

Current Trends in ESG

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What is ESG and why is it important?

Environmental, Social, Governance

- Shift from “Sustainability” and “CSR (Corporate Social Responsibility)” to “ESG” is fairly established at this point
- Investors and other public stakeholders are increasing pressure to address ESG activity and disclosures
- ESG programs include assessing materiality, stating policies and goals, monitoring progress, and reporting on progress

Environmental	Social	Governance
Climate Change	Human Capital	Corporate Governance
Natural Resources	Product Liability	Corporate Behavior
Pollution and Waste	Stakeholder Opposition	Ethics
Environment Opportunity	Social Opportunity	Evolving SEC and other Disclosures and Risk Factors
Environmental Justice	Diversity, Equity & Inclusion (DE&I)	Cyber Security/ Data/ Privacy

Summary of ESG Disclosure Requirements

SEC Modernization Rules – Form 10-K

- Item 105 (Risk Factors) Requires:
 - Summary risk factor section ≤ two pages if risk factor section exceeds 15 pages.
 - Disclosure of “material” risk factors that make investment in company speculative or risky (rather than “most significant” risks).
 - Risk factors organized under relevant headings in addition to sub-captions currently required, with any that may apply generally to any investment in securities disclosed at end under separate caption “General Risk Factors.”
- Item 101(c) (Narrative Description of Business)
 - New requirement for company to provide description of human capital resources, including any human capital measures or objectives that company focuses on in managing business, to the extent disclosure is material to an understanding of company’s business as a whole, **except** if information is material to a particular segment, company should additionally identify segment.

Proxy Rules – Diversity Disclosure

- 2019 SEC guidance - if board or nominating committee considers “self-identified diversity characteristics” (such as race, gender, ethnicity, religion, nationality, disability, sexual orientation, cultural background) of a person in determining whether to recommend him or her as a director and if he or she has consented to disclosure, SEC expects company’s proxy to include identification of those characteristics and discuss how they were considered. As noted, these questions are optional for directors.

Diversity Initiatives Intensifying from States and Investors

- **Nasdaq:** December 2020 proposed listing rule requiring
 - (i) listed companies to disclose board diversity statistics and
 - (ii) at least two diverse directors by tiered schedule deadline
- **February 2021 Amendment proposes following revisions:**
- Boards of 5 or fewer directors may have one diverse director, rather than two
- One year grace period if board ceases to comply due to a vacancy (eg, resignation/illness)
- Issuers make board diversity information publicly available in advance of annual shareholder meetings to align with other governance-related disclosures, such as in proxy
- Newly Nasdaq-listed companies after phase-in period have two years to meet diversity target
- **State Level Example - CA:** September 2020 California enacted director diversity law for California headquartered companies
- **S&P 500:** As of August 2019 no more all-male boards
- **State Street:** Starting 2020, will vote against entire slate of N&G directors if:
 - Company doesn't have at least one female director; and
 - Has not engaged with State Street on board diversity for four consecutive years
- **Black Rock:** In January 2020 stated boards should be comprised of "diverse selection of individuals who bring their personal and professional experiences to bear"
- **McKinsey:** May 2020 report found companies in top quartile for gender diversity on executive teams were 25% more likely than peers to experience above-average profitability

Climate Risk Initiatives Intensifying from Investors and Other Stakeholders

SEC ESG Activity:

- 2010, first public company guidance on existing disclosure requirements applied to climate change matters
- February 1, named inaugural senior policy advisor for ESG matters
- March 4, announced formation of Climate and ESG Task Force, Enforcement Division
- March 15, Acting Chair gave presentation “A Climate for Change: Meeting Investor Demand for Climate and ESG Information at the SEC,” discussing tremendous shift in capital towards ESG and sustainable investment strategies, and ESG risks and metrics underpinning traditional investment analyses, or “ESG integration,” and issued statement requesting public comment on climate disclosure
- March 19, SEC AMAC Meeting included Report and panel discussion on ESG Subcommittee’s potential ESG recommendations of December 1, 2020

Investor ESG Activity:

➤ BlackRock:

- “Climate risk is investment risk,” concluded BlackRock CEO Larry Fink in his 2021 annual letter to chief executives last January. With climate change rewriting core assumptions in modern finance, he argued, trillions of dollars are at stake.”
- Comments at March 19 SEC AMAC Meeting by its Global Head of Sustainability suggested SEC and other governmental agencies should focus on ways to guide private companies, eg through requirements for private funds, regulatory stress tests
- State Street: In State Street’s 2021 CEO letter, Cyrus Taraporevala indicated that its “main stewardship priorities for 2021 will be the systemic risks associated with climate change and a lack of racial and ethnic diversity.”

Practical Considerations Clarify and Ease ESG Obligations

- Know what is material for your company, with some “table stakes” requirements
- Show continued improvement with realistic view of starting point
- Shared company effort increases buy in and efficiencies
- Make auditable data entry as user friendly as possible
- Retain Shareholder (value) focus as focal point, showing “doing good” is “good for business”
- Flexibility is increasingly important: COVID has been an accelerator of trends and companies must keep up with the pace of change
- Remain Vigilant of Potential Liability Issues given Stakeholder Pressure to Disclose;
- **“Greenwashing” and Environmental Justice issues** offer compelling Case Study of Evolving Issues

