations and warranties often are not well-suited to advance ESG objectives, with the possible exception of a scenario where the representation covers a factual situation that is material to the program, or the borrower's equity owners or leaders belong to a target demographic the impact loan program is meant to serve.

In the gender lens sector, participants found gender considerations at stake to be too qualitative or contextual to be captured usefully in covenants. This may also be true for other ESG considerations. Covenants may also constrain the borrower's ability to address opportunities or conditions not foreseen at the time of signing, or impose an obligation on the parties to monitor and report on covenant compliance that would be impractical or commercially unreasonable to fulfil given the size or duration of the loan. Finally, breach of a covenant may throw otherwise performing loans into default, and even trigger cross-defaults, making the borrower's financial situation unnecessarily more precarious if qualitative ESG goals are bound by covenant.

In contrast, the affirmative covenants commonly made as to use of proceeds, reporting, and key persons can be quite useful. Criteria that mandate use of proceeds in furtherance of the ESG objective are a core example, although even there, some parties prefer to draft these commitments into a side letter so that they can be separated from covenants and events of default in the loan agreement. Use of proceeds covenants may be especially important in loans made to intermediaries for on-lending to women or other historically undercapitalized demographic groups. Affirmative reporting obligations may prove especially useful in a gender equity context. These can require periodic reporting to track against achievement of identified milestones or represent an open-ended obligation to report on matters reasonably requested by the lender from time to time. Short-term lenders may find it practical to require borrowers to report on ESG milestones and other key performance indicators after repayment as a condition to additional financing. Key person covenants are also useful where the loan is made specifically to support women or minority-owned businesses.

**Alternatives to Loan Agreements.** As mentioned above, including ESG considerations as terms in loan agreements can have negative unintended consequences, such as limiting flexibility in the lender's or borrower's businesses, or triggering defaults, cross-defaults, or other penalties on otherwise performing loans. Lenders have pursued other tools and strategies to promote ESG goals with their loan portfolio. Side letters are legally enforceable agreements entered into outside the loan agreement itself and, used properly, can support the ESG objectives of the arrangement without adding to the risk of cross-default or cross-acceleration.

Some lenders seek to build long-term relationships with borrowers by entering into relying on informal agreements or a non-enforceable memorandum of understanding or letter of intent to express understandings about the ESG-related goals. Parties using this approach advocate that it gives them greater flexibility to address challenges of ESG-related lending, including borrower non-compliance events. The viability of this route is affected by how many loans will be in the portfolio (*i.e.*, how many relationships of appropriate depth and quality the lender can sustain) and whether monitoring and impact measurement tools are available to demonstrate the efficacy of informal agreements.

### **Consequences of Non-Compliance**

One of the risks in seeking the right to impose penalties for non-compliance with gender lens or other ESG objectives is that borrowers may choose not to work with lenders that do so, at least in markets where other sources of capital are available to the borrower. In some markets this might mean the lowest-risk borrowers gravitate away from an ESG-focused lender, leaving the ESG lender with a weaker suite of borrowers and less diversification of risk. This is one business driver that prompts lenders to prefer consequences for non-compliance that give them the option to return to the table with the borrower rather than terminating the loan or the relationship. In many markets, borrowers face challenges beyond gender equity or other ESG considerations, such as operating in an emerging market or other external challenges. If a borrower seeks credit from more than one lender, the potential for critical consequences for non-economic performance defaults in ESG-based loans may scare off traditional (non-ESG) lenders. For this reason, borrowers also favor mechanisms that offer flexibility in addressing non-compliance or unmet goals.

## **4.3 VALUES-BASED FINANCE: A CASE STUDY OF ISLAMIC FINANCE**

---

Being able to invest capital in a manner that aligns with one's values has been a significant driver of ESG investment, appealing particularly to religious institutions and investor groups with a religious affinity. The market now can offer investors defined by their religious values the opportunity to put endowments, reserves, and other capital to work in ways that are consistent with those values by using negative screening, positive screening, and innovative terms and structures. A good example is the recent rise in demand for Islamic finance investments that also have ESG goals. This chapter discusses examples of applications for Islamic finance, pitfalls, and other considerations in using the elements of Islamic finance as a key ESG tool.

## Islamic Finance Overview

Islamic finance is a type of values-based financing that structures investments to comply with the *sharia* (i.e. the tenets of the religion of Islam), principally found in 12 jurisdictions across the Middle East and Southeast Asia. It is often called “business with ethics,”<sup>10</sup> and aims to avoid potentially harmful and exploitative practices. Islamic finance does this in two main ways: (i) prohibiting *riba* (interest) and excessive *gharar* (uncertainty) in transactions to prevent unjust and unequal exchanges; and (ii) requiring tangible assets in transactions and prohibiting investments in certain businesses deemed unethical or harmful to society. These parameters are then assessed by a *sharia* supervisory board that issues a *fatwa*, or non-binding opinion, on the permissibility of the transaction, akin to obtaining the third-party verification featured by some green bond programs.

## Embedding ESG Objectives in *Sharia*-Compliant Investments

While Islamic finance investment structures address investor values that are aligned against interest and uncertainty, these structures may also be used to promote ESG-related investment objectives. Using positive and negative screening tools common to Islamic finance, capital may be consciously deployed to support beneficial underlying projects and assets. Islamic finance uses exclusionary screening to avoid investments in prohibited (*haram*) industries such as alcohol, tobacco, pornography, gambling, weapons, and human trafficking, and these same techniques can also screen out pollutive industries, companies that are not doing enough to meet Net Zero 2050 goals, or companies with poor records on other ESG issues such as poor labor practices, or negative externalities. Similarly, the due diligence, transparency and monitoring tools already used to identify desirable targets for *sharia*-compliant investing (e.g., measuring the percentage of profits derived from alcohol sales or the debt-to-market capitalization ratio of a business, as some examples) can be applied to identify and oversee investments in companies with ESG-aligned conduct and operations.

While it is possible for an investment to be *sharia*-compliant and ESG-compliant at the same time, investors should note that it is also possible for investment offerings to serve one of these goals and not the other. For example, an investment in a mineral-extracting mine could be *sharia*-compliant, but not ESG-compliant and an investment in a heavily-leveraged wind farm may be an ESG-compliant investment but not *sharia*-compliant.

## Embedding Islamic Values in Investment Structures

The Islamic values opposing the payment or receipt of interest, uncertainty, and exploitative terms must be addressed in the investment structure and terms, beyond the investment objective. We will be discussing those in the context of (i) sustainability-linked loans (SLLs) and (ii) sustainability bonds or *sukuks*.

---

10 See generally Yusuf Talal DeLorenzo & Michael McMillen, Joint Address at the National Council on U.S.-Arab Relations Conference: Islamic Finance and the Global Economic Crisis (Feb. 17, 2009).

As discussed in Chapter 4.1—Overview of Sustainability-Linked Loans and Green Loans Guidance, the most common method of encouraging borrowers under SLLs to improve their ESG performance is through pricing incentives whereby borrowers are rewarded (or penalized) with interest rate margin and fee reductions (or increases) depending on their ability to meet or exceed certain sustainability performance targets relating to ESG factors. The margin and fee adjustments are typically small, commonly plus or minus 2.5 basis points. Such adjustments may be considered interest, and hence prohibited under the Islamic finance principles described earlier. Therefore, Islamic finance practitioners must structure around the prohibition, often treating margin and fee adjustments as they would default interest, another common feature in conventional finance.

In a conventional loan facility, default interest is typically a fixed-rate interest penalty charged for failure to repay loans, and the customary equivalent term in Islamic finance for a loan or *murabaha* facility is to agree contractually to a late payment amount instead. Often, the lender will direct any late payment amounts collected to an Islamic charity after deducting any actual costs that the lender incurred in collecting the late payment amounts. The margin and fee adjustments in a *sharia*-compliant SLL would likely be treated similarly, perhaps characterized as performance payment amounts rather than simply late payment amounts. In investments with ESG investment objectives, parties may decide to have the performance payment amounts contributed to an Islamic charity or other ESG initiatives, which would then help further ESG goals and the aim of positive screening under Islamic finance. Failure to structure these adjustments appropriately may hinder receipt of a timely *fatwa*, potentially resulting in a non-compliant structure unsuitable for most *sharia*-sensitive investors.

## **Embedding Islamic Values in Capital Markets Transactions**

For Islamic values-based investors, there are recent advances in creating capital markets transactions that can both be *sharia*-compliant and promote ESG objectives, notably issuances of sustainable or green *sukuks*. In June 2021, the International Capital Market Association (ICMA) published an updated version of its Green Bond Principles (GBPs). First published in 2014, the GBPs are a voluntary framework for issuers to follow when issuing green bonds, aimed at promoting the role of debt capital markets in financing the transition to environmental sustainability by promoting transparency and disclosure, thereby reducing the risk of transactions that appear on the surface to be ESG-informed but in fact are not, a practice known as “greenwashing.” Sustainable and green *sukuks* comprise the Islamic finance near-substitute for green bonds.

A sustainable *sukuk* is a *sharia*-compliant investment instrument, the proceeds of which are used to fund eligible sustainability projects, and a green *sukuk* is an investment instrument in which the issuer uses the proceeds of the issuance to fund green projects exclusively, most notably renewable energy or green infrastructure projects.

Investors in the fast-growing emerging markets of the Middle East, Northern Africa and Southeast Asia are driving the increasing appetite for these types of investments at the intersection of *sharia*-compliance and ESG mandates. For instance, Riyadh Bank's recent sustainability issued on February 11, 2022 in Saudi Arabia was 4.3 times oversubscribed, and September 2021's Kuveyt Türk Katilim Bankasi's green *sukuk* in Turkey was 12 times oversubscribed.<sup>11</sup> However, conventional ESG investors active in these regions need to understand that most instruments may not be secured in the conventional sense, as collateral provisions are dependent on how the *sukuk* is structured.

A *sukuk* is typically structured along the lines of a repurchase agreement, but the principle under Islamic finance is that *sukuks* are considered to represent an undivided share in the ownership of a pool of tangible assets, usufructs or services which are anticipated to provide an income stream.

In the case of an asset, an asset owner transfers an asset to the issuer, typically a special purpose vehicle (SPV), for cash. From there, a may be structured so that the asset transfer is a nominal sale but not a true sale of the underlying assets to the SPV. Without a true sale, holders are generally treated as unsecured creditors of the SPV.

---

<sup>11</sup> See Oxford Business Group, *What Does This Year Hold for Saudi Arabia's ESG-Focused Islamic Bond?*, OIL PRICE (Feb. 17, 2022), <https://oilprice.com/Alternative-Energy/Renewable-Energy/What-Does-This-Year-Hold-For-Saudi-Arabias-ESG-Focused-Islamic-Bond.html>

Even in the case of a true sale of assets to the SPV, there may be contractual arrangements to ensure that the SPV and the *sukuk* holders (*i.e.*, investors in securities issued by the SPV) have no real claim on the underlying assets. The asset originator normally provides a purchase undertaking such that the SPV must transfer the assets back to the originator upon the redemption of the *sukuk* or in the event of a default. Once the SPV transfers the assets back, it will have a contractual claim against the originator for payment of the purchase price for the assets, equal to the face amount of the *sukuk*, but with no legitimate claim against the assets. The SPV cannot keep the asset and sell it for repayment of this obligation. This therefore places the SPV (and its investors) in a position similar to a bondholder under a conventional unsecured bond. It follows that investors in *sukuk* issuers would likely be treated as unsecured creditors in a bankruptcy or restructuring workout. It is important for ESG investors to be aware of this difference between secured bond offerings and *sukuks*, and to devote appropriate efforts to understand the protection afforded to them based on the particular *sukuk's* structure.

The Accounting and Auditing Organization for Islamic Financial Institutions (AAOIFI), as the primary nonprofit seeking to standardize Islamic financial transactions, is encouraging a movement towards asset-backed structures in which the investors have actual recourse to the assets in the event of a default, and so ESG investors participating in sustainability or green *sukuks* may consider pushing the originators and their counsel for structures based on AAOIFI standards.

## Embedding Islamic Values in Operations

Companies seeking to be suitable investments for Islamic investors with ESG mandates must follow an approach to embedding both types of values in policies and procedures that look beyond the conduct of the company itself, through to its supply chain and arrangements with counterparties and other stakeholders. Recent and proposed SEC rules regarding supply chain disclosures and related developments may assist in this regard, and modern ESG compliance programs include policies and procedures addressing not only the company's own actions, but also the alignment of suppliers and vendors with the company's ESG goals. Similarly, companies that seek to attract *sharia*-sensitive investors should have policies and procedures to assure, or at least promote, that suppliers and vendors of the company also employ *sharia*-compliant products and practices, whether or not mandated by law or regulation.

As an example, companies in the aviation industry and other equipment, and hard asset-driven industries may seek to conduct more of their business operations in accordance with Islamic finance values that satisfy ESG principles. To fulfill these values consistently, an airline or aviation leasing or other equipment leasing company could seek to assure that a certain percentage of its leased fleet was subject to *sukuk* financings in the first instance, that some or all of its owned fleet be financed through *sukuks* as opposed to other capital markets products, and that its supply chain and counterparty practices also support Islamic finance values. Other industries which thoughtfully applied a principled approach to their operations could also be good candidates for Islamic finance, and in turn would be more likely to satisfy ESG-driven concerns.

## Further Considerations

Modern Islamic finance has been in use for at least 60 years, providing interesting data over time. Notably, *sharia*-compliant products have proven to improve the financial bottom line. Case studies have shown that ESG and Islamic finance investments tend to have higher yields in the long term compared to traditional finance investments, because strong ESG or Islamic finance practices are likely to avoid social or public controversies, attract better staff and develop stronger supply chains.<sup>12</sup> In light of these results, finance parties should consider values-based investing and loan structures, whether that means structuring investments to avoid violation of religious values or to pursue ESG objectives, or both.

---

<sup>12</sup> See CFA INSTITUTE, SUSTAINABLE, RESPONSIBLE AND IMPACT INVESTING AND ISLAMIC FIN., SIMILARITIES AND DIFFERENCES (2019), <https://www.cfainstitute.org/-/media/documents/survey/sri-investing-and-islamic-finance.ashx>.



## **ESG for Operating Companies**

# ESG for Operating Companies

## 5.1 PUBLIC COMPANY FINANCIAL DISCLOSURES

---

The SEC and other financial regulators are intensely focused on environmental, social, and governance (ESG) matters, each within the context of their legal/regulatory systems. This focus reflects governmental commitments to climate management treaties and growing pressure from investors and other stakeholders for public companies to disclose and address ESG issues directly and effectively. The SEC's stated policy goal is to develop a framework for companies, and especially public reporting companies, to make accurate and meaningful disclosure of material ESG issues, in the context of regulated filings such as financial statements and annual reports, quarterly and special periodic reporting, securities offering documents, and proxy statements. This focus is intensifying as shareholder engagement, climate science, industry benchmarking, and other market studies drive new understanding of the materiality of ESG risks to company performance and the global economy as a whole.

Although the SEC has been looking at ESG issues for over a decade, the pace of new rules and other guidance has accelerated. Many of the concepts and compliance issues are presently evolving, requiring focus from executive level leadership and corporate counsel.

The SEC has issued several rounds of guidance over the years, and in 2022, the SEC released lengthy proposed disclosure rules, which have stimulated vigorous debate among public commenters and commissioners alike.<sup>1</sup> Observers note that the preexisting general obligation to disclose all material information necessary to evaluate a company already requires disclosures regarding ESG matters, to the extent material. Since one prominent practice trend in disclosure arguably has been an accretive "more is more approach," requirements for specific additional disclosures are viewed by some as adding more volume and not necessarily more substance. Critics of the prior status quo note that existing standards and SEC ESG guidance have failed to produce widespread, consistent, decision-useful information that is meaningful to investors. The proposal's most vociferous detractors have challenged the SEC's authority to adopt the proposed rules.

---

<sup>1</sup> See, e.g., The Enhancement and Standardization of Climate-Related Disclosures for Investors, Securities Act Release No. 11042, Exchange Act Release No. 94478, 87 Fed. Reg. 21334 (Apr. 11, 2022) (proposed Mar. 21, 2022) (to be codified at 17 C.F.R. pts. 210, 229, 232, 239, and 249); Sunshine Act Meeting, 87 Fed. Reg. 14304 (Mar. 14, 2022).

The SEC's voluminous March 2022 release, proposing rules on ESG disclosures, outlines the SEC's new regulatory framework.<sup>2</sup> While the rulemaking process is ongoing, it is clear that these new rules and clarifications will require significantly more detailed disclosures on how companies are addressing climate-related risks, sustainability, and related concerns.

## Regulation of Operating Company Disclosures

Reg S-K sets out disclosure requirements applicable to registration statements, periodic reports, proxy statements and other filings under the Securities Act of 1933 and the Securities Exchange Act of 1934 and, together with Reg S-X rules for presenting financial statements and the statutory anti-fraud provisions, provides the principal regulation for public operating company disclosures. The SEC examines public company filings, has the authority to declare certain filings effective (or not), sometimes after a comment period, and conducts investigations and enforcement actions based on the content of regulated disclosures. As compared to European regulators, SEC action and guidance on ESG disclosures was relatively tentative and piecemeal until recent years.<sup>3</sup> Existing guidance acknowledged the potential materiality of ESG issues to the operations and financial results of public companies, but produced a wide variety of outcomes. The new disclosure proposal aims to allow investors to differentiate more accurately between investments on the basis of, for example, the relative carbon footprint or negative climate effects tied to a particular business, and can make it harder for issuers and the funds that invest in them to practice "greenwashing," where the ESG-compliance of a particular investment is exaggerated or, worse, falsified in disclosures to investors. Specifying disclosure topics will also empower the SEC Division of Corporate Finance and the SEC Division of Enforcement to identify non-compliance and to take action to address ESG-related misconduct.<sup>4</sup>

We cover below the principal available guidance on financial and operations disclosures, starting with guidance currently in effect, followed by the new proposed rules, including:

- The September 2021 sample comment letter<sup>5</sup> regarding climate-related disclosures in annual report filings;

---

<sup>2</sup> See The Enhancement and Standardization of Climate-Related Disclosures for Investors, Securities Act Release No. 11042, Exchange Act Release No. 94478, 87 Fed. Reg. 21334 (Apr. 11, 2022) (proposed Mar. 21, 2022) (to be codified at 17 C.F.R. pts. 210, 229, 232, 239, and 249).

<sup>3</sup> See Chapter 3.2 (Regulations & Foreseeable Developments—United States) for discussion of existing guidance.

<sup>4</sup> *Spotlight on Enforcement Task Force Focused on Climate and ESG Issues*, SEC (June 27, 2022), <https://www.sec.gov/spotlight/enforcement-task-force-focused-climate-esg-issues>.

<sup>5</sup> *Sample Letter to Companies Regarding Climate Change Disclosures*, DIV. OF CORP. FIN., SEC (Sept. 22, 2021), <https://www.sec.gov/corpfin/sample-letter-climate-change-disclosures>.

- The 2010 interpretative guidance,<sup>6</sup> focused primarily on greenhouse gas disclosures, which was not superseded by the 2021 sample comment letter; and
- The March 2022 release, *The Enhancement and Standardization of Climate-Related Disclosures for Investors*, which proposes to formalize existing guidance and will require certain climate-related information in periodic reports and registration statements.<sup>7</sup>

## 2021 Guidance

The 2021 sample comment letter alerted companies to the areas in public filings where climate risk disclosures may be relevant, and to specific aspects of climate-related risks that should be considered. In respect to MD&A in particular, companies are advised to consider the following to the extent material:

1. Pending or existing climate-related legislation, regulations, and international accords and any material effect on the company's business, financial condition, and results of operations. Quantify any resulting material increases in compliance costs.
2. The indirect consequences of climate-related regulation and business trends, such as the following non-exhaustive list:
  - o decreased demand for goods or services that produce significant greenhouse gas emissions or are related to carbon-based energy sources;
  - o increased demand for goods that result in lower emissions than competing products;
  - o increased competition to develop innovative new products that result in lower emissions;
  - o increased demand for generation and transmission of energy from alternative energy sources; and
  - o any anticipated reputational risks resulting from operations or products that produce material greenhouse gas emissions.
3. Discuss and quantify material forecast and/or future capital expenditures for climate-related projects.

---

6 Commission Guidance Regarding Disclosure Related to Climate Change, Securities Act Release No. 9106, Exchange Act Release No. 61469, Financial Reporting Release No. 82, 75 Fed. Reg. 6289 (Feb. 8, 2010).

7 See *The Enhancement and Standardization of Climate-Related Disclosures for Investors*, Securities Act Release No. 11042, Exchange Act Release No. 94478, 87 Fed. Reg. 21334 (Apr. 11, 2022) (proposed Mar. 21, 2022) (to be codified at 17 C.F.R. pts. 210, 229, 232, 239, and 249). In May 2022, the SEC proposed related amendments to existing rules and reporting forms for investment fund disclosures related to ESG matters which are not covered in this chapter. See Chapter 6—ESG for Funds and Advisers.

4. The physical effects of climate change on operations and results. This disclosure may include the following:
  - o severity of weather, such as floods, hurricanes, sea levels, arability of farmland, extreme fires, and water availability and quality;
  - o quantification of weather-related damages to property or operations;
  - o potential for indirect weather-related impacts that have affected or may affect major customers or suppliers;
  - o decreased agricultural production capacity in areas affected by drought or other weather-related changes; and
  - o any weather-related impacts on the cost or availability of insurance.
5. Any purchase or sale of carbon credits or offsets and any related material effects on your business, financial condition, and results of operations.

## 2010 Guidance

The 2010 Guidance highlighted the section of Regulation S-K with respect to which climate-related matters may be most relevant, namely, the description of the business (Item 101), discussion of legal proceedings (Item 103), risk factor disclosures (Item 105), and/or management's discussion and analysis (MD&A) (Item 303). Securities Act Rule 408 and Exchange Act Rule 12b-20 also require a company to disclose any other material information necessary to make the required disclosures not misleading. The 2010 Guidance covered many of the same topics as the more recent 2021 sample comment letter. There were a few additional insights, asking companies to discuss:

1. Considerations the company has given to providing the same type of climate-related disclosure in SEC filings as corporate sustainability reports and explain any differences—for example, certain matters may not be material to overall financial results, but nonetheless merit discussion in a sustainability report to address accountability to employees, community, or other stakeholders;
2. Material litigation risks related to climate change and the potential impact to the company;

3. Reputational risk;
4. Physical effects of climate change;
5. environmental goals and commitments and related controls and procedures; and
6. internal policies and procedures for reporting accountability, as public companies are required to establish and maintain effective disclosure controls and procedures (DCPs), providing assurance that relevant information is reported to the appropriate personnel, including senior management responsible for making disclosure decisions and certifying the information contained in SEC filings.

### ***The SEC's Enhancement and Standardization of Climate-Related Disclosures for Investors (March 2022).***

The March 2022 release included three broad categories of requirements and impacts which must be included in registration statements and Annual Reports: qualitative disclosures, quantitative disclosures, and financial statement disclosures. In each case, to the extent climate change or related issues have materially impacted operations, the financial statements and other disclosures should provide investors with information necessary to assess and track impact over time. The SEC's proposed rules take an approach similar to climate disclosure standards set by the United Kingdom, the European Union, and the International Sustainability Standards Board (ISSB), with a key focus on governance, including board and C-suite oversight of climate-related issues.

- *Qualitative disclosure:* Each filer must identify, assess and prioritize the climate risks it is facing and explain its methodology and strategy in addressing these challenges, including governance and controls aspects and the practical steps management is using to address climate issues and track progress.
- *Quantitative disclosures:* Greenhouse gas (GHG) emissions disclosure across the company's operations, made on gross terms without consideration of offsets, categorized as Scope 1 (owned or controlled operations), Scope 2 (purchased or acquired operations), and in some cases, as material, Scope 3 (indirect upstream and downstream activities)<sup>8</sup> (with attestation for Scope 1 and Scope 2 disclosures, and a safe harbor for Scope 3 disclosures), with related financial statement disclosures. The GHG impact must be separately disclosed on a disaggregated (by each GHG) and aggregated basis, and on a gross basis (before consideration of any offsets) and relative to intensity (e.g., tons of carbon dioxide per dollar of revenue).

---

8 If the registrant has set a GHG emissions target or goal that includes Scope 3 emissions or if Scope 3 emissions are material. Scope 3 GHG emission disclosures would be subject to securities law safe harbor provisions.

- *Financial statement metrics:* The audited financial statements must reflect the cost impact of weather and climate events and expenses related to transition or mitigation activities.
  - o Specifically, footnotes must disclose (a) impacts on financial statement line items (such as repair/maintenance, impairment(s) and loss reserves) if such amount exceeds 1 percent of the related line item, and (b) expenditures related to mitigation and transition activities if such amount exceeds 1 percent of the total amount expensed or capitalized.
  - o Management must disclose how mitigation and transition activities affected estimates and assumptions reflected in the financial statements.
  - o Notably, companies which are front-end loading transition or mitigation measures may use the opportunity to explain and contextualize these costs.

Management should be prepared to describe, among other things:

- How climate-related risks have had or are likely to have a material impact on the business and its financial results, and how these matters have shaped the registrant's strategy, business model, and outlook;
- The methodology for risk assessment, and how management integrates analysis of climate-related risks into the registrant's broader risk management program;
- If applicable, a description of the scenarios, assumptions, and projection methodologies used to evaluate the possible impact of climate-related risks;
- Any climate transition plan, targets and metrics, in detail;
- Any publicly disclosed climate-related targets or goals, in detail as to timing, interim targets, planned milestones, updates and progress reports and carbon offsets or other mitigants such as renewable energy certificates (RECs);
- Specifics on how the board of directors and management oversee climate-related risks, ongoing risk assessment and management, and the registrant's action plans and responses.

Each registrant would provide these disclosures in its registration statements for securities offerings as well as in its annual reports filed under the Securities Exchange Act of 1934. Financial footnote disclosures would be required in the financial statements, and the remaining disclosures, including GHG emissions, would be required in a newly created section of Form 10-K for Annual Reports (Item 6) immediately before the MD&A (Managements' Discussion and Analysis). The disclosures would be required for both domestic and foreign private issuer SEC-registrants.<sup>9</sup> The existing financial statement audit requirements would apply to the financial statement footnote disclosures. (The Scope 1 and Scope 2 GHG emission disclosures would be subject to limited assurance during a phase-in period, followed by reasonable assurance.)

Scope 3 disclosures are required only if Scope 3 emissions are material or if the filer has established its own performance target. Because Scope 3 emissions are generated by sources outside a company's control (including by suppliers), accurately disclosing Scope 3 emissions is likely to be more difficult, and accordingly, companies providing Scope 3 emissions disclosures would not be subject to liability for making a fraudulent statement unless such disclosure was made without a reasonable basis or not in good faith. Presumably, regulators will focus on methodologies and consistency of process when assessing the quality of such disclosures.

If the proposed rule's requirements become effective in December 2022, the earliest mandatory compliance date for their adoption for a registrant with a calendar year-end would be in 2024 for large accelerated filers (for all new disclosures except for Scope 3 GHG Emission Disclosures), and ranging into 2025 for other filers, with the remaining portions phasing in over the following years.

---

<sup>9</sup> Smaller reporting companies would be exempt from Scope 3 GHG emission disclosures and would have an additional year of transition (*i.e.*, all other disclosures would be required in 2025).

Because these disclosures will be mandatory to the extent applicable, and would significantly change the climate-related disclosure requirements both in quantity and granularity, many companies (even those in the pre-IPO phase) will need to start preparing now in order to meet these requirements. Companies and their counsel should consider who will take responsibility for meeting these new disclosure requirements and who has the necessary oversight responsibility. The roles of internal finance, internal audit and reporting team(s), audit committee, and board of directors in shaping and managing policy and disclosure should be evaluated and strengthened as necessary. In parallel, companies should assess policies and procedures and consider the need for additional personnel or oversight.

Management must also make an honest assessment of what climate-related information is currently available, and if there is a gap between what is available and what the new rules will require. Is the information of sufficient quality and is management comfortable with its accuracy? Is additional information needed or desirable (including, especially, for disclosure in the audited financial statements)?

Management should consider a systematic approach to evaluating the materiality of climate-related disclosures to avoid conflicting methodologies and ensure disclosures are accurate and complete. In a related vein, necessary disclosure controls and procedures must be in place to address the proposed rule's new requirements and reporting deadlines.

In addition to the explicit requirements under existing guidance and the proposed rules, companies and their counsel must carefully consider related matters, including issues related to supply chains, material and resource considerations, and human capital management, among many others. Like climate-related risks, these disclosures should also address the company's unique facts and circumstances. It is clear that detailed and thoughtful assessments of the impacts of climate-related risks and related impacts will require companies bring to bear both existing and new resources, and careful planning is needed now to meet these requirements as they are phased in.

## 5.2 STAKEHOLDER CAPITALISM

---

*"In essence, the New Paradigm recalibrates the relationship between public corporations and their major institutional investors and conceives of corporate governance as a collaboration among corporations, shareholders and other stakeholders working together to achieve long-term value and resist short-termism. . . . For corporations, the New Paradigm will . . . encourage corporations to incorporate relevant sustainability, ESG (environmental, social and governance) and CSR (corporate social responsibility) considerations in developing their long-term strategies and operations planning."* "The New Paradigm: A Roadmap for an Implicit Corporate Governance Partnership Between Corporation and Investors to Achieve Sustainable Long-Term Investment and Growth."<sup>10</sup>

Stakeholder capitalism is a theory of corporate management that proposes that a corporation's responsibility is to serve the short- and long-term interests of all its stakeholders, rather than simply maximizing profits for shareholders. A corporation's purpose (*i.e.* the reason a corporation is created and exists) is not *per se* to produce profits, but "to produce profitable solutions for the problems of people and planet."<sup>11</sup>

The roots of these ideas are not new. Corporations have served public purposes since ancient Rome, when *societates publicanorum* were used for minting coins, collecting taxes, or undertaking public works.<sup>12</sup> The emergence of the modern corporation in the 18th and 19th centuries was a response to the need for organizations that could facilitate large-scale trade and infrastructure building.<sup>13</sup> In the U.S., we can find basis for what we now call stakeholder capitalism in the first half of the 20th century, particularly during the New Deal and Second World War, when American firms mobilized to address larger societal needs.

---

<sup>10</sup> Martin Lipton, *The New Paradigm*, WORLD ECONOMIC FORUM, <https://www.wlrk.com/webdocs/wlrknew/AttorneyPubs/WLRK.25960.16.pdf> (last visited June 13, 2022).

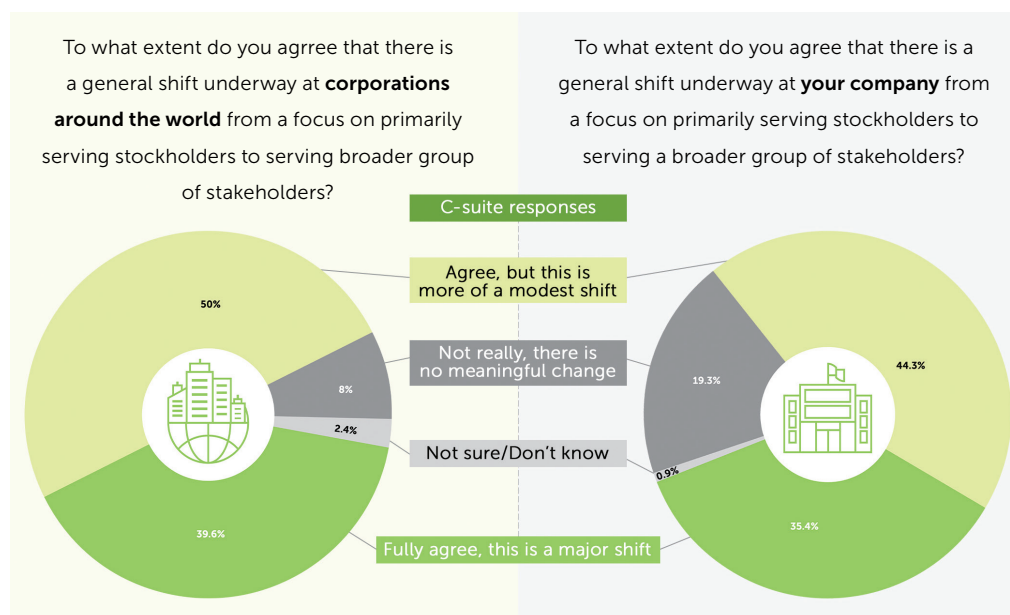
<sup>11</sup> See Martin Lipton, Wachtell, Lipton, Rosen & Katz, *It's Time to Adopt the New Paradigm*, HARV. L. SCH. FORUM ON CORP. GOVERNANCE (Feb. 11, 2019), <https://corpgov.law.harvard.edu/2019/02/11/its-time-to-adopt-the-new-paradigm/> (quoting THE BRITISH ACADEMY, REFORMING BUSINESS FOR THE 21ST CENTURY: A FRAMEWORK FOR THE FUTURE OF THE CORPORATION (Nov. 2018), <https://www.thebritishacademy.ac.uk/documents/76/Reforming-Business-for-21st-Century-British-Academy.pdf>).

<sup>12</sup> THE BRITISH ACADEMY, REFORMING BUSINESS FOR THE 21ST CENTURY: A FRAMEWORK FOR THE FUTURE OF THE CORPORATION 14 (Nov. 2018), <https://www.thebritishacademy.ac.uk/documents/76/Reforming-Business-for-21st-Century-British-Academy.pdf>; Scott Hirst, *Corporate Law Lessons from Ancient Rome* HARV. L. SCH. FORUM ON CORP. GOVERNANCE (June 19, 2011), <https://corpgov.law.harvard.edu/2011/06/19/corporate-law-lessons-from-ancient-rome/>; Leonardo Davoudi et al., *The Historical Role of the Corporation in Society*, 6(S1) J. BRIT. ACAD. 17 (Oct. 31, 2018), <https://www.thebritishacademy.ac.uk/documents/976/JBA-6s1-Davoudi-McKenna-Olegario.pdf>.

<sup>13</sup> Reforming Business For The 21st Century at 14.

However, in the second half of the twentieth century, the economic and business communities turned away from the more comprehensive concept of corporate purpose towards the concept of shareholder primacy. In 1962, Milton Friedman published *Capitalism and Freedom*, which famously outlined his theory that the only social responsibility of business was to “increase its profits so long as it stays within the rules of the game.”<sup>14</sup> Friedman’s ideas caught on in business schools and became the dominant thesis of corporate management in the subsequent decades.<sup>15</sup> This period saw corporations increasingly focused on short-term profits and a rise of attacks on boards of directors by activist investors.<sup>16</sup>

Following several years of re-examination of the role of the corporation in the wake of the 2008 Financial Crisis, 2016 saw a major inflection point. In 2016, the International Business Council of the World Economic Forum published “The New Paradigm,” which outlined a model for corporate governance rejecting “short-termism,” and proposing a model of “corporate governance as a collaboration among corporations, shareholders and other stakeholders working together to achieve long-term value.”<sup>17</sup> In 2019, the members of the Business Roundtable, 181 CEOs of major U.S. companies, explicitly accepted the premise that companies should be run for the benefit of providing long-term value to all stakeholders, rejecting the idea that corporate responsibility ends at shareholder returns.<sup>18</sup>



Source: The Conference Board, “Toward Stakeholder Capitalism” (Dec. 6, 2021)

14 *Id.* (quoting Milton Friedman, *Capitalism and Freedom*, UNIV. CHI. PRESS (1962)); Milton Friedman, *The Social Responsibility of Business is to Increase its Profits*, N.Y. TIMES (Sept. 13, 1970), <https://www.nytimes.com/1970/09/13/archives/a-friedman-doctrine-the-social-responsibility-of-business-is-to.html>.

15 See Lipton, *It’s Time to Adopt the New Paradigm*

16 Lipton, *The New Paradigm*

17 Martin Lipton, *The New Paradigm*, WORLD ECONOMIC FORUM, <https://www.wlrk.com/webdocs/wlrknew/AttorneyPubs/WLRK.25960.16.pdf> (last visited June 13, 2022).

18 *Business Roundtable Redefines the Purpose of a Corporation to Promote ‘An Economy that Serves all Americans’*, BUSINESS ROUNDTABLE (Aug. 19, 2019), <https://www.businessroundtable.org/business-roundtable-redefines-the-purpose-of-a-corporation-to-promote-an-economy-that-serves-all-americans>.

Stakeholder capitalism is not just a salve for progressive investor pressure or a concession to the urgency of the global climate crisis.<sup>19</sup> This philosophy of corporate governance offers CEOs and Boards defenses against short-term financial activists and more flexibility to undertake long-term initiatives that serve the company's business, mission, and communities. It should also empower shareholders advocating against executive compensation schemes that reward short-term results over long-term value, or corporate transactions geared to dress up current earnings reports over more prudent investments in fair pay practices, research and development, employee training and safety, capital improvements, and judicious expansion.

The transition to stakeholder-centric corporate governance, however, is not as straightforward as signing on to public statements that embrace a balanced view of stakeholder interests. There remains evidence that the shareholder-only approach will be hard to change. For example, stock buybacks—a stock price-focused, short-term tactic that is perhaps the least progressive use of company capital—rose at the end of 2019 despite the Business Roundtable announcement, hit a record high in 2021 (after a pullback during the first year of the Covid-19 pandemic), and, according to Goldman Sachs, may set new records in 2022.<sup>20</sup>

**Policy Implications.** In the U.S., the policy implications of this shift are significant. U.S. corporate law is currently focused on shareholders' rights, and officers' and directors' duties to uphold shareholder interests. In response to the change in philosophy, companies and other stakeholders may pursue new laws, amendments, interpretations, or litigation strategies recognizing the authority to prioritize company purpose over profits *per se*, long-term objectives over short-term ones, and the interests of various groups of stakeholders alongside shareholder returns. Similarly, laws governing corporate disclosures will likely change to require performance and risk disclosures that address not only financial capital but also human and natural capital factors. (See Chapter 3.2—United States.)

**Stakeholders.** A company's stakeholders include its employees, communities, suppliers, customers, shareholders, and other groups affected by the company's products or mission. This factors into how companies might build their ESG Response Team (see Chapter 2—Establishing the ESG Response Team and Their Remit), insofar as the Team will be charged with identifying, considering, and, as necessary or desirable, incorporating the interests of these groups.

**Guidance for the C-Suite.** The C-Suite will see its role evolve as the shift to stakeholder capitalism takes hold. Corporate officers are still evaluating what a commitment to stakeholder capitalism means in terms of their job descriptions and day-to-day duties, but forward-thinking executives will use these changes to their company's advantage.

---

<sup>19</sup> Notably, The Business Roundtable statement did not mention investor pressure or the climate crisis, instead focusing on the health of the American economic model. *See id.*

<sup>20</sup> *See* Noel Randewich, *U.S. buybacks seen at record highs ahead of earnings reports*, REUTERS (Apr. 6, 2022), <https://www.reuters.com/business/us-buybacks-seen-record-highs-ahead-earnings-reports-2022-04-06/>.

The Conference Board ESG Center held a series roundtables organized around the examination of the role of the CEO and chief financial, legal, human resources, government relations, communications, marketing, and technology officers in the shift to stakeholder capitalism. Participants in each office-specific roundtable concluded that this shift was significant and durable. Reflecting on the content of company Board meetings, one member of the CFO group captured the shift succinctly when they said, “Before it was ‘this ESG stuff is a bunch of malarkey.’ Now it is a central focus point.”<sup>21</sup>

**CEOs:** For CEOs, the shift to stakeholder capitalism will mean having long-term plans on how to set, report, measure, and achieve goals without over-promising in a way that disappoints investors or harms a company’s reputation.<sup>22</sup> This presents opportunities for CEOs insofar as they will be able to reorient goals from a focus on short-term returns or quarterly share price to milestones and targets that are more in line with the company’s mission or vision. However, such a shift will also require a consistent data set that presents a consistent picture outsiders can evaluate, as well as buy-in from and open dialogue with the other members of the executive team.<sup>23</sup>

**CFOs:** For CFOs, embracing the shift may lead to opportunities to attract new capital and to finance operations or projects at lower cost. CFOs are focusing on: how to build credible data and metrics to support ESG performance claims; how to combine financial and non-financial data as well as quantitative and qualitative factors in evaluating and disclosing risks and opportunities; how to assess materiality of ESG risks; how to assess the implications of stakeholder capitalism to capital allocation in the near and longer terms; how to measure the impact of ESG policies using scenario analysis, models and other tools; how to determine which rating organizations to engage with; how the CFO and the CFO team can gain fluency with ESG matters that may be outside their core expertise; and how to build credibility and trust on these issues as between the CFO team and other departments, the Board, and stakeholder groups.

---

21 Charles Mitchell et al., *Toward Stakeholder Capitalism (CFOs)*, CONFERENCE BOARD (Dec. 6, 2021), <https://www.conference-board.org/topics/toward-stakeholder-capitalism/toward-stakeholder-capitalism-CFO>.

22 See Charles Mitchell et al., *Toward Stakeholder Capitalism* CONFERENCE BOARD 11 (Dec. 6, 2021), <https://www.conference-board.org/topics/toward-stakeholder-capitalism/toward-stakeholder-capitalism-CEOs-C-suite>.

23 See *id.* at 6, 11-12.

**CLOs:** The Conference Board’s CLO participants view Delaware law as already providing Boards sufficient latitude to make decisions that consider the welfare of all stakeholders.<sup>24</sup> However, recognizing that various company constituents and stakeholders have not yet all arrived at the same place in their thinking on ESG issues, and that many ESG issues are not specifically regulated, CLOs are coming to terms with giving general business and strategy advice, assessing how best to move forward in the presence of uncertainty, and identifying meaningful ESG risks that are outside the CLO’s traditional scope. Areas grabbing their attention include political risk, reputational risk, customer risk, government relations, and data collection and analysis. With disclosures set to reach beyond financial and operations risks, CLOs are also collaborating with colleagues in other roles to ensure the integrity and compliance of data gathering and representation. CLOs also cite challenges expediting legal reviews and problem solving; preparing the Board for its expanding role; managing the differences between their roles inside the company and increasingly as a voice of the company to external audiences; developing the “EQ,” empathy, and management skills needed to lead in the presence of controversial and potentially polarizing issues; keeping up-to-date on competing ESG developments in multiple jurisdictions; and managing the CLO team’s workload and opportunities as ESG transforms their responsibilities.

A full set of The Conference Board’s reports from roundtables with the C-Suite cohorts are available through the links below:

- CEOs and the C-Suite: <https://www.conference-board.org/topics/toward-stakeholder-capitalism/toward-stakeholder-capitalism-CEOs-C-suite>
- CFOs: <https://www.conference-board.org/topics/toward-stakeholder-capitalism/toward-stakeholder-capitalism-CFO>
- Chief Legal Officers: <https://www.conference-board.org/topics/toward-stakeholder-capitalism/toward-stakeholder-capitalism-CLO>
- Chief Human Resources Officers: <https://www.conference-board.org/topics/toward-stakeholder-capitalism/toward-stakeholder-capitalism-CHRO>
- Chief Marketing Officers: <https://www.conference-board.org/topics/toward-stakeholder-capitalism/toward-stakeholder-capitalism-CMO>
- Government Relations Executives: <https://www.conference-board.org/topics/toward-stakeholder-capitalism/toward-stakeholder-capitalism-GRE>
- Senior Communications Executives: <https://www.conference-board.org/topics/toward-stakeholder-capitalism/toward-stakeholder-capitalism-comms>

---

24 Charles Mitchell et al., *Toward Stakeholder Capitalism (CLOs)* CONFERENCE BOARD 11 (Dec. 6, 2021), <https://www.conference-board.org/topics/toward-stakeholder-capitalism/toward-stakeholder-capitalism-CLO>.

## 5.3 SHAREHOLDER ACTIVISM

---

"[W]e are on the front end of a profound, long-term structural shift in global investor preferences toward sustainability that is not fully priced into the market today and may therefore drive outperformance during a long transition period." –BlackRock<sup>25</sup>

The main headlines of the 2021 proxy season announced that Engine No. 1, a small hedge fund with a .02% stake in ExxonMobil, had rallied the shareholders to defeat management candidates and elected three new directors to the Board. Engine No. 1's campaign focused on four priorities: to bring fresh thinking to a Board that had overseen a dramatic decline in ExxonMobil's standing in the market; to impose better discipline on capital expenditures; to implement a strategic plan for sustainable value creation, including a greater focus on clean energy and the carbon transition; and finally, to align management incentives with shareholder value creation. Overall, these objectives had much in common with those of shareholder activist campaigns in general—namely, to bring discipline to executives and directors that had overseen a downward spiral<sup>26</sup>—but much of the press focused on the idea that shareholders delivered this victory because they believe a positive strategy for navigating the carbon transition is essential to long-term shareholder value.<sup>27</sup>

Companies can expect to see more ESG-related proposals, including proposals around traditional activist areas like corporate governance. "While the overall number of investor activist campaigns declined in 2021 as compared to 2020, the number of ESG-related campaigns, and the impact and success of investor activist campaigns, rose year over year. From January to August 2021, 13% of activist campaigns were successful, compared to 11% at the same period in 2020."<sup>28</sup> Shareholder proposals are not likely to cluster solely around climate and emissions issues. Shareholders increasingly understand the connection of governance, ethics, executive compensation, and human capital management to long-term value creation. The unifying feature of the campaigns anticipated is likely to be the rejection of short-termism and its replacement with seeking long-term, sustainability-linked objectives for delivering value.

---

25 *Helping our clients invest sustainably*, BLACKROCK (May 2020), <https://www.blackrock.com/corporate/about-us/sustainability-progress-update>.

26 *The Case for Change*, REENERGIZE EXXON, <https://reenergizexom.com/the-case-for-change>.

27 Ironically, the Trump administration rules that chilled the role of proxy advisory services may have partly enabled the Engine No. 1 victory, as institutional investors imprinted more of their ESG policy values on their actual voting decisions.

28 DILIGENT INSTITUTE, *ACTIVIST INVESTORS: SETTING THE PACE ON ESG* (Oct. 2021), <https://www.diligentinstitute.com/wp-content/uploads/2021/10/2021-10-DI-Report-Activist-Investors-Setting-the-Pace-on-ESG-1.pdf>.

Activist campaigns that are well-planned<sup>29</sup> have greater chances to succeed. The surge of index funds and ETFs, with their broad market holdings, has resulted in a small handful of money managers (representing a large, diverse swath of investors, from pension funds to Main Street) having material minority positions in most public companies in the S&P, Russell and MSCI indices. Each of BlackRock, State Street, and Vanguard, the big three sponsors of such funds, voted with Engine No. 1 in the ExxonMobil fight, as did CalSTRS, the second largest public pension in the United States, which manages its public equity portfolio internally. Each of these institutions has been transparent about the changes it expects to see in public company leadership on ESG issues. Each of them has access to a lot of data generated by their own products, to track how companies engaging in pro-ESG conduct, from emissions and waste reductions to diversity and inclusion, are faring against their peers. By giving these investors a sound basis, consistent with their duties, to vote for sustainability and long-termism, an activist may secure meaningful voting blocs in support of its proposals. Given the interest in climate risk and diversity, equity, and inclusion (DEI), ESG-related campaigns are also likely to gain the attention of public shareholders and actively managed funds beyond these institutions, and to achieve higher levels of shareholder engagement (*i.e.*, voting) on ballots involving ESG-linked matters.

Companies with engaged shareholders will likely benefit from attention to peer practice studies (see Chapter 1: Defining ESG For Your Firm). Keeping up with evolving practices in their respective sectors can be useful in addressing shareholder expectations, because sector investors are likely to be aware of practices and disclosures by a company's peers and competitors.

ESG-related activism can have dimensions outside of the specific ESG topic of shareholder concern, and a company engaged by shareholders on these matters can have a more effective response by assessing which of these factors is in play:

- Belief that change in corporate conduct will de-risk operations and/or financial results;
- Belief that change in corporate conduct will create opportunities;
- Belief that change in corporate conduct is necessary for sustainable growth;
- Belief that the investor has a fiduciary duty or ethical obligation to promote change in corporate conduct;
- Belief that the company has a fiduciary duty or ethical obligation to change its conduct;

---

29 Engine No. 1 nominated four candidates with significant experience in oil, gas, and energy sectors, and also made its case based on core indicators of underperformance by existing executives and directors, such as material loss of market cap that resulted in Exxon's removal from the Dow Jones Industrial Average. See The Case for Change, REENERGIZE EXXON, <https://reenergizexom.com/the-case-for-change>.

- Interest in cultivating the attention ESG-related proposals may attract, for the benefit of the specific ESG-related proposal and/or a larger slate of proposals;
- Interest in assuring Board-level understanding of and engagement in ESG planning; and/or
- General rejection of short-termism.

There are other practical considerations in preparing for and responding to shareholder activism. Preparedness can help a company address issues as they arise in the earlier stages of shareholder engagement, and potentially avert progression to an adversarial situation. So, to the extent the company prepares strategy and talking points for shareholder engagement on corporate issues generally, it should also address ESG issues. Companies already engaged with shareholders on ESG issues should consider carefully whether unilateral action on the subject matter will be well-received or considered evasive or insincere. A public company may have to consult counsel to balance the value of including engaged shareholders in the decision-making process in some way, and its duties to manage non-public information and public disclosures properly.

Lawyers who advise a public company on defensive governance matters generally should be consulted with respect to ESG disclosures, including voluntary disclosures, and perhaps be included in the routine of pre-publication review. Similarly, companies should consult counsel and internal disclosure integrity teams before including voluntary disclosures, such as might be made in sustainability reports, in regulatory filings because of the different legal risks associated with statements in regulatory filings.

A public company should consider carefully the ESG rating and data collection services to which it chooses to report. Not all agencies are well-suited for all companies, sectors, or industries. Scores and report cards that do not fairly capture the company's stance or conduct may inadvertently trigger adversarial engagement.

Finally, companies should consult corporate counsel about the authority of directors, under relevant state law, to take actions serving stakeholder concerns other than merely shareholder profits. In this regard, it is worth noting that Leo E. Strine, Jr., former Chief Justice and Chancellor of the State of Delaware (and presently of counsel at Wachtell) has written about the settled law in Delaware, "...[T]he rule in Delaware is plain: corporate fiduciaries may take actions benefiting other corporate stakeholders so long as there are 'rationally relat[ing] benefits' to the stockholders, as famously expressed in the Delaware Supreme Court case *Revlon, Inc. v. MacAndrews & Forbes Holdings, Inc.* . . . . Say what you will about the rational relationship test, but don't say it's dictum."<sup>30</sup>

---

30 Strine, Leo E. Jr., *Restoration: The Role Stakeholder Governance Must Play in Recreating a Fair and Sustainable American Economy A Reply to Professor Rock*, 76 BUS. LAW. 397, 403 (2020).

## 5.4 PUBLIC VS. PRIVATE COMPANIES

---

Much of the focus on ESG disclosure practices for U.S. operating companies understandably centers on the higher profile, regulated disclosures made by public companies, in prospectuses, annual and quarterly reports, financial statements, and proxy statements. These disclosures are filed with the SEC, publicly available, and highly regulated as to both form and substance. The transparency and stability of the public capital markets depend heavily on the disclosure of material information to allow investors and other market participants to make informed decisions.

ESG programs and disclosure practices are also meaningful in private companies. Many private companies aspire to go public (or “IPO”) at the end of the early investment and growth phases, or at minimum preserve the IPO exit option. Small and startup companies have the opportunity to embed ESG in their company DNA from the start. Other private companies may need to transition their practices and culture to present favorably to the public markets and company stakeholders.

Even in the absence of a public markets transaction, private companies may receive equity investment or debt funding from institutions that are actively shaping, measuring and reporting their ESG impacts. Private equity and venture firms may value portfolio companies with ESG-positive profiles and, for banks and non-bank lenders, the primary way to create positive impact is to lend money to companies with ESG-positive objectives and operations.

It is also worth noting that private companies are not necessarily small companies, and the impact of their conduct can have wide effect. The privatization of the capital markets over the last decades has meant that successful companies are remaining private longer than ever, and the institutions whose investment keeps them that way are, in meaningful measure, the same investors whose interest in ESG is driving change in public company practices. In fact, BlackRock recently urged the SEC to consider ways to extend requirements for climate-related risk disclosures to U.S. private issuers.<sup>31</sup> Increasingly, these investors are working out how to have constructive engagement with private company leaders to promote ESG objectives. Finally, private company acquisition by public companies is a common objective. A private company with an ESG-positive profile may be a more attractive and valuable target.

---

<sup>31</sup> Paul Bodnar et al., *The Enhancement and Standardization of Climate-Related Disclosures for Investors (File Number S7-10-22)*, BLACKROCK (June 17, 2022), <https://www.blackrock.com/corporate/literature/publication/sec-enhancement-and-standardization-of-climate-related-disclosures-for-investors-061722.pdf>.

Impact investing in particular, as a style of ESG investment, began and still largely exists in the private investment sector, because testing new methods, products, technologies and markets is risky and generally best explored on a smaller scale, with risk assumed primarily by high-net-worth individuals and other private market investors. For many of the early years of impact and ESG investing, the most vexatious problem was the lack of public markets options that could be broadly available and deployed within traditional diversified portfolios. Scalable investment options for mainstream and Main Street investment are very recent arrivals. It is only the extremely recent, wider acceptance of stakeholder capitalism, with all its implications, that is reshaping investment into public companies into an impact investment in some cases.

Lastly, as the SEC has expanded the scope of required ESG disclosures, most notably in its March 2022 proposed rules,<sup>32</sup> the lead time necessary for compliance has increased as well. Private companies that wish to be eligible for IPO or for acquisition by public reporting companies will need to be ready to timely, efficiently and effectively address necessary public disclosures (see Section 5.1).

---

<sup>32</sup> The Enhancement and Standardization of Climate-Related Disclosures for Investors, Securities Act Release No. 11042, Exchange Act Release No. 94478, 87 Fed. Reg. 21334 (Apr. 11, 2022) (proposed Mar. 21, 2022) (to be codified at 17 C.F.R. pts. 210, 229, 232, 239, and 249).



# 6

## **ESG for Funds and Advisers**

# ESG for Funds and Advisers

A vast proportion of retirement savings and other personal and institutional investment portfolios around the world are committed to pooled investment entities (“Funds”) or managed by investment advisers (“Advisers”).<sup>1</sup> Funds and Advisers have played important roles in the advent of stakeholder capitalism and the progress of ESG-related practices and disclosures. First, by pooling much of the world’s invested wealth, Funds are among the most influential shareholders in operating companies, and have had a commensurate influence in the evolution of company policies, including their ESG-related initiatives. Second, Funds themselves are issuers that offer securities and must answer for the disclosures made to their investors about ESG-related strategies, investments, and results. Below, we outline the rules and regulations surrounding Funds and Advisers, as well as ESG considerations particular to certain institutional investors.

## 6.1 USE OF ESG CONSIDERATIONS IN INVESTMENT PRACTICES

---

A first step for a Fund or Adviser is to determine how its investment processes incorporate ESG considerations. For example, an Adviser can use negative screening to establish which ESG goals its strategy seeks to promote, and avoid investing in companies that do not meet established criteria. An Adviser can pursue an impact investment strategy that seeks to have measurable ESG-related benefits, in which case it is advisable to articulate whether the impact targeted is the impact of the Fund (or client account) on its portfolio companies or the impact of portfolio companies on ESG outcomes. Historically, operating companies pursuing specific impact have been smaller, generally private, companies, making this strategy more suited to venture or private equity-style investing; as stakeholder capitalism spreads across the public markets, this may change. Some Funds and Advisers that follow traditional public equity investment practices use their positions as shareholders in operating companies to influence the companies to make better ESG-related choices, through shareholder activism and engagement. Some Funds or Advisers may pursue specific investment themes, such as renewable energy, faith-based values, or solutions for a more circular economy. Others may simply enhance traditional diversified portfolio investment strategies by adding ESG performance to existing stock analysis or providing loans that promote desired ESG practices.<sup>2</sup> Articulating how ESG factors are used in practice provides the basis for deciding how laws around the world, with their inherent taxonomies, will apply.

---

<sup>1</sup> In this chapter, the terms “Fund” and “Adviser” are used in the broadest sense to refer to, respectively, investment companies of all types and professional providers of investment advice. We note that laws and regulations in different jurisdictions use different terms or definitions to capture the subsets of Funds and Advisers that are subject to (or exempt from) their provisions. While we discuss some of these distinctions, we have chosen general terms for ease of introduction to this topic, and note, again, that this guide is not legal advice and is written with the expectation that readers will consult their lawyers or compliance counselors to determine the applicability of specific laws and regulations.

<sup>2</sup> See FIN. CONDUCT AUTH., SUSTAINABILITY DISCLOSURE REQUIREMENTS (SDR) AND INVESTMENT LABELS (Nov. 2021), <https://www.fca.org.uk/publication/discussion/dp21-4.pdf> (distinguishing various ESG-related investment strategies).

## 6.2 APPLICABLE LAW AND REGULATION

---

**United States.** In the United States, Funds and Advisers are governed by the federal securities laws and regulated by the SEC.<sup>3</sup> Registered Funds and registered Advisers are subject to periodic regular examinations, occasional industry sweep examinations, and incidental for-cause examinations, under the U.S. Investment Company Act of 1940 or the U.S. Investment Advisers Act of 1940, each as amended from time to time. Funds are also issuers of securities (*i.e.*, the shares, limited partnership interests, or other equity in the Fund itself), so they are also subject to the U.S. Securities Act of 1933 and some aspects of the U.S. Securities Exchange Act of 1934, each as amended from time to time, which regulate offering, selling, and trading in securities, as well as certain aspects of disclosure and reporting by securities issuers.

Even those Funds, Advisers, and share offerings that are exempt from registration must comply with the terms of their exemptions under the securities laws. This usually requires them to abide by certain concepts of integrity and fair dealing that require disclosures to be accurate, complete, and free from material omissions. It is worth noting that, while the 1933 and 1934 Acts prohibit intentional misleading statements and manipulative conduct, the Investment Advisers Act and the Investment Company Act impose a higher (fiduciary) standard, which in some cases prohibits conduct that results in deception, manipulation, or fraud, even in the absence of intent to cause such harm.<sup>4</sup>

---

<sup>3</sup> Funds and Advisers that trade commodities are also subject to U.S. federal commodities regulation. However, as of the date of this publication, the Commodity Futures Trading Commission's ("CFTC") climate change initiatives are still in early stages: on March 17, 2021 the CFTC established a Climate Risk Unit, which will focus on the role of derivatives in understanding, pricing, and addressing climate-related risk and transitioning to a low-carbon economy; and on June 2, 2022 it released a public request for information ("RFI") on how climate-related financial risk is pertinent to the derivatives markets and underlying commodities markets. Request for Information on Climate-Related Financial Risk, 87 Fed. Reg. 34856 (June 8, 2022); Press Release, CFTC, CFTC Acting Chairman Behnam Establishes New Climate Risk Unit (Mar. 17, 2021), <https://www.cftc.gov/PressRoom/PressReleases/8368-21>.

<sup>4</sup> See, *e.g.*, Rule 206(4)-1 under the Investment Advisers Act, 17 C.F.R. § 275.206(4)-1 (2021); see also Investment Company Act Section 34(b), 15 U.S.C. § 80a-34. It is worth noting that Rule 206(4)-8 under the Advisers Act extends Advisers' antifraud and fair dealing obligations to investors and potential investors in private funds exempt from registration under the Investment Company Act.

The SEC has not adopted any specific rules around ESG practices for Funds and Advisers, but the Division of Examinations—which is responsible for conducting risk-based examinations of entities registered with the SEC<sup>5</sup>—has used its annual Examination Priorities bulletins to announce its expectations in handling ESG-related matters.<sup>6</sup> The Division’s 2022 Examination Priorities focus on accurate disclosure of ESG investing approaches; implementation of policies, procedures, and practices designed to prevent federal securities law violations in connection with ESG-related disclosures, including alignment of portfolio management processes and practices; voting client securities in accordance with proxy voting policies and procedures; alignment of proxy voting with stated ESG disclosures and mandates; and avoidance of greenwashing (*i.e.*, overstating or misrepresenting ESG factors considered in portfolio selection and management). ESG-related topics covered in recent SEC examinations have included litigation with ESG-related focus; use of ESG scoring systems; side letters related to ESG focus; issuer communications and shareholder proposals related to ESG; and how registrants are measuring the ESG performance of their products.

**Regulatory Developments.** In May 2022, the SEC published two rule proposals affecting Funds and Advisers utilizing ESG in their investment programs. The first of these modernizes the so-called fund name rule<sup>7</sup> by expanding the requirement that funds with certain names (including those suggesting ESG priorities) adopt a policy to invest at least 80% of their assets in the investment suggested by that name. Under the proposal, a fund that considers ESG factors together with other non-ESG factors, but for which ESG factors are not central or determinative in its decision making, would not be permitted to use “ESG” or similar words in the fund name; to do so would be deemed a materially deceptive and misleading practice. The proposal would also impose enhanced disclosure, reporting, and recordkeeping to track portfolio compliance with the 80% investment rule over time, and describes circumstances under which it would be permissible for a Fund to depart from the 80% rule. Although the fund name rule only applies to registered funds, its underlying principles makes it also good guidance for private Funds about what the SEC considers best practices in this area.

---

5 In 2020, the SEC renamed the Office of Compliance Inspections and Examinations (“OCIE”), which is now the “Division of Examinations.” See *Statement on the Renaming of the Office of Compliance Inspections and Examinations to the Division of Examination*, SEC (Dec. 17, 2020), <https://www.sec.gov/news/public-statement/joint-statement-division-examinations>.

6 SEC, 2020 EXAMINATION PRIORITIES, OFFICE OF COMPLIANCE INSPECTIONS AND EXAMINATIONS (2020), <https://www.sec.gov/about/offices/ocie/national-examination-program-priorities-2020.pdf>; SEC, 2021 EXAMINATION PRIORITIES, DIVISION OF EXAMINATIONS (2021), <https://www.sec.gov/files/2021-exam-priorities.pdf>; SEC, 2022 EXAMINATION PRIORITIES, DIVISION OF EXAMINATIONS (2022), <https://www.sec.gov/files/2022-exam-priorities.pdf>.

7 Investment Company Names, Securities Act Release No. 11067, Exchange Act Release No. 94981, Investment Company Act Release No. 34593, 87 Fed. Reg. 36594 (June 17, 2022) (proposed May 25, 2022) (to be codified at 17 C.F.R. pts. 230, 232, 239, 270 and 274).

The second proposal prescribes new disclosure requirements for certain Funds and Advisers with the goal of making available to investors consistent and comparable information concerning the incorporation of ESG factors into investment practices (the “ESG Practices Disclosure Proposal”)<sup>8</sup>. The ESG Practices Disclosure Proposal seeks to prevent greenwashing by requiring the disclosure of information that helps investors understand whether ESG claims in Funds’ and Advisers’ offering and marketing materials are backed by concrete and specific measures in portfolio allocation and other investment practices. It would also require environment-focused Funds to disclose certain greenhouse gas (“GHG”) emissions information, including the carbon footprint and “weighted average carbon intensity” of their portfolio.

The ESG Practices Disclosure Proposal will cover Funds that are either investment companies or business development companies registered under the Investment Company Act, and certain Advisers that consider ESG factors as part of their advisory businesses. The proposed amendments to Form ADV (*i.e.*, the uniform form used by investment advisers to register with both the SEC and state securities authorities) would apply generally to Advisers that are registered or required to be registered under the Investment Advisers Act, and, in more limited circumstances, to those that are exempt reporting advisers.<sup>9</sup>

The content of a Fund’s disclosures under the ESG Practices Disclosure Proposal depend on how central ESG factors are to that Fund’s strategy, and would affect the Fund’s disclosure documents, including the prospectus and the annual report.<sup>10</sup> The Proposal makes three distinctions to signify how ESG factors figure into a Fund’s strategy:

- **Integration Funds** use ESG factors alongside non-ESG factors in making investment decisions, and would be required to describe how ESG factors are incorporated into the investment process. If the Integration Fund specifically considers GHG emissions, it would have to disclose the methodology and data sources it may use to consider GHG emissions.
- **ESG-Focused Funds** make ESG factors a significant or main consideration in investment decisions and would be required to provide detailed disclosure about this practice, including a standardized ESG strategy overview in a table format. ESG-Focused Funds that use proxy voting and/or issuer engagement as a means of implementing their investment strategy would need to make added disclosures about these efforts.

---

8 Enhanced Disclosures by Certain Investment Advisers and Investment Companies About Environmental, Social, and Governance Investment Practices, Securities Act Release No. 11068, Exchange Act Release No. 94985, Investment Advisers Act Release No. 6034, Investment Company Act Release No. 34594, 87 Fed. Reg. 36654 (June 17, 2022) (proposed May 25, 2022) (to be codified at 17 C.F.R. pts. 200, 230, 232, 239, 249, 274, and 279).

9 The additions to Items 6 and 7 of Form ADV would apply to exempt reporting advisers. *Id.*

10 Additionally, the proposal requires that any ESG-related information filed with the SEC be in a machine-readable format called “Inline eXtensible Business Reporting Language” (“Inline XBRL”). *Id.*

- **Impact Funds** are a subset of ESG-Focused Funds that seek to achieve a specific type of impact from their investment strategy and would be required to disclose how they measure progress against this objective.

The ESG Practices Disclosure Proposal would require subject Advisers to use similar distinctions in disclosures on Form ADV based on their use of ESG factors in their advisory strategies.

In April 2021, the Division of Examinations published a Risk Alert on ESG investing, highlighting potentially problematic areas identified in recent examinations, which is discussed in detail below at Section 6.3.

**Proxy Voting.** In September 2021, the SEC proposed amendments to Form N-PX to enhance transparency on proxy voting and make related information more useful to investors.<sup>11</sup> For any securities held, Advisers would have to report whether they voted their shares, and, if so, how they voted. It also would require reporting persons to use standardized categories to identify the matters voted, including several categories of ESG-related concerns such as environment, climate, diversity, equity and inclusion (DEI), human rights, say-on-pay, and human capital/workforce. The proposal would require registered Funds to make their voting record available to shareholders on their website, and remove the current alternative to offer to disclose the voting record only upon shareholder request.

The proposed amendments would mandate that any Advisers that report their holdings on Form 13F<sup>12</sup> also report their voting record for “say on pay” (*i.e.* executive compensation) matters annually on Form N-PX.

Regulation of proxy voting advisors remains a politically fraught area, and one that has arguably had a chilling effect on proxy voting advisors’ ordinary course of business and on the Advisers and Funds that use them. Rules regulating proxy voting advisors adopted in 2020 under the Trump administration are under review,<sup>13</sup> and the SEC’s Division of Corporate Finance announced it would not recommend enforcement action for violation of certain requirements of the 2020 amendments.<sup>14</sup> Advisers and Funds whose policies and procedures (or client agreements) allow or require the use of proxy voting advisors should keep on their radar how the state of play will affect their duties to clients on ESG and other matters submitted for voting. See also Chapter 5.3—Shareholder Activism.

---

<sup>11</sup> Enhanced Reporting of Proxy Votes by Registered Management Investment Companies; Reporting of Executive Compensation Votes by Institutional Investment Managers, Exchange Act Release No. 93169, Investment Company Act Release No. 34389, 86 Fed. Reg. 57478 (Oct. 15, 2021) (proposed Sept. 29, 2021) (to be codified at 17 CFR pts. 232, 240, 249, 270, and 274).

<sup>12</sup> This refers, basically, to institutional investment managers that can trade over \$100 million worth of securities on the SEC’s 13(f) list, which includes most U.S. equities other than mutual funds. *Frequently Asked Questions About Form 13F*, SEC (Feb. 24 2020), <https://www.sec.gov/divisions/investment/13ffaq.htm>.

<sup>13</sup> Gary Gensler, *Statement on the application of the proxy rules to proxy voting advice*, SEC (June 1, 2021), <https://www.sec.gov/news/public-statement/gensler-proxy-2021-06-01>.

<sup>14</sup> *Statement on Compliance with the Commission’s 2019 Interpretation and Guidance Regarding the Applicability of the Proxy Rules to Proxy Voting Advice and Amended Rules 14a-1(1), 14a-2(b), 14a-9*, DIV. OF CORP. FIN., SEC (June 1, 2021), <https://www.sec.gov/news/public-statement/corp-fin-proxy-rules-2021-06-01>.

**Recent Enforcement Actions.** In 2021, the Division of Enforcement launched a task force focused on climate and ESG issues, focusing initially on identifying material gaps or misstatements in ESG-related disclosures. It recently instituted a cease-and-desist order and a civil money penalty of \$1,500,000 against an Investment Adviser that claimed that all of the investments of certain funds and client accounts undergo the adviser's proprietary ESG quality review when, in fact, advisory personnel were permitted to, and did, select numerous investments that did not go through such review.<sup>15</sup> The SEC has also reportedly initiated at least two other investigations: one of an Adviser overstating the use of ESG impact analysis in executing its investment strategy,<sup>16</sup> and another of an Asset Manager overseeing ESG mutual funds.<sup>17</sup>

**EU, UK, and Australia.** As of March 2021, Advisers subject to regulation in the EU have new obligations under the Sustainable Finance Disclosure Regulation ("SFDR"). SFDR imposes a classification of Funds and the duty to collect and report certain ESG and sustainability information.<sup>18</sup> SFDR requires financial market participants and financial advisors (each as defined in the SFDR) to disclose how sustainability risks are integrated into investment decisions and investment advice. A "sustainability risk" is an environmental, social, or governance event or condition that, if it occurs, could cause an actual or a potential material negative impact on the value of an investment arising from an adverse sustainability impact. U.S. Advisers, too, may be required to comply with SFDR if they advise EU clients, directly or by sub-delegation from an EU Adviser. Advisers are also eligible to claim alignment with the EU Taxonomy Regulation if they evaluate their portfolio companies' objectives and economic activities against the SFDR's technical criteria and aggregate alignment percentages by product and by investment.

---

<sup>15</sup> BNY Mellon Investment Adviser, Inc., Investment Adviser Act Release No. 6032, Investment Company Act Release No. 34591 (May 23, 2022), <https://www.sec.gov/litigation/admin/2022/ia-6032.pdf>.

<sup>16</sup> Patricia Kowsmann et al., *U.S. Authorities Probing Deutsche Bank's DWS Over Sustainability Claims*, WALL STREET J. (Aug. 25, 2021), <https://www.wsj.com/articles/u-s-authorities-probing-deutsche-banks-dws-over-sustainability-claims-11629923018>; Joe Miller et al., *DWS Shares Slide After Greenwashing Claims Prompt BaFin Investigation*, FIN. TIMES (Aug. 26, 2021), <https://www.ft.com/content/0eb64160-9e41-44b6-8550-742a6a4b1022>.

<sup>17</sup> Lananh Nguyen & Matthew Goldstein, *Goldman Sachs Is Being Investigated Over E.S.G. Funds*, N.Y. TIMES (June 12, 2022), <https://www.nytimes.com/2022/06/12/business/sec-goldman-sachs-esg-funds.html>.

<sup>18</sup> EUROPEAN COMM'N, SUSTAINABILITY-RELATED DISCLOSURE IN THE FIN. SERVICES SECTOR, [https://ec.europa.eu/info/business-economy-euro/banking-and-finance/sustainable-finance/sustainability-related-disclosure-financial-services-sector\\_en](https://ec.europa.eu/info/business-economy-euro/banking-and-finance/sustainable-finance/sustainability-related-disclosure-financial-services-sector_en).

In October 2021, the UK's economic and finance ministry, HM Treasury, published a roadmap (the "Roadmap") that calls for the Financial Conduct Authority (FCA) to issue disclosure regulations for the largest UK Advisers, life insurers, and FCA-regulated pension schemes in 2022, and for the balance of such firms in 2023.<sup>19</sup> Previously, in July 2021, the FCA issued a letter to Advisers with its observations of effective and ineffective practices, along the lines of the SEC Division of Examination's April 2021 Risk Alert.<sup>20</sup> The Australian regulator also issued a regulatory guide for Advisers, helping them to determine when other existing disclosure regulations require disclosure of ESG matters.<sup>21</sup>

## 6.3 ADDITIONAL DISCLOSURE GUIDELINES

---

While laws set the baseline for ESG-related disclosures, Funds and Advisers generally consult other sources to inform the content of their disclosures and align internal operations, including regulatory guidance and private sector frameworks that seek to foster consistency across the financial services industry. For many, it is important to consider the frameworks preferred by institutional investors for RFP responses, DDQs, and periodic reporting. If a Fund is offered in multiple jurisdictions, or an Adviser advises Funds (or other client accounts) offered abroad, it will need to consider the extent to which disclosures made about the same or substantially similar products or strategies need to be consistent across jurisdictions. For a related discussion about reporting frameworks, see Ch. 1.1.

### Regulatory Guidance

**United States.** In April 2021, the SEC published a detailed Risk Alert on ESG practices for Advisers, including the following guidance:<sup>22</sup>

- Compliance programs should have policies and procedures related to any ESG claims, such as the use of ESG-related terminology, due diligence and other portfolio management processes for selecting and monitoring investments in light of disclosed ESG strategy and other considerations, and voting proxies in a manner consistent with ESG claims.

---

<sup>19</sup> HM TREASURY, GREENING FIN.: A ROADMAP TO SUSTAINABLE INVESTING, <https://www.gov.uk/government/publications/greening-finance-a-roadmap-to-sustainable-investing>; FIN. CONDUCT AUTH., A STRATEGY FOR POSITIVE CHANGE: OUR ESG PRIORITIES (Mar. 2021), <https://www.fca.org.uk/publications/corporate-documents/strategy-positive-change-our-esg-priorities>.

<sup>20</sup> FIN. CONDUCT AUTH., AUTHORISED ESG & SUSTAINABLE INVESTMENT FUNDS: IMPROVING QUALITY AND CLARITY (July 2021), <https://www.fca.org.uk/publication/correspondence/dear-chair-letter-authorized-esg-sustainable-investment-funds.pdf>.

<sup>21</sup> AUSTRALIAN SECURITIES & INVESTMENTS COMMISSION, REGULATORY GUIDE 175 LICENSING: FIN. PRODUCT ADVISERS—CONDUCT AND DISCLOSURE (June 15, 2021), <https://asic.gov.au/regulatory-resources/find-a-document/regulatory-guides/rg-175-licensing-financial-product-advisers-conduct-and-disclosure/>.

<sup>22</sup> *The Division of Examinations' Review of ESG Investing*, DIV. OF EXAMINATIONS, SEC (Apr. 9, 2021), <https://www.sec.gov/files/esg-risk-alert.pdf>

- Funds and Advisers that claim to follow particular public or private sector ESG frameworks should assure consistency with that claim across their investment process, regulatory filings, reports to framework sponsors and rating agencies, marketing materials, client presentations, DDQs, RFPs, and other client-facing documents.
- Funds and Advisers making ESG claims should have controls adequate to implement, monitor, and update clients' ESG guidelines, mandates, and restrictions, particularly negative screens and active preferences. Funds and Advisers that claim to invest only in companies that have certain characteristics, such as high employee satisfaction, or to pursue issuer engagement on ESG-related issues, should be able to substantiate those claims.
- ESG-related proxy voting claims should be consistent with and supported by proxy voting policies and procedures. The SEC staff found shortfalls where Funds or Advisers touted that all proxy proposals would receive independent, case-by-case evaluations, but did not perform such evaluations, and where they claimed to offer clients the ability to vote separately on ESG-related proxy proposals, but did not provide the opportunity to do so.
- Funds and Advisers that tout favorable risk, return, correlation, or other metrics arising from ESG investments should assure that such statements are accurate and free from material omissions, including disclosure of other factors that contributed to favorable results for the ESG product.
- Firms should not exaggerate their contributions to the development of ESG products (such as an index) where their roles were limited or inconsequential.
- Funds and Advisers should provide education and training so that compliance personnel, portfolio management personnel, and client-facing personnel (or personnel who prepare marketing materials) share a level of knowledge and understanding about ESG investing matters generally and specifically as applied in-house.

The Division staff also acknowledged practices that met standards set by the federal securities laws, such as clearly disclosing, where appropriate, that ESG criteria form only a part of the investment analysis and would not necessarily prevent client accounts from making investments that appear to be inconsistent with ESG investing, or explaining how investments are evaluated against the selected frameworks.

**Europe.** The two main developments in Europe in this area are the EU Taxonomy Regulation and the SFDR.<sup>23</sup> The Taxonomy Regulation went into effect in July 2020. SFDR Level 1 requirements went into effect in the EU

---

23 See Commission Regulation 2020/852, 2022 O.J. (L 198/13) (EU), <https://eur-lex.europa.eu/legal-content/EN/TXT/?uri=celex:32020R0852..>

in March 2021, and Level 2 technical standards go into effect in July 2022. We explore these new regulations in detail in Chapter 3.1—European Union.

**UK.** As mentioned above, the UK's plans for Funds and Advisers<sup>24</sup> were announced in HM Treasury's Roadmap, at the end of 2020. In July 2021, the UK FCA published a letter to authorized fund managers (AFMs)<sup>25</sup> providing guiding principles against the risk of misleading ESG-related disclosures, and also during that year, the FCA published its ESG strategy paper.<sup>26</sup>

In December 2021, the FCA adopted a policy statement establishing climate-related disclosure guidelines for Advisers and certain other regulated asset owners, which went into effect January 1, 2022 for the largest-in-scope firms.<sup>27</sup> The requirements will go into effect January 1, 2023 for smaller firms above a £5 billion exemption threshold (calculated on a 3-year rolling average basis) and the first public disclosures in line with FCA requirements must be made by June 30, 2023. Covered Advisers include investment portfolio managers, managers of UK Undertakings for Collective Investment in Transferable Securities (UCITS), full-scope UK Alternative Investment Fund Managers (AIFMs), and small authorized UK AIFMs. Covered managers should refer to an ESG Sourcebook added to the FCA Handbook on these matters.

Firms are required to update climate-related disclosure at product and entity levels annually. Product-level disclosure should be featured prominently on the firm's main website, and included, cross-referenced, or offered upon request in other client-facing materials. Required product information includes GHG emissions, total carbon emissions, total carbon footprint, and weighted-average carbon intensity, with contextualizing disclosure about methodology, assumptions, interpretations of these metrics, historical look-backs after the first year of reporting, and discussion of any material deviations from firm disclosure policies. Firms must also discuss their plans for transition to a low-carbon economy at an entity level. There are certain permissions for cross-referencing disclosures by affiliates and delegates in these new rules. Finally, firms may agree with clients on a one-off basis to make the same disclosures as at different dates.

---

24 It is worth noting that the UK regulations identify regulated persons in this area as authorized fund ("AF"), alternative investment fund ("AIF"), authorized fund manager ("AFM"), and alternative investment fund manager ("AIFM").

25 HM TREASURY, GREENING FINANCE: A ROADMAP TO SUSTAINABLE INVESTING, <https://www.gov.uk/government/publications/greening-finance-a-roadmap-to-sustainable-investing>; FIN. CONDUCT AUTH., A STRATEGY FOR POSITIVE CHANGE: OUR ESG PRIORITIES (Mar. 2021), <https://www.fca.org.uk/publications/corporate-documents/strategy-positive-change-our-esg-priorities>

26 EUROPEAN COMM'N, SUSTAINABILITY-RELATED DISCLOSURE IN THE FIN. SERVICES SECTOR, [https://ec.europa.eu/info/business-economy-euro/banking-and-finance/sustainable-finance/sustainability-related-disclosure-financial-services-sector\\_en](https://ec.europa.eu/info/business-economy-euro/banking-and-finance/sustainable-finance/sustainability-related-disclosure-financial-services-sector_en).

27 FIN. CONDUCT AUTH., ENHANCING CLIMATE-RELATED DISCLOSURES BY ADVISERS, LIFE INSURERS AND FCA-REGULATED PENSION PROVIDERS, POLICY STATEMENT PS21/24 (Dec. 2021), <https://www.fca.org.uk/publication/policy/ps21-24.pdf>.

The FCA proposed two initiatives relating to sustainable investing disclosures, as called for by the Roadmap, namely, proposals for sustainability disclosure requirements (SDR) and investment labels.<sup>28</sup> SDR will build on guidelines published by UK TCFD and ISSB for operating companies and FCA Guiding Principles, IOSCO Recommendations, and the forthcoming UK Green Taxonomy.<sup>29</sup> It is expected that the FCA will eventually expand disclosure beyond climate risk. Disclosures are proposed to have three levels, namely, product labels for ease of navigation among sustainability products, standardized retail consumer-facing disclosures at the product level, and detailed disclosures about product and entity levels aimed at institutional investors and other sophisticated stakeholders. The SDR will seek to remain as consistent as possible with the EU SFDR, subject to the needs and characteristics of the UK market. It will also address how non-UK Funds marketing into the UK under the UK Overseas Fund Regime should be required to address the SDR.

- EU Sustainable Finance Taxonomy—In effect since July 2020, helping firms determine which activities qualify as “sustainable.”

- EU SFDR—Phase 1, currently in effect, requires a Fund to determine which of three types of ESG Fund it is and initiates some light, high-level disclosure requirements. Phase 2, scheduled to go into effect at the start of 2023, will add detailed requirements for disclosures related to ESG claims and risks.

- U.S. SEC—Issued a predominantly principles-based Risk Alert in April 2021, and other guidance in the staff’s annual Examination Priorities.

- The SFDR system of three categories, products that do not consider sustainability factors, products that promote sustainability factors, and products that have sustainable objectives.

- A separate EU project, called the EU Ecolabel, for retail financial products. The Ecolabel will define the minimum environmental performance of investment products, with the objective of identifying the best environmentally performing financial products.

---

28 FIN. CONDUCT AUTH., SUSTAINABILITY DISCLOSURE REQUIREMENTS (SDR) AND INVESTMENT LABELS, DISCUSSION PAPER DP21/4 (Nov. 2021), <https://www.fca.org.uk/publication/discussion/dp21-4.pdf>.

29 *Id.*

- French authorities have adopted an SRI label for ESG Funds, generally,<sup>30</sup> and a Greenfin label for Funds focused on energy, environmental, and ecological transition.<sup>31</sup>

- BSI, the UK's royally-chartered standard-setting body, publishes a Sustainable Finance Programme to promote adoption of sustainable finance practices, products and services, while helping organizations from the financial sector align themselves with the global UN Sustainable Development Goals (SDGs).<sup>32</sup>

- IOSCO publishes its Recommendations on Sustainability-related Practices, Policies, Procedures and Disclosure in Asset Management,<sup>33</sup> focused on consistency with the TCFD recommendations and contributing to the discussion of material sustainability-related product level risk.

### Private Sector Frameworks and Resources

As mentioned above, there are numerous market-driven frameworks, many of which are undergoing consolidation and alignment at the time of this writing. Some oblige managers that adopt them to report to the sponsor of the framework, some purport to require adoption as an all-or-nothing approach, and some are offered to be used in whole or in part, as is most useful to the manager or its clients. There are also many other resources for Funds, Advisers and institutional investors, providing guidance on aspects of ESG-related investing and reporting.

- Task Force for Climate-Related Financial Disclosures (TCFD) publishes a guide to implementing its recommendations,<sup>34</sup> in which the section for Advisers recommends best practices with respect to disclosure of governance, strategy, risk management, and use of metrics and targets.

---

30 LABEL ISR, LABEL GUIDELINES (July 23, 2020), [https://www.llabelisr.fr/wp-content/uploads/SRI-Label-Guidelines\\_EN\\_july2020updates\\_modifications.pdf](https://www.llabelisr.fr/wp-content/uploads/SRI-Label-Guidelines_EN_july2020updates_modifications.pdf).

31 GREENFIN LABEL, CRITERIA GUIDELINES (April 2019), [https://www.ecologie.gouv.fr/sites/default/files/Label\\_TEEC\\_Criteria%20Guidelines.pdf](https://www.ecologie.gouv.fr/sites/default/files/Label_TEEC_Criteria%20Guidelines.pdf).

32 BRITISH STANDARDS INSTITUTION, SUSTAINABLE FIN. STANDARDS PROGRAMME, <https://www.bsigroup.com/en-GB/about-psi/uk-national-standards-body/BIS-Exploring-new-areas-with-government-funding/projects/Sustainability/sustainable-finance/> (last visited July 6, 2022).

33 THE BOARD OF THE INT'L ORG. OF SEC. COMM'NS, RECOMMENDATIONS ON SUSTAINABILITY-RELATED PRACTICES, POLICIES, PROCEDURES AND DISCLOSURE IN ASSET MANAGEMENT: FINAL REPORT, (Nov. 2020), <https://www.iosco.org/library/pubdocs/pdf/IOSCOPD688.pdf>.

34 TASK FORCE ON CLIMATE-RELATED FIN. DISCLOSURES, IMPLEMENTING THE RECOMMENDATIONS OF THE TASK FORCE ON CLIMATE-RELATED FIN. DISCLOSURES (Oct. 2021), <https://www.fsb.org/wp-content/uploads/P141021-4.pdf>.

- Principles for Responsible Investment (PRI), with a global signatory base representing the majority of the world’s professionally managed assets, promulgates six principles for responsible investing and numerous other tools for Advisers, investors, and policy makers to promote ESG investing. There are guides for Advisers broken down by public and private market strategies, numerous asset classes, and different investment processes.

- Net Zero Asset Managers Initiative (NZAMI) is an undertaking by signatories to invest to drive the goal of net zero GHG emissions by 2050. NZAMI signatories commit to its ten steps for assets invested to drive to net zero, assets invested generally, and accountability. NZAMI guidelines incorporate the TCFD reporting framework for Advisers and are meant to be coordinated with the work of its constituent partners, PRI, CDP, Ceres, and the various global and regional standard setting organizations, such as the Investor Group on Climate Change (IGCC, for Australia and New Zealand), the Institutional Investor Group on Climate Change (IIGCC, for Europe), and the Asia Investors Group on Climate Change.

- Net Zero Asset Owners Alliance (NZAOA) provides goals and guidelines similar to NZAMI, but for asset owners—*i.e.*, clients of Advisers—resolved to transition to a climate-positive portfolio.

- SDG Impact publishes standards for private equity Funds, bond issuers, and development finance institutions as a means to drive investment capital toward products and strategies that focus on achievement of the UN SDGs.<sup>35</sup>

- Ceres is more of a resource for Advisers than a framework sponsor, *per se*. It publishes, among other things, an SEC Sustainability Disclosure search tool, tools for assessing climate, supply chain, and water risk, an ESG training module for Board members, and the Climate Action 100+ Net Zero Company Benchmark ratings of the largest GHG emitters. Ceres and the various global investor groups on climate change partner up to support and contribute to sponsored frameworks, such as Climate Action 100+ and The Investor Agenda.

---

35 SDG IMPACT, SDG IMPACT: INVESTMENT SOLUTIONS FOR GLOBAL IMPACT, <https://sdgimpact.undp.org/assets/SDG-Impact-Brochure.pdf>.

- The Investor Agenda publishes a comprehensive framework for Investor Climate Action Plans (ICAPs). Drawing on the expertise of investors and existing guidance and expectations, the new ICAPs Expectations Ladder seeks to provide a practical roadmap for Advisers to navigate the many different initiatives that exist and to establish ambitious plans of action, wherever they are on their journey to net zero.

- Climate Disclosure Project (CDP) is a not-for-profit organization that runs the global disclosure system for investors, companies, cities, states and regions to manage their environmental impacts. CDP has the most comprehensive collection of self-reported environmental data in the world and is more of a framework for operating companies and a data and research resource for Advisers. Adviser signatories can access the CDP Investor Dashboard, an online hub for CDP data and tools where investors can extract data, analyze responses, and identify key engagement areas.

- Impact Management Project (IMP) sets out guidance for categorizing investments by their relationship to impact investing—avoiding harm, benefitting stakeholders, or contributing to solutions—and identifies five facets for measuring impact.

- The Investment Association (IA), the trade body that represents UK investment managers, publishes a Responsible Investment Framework, to define key terms and bring consistency to product descriptions across the industry.<sup>36</sup>

- The CFA Institute published voluntary, global ESG disclosure standards,<sup>37</sup> not as a labeling system, but to discuss disclosure guidelines for various investment product characteristics, including investment objectives, investment processes, use of benchmarks, sources and types of ESG information, governance, and stewardship. It is expected to follow these up with published assurance procedures in 2022.

---

<sup>36</sup> THE INVESTMENT ASSOCIATION, IA RESPONSIBLE INVESTMENT FRAMEWORK FINAL REPORT, (Nov. 18, 2019), <https://www.theia.org/sites/default/files/2019-11/20191118-iaresponsibleinvestmentframework.pdf>.

<sup>37</sup> CFA INSTITUTE, GLOBAL ESG DISCLOSURE STANDARDS FOR INVESTMENT PRODUCTS, (2021), <https://www.cfainstitute.org/-/media/documents/ESG-standards/Global-ESG-Disclosure-Standards-for-Investment-Products.pdf>.

- The IFRS Foundation established the ISSB, with the mission of consolidating guidance from the Value Reporting Foundation (VRF) and the Climate Disclosure Standards Board (CDSB) by June 2022.
- The Institutional Limited Partners Association (ILPA) released updates to its model due diligence questionnaire, in alignment with the updated PRI model questionnaire for private equity, and also revised its diversity metrics template.
- Finally, leading industry standard setters launched the Impact Management Platform (IMP) to coordinate efforts on impact investing practices and disclosures.

## 6.4 MEASURING IMPACT

---

For ESG investment strategies that are intended to have an impact on people or the planet, measuring progress toward the intended impact remains one of the hottest topics in ESG investing. The ability to measure impact is central to regulatory interest in ESG investment disclosures, because the ability to demonstrate impact is relevant to assessing whether marketing claims and other disclosures are truthful or misleading. If an Adviser states that it has an objective of delivering better than average total returns or limiting volatility, there is data to measure and assess whether its investment processes are aligned with those objectives. Similarly, regulators expect Funds and Advisers with ESG-related goals to be able to marshal data and metrics to design, test and demonstrate that investment processes are actually pursuing, if not also achieving, stated impact objectives. In spite of work done in this area by numerous organizations, measuring impact continues to be a challenging task because of gaps in available data, no established standard best practices, and the proliferation of tools and guidance in the absence of clear governing standards. The TCFD provides probably the most generally-accepted instructions for performance toward climate-related risk mitigation,<sup>38</sup> but there is not as much consensus around other investable ESG goals.

Global Impact Investing Network (GIIN) is one of the earliest leaders in the impact investing space. GIIN maintains IRIS+, an impact measurement and management system,<sup>39</sup> as a free, public resource. IRIS+ encompasses Core Metrics Sets to increase data clarity and comparability; a uniform taxonomy based on generally accepted Impact Categories and Impact Themes; a catalogue of standard social and environmental performance metrics used by leading impact investors; curated resources and practical how-to guidance to support implementation; alignment with the UN Sustainable Development Goals (SDGs); alignment with other major frameworks, standards, and conventions; and interoperability with third-party data platforms and systems.

<sup>38</sup> See TASK FORCE ON CLIMATE-RELATED FIN. DISCLOSURES, IMPLEMENTING THE RECOMMENDATIONS OF THE TASK FORCE ON CLIMATE-RELATED FIN. DISCLOSURES 47-48 (Oct. 2021), <https://www.fsb.org/wp-content/uploads/P141021-4.pdf>.

<sup>39</sup> *Getting Started With Impact Measurement & Management (IMM)*, GLOBAL IMPACT INVESTING NETWORK, <https://thegiin.org/imm/>.

## 6.5 QUALIFIED BENEFIT PLANS/FIDUCIARY DUTY

---

Qualified pension plans—whose conduct is regulated by the Department of Labor (DOL) under ERISA—are among the largest investors in the United States. Workers and retirees whose retirements rely on qualified pension plan assets are sometimes a vocal constituency with regard to values-based investing. Fiduciaries who make investment decisions for qualified plans must exercise their judgment for the exclusive purpose of fulfilling the plan’s obligations to provide benefits to its participants and their beneficiaries.

This limitation on plan fiduciary investment decisions has been a politically fraught one, as it relates to the flexibility to consider non-economic factors as are generally connected to ESG and impact investing. The DOL was first asked to consider the duty of fiduciaries with respect to investments that have collateral social or environmental benefits (called, in this context, “economically targeted investments” or “ETIs”) in 1994, during the Clinton administration. The DOL took the position that ERISA did not prevent plan fiduciaries from investing plan assets in such investments so long as the ETI had an expected rate of return commensurate to returns expected from other investments with similar risk characteristics and was otherwise an appropriate investment for the plan in terms of diversification and other investment policies. This came to be called the “all things being equal test” or the “tie-breaker test.”

When revisiting the all things being equal test in 2008 under the George W. Bush administration, the DOL endorsed the view again, and also emphasized that consideration of collateral, non-economic factors in investment decisions should be rare and, when considered, should be documented in a manner that demonstrated compliance with ERISA’s rigorous fiduciary standards. Adding this emphasis on process, record keeping, and fiduciary rigor to a test that was already difficult to deploy (how do you document a reasonable expectation that an ETI will return the same growth as an investment opportunity without non-economic factors?) imposed a significant chill on plan fiduciaries’ willingness to consider ETIs. Thus, in 2015, during the Obama administration, the DOL wrote, “the Department believes that in the seven years since its publication, [the 2008 guidance] has unduly discouraged fiduciaries from considering ETIs and ESG factors. In particular, the Department is concerned that the 2008 guidance may be dissuading fiduciaries from (1) pursuing investment strategies that consider environmental, social, and governance factors, even where they are used solely to evaluate the economic benefits of investment and identify economically superior investments, and (2) investing in ETIs even where economically equivalent.”

The DOL withdrew the 2008 guidance and confirmed its “longstanding view” that plan fiduciaries may invest in ETIs based, in part, on non-economic factors so long as the investment is appropriate for the plan and economically and financially equivalent to competing investment options. The DOL acknowledged that ESG factors may have a “direct relationship to the economic and financial value” of an investment and, as such, are not merely collateral concerns or tie-breakers but proper elements of the primary analysis of an investment’s merits. It also assured plan fiduciaries that ERISA does not prohibit a plan’s investment policy statements from addressing ETIs or incorporating ESG factors or ESG-related metrics or other tools. ERISA fiduciaries were relieved of the implied obligation to give special scrutiny, skepticism, or documentation toward an otherwise commercially reasonable investment that also has ESG factors related to it.

In 2020, in the final days of the Trump administration, the DOL published a new rule to supersede the prior guidance and instead enforce the primacy of economic factors. The rule sought to prohibit plan fiduciaries from considering any non-economic benefits or goals of an investment. The rule itself and the unusual, accelerated process for its proposal and adoption were controversial, and drew opposition from many sector participants, including major financial institutions. Regulations published in the U.S. Federal Register generally become effective 60 days after publication, which left room for a new administration to act but, as a practical matter, the mere proposal of the rule in June 2021, with the possibility of a second Trump term, created enough uncertainty to create what the DOL would later call an inappropriate chilling effect on fiduciary conduct in this area.<sup>40</sup>

---

40 “The Department has also heard from stakeholders that the rules, and investor confusion about the rules, have already had a chilling effect on appropriate integration of ESG factors in investment decisions, including in circumstances that the rules can be read to explicitly allow.” *Statement on Enforcement of its Final Rules on ESG Investments and Proxy Voting by Employee Benefit Plans*, EMP. BENEFITS SEC. ADMIN., U.S. DEPT. OF LABOR (Mar. 10, 2021), <https://www.dol.gov/sites/dolgov/files/ebsa/laws-and-regulations/laws/erisa/statement-on-enforcement-of-final-rules-on-esg-investments-and-proxy-voting.pdf>.

In 2021, as part of an omnibus executive order,<sup>41</sup> President Biden instructed the DOL to consider rescinding the 2020 rule and protecting plan fiduciaries' flexibility in considering ESG factors. Accordingly, in March 2021, the agency announced that it would not enforce the 2020 rule,<sup>42</sup> and in October 2021 it proposed a new rule<sup>43</sup> to clarify that fiduciaries may consider, and in some cases may be required to consider as a matter of prudence, climate-related risks and other ESG factors in evaluating investments for a qualified plan. If the proposed rule is adopted as proposed, it would be accepted that ESG factors are no different than traditional material risk-return factors, that an ESG factor with economic materiality is not a "collateral" factor, and that consideration of such ESG factors is consistent with the duties of prudence and loyalty. The proposed rule offers a more practical application of the tie-breaker test by allowing fiduciaries to compare and consider relative performance over a relevant time horizon, and would eliminate special documentation obligations. It would not, however, change DOL's underlying view that ERISA fiduciaries cannot, in any case, sacrifice returns or assume greater investment risk solely for the purpose of promoting collateral ESG goals. The rule proposal received 22,393 public comments, of which more than 97% supported reversing the 2020 rule.

For ERISA fiduciaries, and the many public pension fiduciaries who look to ERISA interpretations as instructive guidance for their conduct, it would be extremely valuable to have definitive rules adopted that support the opportunity for a complete examination of relevant information. For so long as their freedom to use their judgment to consider the materiality of ESG factors and the investment decisions that raise them is in doubt, ERISA fiduciaries may be counseled with an excess of caution to avoid considering all relevant factors, to the detriment of plan beneficiaries.

---

41 Exec. Order No. 13990, 86 Fed. Reg. 7037 (Jan. 20, 2021) ("Protecting Public Health and the Environment and Restoring Science to Tackle the Climate Crisis").

42 See *Statement on Enforcement of its Final Rules on ESG Investments and Proxy Voting by Employee Benefit Plans*, EMP. BENEFITS SEC. ADMIN., U.S. DEPT. OF LABOR (Mar. 10, 2021), <https://www.dol.gov/sites/dolgov/files/ebsa/laws-and-regulations/laws/erisa/statement-on-enforcement-of-final-rules-on-esg-investments-and-proxy-voting.pdf>.

43 Prudence and Loyalty in Selecting Plan Investments and Exercising Shareholder Rights, 86 Fed. Reg. 57272 (Oct. 14, 2021) (proposed Oct. 7, 2021) (to be codified at 29 C.F.R. 2550).



## **Topics Your ESG Program May Cover**

# Topics Your ESG Program May Cover

## 7.1 NET ZERO AND CARBON REDUCTION PLEDGES

---

Since its adoption in 2015, the Paris Agreement has been the cornerstone of the international community's fight against climate change. To date, 194 countries and the EU have signed the treaty,<sup>1</sup> which aims to hold the increase in global average temperature to well below 2°C above pre-industrial levels, and, aspirationally, to below 1.5°C above pre-industrial levels.<sup>2</sup> To do so, the Paris Agreement calls for the reduction of greenhouse gas ("GHG") emissions and other mitigative and adaptive actions. In order to meet the climate goals set forth in the Paris Agreement and preserve a livable planet, climate scientists prescribe a reduction in global GHG emissions of 45% by 2030 and the world reaching "net zero" GHG emissions by 2050.<sup>3</sup>

Business activities are among the largest sources of GHG emissions, and, consequently, the cooperation of businesses is necessary to achieve the Paris Agreement targets. In response, many in the business community have embraced the goals of the Paris Agreement. In the last decade, thousands of businesses have announced their intentions to, independently, take action to help achieve Paris Agreement targets. Initiatives like the We Mean Business Coalition and the Race to Zero campaign are mobilizing businesses and other non-state actors to address their own contributions to climate change.<sup>4</sup>

Most large organizations—in particular, publicly traded companies—have made some form of net zero pledge with respect to GHG emissions, often pledging to have their operations be net zero (or, in some cases, "net positive") by 2050. While each company must evaluate for itself the timing, scope, and details of making such a pledge, good practices for doing so include:

1. Providing information and training to executive officers and the Board of Directors so they can set and support a net-zero emissions target. Peer studies and industry overviews may be useful in this regard (see Chapter 1.2—Benchmarking ESG Practices).

---

1 As of July 19, 2022, there are 193 parties (and 195 signatories) to the Paris Agreement. See UN, STATUS OF TREATIES, PARIS AGREEMENT, [https://treaties.un.org/Pages/ViewDetails.aspx?src=TREATY&mtdsg\\_no=XXVII-7-d&chapter=27&clang=\\_en#5](https://treaties.un.org/Pages/ViewDetails.aspx?src=TREATY&mtdsg_no=XXVII-7-d&chapter=27&clang=_en#5) (last visited July 19, 2022).

2 Paris Agreement art. 2, opened for signature Apr. 22, 2016, [https://treaties.un.org/doc/Treaties/2016/02/20160215%2006-03%20PM/Ch\\_XXVII-7-d.pdf](https://treaties.un.org/doc/Treaties/2016/02/20160215%2006-03%20PM/Ch_XXVII-7-d.pdf) (July 19, 2022).

3 See, e.g., UN, *For a Livable Climate: Net-Zero Commitments Must be Backed by Credible Action*, <https://www.un.org/en/climatechange/net-zero-coalition> (last visited July 19, 2022).

4 See WE MEAN BUSINESS COALITION, <https://www.wemeanbusinesscoalition.org/> (last visited July 19, 2022) ("Over 1,300 companies are aligning their emission reduction targets with the 1.5°C trajectory, through Business Ambition for 1.5°C."); RACE TO ZERO, JOIN THE RACE, <https://racetozero.unfccc.int/join-the-race/> (last visited July 19, 2022).

2. Identifying and quantifying the company's Scope 1, 2, and 3 emissions.<sup>5</sup>
3. Setting responsible, science-based targets and timelines for GHG emissions reductions.
4. Creating a written implementation plan of the actions that will move the company toward net zero within the agreed-upon time frame. Company leadership should enlist the help of the company's operations, sustainability, engineering, and science teams in developing its implementation plan. Additionally, companies should consult legal counsel and the company's financial reporting team, so that regulatory reporting requirements and mandatory and voluntary disclosures can be considered in the plan design.
5. Establishing resources for monitoring company progress against the implementation plan and targets.
6. Determining if the company is (or will soon be) subject to any audit or assurance requirements and, if so, consulting an appropriate service provider so that the implementation plan facilitates an audit or assurance phase.

Many companies are far enough along in this journey that an assessment of their results can be instructive to companies just getting started. However, as discussed below, companies should choose carefully from among their peers when it comes to finding a model for carbon reduction goals.

Notwithstanding widespread support for the Paris Agreement, GHG emissions reductions have been happening at a slower pace than necessary to achieve net zero by 2050. Scientists, regulators, and climate progressives are increasingly focusing on whether companies' targets and processes are actually effective in reducing GHGs at the pace necessary to manage climate change. In particular, the parameters companies use to define and meet their respective pledges will determine whether companies' carbon-reduction pledges have the effect of actually reducing global emissions enough to meet Paris Agreement commitments.

To date, companies' net-zero and carbon-reduction pledges largely have not stood up to close scrutiny. Recent reports indicate that many large companies and investment funds may be failing to set goals that would achieve the Paris Agreement targets, or that they are failing to meet their own stated climate pledges. Companies should be concerned both about the potential consequences of failing to meet their GHG reduction goals, and about enforcement risk where they are setting goals that are potentially misleading to investors.

---

5 There is widespread understanding that companies may still encounter gaps in available data on Scope 3 GHG emissions, and that, as a result, companies have less assurance about the data they can gather—and less control over progress—toward reducing Scope 3 emissions.

In February 2022, the New Climate Institute and Carbon Market Watch released a report entitled “Corporate Climate Responsibility Monitor 2022: Assessing the Transparency and Integrity of Companies’ Emission Reduction and Net-Zero Targets,” which examined the overall emissions reductions likely to result from various net-zero pledges. The report assessed the net-zero pledges of 25 large companies—which it estimated accounted for roughly 5% of GHG emissions in 2019—and found that while all make some form of a net-zero pledge, the aggregate reduction in emissions of the companies would likely equal only 40% by 2050, far from the 100% reduction as the term “net zero” suggests.<sup>6</sup> None of the 25 companies achieved a “high integrity” rating for its climate pledge.<sup>7</sup> The report determined that this discrepancy resulted from a number of factors, including the following:

- *The scope of climate pledges:* The scope of emissions within a company’s commitment can cause significant discrepancies between perceived and actual emissions reductions. Fifteen of the 25 included organizations had headline targets that included Scope 1 emissions (direct emissions arising out of the organization’s own activities), Scope 2 emissions (those emissions arising out of indirect energy use), and Scope 3 emissions (emissions arising out of an organization’s upstream and downstream activities, including product use). However, eight companies had targets that included only their own operational emissions (Scopes 1 and 2), and the majority of these companies were not transparent about these limitations.<sup>8</sup>
- *Sufficiency of disclosures:* Excluded data adversely affected the integrity of most of the companies’ GHG disclosures. For example, certain companies excluded a portion of sales or company-branded stores from their emissions data. Many of the included organizations disclosed their Scope 1 and Scope 2 emissions, but only seven companies disclosed full details of Scope 3 emissions.<sup>9</sup> While Scope 3 emissions are much harder to quantify and, by extension, reduce to zero, for many companies, Scope 3 emissions constitute their largest category of emissions.<sup>10</sup> Additionally, in some cases, companies reported only their indirect Scope 3 emissions (but not their direct emissions), which could enable them to claim reductions for actions that they had no role in achieving or even encouraging.<sup>11</sup>

---

6 See NEW CLIMATE INSTITUTE, CORPORATE CLIMATE RESPONSIBILITY MONITOR 2022: ASSESSING THE TRANSPARENCY AND INTEGRITY OF COMPANIES’ EMISSION REDUCTION AND NET-ZERO TARGETS (February 2022), <https://newclimate.org/resources/publications/corporate-climate-responsibility-monitor-2022>.

7 *Id.* at 9.

8 *Id.* at 25.

9 See *id.* at 17-19, 23-25.

10 *Id.* at 34 (“Upstream and downstream value chain emissions (scope 3) account on average for 87% of total emissions for the 25 companies assessed in this report, but companies appear unclear about how they will address these emissions.”).

11 See *id.* at 20 (“In the case of Unilever, where [indirect scope 3] emissions account for approximately two thirds of the company’s reported scope 3 emissions in 2020, the company is likely to achieve a significant share of its target for a 50% emission intensity reduction in scope 3 emissions between 2010 and 2030 simply through other companies’ actions to improve the efficiency of appliances and the emission intensity of the electricity grid.”).

- *Measurement criteria:* Measurement criteria can affect significant portions of a company’s reported emissions. The report found that most companies obscured the real climate impact of their electricity consumption.<sup>12</sup> For example, companies can measure their Scope 2 emissions using market-based or location-based criteria.<sup>13</sup> The majority of the assessed companies used the market-based accounting method, by means of which they were able to demonstrate a reduction of their energy-related emissions via purchases of renewable energy.<sup>14</sup> However, the report found that the data was not sufficiently transparent, and the company’s claims may have been overstated due to the many factors that go into electricity-related emissions, as well as their misunderstanding of renewable energy certificates (“RECs”).<sup>15</sup> The report suggested that companies should, instead, “report on both market-based and location-based scope 2 emissions, and to use the larger of the two values towards the company’s aggregated total emissions.”<sup>16</sup>
- *The exclusion of emissions sources:* Whether companies include their subsidiaries, partnerships, or affiliated companies in their emissions disclosures can also have an impact on the completeness and accuracy of the data that they are reporting. As companies move carbon-intensive infrastructure, assets, or products to wholly or partially-owned subsidiaries, the inclusion of such subsidiaries in companies’ emissions data is increasingly important for accurate reporting.<sup>17</sup> For example, the two energy utilities included in the report only partially reported the emissions of their subsidiaries, and a third company included only activities in certain “integrated countries” representing only 12% of the company’s locations.<sup>18</sup>

---

12 *Id.* at 19.

13 *Id.* at 17 (the market-based method reflects emissions from electricity that companies purposefully choose, and the location-based method accounts for the average emissions intensity of the grids where companies consume energy).

14 *See id.* at 17, 19, 30.

15 *See id.* at 6, 19, 30, 35.

16 *Id.* at 17.

17 *See id.* at 20.

18 *Id.* at 20, 62.

- *Offsets versus reductions:* Ten of the 25 assessed companies currently use offsets to claim to neutralize all, or part of, their actual emissions.<sup>19</sup> The report was critical of the offsetting or neutralizing plans for a variety of reasons. First, claims were misleading or questionable, as it was difficult to substantiate the neutralizing of emissions.<sup>20</sup> Next, offsetting efforts, often in the form of reforestation or biological carbon storage, can be reversed (for example, in the case of reforestation, by a forest fire).<sup>21</sup> Moreover, carbon offsets appeared to distract from or displace companies' emissions reductions targets.<sup>22</sup> Finally, companies may be conflating future carbon storage capacity with the avoidance of past emissions.<sup>23</sup> Globally, the report points out, meeting the Paris Agreement goals will require both the reduction of emissions and the increase of carbon storage, not the substitution of one for the other.
- *Target base years:* The year against which a company sets its GHG reduction target has a large effect on the carbon-reduction impact of meeting that target. Companies can show a greater year-over-year emission reduction depending on the "target base year" for their net-zero pledge. Using target base years with extraordinarily high emissions can conceal the real meaning of targets as well as companies' progress in reaching those targets.<sup>24</sup>
- *Failure of standard-setting initiatives:* The report was critical of standard-setting initiatives like the Science-Based Targets initiative ("SBTi") and CDP (formerly the "Carbon Disclosure Project") (see Chapter 1.2—Benchmarking ESG Practices) for potentially lending credibility to low-quality or misleading targets. For the majority of companies in the report, SBTi ratings were "either highly contentious or inaccurate," due in large part to companies' base year selection.<sup>25</sup> As a result, the report called for a division of responsibilities between organizations doing standard-setting and those doing verification.<sup>26</sup>

Overall, the Corporate Climate Responsibility Monitor report painted a negative picture of the climate pledges of those companies it studied, their progress in fulfilling their pledges, and the transparency with which such pledges are reported out to stakeholders.

---

19 *Id.* at 44.  
 20 *Id.* at 44-46.  
 21 *See id.* at 7, 45.  
 22 *Id.* at 25.  
 23 *Id.* at 7.  
 24 *Id.* at 20.  
 25 *Id.* at 26.  
 26 *Id.* at 27.

It is not just operating companies that are finding it difficult to meet verifiable climate pledges.

A June 7, 2022 report from S&P Global, “Green funds have a Paris alignment problem,” identified similar obstacles to progress by investment funds.<sup>27</sup> S&P Global found that only 11% of 12,000 equity mutual funds and exchange-traded funds (representing more than \$20 trillion in market value) were aligned with the Paris Agreement goal of limiting global warming to “well below” 2°C.<sup>28</sup> The 300 “Green” or “Climate” funds performed only slightly better—12% were aligned with the Paris goal, while nearly a third were on track to overshoot a 3°C warming scenario. While the report noted that it was not stating that such funds were necessarily mislabeled, it emphasized the importance of examining the emissions trajectories and decarbonization pathways of funds’ holdings, particularly given the increased investment in environmental or climate-focused funds.

In light of recent regulatory enforcement actions, companies will have to take seriously the criticism contained in these reports. Going forward, governments, stakeholders, and outside groups will likely place increased scrutiny on climate pledges and similar representations or marketing claims. Transparency and specificity with respect to climate goals, progress, and how companies intend to achieve their targets (including metrics used, timelines, and milestones) will continue to grow in importance, especially as industry and investors face a stepped-up enforcement landscape.

## 7.2 NATURE-RELATED DISCLOSURES: BEYOND CLIMATE

---

In the last several years, regulators and the business community have made significant progress with respect to climate-related disclosures, but have made slower progress on the development of disclosures related to other aspects of environmental sustainability. This has begun to change. The cutting-edge thinking on ESG-related disclosures is now addressing environmental sustainability more broadly by taking into consideration risks related to loss of natural resources, ecosystems, and biodiversity.

**TNFD.** The most prominent development in this area is the launch of the Taskforce on Nature-related Financial Disclosures (“TNFD”) in 2021.<sup>29</sup> Modeled on the Task Force on Climate-related Financial Disclosures (“TCFD”), the TNFD is an industry-led initiative seeking to address nature-related risks beyond climate change. The task force is comprised of senior executives of corporations, financial institutions, and market service providers that represent \$3.1 trillion in market capitalization.<sup>30</sup> Its broader resources include the TNFD Forum, a consultative grouping of over 400 institutional supporters; and the TNFD Knowledge Hub, a network of leading subject matter experts on biodiversity, natural capital, market standards and reporting practices.<sup>31</sup>

---

27 Matt MacFarland et al., *Green Funds have a Paris Alignment Problem*, S&P GLOBAL (June 7, 2022), <https://www.spglobal.com/esg/insights/green-funds-have-a-paris-alignment-problem>.

28 *Id.*

29 TNFD, <https://tnfd.global/>.

30 *Who we are*, TNFD, <https://tnfd.global/who-we-are/>

31 *Id.*

The rationale behind TNFD is that natural resources underpin the global economy.<sup>32</sup> The TNFD posits that “more than half the world’s economic output—US\$ 44tn of economic value generation—is moderately or highly dependent on nature.”<sup>33</sup> These “dependencies” or “natural capital” like air, water, soil, forests, mineral resources, and biodiversity are the global economy’s inputs, and most companies and financial institutions are inadequately accounting for risks related to these inputs.<sup>34</sup>

TNFD’s goal is to “develop and deliver a risk management and disclosure framework for organisations to report and act on evolving nature-related risks, with the ultimate aim of supporting a shift in global financial flows away from nature-negative outcomes and toward nature-positive outcomes.”<sup>35</sup> TNFD’s assessment framework uses the four-pillar approach previously introduced by the TCFD, focusing on governance, strategy, risk management, and metrics and targets.<sup>36</sup> Seven principles guide the TNFD recommendations, namely, market usability, science-based, nature-related risks, purpose-driven, integrated & adaptive, climate-nature nexus, and globally inclusive.<sup>37</sup>

In March 2022, the TNFD released the first of four planned “beta” versions of its framework. This initial release contains:

- An outline of fundamental concepts and definitions that the TNFD recommends companies use when assessing and disclosing their nature-related risks and opportunities;
- Draft disclosure recommendations for nature-related risks and opportunities (which hew closely to those of the TCFD); and

---

32 TNFD, THE TNFD NATURE-RELATED RISK & OPPORTUNITY MANAGEMENT AND DISCLOSURE FRAMEWORK BETA V0.1 RELEASE at 14 (Mar. 15, 2022) (“BETA V0.1 RELEASE”) <https://framework.tnfd.global/wp-content/uploads/2022/06/TNFD-Full-Report-Mar-2022-Beta-v0-1.pdf>.

33 TNFD, NATURE IN SCOPE 2 (June 4, 2021), <https://tnfd.global/wp-content/uploads/2021/07/TNFD-Nature-in-Scope-2.pdf>.

34 See TNFD, PROPOSED TECHNICAL SCOPE 38 (June 2021), <https://tnfd.global/wp-content/uploads/2021/07/TNFD-%E2%80%93-Technical-Scope-38.pdf>; BETA V0.1 RELEASE at 14.

35 About, TNFD, <https://tnfd.global/about/>.

36 *Id.*

37 A full description of the TNFD principles is as follows:

1. Market Usability: Develop frameworks directly useful and valuable to market reporters and users, notably corporations and financial institutions, as well as policy and other actors.
2. Science-based: Follow a scientifically-anchored approach, incorporate well-established and emerging scientific evidence and aim to incorporate other existing science-based initiatives.
3. Nature-related Risks: Address nature-related risks that include immediate, material financial risks as well as nature dependencies, and impacts and related organisational and societal risks.
4. Purpose-driven: Be purpose-driven and actively target reducing risks and increasing nature-positive action by using the minimum required level of granularity to ensure achievement of the TNFD goal.
5. Integrated & Adaptive: Build effective measurement and reporting frameworks that can be integrated into and enhance existing disclosures and standards. Account for and be adaptive to changes in national and international policy commitments, standards and market conditions.
6. Climate-Nature Nexus: Employ an integrated approach to climate- and nature-related risks, scaling up finance for nature-based solutions.
7. Globally Inclusive: Ensure the framework and approach is relevant, just, valuable, accessible, and affordable worldwide, including emerging and developed markets. TNFD, NATURE IN SCOPE 5 (June 4, 2021), <https://tnfd.global/wp-content/uploads/2021/07/TNFD-Nature-in-Scope-2.pdf>.

- Guidance for TNFD’s risk assessment methodology, which it calls LEAP (Locate, Evaluate, Assess, Prepare).<sup>38</sup> TNFD hopes this guidance will help companies and financial institutions undertake nature-related risk and opportunity assessment and incorporate it into their enterprise risk management (ERM) processes to inform corporate and capital allocation decisions, including those relating to reporting and disclosure.<sup>39</sup>
- In June 2022, the TNFD released its “Beta v0.2” framework, which added:
- A first draft of the architecture for metrics and targets, and draft guidance on dependency and impact metrics, including illustrations of their use;
- A proposed approach to specific guidance; and
- An update to LEAP targeted at financial institutions (“LEAP-FI”).<sup>40</sup>



Source: TNFD Nature-related Risk & Opportunity Management and Disclosure Framework, Beta v0.1 Release (March 15, 2022) at fig. 19 (TNFD draft disclosure recommendations)

38 Per the guidance: “Locate your interface with nature; Evaluate your dependencies and impacts; Assess your risks and opportunities; and Prepare to respond to nature-related risks and opportunities and report.” See BETA V0.1 RELEASE at 56.

39 *Id.* at 7, 43.

40 TNFD, THE TNFD NATURE-RELATED RISK & OPPORTUNITY MANAGEMENT AND DISCLOSURE FRAMEWORK, BETA V0.2 RELEASE at 4 (June 2022), <https://framework.tnfd.global/wp-content/uploads/2022/06/TNFD-Framework-Document-Beta-v0-2.pdf>.

TNFD plans to publish subsequent beta versions of the framework in October 2022 and February 2023 before distributing final disclosure recommendations in September 2023.<sup>41</sup> Between beta releases, TNFD will gather feedback from market participants and other interested parties, and conduct pilot tests. Interested parties can comment on the draft frameworks via TNFD's interactive online portal: <https://framework.tnfd.global/>

**Regulations.** Government regulation with respect to nature-related disclosures is still in the earliest stages. However, recent legislation in the EU is likely a preview of a coming broader trend.

The EU Sustainable Finance Disclosures Regulation ("SFDR"), which we discuss more extensively in Chapter 3, took effect on March 10, 2021, and imposed disclosure requirements on financial market participants.<sup>42</sup> On April 6, 2022, the European Commission adopted technical standards for disclosing sustainability-related disclosures under the SFDR. These technical standards, which take effect on January 1, 2023, include requirements that financial institutions disclose not only how their activities depend on and affect climate, but also how their activities depend on and affect biodiversity and other nature-related factors like water resources and hazardous waste.<sup>43</sup>

On the national level, France has also adopted disclosure requirements consistent with the SFDR. On May 27, 2021, the French government issued a decree implementing Article 29 of the Energy-Climate Law.<sup>44</sup> The decree requires financial institutions to disclose how their financial activities depend on and impact both climate and biodiversity, and disclose their strategy for reducing biodiversity impact, including specific targets and a measure of alignment with international biodiversity goals.<sup>45</sup>

While these are the most prominent developments to date, companies should expect nature-related disclosure regulations to gradually roll out over the next several years and to pick up speed following the publication of the TNFD framework.

**Resources and Analysis.** In April 2022, the UN Environment Program published a report entitled "Are You Ready for Nature-related Disclosure?"<sup>46</sup> The report found that most of the companies within its scope were only

---

41 See BETA Vo.1 RELEASE at 43.

42 Commission Regulation 2019/2088, 2019 O.J. (L 317/1) (EU), <https://eur-lex.europa.eu/legal-content/EN/TXT/?uri=CELEX:32019R2088>.

43 See *Sustainability-Related Disclosure in the Financial Services Sector*, EUROPEAN COMM'N, [https://ec.europa.eu/info/business-economy-euro/banking-and-finance/sustainable-finance/sustainability-related-disclosure-financial-services-sector\\_en](https://ec.europa.eu/info/business-economy-euro/banking-and-finance/sustainable-finance/sustainability-related-disclosure-financial-services-sector_en); *Annex to the Commission Delegated Regulation (EU) .../... Supplementing Regulation (EU) 2019/2088*, EUROPEAN COMM'N (June 4, 2022), [https://ec.europa.eu/finance/docs/level-2-measures/C\\_2022\\_1931\\_1\\_EN\\_annexe\\_acte\\_autonome\\_part1\\_v6.pdf](https://ec.europa.eu/finance/docs/level-2-measures/C_2022_1931_1_EN_annexe_acte_autonome_part1_v6.pdf).

44 *Publication of the Implementing Decree of Article 29 of the Energy-Climate Law on Non-Financial Reporting by Market Players*, MINISTÈRE DE L'ÉCONOMIE (June 8, 2021), <https://www.tresor.economie.gouv.fr/Articles/2021/06/08/publication-of-the-implementing-decree-of-article-29-of-the-energy-climate-law-on-non-financial-reporting-by-market-players>

45 Loi 2021-663 du 27 mai 2021 pris en application de l'article L. 533-22-1 du code monétaire et financier [Decree no. 2021-663 of 27 May 2021 implementing Article L.533-22-1 of the Monetary and Financial Code] JOURNAL OFFICIEL DE LA RÉPUBLIQUE FRANÇAISE [J.O.] [OFFICIAL JOURNAL OF THE FRENCH REPUBLIC], May 28, 2021, pp. 4-5, <https://www.tresor.economie.gouv.fr/Articles/80af1116-2fcd-47d0-ad1d-ea24352e6295/files/273f9026-bbc4-4fc2-ba60-f86f6fe16c1f>.

46 UN WCMC ET AL., ARE YOU READY FOR NATURE-RELATED DISCLOSURE? AN ASSESSMENT OF READINESS AND EXPECTATIONS FROM THE CORPORATE MARKET (2022), <https://www.unepfi.org/publications/are-you-ready-for-nature-related-disclosure/>.

starting to tackle these challenges.<sup>47</sup> In other words, for most companies, the answer is no. However, forward-thinking companies seeking to prepare for future nature-related disclosure requirements will find that there are a variety of excellent resources that companies and investors can access in order to prepare for future disclosure requirements. Below is a non-exhaustive list of these resources:

- The United Nations Environmental Program Finance Initiative (UNEP-FI) has a variety of resources and reports regarding the intersection of the economy and nature, including regarding nature-related disclosures: <https://www.unepfi.org/nature/nature/>
  - Beyond 'Business As Usual': Biodiversity Targets And Finance (June 2020): <https://www.unepfi.org/publications/banking-publications/beyond-business-as-usual-biodiversity-targets-and-finance/>
  - Prioritising Nature-Related Disclosures: Considerations For High-Risk Sectors (April 2022): <https://www.unepfi.org/publications/prioritising-nature-related-disclosures-considerations-for-high-risk-sectors/>
  - Nature In A Haystack: Leveraging Public Nature-Related Data In Disclosure Frameworks (April 2022): <https://www.unepfi.org/publications/nature-in-a-haystack-leveraging-public-nature-related-data-in-disclosure-frameworks/>
- Sustainability Accounting Standards Board (SASB) has developed metrics and models (see Chapter 1) that TNFD has incorporated into its proposed disclosure framework.
  - The Sustainable Industry Classification System (SICS) groups companies based on sustainability profiles rather than financial and market characteristics: <https://www.sasb.org/find-your-industry/>
  - SASB's Materiality Finder (<https://www.sasb.org/standards/materiality-finder/>) and Materiality Map (<https://www.sasb.org/standards/materiality-map/>) are tools that help companies identify which risks may be material from a disclosure perspective.
- The Natural Capital Finance Alliance (NCFA), is an initiative of the financial sector and the UNEP-FI whose goal is to help the financial sector to reduce and manage the risks of environmental impacts and dependencies. NCFA has a variety of resources and reports regarding natural capital: <https://naturalcapital.finance/>

---

47 *Id.* at 14-15.

- o ENCORE (Exploring Natural Capital Opportunities, Risks and Exposure), a NCFA project with the UN Environment World Conservation Monitoring Centre, is an online tool that allows users to see how the economy depends on nature: <https://encore.naturalcapital.finance/><sup>48</sup>
- The Finance for Biodiversity (F4B) initiative whose goal is to “increase the materiality of biodiversity in financial decision-making, and so better align global finance with nature conservation and restoration.”
  - o Report: The Climate-Nature Nexus: An investor guide to expanding from climate-to nature-data (April 13, 2022): <https://www.f4b-initiative.net/publications-1/the-climate-nature-nexus%3A-an-investor-guide-to-expanding-from-climate--to-nature-data>
- The Natural Capital Project, based at Stanford University, is a partnership of academic institutions and environmental NGOs creating tools to bring the values of nature into decision-making: <https://naturalcapitalproject.stanford.edu/>
  - o InVEST (Integrated Valuation of Ecosystem Services and Tradeoffs) is a suite of free, open-source software models used to map and value the goods and services from nature that sustain and fulfill human life: <https://naturalcapitalproject.stanford.edu/software/invest>
- The Science Based Targets Network (see Chapter 1.2, Benchmarks) is a network of organizations developing methods and resources for science-based targets for nature preservation: <https://sciencebasedtargetsnetwork.org/resources/>. It published an initial step-by-step guide in 2020: <https://sciencebasedtargetsnetwork.org/wp-content/uploads/2020/09/SBTN-initial-guidance-for-business.pdf>

---

48 For an explanation of ENCORE see NATURAL CAPITAL FINANCE ALLIANCE ET AL., EXPLORING NATURAL CAPITAL OPPORTUNITIES, RISKS AND EXPOSURE: A PRACTICAL GUIDE FOR FINANCIAL INSTITUTIONS (2018), <https://www.unepfi.org/publications/ecosystems-publications/exploring-natural-capital-opportunities-risks-and-exposure-a-practical-guide-for-financial-institutions/>.

- The EU Business @ Biodiversity Platform is a project by the European Commission that aims to work with and help businesses integrate natural capital and biodiversity considerations into business practices. Its website has a variety of tools and resources (including its Align accounting project) for businesses to address nature-related issues: [https://ec.europa.eu/environment/biodiversity/business/index\\_en.htm](https://ec.europa.eu/environment/biodiversity/business/index_en.htm)
- The Intergovernmental Science-Policy Platform on Biodiversity and Ecosystem Services (IPBES) is “an independent intergovernmental body established by States to strengthen the science-policy interface for biodiversity and ecosystem services for the conservation and sustainable use of biodiversity, long-term human well-being and sustainable development.”<sup>49</sup> Its Global Assessment Report on Biodiversity and Ecosystem Services can be found here: <https://ipbes.net/global-assessment#:~:text=The%20IPBES%20Global%20Assessment%20on,accepted%20by%20the%20IPBES%20Plenary>
- The World Economic Forum New Nature Economy Series is a “series of reports showing the relevance of nature loss to boardroom discussions on risks and opportunities.” The entry to the series can be found here: <https://www.weforum.org/reports/new-nature-economy-report-series>

---

49      *About, IPBES, <https://ipbes.net/about>.*

## 7.3 DIVERSITY, EQUITY, AND INCLUSION

---

The “Social” component of ESG focuses on how companies treat their employees, as well as other internal and external stakeholders. In assessing a company’s social impact, diversity, equity, and inclusion (or “DEI”) considerations are key, as they cover the processes, practices, and mechanisms in place to support engagement and fair treatment of all stakeholders. Companies embracing these values seek to ensure that diversity, equity and inclusion are present not only within the ranks of their own personnel, but also in those of the vendors in their supply chain. Some companies extend their objectives to consider how their practices impact equity and social justice in the communities in which they operate and do business.

Although DEI is often considered holistically, it is worth examining each component in turn:

- *Diversity*: Diversity focuses on whether a company engages employees and stakeholders with a wide variety of backgrounds and perspectives. Diversity may include, for example, racial and ethnic diversity, economic diversity, ideological diversity, gender diversity, as well as diversity in ability, age, skills, function, religion, sexual orientation, or geography. Arguably, diversity has been around the longest of the different aspects of DEI. Accordingly, data and studies are becoming available to which companies can refer when establishing their goals and practices. Data demonstrates that companies that engage diverse perspectives outperform their non-diverse peers. For example, a 2019 analysis conducted by McKinsey & Company found that companies in the top quartile of ethnic and cultural diversity outperformed those in the fourth quartile by 36% with respect to profitability in 2019.<sup>50</sup> The same study also examined gender diversity, finding that “companies in the top quartile of gender diversity on executive teams were 25 percent more likely to enjoy above-average profitability than peer companies in the fourth quartile.”<sup>51</sup>
- *Equity*: Equity focuses on providing fair, unbiased opportunities, access, and outcomes to employees and other stakeholders. In addition to addressing equity within their own organizations, companies are increasingly required to take a stand on equity and social justice matters in their local and global communities.<sup>52</sup>

---

50 Sundiatu Dixon-Fyle et al., *Diversity Wins: How Inclusion Matters*, MCKINSEY & COMPANY (May 19, 2020), <https://www.mckinsey.com/featured-insights/diversity-and-inclusion/diversity-wins-how-inclusion-matters>.

51 *Id.*; see also Katie Koch, *The Daily Check-In: The Business Case for Investing in Diversity*, GOLDMAN SACHS (Aug. 18, 2020), <https://www.goldmansachs.com/insights/pages/the-business-case-for-investing-in-diversity.html> (video discussion about how Goldman Sachs set diversity goals and practices at Goldman Sachs Asset Management).

52 Addressing how values relating to systemic issues like equity and social and economic justice can be implemented in an investment strategy is, perhaps, the cutting edge of sustainable investing study at the time of this publication. To better understand the challenges and advances in this area, it may be helpful to follow thought leaders at the Columbia University School of International and Public Affairs (<https://www.sipa.columbia.edu/news/sipa-launches-sustainable-investing-research-initiative>) and The Investment Integration Project (<https://tiiproject.com/>).

- *Inclusion*: Inclusion focuses on ensuring that once diversity and equity are established, companies create a culture that fosters meaningful engagement and consideration of the diverse perspectives that it includes.

New legal requirements to disclose diversity, equity, and inclusion practices are here and on the horizon. For example, as described in further detail below, new Nasdaq rules require Nasdaq-listed companies to disclose information on diversity characteristics of their boards and have at least two diverse board members, subject to limited exceptions.

Further, in August 2020, the U.S. Securities & Exchange Commission adopted rules on the Modernization of Regulation S-K Items 101, 103, and 105 that require a company subject to Regulation S-K to provide, when material to an understanding of the business taken as a whole, a description of its human capital resources, including any human capital measures or objectives that management focuses on in managing the business. This rule may be interpreted to require disclosure of information related to the diversity of company personnel, as well as diversity, equity, and inclusion measures that are the focus of managing the business.

## **Diversity, Equity, and Inclusion: Governance**

According to the Organization for Economic Co-operation and Development (“OECD”), corporate governance “involves a set of relationships between a company’s management, its board, its shareholders and other stakeholders. Corporate governance also provides the structure through which the objectives of the company are set, and the means of attaining those objectives and monitoring performance are determined.”<sup>53</sup> Under the stakeholder capitalism model, good governance involves taking into consideration the interests of a variety of company stakeholders, including shareholders, customers, suppliers, employees, and the communities in which companies operate.

An effective corporate ESG program incorporates Diversity, Equity, and Inclusion (“DEI”) considerations into the company’s governance model by both (1) ensuring DEI is present in the company’s management and governance bodies themselves, and (2) ensuring that the elements of good governance that would apply to any program or initiative undertaken by a company are applied to the company’s DEI-focused programs and initiatives.

### **DEI in Governance Mechanisms**

Corporate boards of directors are responsible for incorporating the company’s objectives into its governance and day-to-day operations. Various recent developments have focused on ensuring that companies cultivate diverse boards of directors—the main mechanism for applying good corporate governance.

---

53

See OECD, G20/OECD PRINCIPLES OF CORPORATE GOVERNANCE 9, 14 (Nov. 30, 2015).

### *Nasdaq Rules 5605(f), 5606, and 5900-9*

On August 6, 2021, in response to investors' increasing demand for diverse boards and diversity-related information about public companies, the SEC issued an order approving rules proposed by Nasdaq which require a listed company (i) to have at least two diverse board members or explain why it does not, and (ii) to disclose board-level diversity data annually (the "Board Diversity Rule"). An additional new rule offers listed companies access to a board recruiting service.

### *California Laws*

In September 2018, California amended its Corporations Code to require that California-based public companies include at least one female director on their board of directors by the end of 2019. The law also required that by the end of 2021, California-based public companies with boards of six or more directors have at least three female directors, California-based public companies with boards of five directors have at least two female directors, and California-based public companies with boards of four or fewer directors have at least one female director.

In September 2020, California again amended its Corporation's Code with similar requirements for underrepresented communities. The law required public companies headquartered in California to have at least one director from an underrepresented community. The law also required that by the end of 2022, California-headquartered public companies with (a) boards of nine or more directors have at least three directors from underrepresented communities, (b) boards of five to eight directors have at least two directors from underrepresented communities, and (c) boards of four or less directors have at least one director from an underrepresented community.

In the spring of 2022, the two California board diversity laws were struck down by two Los Angeles Superior Court judges who found that the laws violated California's state constitution.<sup>54</sup> Appeals are expected in both cases, and California-based companies would be well-advised to track legislative and judicial developments.

---

54 *Crest v. Padilla*, No. 19STCV27561 (Cal. Super. Ct. May 13, 2022) (striking down S.B. 826); *Crest v. Padilla*, No. 20STCV37513, 2022

## Shareholder derivative lawsuits

In past years, a series of shareholder derivative lawsuits have been filed against major corporations, focused on the companies' alleged lack of board and executive diversity.<sup>55</sup> In these actions, among other claims, shareholders allege violations of securities laws and breach of fiduciary duty. Claims include, for example, that relevant directors have issued misleading statements about the board's commitment to diversity. Although these lawsuits have proven unsuccessful to date, companies may view them as signaling a trend in the strategy and approach stakeholders may use to advance corporate DEI progress moving forward.

### Applying Good Governance to DEI Programs & Initiatives

The most effective DEI programs and initiatives will incorporate the key elements of good governance in their design and execution. Among the key elements of good governance that should be applied to companies' DEI programs are commitment from top management, the development of written DEI policies, the provision of adequate resources for DEI programs and initiatives, accountability and transparency regarding companies' efforts to promote DEI, periodic review and critical self-assessment of DEI programs and initiatives, and incorporation of lessons learned into the structure and execution of DEI programs and initiatives.

Companies should also be mindful that they pursue DEI objectives without running afoul of the law. To do this, companies should focus on creating an inclusive definition of diversity, identifying areas where representation and inclusion are lacking and focus on remedying those gaps without implementing quotas, and linking DEI goals to business objectives. Companies should also incorporate diversity training, including non-discrimination training and equal opportunity training, into their corporate training. In implementing these efforts, companies should involve their legal counsel, as DEI initiatives may be affected by employment law and other laws affecting human resources. Finally, organizations operating across borders should consider that legal standards with respect to DEI vary from country to country.

---

LEXIS 5531 (Cal. Super. Ct. Apr. 1, 2022) (striking down A.B. 979).

55 See, e.g., *Ocegueda v. Zuckerberg*, 526 F. Supp. 3d 637 (N.D. Cal. 2021); *Kiger ex rel. Qualcomm Inc. v. Mollenkopf*, 2021 U.S. Dist. LEXIS 220509 (D. Del. 2021); *Klein v. Ellison*, 2021 U.S. Dist. LEXIS 97880 (N.D. Cal. 2021); *EllieMaria Toronto Esa v. NortonLifeLock Inc.*, 2021 U.S. Dist. LEXIS 164000 (N.D. Cal. 2021); *Lee v. Fisher*, 2021 U.S. Dist. LEXIS 82840 (N.D. Cal. 2021).

## 7.4 DUTY OF CARE AND ANTI-SLAVERY

---

### Regulatory Framework

Standards for responsible business conduct with respect to the basic human rights to physical safety, self-determination, and voluntary labor, among other things, have traditionally been published by international organizations, such as the Organization for Economic Co-operation and Development (“OECD”)<sup>56</sup> and the United Nations (“U.N.”).<sup>57</sup> While corporations were strongly encouraged to comply with such principles and standards, they did not have any legal obligation to do so.

Nonetheless, in recent years, an increasing number of countries have adopted dedicated legislation imposing specific due diligence obligations for corporations in order to prevent human rights and environmental violations through their operations and value chains. Relevant legislation includes the following:

- The California Transparency in Supply Chains Act (2010);
- The U.K. Modern Slavery Act (2015);
- The French Duty of Care Law (2017);
- The EU Regulation No. 2017/821 on Conflict Minerals (2017);
- The Australian Modern Slavery Act (2018);
- The Norwegian Act on Business Transparency and Work on Basic Human Rights and Decent Working Conditions (2021);
- The Swiss Regulation on Sustainability Reporting and Human Rights Due Diligence (2021); and
- The German Supply Chain Due Diligence Act (2021).

The number of countries that are currently discussing analogous draft legislation is rapidly increasing.<sup>58</sup> While these regulations have different scopes, they all require relevant companies to establish certain due diligence steps to prevent, mitigate and address adverse impacts on, inter alia, human rights and the environment resulting from their operations and value chains.

---

<sup>56</sup> See, e.g., OECD, OECD GUIDELINES FOR MULTINATIONAL ENTERPRISES (2011 ed.), <http://mneguidelines.oecd.org/guidelines/>; OECD, OECD DUE DILIGENCE GUIDANCE FOR RESPONSIBLE BUSINESS CONDUCT (2018), <https://www.oecd.org/investment/due-diligence-guidance-for-responsible-business-conduct.htm>.

<sup>57</sup> See, e.g., U.N. Global Compact (2000), <https://www.unglobalcompact.org/what-is-gc/mission/principles>; OFFICE OF THE HIGH COMMISSIONER FOR HUMAN RIGHTS, GUIDING PRINCIPLES ON BUSINESS AND HUMAN RIGHTS (2011), [https://www.ohchr.org/sites/default/files/Documents/Publications/GuidingPrinciplesBusinessHR\\_EN.pdf](https://www.ohchr.org/sites/default/files/Documents/Publications/GuidingPrinciplesBusinessHR_EN.pdf).

<sup>58</sup> Jurisdictions that are currently discussing legislation imposing duty of care obligations on corporations include Austria, Belgium, Canada, the E.U., Finland, Mexico, the Netherlands, and the State of New York.

While certain bills are intended to prevent specific human rights violations (e.g., forced labor and child labor, as is the case for the U.K. and Australian Modern Slavery Acts), an increasing number of laws provide for much broader protection (such as the French Duty of Care Law, which covers “potential adverse impacts on human rights and fundamental freedoms, severe harm to the health and safety of individuals, and serious environmental damage”). Similarly, more recent regulations require corporations to prevent violations throughout their entire value chains (as opposed to simply their supply chains) by integrating, for example, distribution and sales activities, which is the case in the draft E.U. Directive on corporate sustainability due diligence. Relevant obligations target not only corporations having an office registered in the country, but also those established abroad that operate or “provide goods or services” in the country (which is the case in the Norwegian Act on Business Transparency and Work on Basic Human Rights and Decent Working Conditions).

In most countries (including France), non-compliance with these obligations is not yet subject to specific penalties or fines. Nonetheless, an increasing number of laws provide for specific enforcement authorities having the power to conduct investigations and to impose corrective measures and administrative sanctions designed to ensure compliance with relevant obligations (this is the case in Germany, Norway, and in the draft E.U. Directive on corporate sustainability due diligence).

## Key Obligations

As noted above, these laws require companies to establish certain due diligence steps to prevent, mitigate, and address adverse impacts on, *inter alia*, human rights and the environment. Relevant requirements mostly mirror those established by the OECD Due Diligence Guidance for Responsible Business Conduct. According to this guidance, the due diligence should entail the following steps:

- Formalizing the company’s commitment to responsible business conduct into corporate policies and management systems;
- Identifying and assessing adverse impacts on human rights and environmental protection throughout their operations and supply chains;
- Establishing appropriate controls designed to prevent, mitigate or cease relevant risks and prevent serious abuses and damages, including with respect to the activities of external stakeholders (including throughout the supply chain);
- Monitoring the effectiveness of the controls in place;
- Communicating on the steps above (including externally); and
- Providing for, or cooperating in, remediation when appropriate.<sup>59</sup>

---

59 See generally OECD DUE DILIGENCE GUIDANCE FOR RESPONSIBLE BUSINESS CONDUCT (2018), <https://www.oecd.org/investment/due-diligence-guidance-for-responsible-business-conduct.htm>.

The extent of the above obligations varies depending on the relevant jurisdiction(s), including with respect to applicable reporting requirements. For example, while certain regulations require the publication of certain reports on the company's website (such as the French Duty of Care Law), others require that these be submitted to a specifically-designated administrative authority (such as the Australian Modern Slavery Act).

## Practical Features

In practice, ensuring full compliance with applicable duty of care requirements can be challenging for corporations, particularly those operating in multiple countries. Indeed, such corporations might be required to simultaneously comply with several regulations having different scopes and establishing different obligations. As such, corporations should make sure to:

- Anticipate key developments by monitoring the adoption and entry into force of new legislation;
- Determine whether they fall within the scope of relevant laws (including based on their place of incorporation or organization, possible thresholds, and the location(s) of their operations);
- Gain a thorough understanding of the relevant obligations, including disclosure requirements. Should the obligations imposed by applicable regulations differ, companies should ensure compliance with those having the broadest scope/imposing the strictest obligations;
- Take active steps to fully comply with relevant obligations (including through the assistance of third party experts, such as external counsel and NGOs). This will require, *inter alia*, a clear definition of the role and responsibilities of the different functions responsible for implementing them;
- Train employees and other stakeholders; and
- Communicate extensively on the steps taken to ensure compliance with relevant requirements.



# 8

## **ESG Investigations and Enforcement**

# ESG Investigations and Enforcement

A need for investigation can arise in multiple areas of concern to an ESG program. ESG issues touch on a broad array of company functions, and potential violations of law or company policies can arise in numerous contexts. Indeed, many areas of traditional corporate compliance implicate ESG initiatives and policy: fraud and conflicts of interest; human rights issues in supply chains; payment of bribes to foreign or domestic government officials; and the potential for a company's public misstatement of potentially material information, including its progress in meeting environmental benchmarks or implementing environmental standards.

ESG-specific investigations and prosecutions remain limited, but that is rapidly changing, particularly as countries and companies shift from disclosing around voluntary standards to disclosures grounded in law. These mandatory disclosures will, in turn, prompt additional regulatory scrutiny, as evidenced by the 2021 formation of an ESG Task Force within the U.S. Securities and Exchange Commission's Division of Enforcement. The increase in regulatory scrutiny, as well as an increased focus on such disclosures by investors and consumers, will result in regulatory, compliance and litigation risk for companies, necessitating investigations into these issues.

This chapter discusses relevant considerations in reactive, *i.e.*, post-notification or suspicion of misconduct, ESG-related investigations. Many organizations are also conducting proactive investigations in the ESG context, such as evaluations of a firm's DEI initiatives or even overall workplace culture. Proactive investigations frequently utilize methods similar to those used in reactive investigations, and can enable a company to test and better understand the status of ESG-related initiatives.

## 8.1 WHEN THE NEED FOR INVESTIGATION ARISES

---

The first step following receipt of an allegation of misconduct is to assess the credibility of the allegation and seek to understand the nature and potential severity of the possible violation, including whether it involves a potential violation of law. These factors will drive decisions concerning the investigation, including who should conduct and supervise the investigation, the scope of the investigation, whether authorities should or must be notified, and whether to involve outside counsel.

Where an allegation involves a potential violation of law(s), an organization should consider what law(s) may have been violated, whether the potential violation is criminal or civil in nature, whether a records hold is called for, and whether it is restricted to one country or multiple countries. In many instances, an investigation will be sparked by a government inquiry or subpoena. The government's interest, and whether the organization is a potential target or witness in the investigation, are important factors in structuring the organization's response to the allegations.

If the potential misconduct is not a violation of law, but rather, a violation of internal policies and practices, the organization should seek to understand which policies are implicated and what control gaps allowed any policy violation(s). For example, in evaluating a discrimination complaint, which can implicate DEI policies and procedures, investigators should seek to understand whether the violation reveals an omission in policies, training, or supervision, or just violative conduct by a single individual. Investigators should also seek to understand whether financial or performance incentives contributed to or permitted the misconduct, which may indicate more widespread problems and require policy changes with broader application. When dealing with potential internal policy violations, the company's compliance team can often be valuable because of their expertise with existing policies and their experience monitoring and enforcing compliance with other company policies.

It is worth noting that corporate policies and procedures can acquire the weight of law if they were disclosed to investors or the market in regulated disclosure documents or statements.

## 8.2 CONDUCTING THE INVESTIGATION

---

An effective investigation is essential to understanding whether a violation of law or internal policies occurred, what the violation was, who was involved, and how to remedy the situation and prevent reoccurrence. Additionally, effectively gathering the facts regarding an allegation is helpful to the company in the event of enforcement or regulatory action or private litigation. For example, a company's "processes for handling investigations of such complaints, including the routing of complaints to proper personnel, timely completion of thorough investigations, and appropriate follow-up and discipline" is a factor in DOJ's evaluation of corporate compliance programs, and a prompt, thorough, and competent investigation can help organizations avoid or lessen the consequences of claims related to identified misconduct. Similarly, in the event of later litigation, a company will have already identified the involved individuals and done much of its initial fact collection while witnesses' memories were fresh and the context of decisions more apparent.

Taking statements from witnesses at any stage of the investigation deserves the attention of the company's lawyers. There may be issues of privilege and disclaimers around witness accounts that benefit from legal advice and proper handling.

From the earliest stages of an investigation, the investigative team should consider the scope and conduct of an investigation, and whether to report the potential misconduct voluntarily to enforcement or regulatory authorities. In devising a workplan for an investigation, a company should follow best practices to preserve the integrity of the investigation and demonstrate management's commitment to compliance oversight, including by taking steps to prevent the continuation of any potential misconduct during the pendency of the investigation.

The initial considerations and best practices discussed here are broadly applicable in many types of investigations. Each investigation will present its own challenges and opportunities to tailor the investigation to the needs of the business and the allegations at issue.

## Initial Considerations

**Scoping.** The initial scope of an investigation should be tailored to the nature and apparent seriousness of the allegations made, and, as it proceeds, the investigation should expand or narrow as additional facts are learned. These preliminary steps may include an initial interview of the individual(s) who made the allegations, interviews of other employees in the affected business unit, and consultation with the ESG Response Team. If facts are learned during the investigation that suggest that a violation may be occurring in more divisions or subsidiaries of the company than originally alleged or that other violations may be occurring, the scope of the investigation should broaden to follow those leads.

Additionally, it is important to ensure that the scope of the investigation is broad enough to produce a root cause analysis, which is an evaluation of facts and circumstances that permits a full understanding of how the violation was able to occur.<sup>1</sup> Understanding how a violation was able to happen is essential to properly remediating the causes of a breach and preventing future violations.

**Prevention of Possible Ongoing Misconduct.** From its earliest stages, the investigation must seek to identify and put a stop to any ongoing misconduct. This is critically important in evaluating a company's response to alleged misconduct in the event of a civil or criminal enforcement proceeding. Early efforts to stop potential ongoing misconduct also allow an investigation team to make an early assessment of the potential scope of the issues.

**Investigation Team and Supervision of Investigation.** An investigation should be independent and objective, and conducted by qualified personnel, sometimes including or led by outside counsel. The specific group appointed to conduct an investigation may depend on a company's size and structure, as well as the nature of the potential violation. In ESG-related violations, it may be appropriate to coordinate with the ESG Response

---

<sup>1</sup> The ability to conduct a thoughtful root cause analysis that accurately addresses root causes is a "a hallmark of a compliance program that is working effectively in practice," in DOJ's Evaluation of Corporate Compliance Programs. U.S. DEP'T JUST. CRIM. DIV., EVALUATION OF CORPORATE COMPLIANCE PROGRAMS (June 2020), <https://www.justice.gov/criminal-fraud/page/file/937501/download>.

Team (cf. Chapter 3), who should be subject-matter experts on the company's ESG policies and practices and how they apply to different business units.

Investigations conducted by counsel have the benefit of being protected by attorney-client privilege, which can be valuable in some circumstances. Engaging outside counsel is particularly advisable where the matter presents significant enterprise risk, enforcement or regulatory action is possible, senior management is implicated, or the allegations implicate the company's legal or compliance personnel.

**Preservation.** At the outset of an investigation, steps should be taken to preserve potentially relevant documents or data. While the nature of the potential violation or misconduct will determine the precise sources and steps that should be considered, the investigation team should, at a minimum:

- identify individuals with potentially relevant information;
- issue a document hold to relevant individuals, directing them to preserve and not to delete documents or data related to the investigation topics (or, in the case of a covert investigation, utilize tools that permit preservation without notification);
- suspend any document retention policies and processes that permit the deletion of data; and
- gather potentially relevant documents and data, including potentially collecting devices from employees or others within the company's control.

A company should take broad preservation steps at the outset of an investigation to ensure that all potentially useful information is preserved, particularly as the precise contours of the violation or misconduct are not yet fully understood. Effective preservation is especially important when there is a risk of government action or third-party litigation. When gathering documents and materials, companies should be aware of and comply with any company policies or local laws that impose obligations on the company to safeguard an employee's privacy rights.

Companies should bear in mind that certain relevant facts or documents may not be in the company's possession. For example, investigations concerning an organization's relationships with third parties can require seeking information that is not in the possession of the organization. Organizations should consider what additional necessary information is reasonably available, including information in the possession of suppliers, consultants, and agents, and how they could obtain that information.

**Disclosure.** In some circumstances, a company may have an affirmative duty to disclose potential misconduct to government enforcement or regulatory agencies. Alternatively, a disclosure can be required simply to correct a prior material misstatement. In these instances, the company must promptly disclose the relevant facts known to it, and should be prepared to answer questions or provide responses to follow-up inquiries. It is also

important to note that a company's obligation to disclose suspected or confirmed misconduct can come from a variety of sources: for example, in February 2022, the Department of Justice found Deutsche Bank in breach of a 2021 deferred prosecution agreement for failing to disclose allegations that it overstated its use of various ESG benchmarks. While the original deferred prosecution agreement was to resolve allegations of foreign bribery, the company's failure to report allegations related to its ESG disclosures was determined to be a breach of that agreement, and subjected the company to an extended period of monitorship.

In addition to government agencies, companies may also be contractually required to report potential misconduct or violations to investors, joint venture partners, or other third parties. When a potential violation is suspected, companies should seek to understand any disclosure requirements and assess what facts must be disclosed and on what timeline. Depending on the circumstances, the company may disclose that it is investigating allegations, and in others it may choose to complete an investigation before disclosing key relevant facts to third parties.

Even where a duty to disclose does not exist, there may be advantages to voluntarily self-disclosing an issue, and companies should weigh those benefits against the disadvantages of such a disclosure. For example, when determining whether to take enforcement action against a company, the SEC weighs a number of factors (known as the "Seaboard Factors"<sup>2</sup>), including whether the company self-reported misconduct after it was discovered internally. Beyond the mere fact of reporting, the SEC considers whether the company conducted a thorough review of the nature and root causes of the misconduct, whether it made the results of its investigation and documentation concerning the company's response available to the SEC, and how completely the company provided this information to the SEC. In the absence of ESG-specific frameworks, these are the factors likely to drive the SEC's evaluation of a company's conduct in ESG-related matters that fall under the SEC's remit.

---

2 *Spotlight on Enforcement Cooperation Program*, SEC (Sept. 20, 2106), <https://www.sec.gov/spotlight/enforcement-cooperation-initiative.shtml>; Report of Investigation Pursuant to Section 21(a) of the Securities Exchange Act of 1934 and Commission Statement on the Relationship of Cooperation to Agency Enforcement Decision, Exchange Act Release No. 44969 (Oct. 23, 2001), <https://www.sec.gov/litigation/investreport/34-44969.htm> ("Seaboard Report").

The Department of Justice also offers leniency or other preferential treatment for organizations that self-disclose improper conduct. For example, in evaluating whether criminal charges are warranted for environmental violations, the Department of Justice considers whether the misconduct was voluntarily self-reported in the absence of a specific legal obligation to disclose, and whether that disclosure assisted the government's own investigation or took place before the government had knowledge of the noncompliance.<sup>3</sup> Cooperation, in this and other contexts, often relies on the information that is disclosed, and an effective investigation can put the company in a better position to make a full disclosure of all relevant facts. In the context of Foreign Corrupt Practices Act violations, where "a company has voluntarily self-disclosed misconduct in [a Foreign Corrupt Practices Act] matter, fully cooperated, and timely and appropriately remediated," the United States Department of Justice's Corporate Enforcement Policy provides for a presumption against prosecution absent aggravating circumstances. Additionally, the Antitrust Division's Leniency Policy allows the first individual or company to self-report participation in an antitrust cartel to avoid prosecution,<sup>4</sup> and the National Security Division grants companies the presumption of a non-prosecution agreement when they voluntarily self-disclose potential export control or sanctions violations, timely and appropriately remediate those violations, and fully cooperate with the division.<sup>5</sup> These policies generally emphasize a company's timeliness and thoroughness in making a self-report as the primary factors for granting leniency.

In deciding whether to voluntarily self-disclose a potential issue to a government enforcement or regulatory agency, a company will need to weigh a variety of factors—including any benefits offered for a self-report, the risks of adverse government action following such a report, the strength of its remediation efforts, and the likelihood that the agency will eventually become aware of the issue without the self-report. These factors may also be relevant when determining the timing of any disclosure to regulators.

---

<sup>3</sup> *Factors in Decisions on Criminal Prosecutions for Environmental Violations in the Context of Significant Voluntary Compliance or Disclosure Efforts by the Violator*, U.S. DEP'T JUST. (Dec. 8, 2020), <https://www.justice.gov/enrd/factors-decisions-criminal-prosecutions-environmental-violations-context-significant-voluntary>.

<sup>4</sup> Press Release, U.S. Dep't Just., Antitrust Division Updates its Leniency Policy and Issues Revised Plain Language Answers to Frequently Asked Questions (Apr. 4, 2022), <https://www.justice.gov/opa/pr/antitrust-division-updates-its-leniency-policy-and-issues-revised-plain-language-answers>.

<sup>5</sup> EXPORT CONTROL AND SANCTIONS ENFORCEMENT POLICY FOR BUSINESS ORGANIZATIONS, U.S. DEP'T JUST. (Dec. 13, 2019), [https://www.justice.gov/nsd/ces\\_vsd\\_policy\\_2019/download](https://www.justice.gov/nsd/ces_vsd_policy_2019/download).

Similarly, a company may consider voluntarily reporting an issue to investors or the public more generally. In the environmental or diversity and equity areas; for example, there can be public relations benefits to proactively correcting prior statements, even if not material, and highlighting the steps that a company is taking to strengthen its practices. At the same time, however, even if not material to a company's financial statements, inaccurate statements about a company's ESG practices can subject the company to litigation risk, even once corrected. As regulators, investors, and consumers push for more ESG-related disclosures, companies will face additional scrutiny of claims they make about their ESG efforts. Indeed, the SEC has announced that its exam priorities for 2022 include statements about investments that incorporate ESG strategies or criteria. The SEC recently charged Vale S.A., a Brazilian mining company, with making false and misleading statements to investors about the safety of its dams through its ESG disclosures, signaling that the SEC has already begun scrutinizing companies' ESG-related disclosures.<sup>6</sup> Additionally, consumers are increasingly examining marketing claims more closely, and companies face additional compliance or litigation risk as a result. For example, a California federal court recently rejected Nestlé's motion to dismiss a putative class action brought by consumers alleging that its cocoa products are deceptively labeled where they stated that cocoa was "sustainably sourced," and "improve the lives of farmers," despite the use of child labor within the supply chain.<sup>7</sup> The FTC has issued regulations on the use of environmental marketing claims,<sup>8</sup> and revisions to a company's website or marketing material may be warranted to ensure that any public statements are not deceptive.

## The Investigation

**Fact-Finding and Interviews.** After gaining an initial understanding of the allegations through the preliminary steps outlined above, the investigation team should gather and review potentially relevant documents. In most investigations, documents will help the investigation team come to a preliminary understanding of the events at issue, assess the credibility of the allegations, and determine whether interviews are necessary, and if so, how they should be conducted. For example, in some circumstances it can be appropriate to interview employees in groups; if interviews should occur individually, the order of the interviews should receive special consideration. Once an interview list is compiled, the investigation team should prepare for the interviews by gathering any documents that may be necessary during the interview and drafting an outline of topics and potential questions. Proper preparation will enhance the efficiency and productivity of the interviews.

---

6 Complaint, SEC v. Vale S.A., Civil Action No. 22-cv-2405 (E.D.N.Y. Apr. 28, 2022), ECF No. 1.

7 *Walker v. Nestlé USA, Inc.*, 3:19-cv-00723, 2022 WL 901553 (S.D. Cal. Mar. 28, 2022).

8 16 C.F.R. §260 (the "Green Guides").

At the outset of an interview, the investigation team should remind the employee witness of his or her obligation to cooperate with the investigation as part of her employment responsibilities. If the interview is being conducted by counsel, counsel should give the employee an *Upjohn* warning, by which the employee is explicitly informed that the counsel conducting the interview represents the company, not the individual in his or her personal capacity, and that the interview is covered by the attorney-client privilege, which is owned by the company and may be waived by the company. In non-US jurisdictions, different or conflicting privilege rules may apply, and investigators should take steps, if possible, to preserve privilege under the relevant law. Labor law or union contracts in certain jurisdictions or at certain companies may mandate additional disclosures or protections, and the investigating team should ensure that they learn and abide by any relevant laws or agreements.

Interviews can be very useful tools for investigators, and can greatly assist in developing an understanding of the relevant facts. In particular, investigators may use an interview for any of the following purposes:

- Clarify questions raised by documents and emails, and understand the context of documents;
- Learn about facts and events not included in documents, including conversations among relevant employees;
- Confirm understanding of relevant individuals, scope of potential issue, and time period involved.

**Memorialize Facts and Management Responses.** It is generally advisable to document an employee's statements to investigators in a written interview memorandum. In the United States, if the interview is conducted by counsel, interview memoranda will often be protected from disclosure by the attorney-client privilege and work product protections. To increase the chances of receiving such protections, the memorandum should be drafted in a way that captures the attorney's thoughts and mental impressions about the interview, rather than consisting merely of a transcript of the interview. However, in jurisdictions with narrower attorney-client privilege, such as England, records of employee interviews may not be protected from disclosure, and as such, companies should carefully consider how to best document facts learned.

While management should generally be kept apprised of the status of an investigation, a company should also consider whether a final investigation report should be prepared, and if so, whether it should be written or presented orally. The final report should provide necessary information to corporate decision-makers, and endeavor to explain the root causes of any violations and propose improvements to remediate any deficiencies. Whether the final report is written or oral, it is advisable to document the findings and management's response, including decisions about employee discipline and improvements to business processes or internal controls that are implemented following an investigation.

## 8.3 REMEDIATION

---

Remediation efforts should begin once allegations of misconduct or policy violations are deemed credible, and investigators should ensure that any misconduct is not permitted to continue while the investigation is taking place.

Early intervention to remediate identified deficiencies allows the company to quickly begin to fill gaps in its policies or controls, and puts the company in an advantageous position if the events later become the subject of a government inquiry, or the company chooses to voluntarily disclose identified misconduct. Remedial efforts are a key factor in government decisions, including whether to bring an enforcement action and in the form and terms of a resolution.

Appropriate remedial measures will depend on the issues identified during the investigation, and their identification should be a priority throughout the process. Identifying the root causes of identified violations and misconduct permits investigators to identify gaps in company policy or procedure, and to propose appropriate remedial actions. Depending on the circumstances, remediation can include:

- Employee discipline, including termination;
- Improvements to company processes or internal controls;
- Investment in training, including the provision of targeted training to affected business units;
- Examination of incentive structures, including financial incentives that may encourage employees to disregard policies or otherwise engage in misconduct;
- Terminating relationships with third-party agents or consultants who engage in misconduct or do not provide sufficient transparency to allow the company to verify their compliance.

# GLOSSARY OF ESG-RELATED TERMS

## **Carbon Footprint**

- o The total greenhouse gas emissions attributable to a company or individual.

## **Carbon Neutral**

- o When the greenhouse gas emissions that are attributable to an organization's activities are equal to the greenhouse gas emissions that are removed or absorbed from the atmosphere as a result of the organization's activities.

## **Circular Economy**

- o An economic system by which raw materials that are consumed are recycled and reused again for as long as possible.

## **Corporate Social Responsibility (CSR)**

- o CSR is a business policy or philosophy that recognizes that a company has responsibility to the society in which it operates. CSR may be defined differently by different companies, and may be implemented through the company's core business or actions taken outside the core business, such as philanthropy and community service.

## **Corporate Sustainability Reporting Directive (CSRD)**

- o The CSRD is an EU Directive that revises and expands sustainability reporting requirements for companies. CSRD goes into effect in 2023, when it will replace the existing Non-Financial Reporting Directive (NFRD).

## **DEI**

- o DEI is an abbreviation for diversity, equity, and inclusion.

## **Double Bottom Line (2BL or DBL)**

- o Double bottom line is a concept relevant to impact investing that suggests that when measuring fiscal performance—financial profit or loss—a company should add a second bottom line to show performance quantified in terms of the company's social impact.

## **Dynamic Materiality**

- A concept that acknowledges that topics that are considered non-material at a given time may become material over time based on value creation or emerging evidence of impact. With respect to ESG reporting, this may embrace reporting about a company's significant impacts on people, the planet, and the broader economy, as well as reporting on sustainability topics that may be material to the company's prospects for value creation.

## **ESG**

- An abbreviation for factors concerning impact relating to "environmental," "social," and "governance" considerations, which are widely thought of as the pillars of sustainable finance and corporate responsibility.

## **ESG Audit**

- An assessment or assurance process performed to ensure that company or fund is actually implementing, or working to implement, its stated ESG goals.

## **Framework**

- A publicized method by which companies can gather, evaluate, and/or report ESG data.

## **Greenhouse Gas (GHG) Emissions**

- Gases emitted into the Earth's atmosphere that trap heat and contribute to climate change, primarily consisting of carbon dioxide, methane, and nitrous oxide.

## **Global Reporting Standardization**

- The goal that, ultimately, ESG reporting will be standardized, so that companies can report ESG data using the same methodology, and investors can more easily use that data in their decision making.

## **Green Bonds**

- Debt instruments issued for the stated purpose of raising capital to fund environmental projects.

## **Greenwashing**

- When an organization presents itself to the public as environmentally friendly (or ESG friendly) without actually implementing practices that have a positive environmental (or ESG) impact.

## **Impact Investing**

- Impact investing is a general investment strategy that seeks to generate financial returns while also creating a positive social or environmental impact.

## **Net Zero 2050**

- Net Zero 2050 refers to the commitment to achieve net-zero GHG emissions by the year 2050, a goal that climate scientists estimate as necessary to achieve the goals of the Paris Agreement.

## **Non-Financial Reporting Directive (NFRD)**

- The NFRD is an EU Directive (Directive 2014/95/EU) that sets the disclosure rules for non-financial and diversity information by covered companies. It was amended by the Taxonomy Regulation, and will be replaced by the CSRD in 2023.

## **Paris Agreement**

- The Paris Agreement is a legally binding international treaty on climate change. It sets out a global framework to avoid dangerous climate change by limiting global warming to well below 2°C above pre-industrial levels, and to make efforts to limit it to 1.5° above pre-industrial levels.

## **Screening (or Negative Screening)**

- A process by which a company or fund with publicly stated ESG goals chooses whether or not to do business with, or invest in, a potential partner based on that partner's ESG risks.

## **Stakeholder Capitalism**

- A business philosophy in which organizational leaders seek to advance the interests not only of its shareholders, but also of its employees, community, business partners, customers, suppliers, and others.

## **Stewardship**

- The use of influence by ESG-minded companies or investors to actively promote and advance their ESG goals with their business partners or companies in which they are invested.

## **Sustainable Development Goals (SDGs)**

- Seventeen environmentally- and socially-focused development goals emerging from the United Nations Sustainable Development Summit on September 25, 2015 and memorialized in the “2030 Agenda for Sustainable Development” (<https://sdgs.un.org/goals#goals>).

## **Sustainable Finance**

- Any form of financial service, including financing and investment activities, that integrates ESG criteria into business or investment decisions.

## **Sustainable Finance Disclosure Regulation (SFDR)**

- The SFDR is an EU regulation effective from March 10, 2021 that imposes mandatory ESG disclosure obligations on asset managers and other financial markets participants.

## **Taxonomy Regulation**

- The Taxonomy Regulation is an EU regulation effective from July 12, 2021 that establishes a classification system to identify whether or not a given business or economic activity should be considered environmentally sustainable.

## **Tokenism**

- Making solely symbolic efforts to increase diversity within a workforce without substantively including underrepresented persons in meaningful roles.

## **Triple Bottom Line (3BL or TBL)**

- The triple bottom line is a business concept that posits firms should commit to measuring their social and environmental impact rather than solely focusing on generating profit. It can be broken down into “three Ps”: profit, people, and the planet.

# ESG TOOLKIT INDEX OF ORGANIZATIONS

## **Business Roundtable**

- o An association of chief executive officers of America's leading companies working to promote policies favorable to business interests. In 2019, the Business Roundtable released a Statement on the Purpose of a Corporation, signed by CEOs who commit to lead their companies for the benefit of all stakeholders.
- o <https://www.businessroundtable.org/about-us>

## **Cambridge Institute for Sustainability Leadership**

- o A multidisciplinary leadership institute working with international corporations and educational institutions to aid and develop leaders who seek to address sustainability issues.
- o <https://www.cisl.cam.ac.uk/>

## **CDP (formerly, the Carbon Disclosure Project)**

- o A not-for-profit charity that publishes a disclosure framework for companies to measure their performance relating to environmental metrics and risk management. As of 2022, over 680 investors with more than \$130 trillion in assets requested companies disclose through CDP on certain issues, and more than 200 major buyers representing \$5.5 trillion in purchasing power requested their suppliers disclose through CDP.
- o <https://www.cdp.net/en>

### **Climate Action 100+**

- An investor-led initiative encouraging investor engagement with companies critical to the net-zero emissions transition focused on improving climate change governance, cutting emissions, and strengthening climate-related financial disclosures. As of 2022, its membership included 700 investors with \$68 trillion in assets under management that engaged with 166 companies which account for an estimated 80% of global industrial emissions.
- <https://www.climateaction100.org/>

### **Climate Disclosure Standards Board (CDSB)**

- An international collaboration of businesses and NGOs that published the CDSB Framework for environmental reporting in companies' public filings. In 2022, CDSB was consolidated into the IFRS Foundation.
- <https://www.cdsb.net/>

### **Climate Action Tracker**

- An online tool published by independent scientific organizations to track government climate action and measure its effectiveness against Paris Agreement goals.
- <https://climateactiontracker.org/>

### **The Conference Board ESG Center**

- A nonprofit think tank providing research, programs, and expertise on corporate governance, sustainability, citizenship, and philanthropy to business leaders.
- <https://www.conference-board.org/us/environmental-social-governance>

### **Global Reporting Initiative (GRI)**

- An Amsterdam-based organization that publishes GRI Standards, a widely-used standard for sustainability reporting framework used in over 100 countries.
- <https://www.globalreporting.org/>

### **European Commission High-Level Expert Group (HLEG) on sustainable finances**

- A group consisting of senior experts from EU member states responsible for drafting recommendations for actions the EU should take to promote sustainable finance in Europe and around the globe.

### **International Financial Reporting Standards Foundation**

- A nonprofit organization that seeks to develop, promote, and facilitate adoption of the International Financial Reporting Standards, a single set of accounting and sustainability reporting disclosure standards. IFRS Foundation maintains the IFRS Accounting Standards and the IFRS Sustainability Disclosure Standards, which are set by the International Accounting Standards Board (IASB), a London-based accounting organization, and the International Sustainability Standards Board (ISSB), a new standard-setting board established in 2021.
- <https://www.ifrs.org/>

### **International Sustainability Standards Board (ISSB)**

- A standard-setting board established by IFRS Foundation in 2021 to develop comprehensive sustainability disclosure standards. ISSB began publishing draft standards in March 2022 and expects to issue new standards by the end of 2022.
- <https://www.ifrs.org/groups/international-sustainability-standards-board/>

### **Investor Group on Climate Change (IGCC)**

- A coalition of Australian and New Zealand institutional investors seeking to incorporate climate change risks into investment decisions. As of 2022, represents investors with total funds under management of more than \$3.6 trillion in Australia and New Zealand and \$33 trillion around the world.
- <https://igcc.org.au/>

### **Institutional Investors Group on Climate Change**

- A European coalition of asset managers and pension funds seeking to drive significant progress towards net zero emissions by 2030 through capital allocation decisions and engagement with companies and policy makers. As of 2022, has more than 350 members with over €51 trillion in assets under management.
- <https://www.iigcc.org/>

### **Net Zero Asset Managers Initiative**

- An international group of asset managers committed to achieving net zero emissions by 2050 or sooner, and supporting investment decisions aligned with the net zero goal. In 2022, represented 273 signatories with \$61.3 trillion in assets under management.
- <https://www.netzeroassetmanagers.org/>

### **Un-convened Net-Zero Asset Owner Alliance**

- An international group of institutional investors committed to transition investment portfolios to net-zero GHG emission by 2050, convened by the U.N. Environment Programme – Finance Initiative and PRI. Group consists of 74 institutional investors with \$10.6 trillion in assets under management.
- <https://www.unepfi.org/net-zero-alliance/>

### **Principles for Responsible Investment (PRI)**

- An investor initiative established in 2006 in partnership with the U.N. Environment Programme – Finance Initiative and the United Nations Global Compact that works to promote six Principles for Responsible Investment, which guide inclusion of ESG issues into investment practice. In 2021, PRI reported that 3,826 signatories, with \$121.3 trillion in assets under management, had signed onto the Principles for Responsible Investment.
- <https://www.unpri.org/>

### **Science Based Targets initiative (SBTi)**

- A partnership between CDP, the U.N. Global Compact, World Resources Institute, and the World Wide Fund for Nature that aims to define and promote best practices in emissions reductions and net-zero targets in line with climate science, and provides technical assistance and expert resources to companies that set science-based targets. By the end of 2021, more than 2,200 companies worked with SBTi, covering more than one-third of global market capitalization.
- <https://sciencebasedtargets.org/>

### **Task Force on Climate-related Financial Disclosures (TCFD)**

- An organization created in 2015 by the Financial Stability Board (FSB) to draft climate-related financial disclosure recommendations to help companies better promote environmental transparency and climate-risk management.
- <https://www.fsb-tcf.org/>

### **Taskforce on Nature-related Financial Disclosures (TNFD)**

- A group launched in 2021 to develop a risk management and disclosure framework for organizations to report and act on evolving nature-related risks. Released a draft framework in March 2022, and plans to release subsequent drafts before issuing the formal framework in September 2023.
- <https://tnfd.global/>

### **Value Reporting Foundation**

- A global nonprofit organization formed in June 2021 as a result of the merger of two ESG reporting organizations, the Sustainability Accounting Standards Board (SASB) and the International Integrated Reporting Council (IIRC). Publishes SASB Standards to address sustainability-related risks and opportunities, and an Integrated Reporting Framework to guide companies to make integrated disclosures using the SASB Standards.
- <https://www.valuereportingfoundation.org/>
- <https://www.integratedreporting.org/>

### **World Business Council for Sustainable Development (WBCSD)**

- An organization led by CEOs of major global companies seeking to accelerate system transitions needed to achieve net zero emissions. Analyzes sustainability reports from member companies and annually publishes an overview of reporting trends and best practices in its publication "Reporting matters." In 2017, WBCSD created The Reporting Exchange, which provides resources on ESG indicators; sustainability ratings, rankings, and indices; and mandatory and voluntary climate reporting requirements for different countries and sectors.
- <https://www.wbcsd.org/>

### **World Economic Forum International Business Council (WEF IBC)**

- An international NGO and business group made up of member companies and individuals. In 2020, published an influential white paper on stakeholder capitalism that set forth 21 core and 34 expanded metrics and disclosures, drawn from existing voluntary standards, for measurement of a variety of ESG-related issues.
- <https://www.weforum.org/>

### **U.N. Department of Economic & Social Affairs**

- A department of the United Nations working to promote sustainable development while reducing economic inequality and eliminating poverty, and author of the U.N. Sustainable Development Goals.
- <https://www.un.org/en/desa>

### **U.N. Global Compact**

- An international corporate initiative that supports companies that adopt its Ten Principles on human rights, labor, environment, and anti-corruption.
- <https://www.unglobalcompact.org/>

### **U.N. Environment Programme-Finance Initiative (UNEP FI)**

- An international partnership between the United Nations Environment Programme and financial institutions across the globe seeking to utilize private financing for sustainable development.
- <https://www.unepfi.org/>

### **U.S. Sustainable Investment Forum**

- An organization of asset managers seeking to promote ESG issues in investment decisions across all asset classes. As of 2022, members represented \$5 trillion in assets under management or advisement.
- <https://www.ussif.org/>