A Guide to ESG:

What Ethics & Compliance Professionals Need to Know About the Rise in ESG Investing and How It May Impact Their Work

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ABOUT ECI

The Ethics & Compliance Initiative™ (ECI™) has a mission to empower individuals and organizations to build and sustain high-quality ethics & compliance programs. Established in 1922, the organization comprises the two oldest nonprofits in the ethics & compliance industry. As an association, ECI brings together ethics & compliance professionals and academics from all over the world to share techniques, resources and exciting new ideas.

Through its research, ECI identifies the practices that improve ethics & compliance program effectiveness and build institutional culture strength. ECI also has an established track record of providing support to organizations seeking to transform their cultures, often in the wake of significant challenges with noncompliance.

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Table of Contents

I. Introduction

Expectations regarding the role of the corporation in society are shifting. As a consequence, many investors and companies are reexamining and adjusting the way they do business. For decades, the nearly unquestioned wisdom, at least in the United States, has been that, as economist Milton Friedman famously declared in 1970, “the social responsibility of business is to increase its profits” in the service of shareholders.[1] That foundational premise has started to crack. Many business leaders, investors, legal practitioners, and scholars are now calling into question the “shareholder primacy” business model. Instead, they say, a corporation must jointly serve the interests of many stakeholders, including customers, suppliers, employees, local communities, and shareholders, and should no longer focus narrowly on “maximizing shareholder value.”[2] One manifestation of these sentiments is the emergence of non-financial corporate performance metrics, often referred to as “environmental, social, and governance,” or just “ESG.”

The rise of ESG and the changing attitudes about the role of the corporation in society have important implications for ethics and compliance (E&C) professionals. This Working Group set out to write a paper to help these professionals better understand the nature of ESG reporting and performance ratings and the opportunities and pressures they create. We hope this understanding will help to guide E&C professionals as they work to assist their own organizations in adapting to a competitive landscape that places more weight on non-financial performance indicators and pushes companies to adopt more sustainability-focused business strategies.

II. What Is ESG?

A. Scope of ESG (Identifying What Belongs Under E, S and G)

While there may be no precise commonly accepted definition of ESG, it is broadly speaking a constellation of corporate performance metrics across three non-financial dimensions: E - the impact on the environment, S - the impact on social institutions and human relationships, and G – the way in which an organization governs itself and makes decisions.

Today, most publicly traded companies are being evaluated and rated on their ESG performance by various third-party organizations.[3] The rating scales and methodologies employed by ESG reporting providers vary significantly. Generally speaking, however, their goal is the same: to gather and share data regarding corporations’ impact on the environment and society and the effectiveness with which they govern themselves. These data, in turn, are considered by investors, who use them to determine in which companies to invest. As a consequence, many companies have sought to improve their ESG performance to both enhance their reputation and strengthen their access to capital markets.

> "E – the impact on the environment, S – the impact on social institutions and human relationships, and G – the way in which an organization governs itself and makes decisions."

The table below sets out by category a sample of the broad array of non-financial topics covered by ESG rating agencies.[4]

ENVIRONMENT	SOCIAL	GOVERNANCE
Clean air	Human rights	Executive compensation
Clean technology / energy usage & efficiency	Child & forced labor	Board diversity & independence
Water use & conservation	Human trafficking / modern slavery	Shareholder rights
Use of sustainable natural resources / agriculture	Diversity & inclusion	Transparency & disclosure
Green building / smart growth	Working conditions / workplace health and safety	Information governance & cybersecurity
Climate change impact, risks & opportunities	Workplace benefits / living wage, gender pay ratio	Anti-bribery and corruption
Greenhouse gases / carbon emissions measurement	Discrimination & harassment / mobbing	Anti-competition / antitrust
Product life cycle / recycled material use	Workplace violence	Anti-money laundering
Protection of biodiversity	Privacy	Accounting standards, audit independence
Animal welfare / rights	Indigenous rights	Fraud
Pandemics and other threats to public health	Community relations	Business ethics
	Avoidance of tobacco and other harmful products	Corporate culture
	Product integrity and safety	Supplier code of conduct / responsible supply chain
		Regulatory compliance
		Corporate political contributions
		Conflicts of interest

The division between categories may not be as clear as it may seem. For example, some rating agencies put worker rights under Social, and others place it under Governance. Factory discharges that pollute water supplies are an Environmental issue but may also be considered a Social issue if the pollution adversely impacts a community water supply. In addition, the relative importance of these non-financial performance indicators varies not only from one sector to another but will also change over time. For example, on the Environmental side, the original focus was on reducing carbon emissions, but biodiversity and water pollution are reportedly gaining more attention.[5] Some have already suggested adding new categories to the mix: another E for employees and a T for technology.[6]

B. How Is ESG Different from CSR?

In many ways, ESG is an outgrowth of Corporate Social Responsibility (CSR). CSR arose out of the desire for companies to demonstrate good corporate citizenship through activities such as volunteering in the community, recycling, and working to reduce their environmental footprint on society. In many cases, however, the CSR activities were independent add-ons that were separate and apart from the organization's business activities. As such, CSR was often not a measurable, organized, or well-funded program within companies.

ESG differs in at least three ways. First, whereas CSR disclosures did not garner much attention on the part of large shareholders, it is those very same large investors that are driving much of the ESG disclosures. In fact, a recent survey indicated that investors were looking to increase their access to companies' Chief Sustainability Officers.[7] Second, because CSR disclosures were not viewed as material to investment decisions, there was little demand for a uniform disclosure regime. Investor scrutiny on ESG performance, on the other hand, creates an increasing need for rigor and consistency in ESG disclosures (although, as

discussed below, consistency has to date been elusive). Third, the increased attention by investors on ESG, as opposed to CSR, forces companies to weave ESG into their business strategies. This requires companies to think carefully about their role in society and develop strategies to lessen or remediate any harm their business causes (even if unintended) or find ways to channel business operations to positively address a societal need.

C. The Debate over Shareholder vs. Stakeholder Capitalism

Maximizing profits and value creation for shareholders has been a well-accepted measure of successful corporations for decades. As mentioned above, the idea was popularized by Nobel Prize-winning American economist Milton Friedman, whose 1970 article "The Social Responsibility of Business Is to Increase Its Profits" laid out a strong argument for profit being the sole motive of business.[8]

In the 50 years since then, several forces have converged to reshape attitudes towards the corporation.

- The world witnessed multiple environmental disasters caused by corporate negligence that killed thousands and made life unlivable or hazardous for large and often poorer communities, and scientific consensus emerged about the threat of global warming caused by carbon emissions.[9]

- A constant stream of corporate scandals, particularly beginning in the 2000s, exposed widespread fraud and corruption motivated by the drive for profits.[10]

- Globalization sent multi-national corporations into emerging markets, where they could take advantage of cheap labor and weak labor and regulatory protections and build sprawling supply chains that heightened interdependence.

- The internet, social media and mobile phone technology ushered in the age of hyper-transparency, which made corporate reputations vulnerable to dissatisfied communities, employees, and activists. Investors, employees, and consumers had greater information to choose to fund, work for, and buy from companies that reflected their personal values.

- Consumer preferences gradually shifted. Led by millennials, consumers are more willing than in the past to pay more for products that are sustainably produced.[11]

- Social movements (e.g., #MeToo and Black Lives Matter) became so powerful that corporations, normally reticent about taking positions on hot-button political issues, could no longer maintain the stay-on-the-sidelines approach and issued public statements of support.

- At the same time, decreasing trust in governments and the media has led to a relative increase in trust of business,[12] creating a greater demand for CEOs to take a leading role on important societal issues, such as LGBTQ rights and political contributions.

- In the world of finance, the rapid growth of large institutional investors and asset managers, and the power of proxy advisory firms (e.g., ISS, Glass Lewis), increased their leverage over corporations to demand corporate change.

These and other changes have pushed corporations to pay more attention to maintaining positive relations with key stakeholder groups, including employees, customers, suppliers, governments, and the environment. In general terms, these stakeholders are more likely to give greater weight to the achievement of corporate goals beyond short-term profitability and to performance over a longer term.

In August 2019, 180 CEOs signed a statement issued by the Business Roundtable (BRT), which stated explicitly that businesses exist to serve multiple stakeholders in addition to shareholders.[13] A few months later, world leaders at the World Economic Forum in Davos endorsed a manifesto that recognized that "the purpose of the corporation is to engage all its stakeholders in shared and sustained value creation" and that, in creating such value, "a company serves not only its shareholders, but all its stakeholders – employees, customers, suppliers, local communities, and society at large."[14]

Critics have dismissed these statements as mere public relations with no underlying substance,[15] but corporate performance across ESG metrics goes beyond PR. Publicly traded corporations and their boards are taking actions largely in response to investor interest in ESG performance metrics.[16] Ironically, corporations are being pushed by investors to adopt a more stakeholder-oriented business model, not only to be more responsible corporate citizens, but also to enhance long-term shareholder value via improved ESG risk management.[17]

"...corporations are being pushed by investors to adopt a more stakeholder-oriented business model, not only to be more responsible corporate citizens, but also to enhance long-term shareholder value via improved ESG risk management."

III. An Overview of ESG Investing

A. Origins of ESG Investing

In 2005, at the invitation of then UN Secretary-General Kofi Annan, 20 executives from large institutional investors in 12 countries developed six Principles of Responsible Investment.[18] These Principles, published in 2006 and set out below, represent a commitment to incorporate ESG factors into investment decision-making, where doing so would be consistent with fiduciary duties. While the Principles are not binding, signatories are required to report on their responsible investment activities annually. Since the Principles were published, the number of signatories has grown to more than 3,000 companies, and the value of their assets under management has surpassed US$100 trillion.[19]

FIGURE 1:
Principles of Responsible Investment (PRI)

Principle 1: We will incorporate ESG issues into investment analysis and decision-making processes.
Principle 2: We will be active owners and incorporate ESG issues into our ownership policies and practices

Principle 3: We will seek appropriate disclosure on ESG issues by the entities in which we invest.

Principle 4: We will promote acceptance and implementation of the Principles within the investment industry.

Principle 5: We will work together to enhance our effectiveness in implementing the Principles.

Principle 6: We will each report on our activities and progress towards implementing the Principles.

Large institutional investors remain at the forefront of the ESG movement. In the United States, the big three asset managers—BlackRock, Vanguard, and State Street, which together represent the largest shareholders of 88 percent of firms in the S&P 500[20]—use their substantial influence to pressure corporations to adopt ESG-driven business strategies. For example, Larry Fink, the CEO of BlackRock, wrote in his 2020 letter to CEOs that BlackRock "will be increasingly disposed to vote against management and board directors when companies are not making sufficient progress on sustainability-related disclosures and the business practices and plans underlying them."[21] In January 2021, Fink highlighted to CEOs that he expected their companies to disclose a plan for how their business model will be compatible with a net zero economy by 2050.[22]

B. Categories of ESG Investing – Value vs. Values

ESG investing, as we have defined it, comprises investment decisions that give *considerable weight* to a corporation's performance across the three non-financial dimensions. That definition allows for a spectrum of investment approaches, as depicted in Figure 2. On the left is conventional investing that focuses exclusively on financial performance: value over values. To the right are four different degrees of ESG investing, each giving more weight to ESG factors in the investment strategy and correspondingly less weight to the importance of short-term financial returns. At the extreme, depicted on the far right, are the "values over value" investors who are willing to accept lower returns on investment in order to ensure that investments work towards a desired impact.

FIGURE 2: Investing Spectrum

Sustainable or responsible investment, depicted second and third from left, focuses on integrating ESG criteria into investment management from a process and product perspective. Impact investing, the fourth from the left, takes this a step further, in that it integrates ESG factors into the process of study, analysis, and selection of securities of an investment portfolio with the intention of generating social and environmental impact, while still generating acceptable financial return. Sometimes this may take the form of divesting from organizations involved in "brown" activities deemed to have negative ESG impacts. Other times, impact investing may actively seek out "green" sectors or companies that are deemed to impact society positively across one or more of the ESG categories, such as companies producing renewable energy. There is also an emerging discussion about continuing to invest in organizations involved in "brown" activities that are on the path of "greening." Given the size, scale, footprint, technical capabilities and resources in some of the organizations in this category, continuing to invest in them could help deliver meaningful and widespread positive impact more quickly.[23]

Much of the growth in investments comes from funds occupying the middle of the spectrum, where investors do not see themselves as sacrificing on financial returns by taking ESG performance into account. In fact, there is growing evidence that over the long-term companies with superior ESG performance are more resilient and have greater long-term financial success, which some label a "sustainability premium."[24]

Where an investor falls on this spectrum will depend in part on the fiduciary duties of the investor. Investment advisors investing on behalf of wealthy clients can execute their clients' wishes, which may include a desire to invest in companies for social impact rather than financial performance. Asset managers who represent pension funds, on the other hand, must pursue investment strategies that focus on financial returns.[25] In between are funds that are advertised as "sustainable," "green," "socially responsible," or as having some other ESG orientation. While this gives fund managers the authority to incorporate specified ESG factors into investment decisions, the U.S. Securities

"The more investors use ESG criteria to make investing decisions, the greater the pressure on companies to demonstrate their ESG bona fides."

and Exchange Commission has signaled that it will be watching closely to make sure funds are actually investing as advertised. And in the EU, new rules that began to take effect in March 2021 require fund managers and investment advisors to disclose which of 18 social and environmental metrics are being used in investment decisions.[26]

C. The Rapid Rise of ESG Investing

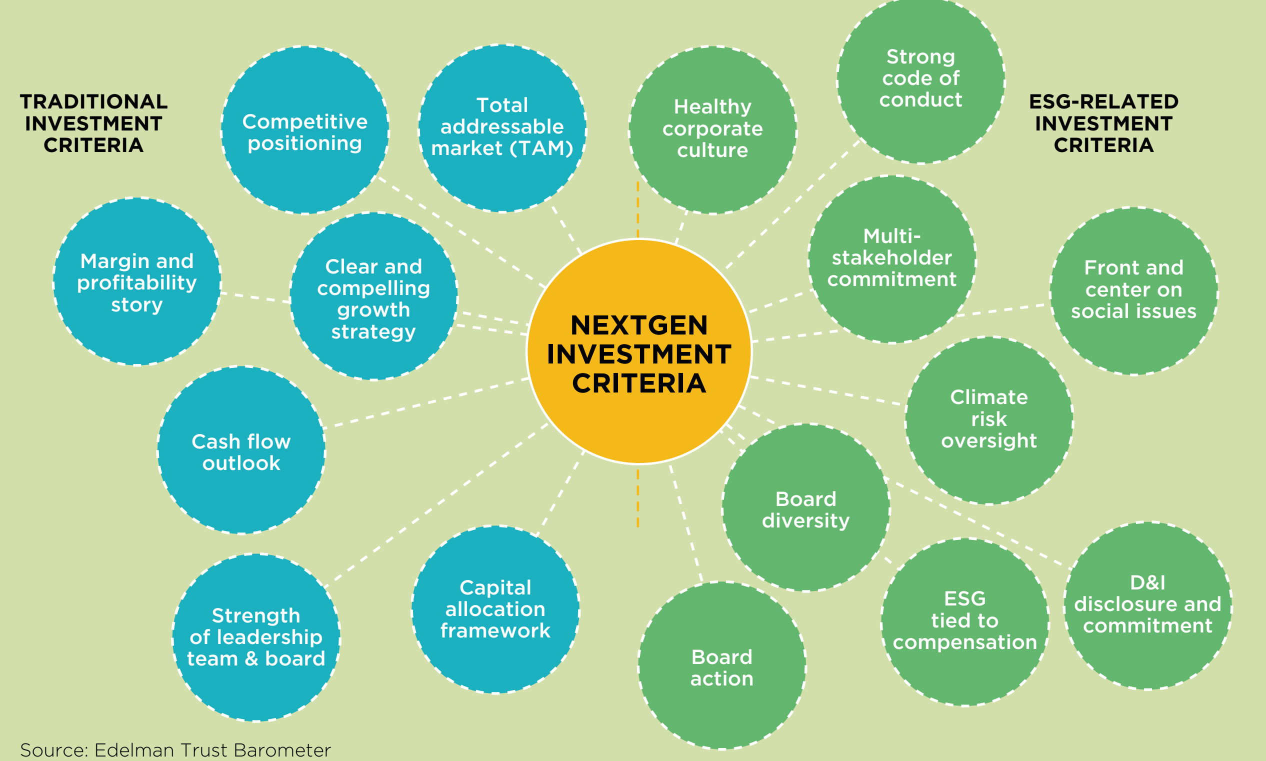
The more investors use ESG criteria to make investing decisions, the greater the pressure on companies to demonstrate their ESG bona fides. And the acceleration in ESG investments has been remarkable. After starting as a niche investment strategy, ESG has gone mainstream, first in Europe and then moving to other parts of the world, including the United States. The pace of ESG investing in just the past two years has seen tremendous growth. For example, TrackInsight, which tracks exchange-traded funds (ETFs), reported that ESG ETF assets globally nearly tripled in 2020, achieving a 223% growth over the course of the year to reach a new assets under management (AUM) record of US$189 billion.[27]

Better data on sustainable finance enabled this "tectonic shift" in capital allocation towards sustainable companies, according to BlackRock's Larry Fink.[28] By the end of 2020, about one third of the AUM in the United States were using ESG criteria in making investment decisions, and that percentage is expected to rise.[29]

A recent special study of the Edelman Trust Barometer shows the extent to which an ESG approach to investing has permeated the investment community.[30] Edelman's survey of 600 investors between September and October 2020 found:

- 88% say they monitor specific ESG key performance indicators (KPIs such as carbon emissions reduction or diversity targets) to inform investment decisions on an ongoing basis;
- 90% agree that companies that prioritize ESG initiatives represent better opportunities for long-term returns than companies that do not;
- 91% agree that companies with strong ESG performance are more resilient in a crisis;

FIGURE 3: The Expanding Scope of Investment Criteria



Source: Edelman Trust Barometer

- 91% expect the prioritization of ESG as an investment criterion to increase as the economy recovers from the global pandemic;
- 82% state that their firms will not invest in companies with a lack of sufficient information/data on their ESG performance, and 84% believe that most companies are unprepared to comply with potential ESG disclosure regulations; and
- 96% agree that the multi-stakeholder model of governance is more conducive to delivering long-term financial returns than other models.

The Edelman special report visually depicted the changes Figure 3 on the previous page, showing the next generation of investment criteria.

IV. ESG Reporting and Ratings Landscape

Investors rely on data, so it is not surprising that as ESG investing has increased, so too has demand for ESG data. Many companies report being inundated by requests for ESG information and are struggling to catch up. Demand for such information is projected to increase.[31] In this section, we provide an overview of the various voluntary and mandatory disclosures organizations make and describe how ESG data is used to rate companies on their ESG performance.

A. The Challenge of Reporting on ESG

With a few notable exceptions, companies are not generally required by law to report on their ESG performance. Rather, most disclosures are made voluntarily. Companies often publicly commit to voluntary disclosures on a recurring basis, while others selectively disclose without making explicit public commitments to do so. There are a variety of reasons a company may choose to make recurring or selective voluntary disclosures, not the least of which is to get ahead of the rating agencies by providing accurate data that will put the company in the best light. Once a company decides to voluntarily disclose one or more ESG performance metrics, however, it must determine:

- which data to gather and how to present it;
- which means to use in gathering the data;
- whom to make accountable for compiling the data;
- which disclosure frequency and distribution methodology to employ; and
- which means to apply to ensure data integrity.

A significant consideration in making these determinations is whether to adopt a company-specific reporting format or conform to one of several voluntary disclosure formatting regimes such as those detailed below.

B. Voluntary Disclosure Regimes and Formats

There are many disclosure regimes and frameworks in the market, each with its own approach to the type of information a company must disclose and in what format. Some disclosure regimes are issue-focused, and others cover all areas of ESG. Some notable examples include:

- **CDP (previously the Carbon Disclosure Project):** A not-for-profit organization formed in 2000 that runs a global disclosure system for investors, companies, cities, states, and regions to manage their environmental impacts.
- **Task Force on Climate-Related Financial Disclosures (TCFD):** In 2015, the Financial Stability Board, an international body that monitors and makes recommendations about the global financial system, created an industry-led disclosure task force on climate-related financial risks. In 2017, that task force published recommendations for a set of voluntary, consistent disclosure

recommendations to "promote more informed investment, credit, and insurance underwriting decisions and, in turn, enable stakeholders to understand better the concentrations of carbon-related assets in the financial sector and the financial system's exposures to climate-related risks."[32] TCFD reporting became mandatory for PRI signatories in 2020, and is scheduled to become mandatory over the next few years in the United Kingdom, New Zealand, and perhaps other countries.[33]

- **Global Reporting Initiative (GRI):** GRI, founded in 1997 after the Exxon Valdez oil spill, is an international independent standards organization that has established widely-used standards for sustainability reporting on topics ranging from anti-corruption to water, biodiversity to occupational health and safety, tax to emissions.
- **Sustainability Accounting Standards Board (SASB):** SASB is an independent standards board that has developed industry-specific reporting standards across financially material environmental, social, and governance topics.
- **United Nations Global Compact:** Established in 2000, the United Nations Global Compact encourages participating companies to make progress and report on ten principles covering human rights, labor, the environment, and anti-corruption. In 2017, the Compact partnered with GRI to develop a common framework for companies to report on their performance on these ten principles, as well as on the UN's Sustainable Development Goals.[34]

The year 2020 saw a move towards consolidation of disclosure regimes. In August of 2020, the five leading voluntary disclosure regimes—CDP, the Climate Disclosure Standards Board (CDSB), GRI, the International Integrated Reporting Council (IIRC) and SASB—published their shared vision of comprehensive corporate reporting and a commitment to work together to achieve this goal. This was followed by the International Business Council of the World Economic Forum publishing a white paper on common sustainability metrics, which sets out 21 core and 34 expanded metrics and disclosures that any company can adopt.[35] Disclosure regimes may become more consolidated in the future, but for now, companies must choose which disclosure regimes, if any, to use.

C. Legally Required Disclosures in the US, EU and UK

1. United States

There is no comprehensive legally-required ESG disclosure in the United States, and the Securities and Exchange Commission (SEC) has declined to adopt any particular ESG reporting framework. The SEC position is that disclosures are governed by the general principle of "materiality." This requires listed companies to decide the extent to which a reasonable investor would consider particular ESG information important in relation to an investment decision. As investor demand for particular ESG data is evolving, this is often a complex decision, and companies that choose to make voluntary disclosure of non-material information, for example in sustainability reports, need to consider the risks that those disclosures may be incomplete or misleading. Additionally, if particular ESG data is material, a public company must ensure that the manner and timing of the disclosure complies with securities regulations. That makes the distinction between material and non-material ESG information critically important.

It is possible that the SEC's approach will change under the Biden administration.[36] In 2020, the SEC's Investor Advisory Committee did recommend mandatory standardized ESG reporting,[37] but that approach was rejected by a majority of the SEC's Commissioners. In spite of the SEC's approach to not regulate ESG disclosures in general, there are particular federal and state law disclosure requirements. Here are three examples:

Diversity on Publicly-Held Company Boards: Publicly-held companies must disclose board "diversity" considerations—but only if they base nominating decisions on those considerations.[38] The SEC has left it up to each board to develop a diversity policy that fits its particular circumstances; if a board has such a policy, it must describe its implementation and assessment process. When the regulation was drafted in 2009, the SEC intentionally did not define the term "diversity" to allow companies to use the definition that best reflects their unique perspective.

Conflict Minerals: Certain companies are required[39] to report on "conflict minerals" (i.e., tin, tantalum, tungsten and gold, a/k/a 3TG) in corporate supply chains. This is due to concerns that the exploitation and trade of conflict minerals by armed groups help finance conflict in the Democratic Republic of the Congo (DRC) region and contribute to an emergency humanitarian crisis. Reporting companies that submit SEC filings must, among other things:

- disclose annually whether products they manufacture contain conflict minerals from the DRC or an adjoining country;
- briefly describe the reasonable "country of origin inquiry" they undertook; and
- publish on their websites the information they disclose to the SEC.

In 2017, a federal court ruled that parts of this rule violate the constitutional right to free speech. Companies are still encouraged to continue their due diligence efforts and file reports, but the enforcement of some requirements is suspended while final guidance is being developed.

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California Transparency in Supply Chains Act (2015): Covered entities are retail manufacturers and sellers doing business in California with annual worldwide gross receipts of more than $100 million. Companies must post the required information on their company websites, and the company's homepage must have a conspicuous and easily understood link to the required information. The information must cover to what extent, if any, the company:

1. **Verifies its product supply chain;**
2. **Evaluates compliance** with company standards relating to human trafficking and slavery in supply chains;
3. **Requires direct suppliers to certify** that materials incorporated in the product comply with applicable laws relating to slavery and human trafficking;
4. **Maintains internal accountability** standards and procedures for employees and contractors not meeting company standards relating to slavery and human trafficking; and
5. **Trains its management and employees** with direct supply chain responsibility on human trafficking and slavery, especially on how to mitigate these risks in the supply chain of products.

The Act does *not require* that companies *actually make any efforts* to eliminate slavery and human trafficking.

2. EU and UK

In the EU, the primary legislation governing ESG reporting is the EU's Non-Financial Reporting Directive, which requires listed companies, banks, insurance companies, and other public-interest entities to report on environmental, social, and employee matters, respect for human rights, anti-corruption and bribery matters in their annual reports as of 2018.[40] Each member state has drafted its own legislation to implement the Directive's requirements. Companies are permitted to choose their own reporting framework, so long as the required information is disclosed. The Directive is currently under review with updates expected in Q1 2021.

In addition to EU-wide legislation, some countries have published their own ESG reporting requirements. The UK, for example, enacted the *UK Modern Slavery Act* in 2015, which requires companies to publish an annual statement setting out the steps they take to prevent modern slavery in their business and supply chains. In 2017, the UK enacted Gender Pay Gap reporting rules, which require any organization with 250 or more employees to report specific gender-related pay data.

In March 2021, the EU's Sustainable Finance Disclosure Regulation (the "SFDR") comes into effect. The SFDR will require fund managers, financial advisers, and many other regulated firms in the EU, as well as non-EU fund managers marketing their funds in the EU, to disclose 32 categories of sustainability-related information about themselves and their products.[41]

The EU is also contemplating legislation relating to human rights and environmental due diligence for corporations, which may include associated reporting requirements.[42] Finally, the UK government has announced plans to implement legislation relating to forest risk commodities, which is expected to require businesses to report on due diligence activity in their supply chains.[43]

D. The Multiplicity of ESG Rankings

The lack of standardization in ESG disclosure frameworks makes it difficult for investors to assess a company's ESG performance and thus makes investment decisions more difficult. In July 2020, the U.S. Government Accountability Office released a study detailing investor frustration with inconsistencies in quantitative disclosures on the same topic and the gaps in narrative disclosures.[44] According to the study, those difficulties compel investors to purchase ESG rankings from third-party data providers.

There are dozens of ratings frameworks, each with its own scope and methodology, resulting in differences in company rankings. As with reporting frameworks, the rankings systems can be either topic-focused (e.g., those dealing specifically with climate) or broader ESG rankings.

Through its Bloomberg Terminal, Bloomberg offers ESG data with 10+ years of history for more than 11,700 companies in 102 countries, organized into 1,300+ fields.[45] Bloomberg also provides multiple rankings for investors, including its own proprietary rankings, and those from MSCI, RobecoSAM, Sustainalytics, ISS Quality Score, and CDP. It also provides more detailed rankings under each ESG category, as indicated in the image below, and for each it shows historical trends and performance versus peer groups.

The number of investors with access to this Terminal dashboard has been growing, and in 2018, Bloomberg decided to make the data available outside of the Terminal through a licensed data feed.[46]

FIGURE 4: Bloomberg Terminal

Rankings companies, which are largely unregulated,[47] tend to rely solely on publicly-disclosed information, and frequently there is no engagement with the target companies. Companies can be frustrated as they learn of a low score simply because they did not publish a particular policy on their website. Some rankings companies offer to engage in a dialogue with a company to review and possibly improve a score, but they may charge for this service. This gives companies an incentive to pay to participate in those rankings that use a framework most likely to lead to a higher rating.

E. Assurance of ESG Reporting

As mentioned above, today's ESG reporting is an evolution of the CSR reporting of previous years. Company-issued CSR reports often stood separate from annual reports and accounts and were commonly led by communications teams with a focus on setting out a positive narrative about a company's CSR activities for the purpose of elevating the company's reputation. Often, the content of these reports was not subjected to the same level of scrutiny as the financial reporting.

Today, however, ESG reporting is being reviewed by many institutional and private investors to inform investment decisions. In addition, new legislation requires that it be reported alongside, or as part of, a company's annual report and accounts. Misleading or inaccurate statements in ESG reporting could expose a company to litigation risks, as discussed in the next section. It is therefore essential to ensure that ESG data disclosed publicly is subject to controls, review, and oversight similar to the treatment of company financial data. Further, internal teams that manage and compile ESG data should be made aware of the importance of accurate reporting and provided training on creating effective control and assurance frameworks, including mechanisms for exposing and resolving violations.

V. Litigation Risks

As mentioned above, inaccurate ESG reporting subjects companies to various litigation risks, and those risks are expected to increase, particularly in the United States. Disclosure-related lawsuits have been brought by company shareholders, consumers, and different government entities under various theories of liability. ESG-related lawsuits have also been brought by alleged victims.

While many of these types of cases may not lead to a judicial verdict against the companies or their directors, the time, effort, and money spent on defending a lawsuit can be substantial. Perhaps more importantly, the harm to the company's reputation, as well as negative reactions by customers and employees, may prove difficult to repair. Thus, the mere existence of ESG lawsuits and the inevitable resultant media attention can be extremely harmful to the companies named in the lawsuits, as well as entire industries.

A. Shareholder Lawsuits

Shareholders have brought various class actions against companies based on federal securities laws,[48] alleging misstatements regarding ESG matters in corporate filings, codes of conduct, and other documents.[49] One important requirement for such a claim is that the company made a false or misleading statement regarding a "material" fact. A fact is considered material if a "reasonable investor" would consider it important. The vagueness of this definition and the impact of shifting values and evolving viewpoints have regularly put this standard at the center of these legal battles and wider public discussion.[50]

Shareholders have also brought derivative actions against directors for, among other things, breach of fiduciary duty. In a recent case, for example, Oracle's directors were accused of falsely claiming in public statements that the company had policies "designed to ensure diversity both at the management level and the Board itself."[51]

Claims may also be based on the argument that a company's focus on ESG issues is detrimental to shareholder value, or that a company's ESG disclosures mask true financial performance.[52]

B. Consumer Lawsuits

Consumer lawsuits have pointed to ESG disclosures in formal corporate documents, publicly accessible websites, and on products offered to the consuming public. Many of these cases are based on state consumer protection laws. For example, Walmart was sued for assertions it made in its corporate social responsibility statements available on its website regarding the company's supply chain management. The court dismissed parts of the lawsuit relating to "aspirational" statements and accepted other parts relating to Walmart's "efforts to audit suppliers' compliance with its standards."[53]

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C. Suits Brought by Governments

A number of states and municipalities in the U.S. have also commenced lawsuits prompted by ESG disclosures, albeit based on different legal theories.

For example, in 2018, Baltimore sued 26 multinational oil and gas companies, alleging that those companies have substantially contributed to greenhouse gas pollution, global warming and climate change by extracting, producing, promoting, refining, distributing, and selling fossil fuel products, while simultaneously deceiving consumers and the public about the dangers associated with those products.[54] Baltimore claims that, as a result, it has sustained and will sustain "climate change-related injuries," including a rise in sea level along Maryland's coast, an increase in storms, floods, heatwaves, drought, extreme precipitation and other conditions. The case was brought under Maryland law in a Maryland state court. The parties' disagreement regarding Baltimore's choice of court is currently pending before the U.S. Supreme Court.

New York State, Minnesota and the District of Columbia have brought similar lawsuits.[55]

D. Suits Brought by Victims

Apart from claims arising from ESG *disclosures,* there is a risk of litigation based on a company's alleged *violations* of ESG norms. Below, we list examples of such cases currently pending in courts:

Doe v. Apple: In December 2019, a group of child laborers sued Apple, Alphabet (Google), Microsoft, Dell, and Tesla for damages, arguing that those companies are part of a "venture" that exploits child laborers who mine cobalt in the Congo for use in smart phones, etc. The children further alleged that the supply chain for much of the cobalt used by the tech companies starts with a Congolese subsidiary of Glencore (which itself is not a defendant). The complaint includes horrific details and photos of injured children and has been widely covered in the news media.

Doe v. Nestlé:[56] In 2005, former child slaves who were forced to harvest cocoa in the Ivory Coast sued Nestlé and other large manufacturers, purchasers, processors, and retail sellers of cocoa beans in California for aiding and abetting child slavery in the Ivory Coast. The essence of the complaint is that the defendants "depended on—and orchestrated—a slave-based supply chain." The issue of whether U.S. courts have jurisdiction over the defendant companies for the acts alleged is currently pending before the U.S. Supreme Court.

Huaraz v. RWE (Germany):[57] In 2015, a Peruvian farmer sued RWE, a German energy company, in a German court, alleging his home is threatened by climate change caused at least partially by RWE. The farmer demands that RWE pay part of the repair costs for his home, calculating the amount as the percentage RWE has contributed to global warming. RWE argues that a single company cannot be held responsible for the consequences of climate change.

> **"Shareholders have brought various class actions against companies based on federal securities laws, alleging misstatements regarding ESG matters in corporate filings, codes of conduct, and other documents. One important requirement for such a claim is that the company made a false or misleading statement regarding a "material" fact. A fact is considered material if a "reasonable investor" would consider it important. The vagueness of this definition and the impact of shifting values and evolving viewpoints have regularly put this standard at the center of these legal battles and wider public discussion."**

VI. Implications for E&C Professionals

As companies adapt to the increased focus on ESG reporting, E&C professionals need to think strategically about how their own roles should evolve. The steps suggested below are intended to help guide E&C professionals through this process.

A. Identify the Key Functions and Individuals Within Your Organization with Roles in ESG Reporting

Regardless of which set of ESG metrics your organization elects to report, the work will necessarily require a significant investment of resources and a sustained team effort by personnel in multiple corporate functions. Whereas initially, ESG reporting may have been the responsibility of the Sustainability, Corporate Responsibility, and Environmental Health & Safety teams, today more functions are getting involved, including Finance, Investor Relations, Legal and HR.[58] The question is, where does the E&C function fit in? Specifically, what, if any, contribution should the E&C function make in support of the work necessary to gather, report upon, and improve the company's ESG metrics and associated performance goals?

There are no "one-size-fits-all" answers to these questions. The size, scope, authority, and responsibilities of E&C functions vary widely from sector to sector and from one corporation to another. In developing the right answers for your organization, it can be helpful to map out the different internal actors who have roles in ESG performance and reporting. Broadly speaking, the roles can be categorized into goal setting, goal implementation, ESG reporting, and verification.

- The C-Suite is generally charged with **setting performance targets**, and this applies across non-financial ESG areas as it does in areas of financial performance. But it goes further. In ESG areas, the C-Suite must consider whether the organization should commit to going beyond what the law requires. If so, how is that goal set? Does the organization want to submit to a voluntary disclosure regime, such as the UN Global Compact? Generally, this is a function of the C-Suite, but it can involve experts within the organization with relevant specialized knowledge to help inform these judgments. Some examples would be decisions about targets for net carbon emissions, gender diversity in management, fair wages, or combatting money laundering.

- In the **goal implementation** category are those charged with achieving those goals and perhaps designing the metrics to show progress towards achieving them. This role may be headed by one function or sub-function, but the work will typically involve cross functional teams. Within this category, there are questions about what investments in human resources, technologies or third parties may be needed to achieve a particular goal. There is also a need to set up internal policies and procedures and supporting training and communications. And there will be a need to set up internal monitoring and reporting to assess performance.

- The **ESG reporting** category involves those charged with reporting externally on ESG matters, whether for mandatory disclosures filed with the SEC for publicly listed companies or through voluntary disclosures posted on a website, shared with stakeholder groups, or as reported to an organization as part of a voluntary disclosure regime. This ESG reporting role will require support and input from the legal, corporate secretary, finance, and investor relations functions that are already involved in making financial disclosures. It may also involve support from those in external relations/communications, as well as from relevant internal or external experts required to generate and accurately characterize ESG data. Some organizations have a dedicated sustainability function with a Chief Sustainability Officer charged with bringing all this data together.

> **"Whereas initially, ESG reporting may have been the responsibility of the Sustainability, Corporate Responsibility, and Environmental Health & Safety teams, today more functions are getting involved, including Finance, Investor Relations, Legal and HR."**

- In the last category are the **controls functions** that are charged with verifying that internal policies and procedures are followed and that disclosures are accurate and not misleading. An organization's existing controls and audit functions all play a role here. In some cases, organizations may opt for third-party verification of non-financial reporting metrics to provide a level of independence, similar to the role of an external auditor for financial reporting.

Clearly, E&C must exercise its traditional role as a controls function, with its focus on overseeing compliance risk management, setting policies, overseeing compliance training and communications, managing the organization's Speak Up program, conducting investigations, and working to foster a culture of compliance. These traditional roles comprise a vital part of the "G" in ESG. But E&C professionals might be called upon or may actively seek to perform additional duties in one or more of the first three categories to support their organization's ESG reporting work. The appropriate role may vary from one ESG area to another. For example, in the area of anti-corruption, the E&C function may span across all four categories, whereas in the area of carbon emissions, its role may be limited to its traditional control function.

In the remainder of this section, we discuss several activities you might undertake to determine the role your E&C function should play in generating and reporting on ESG metrics.

B. Understand Your Company's Material ESG Risks and the Applicable Disclosure Framework

1. Start with an ESG Risk Assessment

If your company has been engaged in ESG reporting for some time, an ESG risk analysis has likely been done. If this is the case, there is no need for the E&C function to duplicate this work. Instead, you should seek to review and understand your organization's risk assessment findings. If your company has yet to commence a coordinated effort to generate and report ESG data, your first step in determining what, if any, role the E&C function might play in such an initiative should be to participate in an exercise to identify your organization's material ESG risks. Ideally, you would perform this work within a multi-disciplinary task force comprising ESG subject matter experts (which in some cases may include E&C itself) to inventory/map key ESG risk areas and identify those most relevant to your company's operations and strategic plans. ESG risks vary widely from organization to organization. A multinational chemical manufacturer has significantly higher environmental risks than an Internet-based advertising company. A well-established, multi-billion-dollar company may have very mature governance structures relative to smaller, less sophisticated organizations or young startups. To ensure you have a solid understanding of your company's material ESG risks, consider seeking answers to the following questions:

Environmental Risks

- How significant is your company's on-going impact on the environment and the communities in which it operates? Specifically, if your organization provides products and/or services, what impact does that have on the environment? In addition, if products are provided to customers, what impact do they have on the environment when used?
- How significant would the consequences be if your company failed to effectively manage its environmental performance?
- What are your company's crisis management plans? Do you have strategies for different scenarios?
- What, if any, impact do environmental risks have on your company's balance sheet, reserves for contingent liabilities, and income statement?

> **"E&C must exercise its traditional role as a control function, with its focus on overseeing compliance risk management, setting policies, overseeing compliance training and communications, managing the organization's speak-up program, conducting investigations, and working to foster a culture of compliance. These traditional roles comprise a vital part of the "G" in ESG. But E&C professionals might be called upon or may actively seek to perform additional duties in one or more of the first three categories—ESG goal setting, goal implementation, and reporting."**

- How significant is your company's energy consumption relative to stakeholder expectations?
- Has your company or your industry had a history of environmental incidents and/or regulatory fines for environmental infractions?
- What are your company's environmental controls and how effective are they?
- Does your company have a good understanding of its environmental performance relative to stakeholder expectations? For example, do you know the answers to the following questions:
  - What is your company's energy efficiency?
  - What is your company's carbon efficiency?
  - How effective is your company's waste management?
  - How effective is your company's water management?
- Are investors or other stakeholders interested in receiving information regarding your company's environmental impact?
- Does your company have adequate policies, procedures and training to effectively mitigate its environmental risk?

Social Risks

- How significant is your company's impact, both positive and negative, on communities in which it operates and on society at large?
- How significant is the risk that one or more of your company's divisions is engaging in illegal, unethical, or abusive employment practices? How do your company's labor standards compare with those of its peers and the expectations of its stakeholders?
- How significant is the risk that one or more of the company's suppliers, agents, or third-party intermediaries is engaging in illegal, unethical, or abusive employment practices? How do your company's suppliers', agents', and third-party intermediaries' labor standards compare with peer companies and the expectations of key stakeholders? Does your company have line of sight to your suppliers', agents', and third-party intermediaries' employment practices?
- Does your company have potential issues with respect to gender equality, diversity, data security, health, safety, or human rights?
- Does your company have a well-trained, satisfied, and financially secured workforce? Do all your employees know the company's values and behave in compliance and with integrity?
- Do your company's suppliers, agents, and third-party intermediaries have potential issues with respect to gender equality, diversity, data security, health, safety, or human rights?
- Are investors or other stakeholders interested in seeing information regarding your company's social impact both inside and outside the company?
- Does your company have adequate policies, procedures, and training to effectively mitigate its social risk?

Governance Risks

- How significant are any gaps in the governance structures your company relies upon to manage enterprise risks?
- How significant are your company's corruption, antitrust, and other compliance risks? Are these risks well managed?
- Has your company paid fines for violations of applicable laws, rules, or regulations?
- What is your company's relationship with government regulators and enforcement agencies?
- Are your company's executive and employee compensation practices appropriate and defensible? Is the compensation structure reviewed independently to evaluate the degree to which it may incentivize excessive risk-taking or other improper behavior? Are there "clawback" provisions that allow the company to take (or claw) back incentive awards from executives found to have engaged in misconduct?
- How strong is your company's ethical culture? What, if any, concerns do you have about the strength of your company's ethical culture?
- How effective are your company's auditing and monitoring programs? To what degree are you possibly unaware of significant enterprise risks or corrupt business practices by your employees, agents, or intermediaries?
- Are investors and other stakeholders interested in seeing information regarding your company's governance practices? If not, what kind of information are they seeking?
- Does your company have good and stable customer relationships and rules of conduct for business partners?
- Does your company have adequate policies, procedures, and training to effectively mitigate its governance risk?

The questions listed above are not intended to be an exhaustive list of those you might consider in identifying your company's material ESG risks. But they are examples of the kinds of issues your company should consider when determining the ESG risk areas most important to your investors and other stakeholders. While you may not be able to answer each of those questions, you want

to make sure that you are putting processes and procedures in place that will allow you to answer those questions.

In addition to collecting internal data to inform an ESG risk assessment, E&C professionals should review data that originates from regulators or other external evaluators, such as ESG ratings companies. Perhaps a bad score highlights an underperformance in a particular area that is not aligned with your own internal risk assessment. Or perhaps a good score does not reflect an identified deficiency. Either way, having an awareness can identify areas that warrant attention.

2. Identify Applicable Disclosure Frameworks

As mentioned in Section IV, there are multiple disclosure frameworks promoted by a wide variety of entities. The metrics required to satisfy these disclosure frameworks have broad similarities. They also have important differences you will need to consider when gathering ESG performance data. By considering your primary ESG risk areas and disclosure framework requirements, you will be in a position to start determining what data you must gather to satisfy applicable ESG reporting requirements. Transparency in external communication is of utmost importance in order to be perceived as a trustworthy and credible company that is serious about the defined ESG approach.

In light of the broad scope of ESG metrics, it is evident that executing the steps outlined above is a significant undertaking that will ultimately require a coordinated effort by a wide variety of professionals across your organization. Some E&C departments might be uniquely positioned to play a leading role in gathering and reporting ESG data. Most, however, will likely lack the bandwidth to assume responsibility for such a significant initiative without the investment of additional resources. Regardless of where your E&C function falls on this spectrum, at the least, it will likely be called upon to generate "ethical behavior" metrics related to codes of conduct, employee compliance training, ethical culture strength, and compliance programs (e.g., anti-corruption). If this is the case at your organization, by performing the analysis detailed above, you will be better prepared to take a seat at the table and make a meaningful contribution in helping your company define and establish ESG goals.

C. Manage Risks Arising from ESG Disclosures

Many journalists and commentators have highlighted cases of alleged corporate "greenwashing"—a term used when a company characterizes its own "green" performance (e.g., in reducing emissions) in a way that is deliberately misleading so as to improve the company's reputation or its attractiveness to investors.[59] While false statements made to mislead investors are unlawful, truthful statements can also be misleading by highlighting certain facts and omitting others. Given the lack of clarity of what needs to be reported and the diversity of reporting standards, ESG disclosures are susceptible to this phenomenon. This applies equally to funds that are marketed as "green." One study concluded that up to 85 percent of green-themed funds globally were guilty of "misleading marketing."[60]

Marketing campaigns regarding ESG performance metrics should be carefully vetted for accuracy, transparency, and truthfulness before being launched. The E&C function plays an important role to guard against the risks of greenwashing, both by managing the pressures of meeting ESG targets and by working with other corporate functions to establish controls around the data gathering and disclosures process.

1. Mitigating Risks Associated with Pressure to Achieve ESG Performance Targets

E&C professionals often see the consequences of performance targets that drive employees to "cut corners" and violate policies or laws. Many ill-considered sales and financial targets have led to compliance failures with significant financial and reputational damage. But there are also risks with aggressive ESG targets. In one sense, ESG targets can induce less pressure than sales targets. Stakeholders often understand that work in this area can be difficult and are satisfied to learn that an organization is working towards a target, rather than criticizing them for not having advanced as far as they had hoped in any given year.
That said, ESG rankings, as seen on the image of the Bloomberg terminal, highlight year-on-year improvements and performance against peer groups, so a failure to demonstrate improvement over time or solid performance within a peer group can impact investor demand. And there may come a time, with respect to a particular ESG target, that showing improvement is not enough for key stakeholders or investors.

As boards and executive teams give ESG performance a higher priority, the performance targets they set are translated into performance metrics and KPIs, which are often tied to compensation.[61] While the adoption of such metrics and KPIs helps to align the priorities across an organization, it also creates pressures for individual employees or groups of employees. As with pressure to meet sales or financial targets, such pressure may induce employees to report inaccurate data or otherwise cut corners to please their superiors. These risks are not new for E&C professionals. For years, they have been developing whole programs geared towards mitigating the risks arising from pressures to meet business or financial performance targets or from misconduct in the supply chain. These programs—based on a foundation of robust risk management, a strong speak-up culture, consistent supportive messaging from leadership at the top and from supervisors, clear policies, and effective training—can be adapted to meet these emerging risks arising from ESG.



> "To the extent that the E&C function provides data that is incorporated in the organization's ESG disclosures, it will need to ensure that it has the data to support whatever statements are made."

2. Ensuring Accurate Non-Misleading Disclosures

The risks of inaccurate or misleading ESG disclosures, even voluntary disclosures, range from legal risks to reputational risks to significant setbacks with key stakeholder groups, such as customers or employees. Companies have developed robust processes to ensure that financial information disclosed to the market or product information advertised to consumers is accurate and non-misleading. Similar protocols should be in place for ESG disclosures.

To the extent that the E&C function provides data that is incorporated in the organization's ESG disclosures, it will need to ensure that it has the data to support whatever statements are made. Most ESG disclosures, however, will draw from other functions, so it is important that each data provider within the organization is subject to a controls framework to ensure the accuracy of both the published data and any accompanying narrative descriptions. The E&C function may have a role, together with the organization's controls and audit functions, for setting up that framework, ensuring that appropriate documentation is organized to allow for verification of any statements, and that there is an audit process to verify the integrity of the controls framework and the accuracy of reported data. In some cases, an organization may contract with a third party, such as Verité or ERM CVS, to provide greater credibility to the disclosures in a particular ESG area, such as child labor. Where this is the case, the need for independent internal fact-checking controls processes is less urgent.

The degree of involvement of E&C professionals in the disclosure process may vary depending on the type of data being disclosed. In certain areas, E&C may play an active role in managing risks in the relevant area, such as perhaps diversity and inclusion, and would naturally have more direct involvement in related disclosures. In other areas, such as risk relating to carbon emissions, the E&C function may not have the capacity or expertise to participate meaningfully in the disclosure process. It can be a helpful exercise for the E&C function to map out its role across the spectrum of all ESG disclosures.

D. Leverage E&C's Expertise in Third-Party Risk Management

Third-party risk management is an area where the E&C function's expertise can be particularly valuable in adapting to the growing attention to ESG reporting. Many E&C functions have for several years been playing a leading role in the management of third-party risks, often as part of an anti-bribery, anti-money laundering, or trade sanctions compliance program. In this role, they have established well-designed and resourced processes and controls to (i) conduct due diligence before entering into new relationships with third parties, (ii) apply a risk-scoring algorithm based on relevant data, (iii) establish escalation procedures when significant risks are identified, (iv) design approval workflows commensurate with risk levels, and (v) develop procedures for ongoing monitoring of existing third parties. These processes often require significant resources and expertise and leverage increasingly sophisticated technology tools. Organizations also typically have control checks to verify that established policies and procedures have been followed. Finally, large global companies also often have a supplier code of conduct that sets out the organization's expectations from those seeking to supply goods and services to the company.

The ESG risk assessment and mapping exercise in all these areas can play a valuable role as companies see a growing need to expand the scope of third-party management to areas such as environmental waste, workers' rights and safety, and product integrity. The mapping exercise and the ESG risk assessment exercises described above can help to identify areas where this expertise can add value.

E&C professionals should also use the exercise to identify silos that lead to duplication of processes or technologies. For example, in the absence of an integrated approach to third-party risk management, there can be separate and independent processes by which to evaluate suppliers, for example, corruption, cybersecurity, and human rights risks.[62] This can create extra work for suppliers that need to complete different sets of questionnaires containing overlapping questions. Siloed approaches can also create inefficiencies for the organization in conducting due diligence and can lead to fragmented or inconsistent decision-making about whether to engage or continue to do business with particular third parties.

E. Participate in Defining Your Organization's ESG Goals and Its Broader Purpose

ESG reporting risks can also be mitigated by paying careful attention to the setting of goals. Companies will be under pressure—from investors, activists, employees, or other stakeholders—to set ambitious ESG targets such as on issues of carbon emissions or pay equity.[63] It is also important that the targets are realistic and structured in a way that does not create undue pressures that could lead to employees producing fraudulent ESG data or misleading ESG reports.

E&C professionals should seek out opportunities to have a seat at the table when their organization is defining its ESG targets. By doing so, they can contribute their unique perspective, including on the risks of aggressive performance targets and on how to mitigate those risks. They can also bring to the fore the ethical implications of any decision and can work to have all participants apply the organization's ethical decision-making framework in selecting ESG goals. Participating in goal-setting discussions also allows E&C professionals to consider up front several critical issues: Do the targets require any changes to the company's code of conduct or compliance policies? How can the targets be communicated internally and externally in a context that incorporates the organization's broader values? How will employment compensation be structured to incentivize achievement of the targets, and will that structure have any foreseeable collateral consequences? Are there appropriate controls in place to verify performance reporting?

For similar reasons, it can be helpful to participate in discussions relating to updates to your organization's purpose or mission statement, or its values, as these provide the frame for defining corporate culture and a company's approach to ESG. During the course of 2020, the fallout from the pandemic—and the deep societal divisions it exposed—has been a natural occasion for corporations to reflect more fundamentally on their purpose, and there has been more pressure on businesses to pay attention to purpose.[64] A well-crafted, credible, and authentic statement of purpose or mission statement, for example, will be inspirational, and at the same time can signal core principles that are the bedrock of a culture of compliance.

"E&C professionals should seek out opportunities to have a seat at the table when their organization is defining its ESG targets. By doing so, they can contribute their unique perspective, including on the risks of aggressive performance targets and on how to mitigate those risks. They can also bring to the fore the ethical implications of any decision and can work to have all participants apply the organization's ethical decision-making framework in selecting ESG goals."

VII. Challenges and Opportunities for E&C Professionals

The increased attention to ESG creates both challenges and opportunities for E&C professionals. The challenge is to adapt to the new pressures generated by ESG investing and reporting so the E&C function is a true partner in the company's long-term sustainable success. Meeting this challenge starts with acquiring the relevant knowledge and skills. That is, E&C professionals must understand the vocabulary, any underlying science, the relevant regulatory frameworks, and the disclosure landscape. While some of this may be new for E&C professionals, it has always been the case that E&C professionals must "know the business." Today, knowing the business includes understanding the pressures companies face to reach and report on a variety of ESG performance metrics. The other change for E&C professionals is organizational. They must understand the array of internal players with ESG roles, determine how they fit into this array today, and what changes to make for the future.

Growing demand for ESG disclosure also creates opportunities for E&C professionals. ESG focuses attention on the non-financial aspects of a company's performance, and E&C teams have expertise to help their companies improve their "performance" across these ESG dimensions. This may make the contributions of the E&C function more visible. That is, instead of its traditional role of adding value by preventing potential compliance failures (which is hard to measure), the E&C function in the ESG space can help improve a company's ESG performance, making the company more attractive to investors and generating trust from stakeholders and even loyalty from customers.

In addition, the widening of the risk spectrum that comes with ESG investing also broadens the potential remit of the E&C function, creating the need for greater collaboration with other business functions as key stewards of organizational culture. While E&C's job is not to 'fix' any of these diverse risks by itself, E&C professionals are in a position to help drive the company's purpose in a way that every employee understands it and is responsible and accountable. This can help advance another key objective of the E&C function: creating and nurturing a culture of compliance. As companies rethink their corporate purpose and their relationship with stakeholders, space can be opened up to pay more attention to corporate values, including traditional E&C values of integrity, honesty, and trust.

An ESG approach to investing provides companies the opportunity to deliver more value to stakeholders over the long term and, in turn, to generate stronger financial returns. E&C professionals can increase their own value to their organizations by getting ahead of the curve and developing a strategy that helps their organizations take advantage of this opportunity.

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[29] US SIF, The US SIF Foundation's Biennial "Trends Report" Finds That Sustainable Investing Assets Reach $17.1 Trillion, (Nov. 16, 2020). See also Nasdaq, ESG Investments Now a Whopping One Third of AUM, (Nov. 19, 2020); Umunna, Chuka, *ESG Investing Came Of Age In 2020 - Millennials Will Continue To Drive It In 2021,* Forbes (Dec. 18, 2020).

[30] Edelman Trust Barometer, Special Report: Institutional Investors U.S. Results, (Nov. 2020).

[31] Lee, Linda-Eling et al., MSCI, 2021 ESG Trends to Watch, at 19 (Dec. 2020)

[32] See TCFD website at https://www.fsb-tcfd.org/about/.

[33] Lee, Linda-Eling et al., MSCI, 2021 ESG Trends to Watch, at 19 (Dec. 2020)

[34] United Nations Global Compact, The Ten Principles of the United Nations Global Compact. See also GRI, https://www.globalreporting.org/about-gri/news-center/2020-11-09-driving-corporate-reporting-for-the-sdgs/ (noting the formation of The Corporate Action Group for Reporting on the Sustainable Development GoalsDriving Corporate Reporting for the SDGs, which expired at the end of 2020.

[35] Statement of Intent to Work Together Towards Comprehensive Corporate Reporting: Summary of alignment discussions among leading sustainability and integrated reporting organisations CDP, CDSB, GRI, IIRC and SASB (September 2020).

[36] Maurer, Mark, Biden's Candidate for SEC Chairman Is Expected to Be Tough on Companies, Wall Street Journal (Jan. 27, 2021)

[37] Securities & Exchange Commission, Recommendation from the Investor-as-Owner Subcommittee of the SEC Investor Advisory Committee Relating to ESG Disclosure (May 14, 2020).

[38] SEC Regulation S-K Item 407(c)(2)(vi), 17 CFR § 229.407(c)(2)(vi).

[39] Dodd-Frank Wall Street Reform & Consumer Protection Act (2010) § 1502.

[40] European Commission, Non-Financial Reporting: Overview, available at https://ec.europa.eu/info/business-economy-euro/company-reporting-and-auditing/company-reporting/non-financial-reporting_en.

[41] Bloomberg Professional Services, *Demystifying the Sustainable Finance Disclosure Regulation* (Aug. 10, 2020). Lee, Linda-Eling et al., MSCI, 2021 ESG Trends to Watch, at 28-29 (Dec. 2020).

[42] European Parliamentary Research Service, Towards a mandatory EU system of due diligence for supply chains, (Oct. 2020).

[43] Hughes, Laura and Terazono, Emiko, *UK companies face fines for links to illegal deforestation*, Financial Times (Aug. 24, 2020)

[44] U.S. Government Accountability Office, Public Companies: Disclosure of Environmental, Social, and Governance Factors and Options to Enhance Them," (July 2020).

[45] See Bloomberg website at https://www.bloomberg.com/professional/solution/sustainable-finance/.

[46] See Bloomberg website at https://company.content.cirrus.bloomberg.com/impact/products/esg-data/.

[47] French and Dutch securities regulators are pushing the EU to adopt regulations covering ESG ratings firms, which charge money to rate companies and may therefore have a financial incentive to give our favorable ratings. See Jones, Hew, *"EU faces Franco-Dutch call for rules to stop 'greenwashing,"* Reuters (Dec. 15, 2020).

[48] *See* Section 11 of the 1933 Securities Act and Section 10(b) of the 1934 Exchange Act.

[49] *See*, e.g., In re BP PLC Sec. Litig., 2013 WL 6383968 (S.D. Tex. Dec. 5, 2013) (in claim related to 2010 Deepwater Horizon explosion, plaintiffs adequately alleged that BP's disclosures re safety were sufficiently specific and detailed to be considered materially misleading).

[50] *See*, e.g., World Economic Forum, Embracing the New Age of Materiality, Harnessing the Pace of Change in ESG (White Paper, March 31, 2020).

[51] *Klein v. Ellison*, No. 20-cv-04439 (N.D. Cal. 2020) Complaint ¶ 2: https://regmedia.co.uk/2020/07/06/klein_v-oracle.pdf.

[52] See Eaglesham, J. & Brown, E., *WeWork Was Wrestling With SEC Over Key Financial Metric Just Before It Scrapped IPO*, Wall Street Journal (Nov. 10, 2019) (WeWork's "community-adjusted EBITDA" deducted "building and community-level operating expenses").

[53] *See National Consumers League v. Wal-Mart Stores, Inc.*, No. 2015 CA 007731 B, 2016 WL 4080541 (D.C. Super. Ct. July 22, 2016), Court Order available at https://nclnet.org/wp-content/uploads/archive-page-media/2016-07-22_Denying_Joint_Motion_to_Dismiss.pdf.

[54] *Mayor & City Council of Baltimore v. BP P.L.C.,* 952 F.3d 452 (4th Cir. 2020), cert. granted, No. 19-1189, 2020 WL 5847132 (S.Ct. Oct. 2, 2020); see Supreme Court Docket for underlying documents available at https://www.supremecourt.gov/search.aspx?filename=/docket/docketfiles/html/public/19-1189.html.

[55] *See People v. Exxon Mobile Corp.*, 65 Misc.3d 1233(A), 119 N.Y.S.3d 829 (Table), 2019 WL 6795771 (S.Ct, N.Y. County, Dec. 10, 2019) (dismissing case after 12-day trial); Morris, Christian, Minnesota and D.C. Attorneys General Sue Fossil Fuel Companies, ClimateXChange (July 1, 2020).

[56] *Doe I v. Nestle, S.A.*, 929 F.3d 623 (9th Cir. 2019), cert. granted sub nom. Cargill v. Doe I, No. 19-453, 2020 WL 3578679 (S.Ct., July 2, 2020); see Supreme Court Docket for underlying documents.

[57] *See* Business & Human Rights Resource Centre, RWE lawsuit (re climate change).

[58] Lee, Linda-Eling et al., MSCI, 2021 ESG Trends to Watch, at 22 (Dec. 2020).

[59] Alexander, Gemma, *How To Spot Greenwashing*, Earth911 (Dec. 14, 2020); Hicks, Robin, *8 brands called out for greenwashing in 2020*, Eco-Business (Dec. 18, 2020).

[60] Chan, Ernest, *Investors call for more clarity on Singapore ESG fund labels*, Financial Times (Jan. 27, 2021).

[61] Drimmer, Jonathan et al., *Integrating Human Rights and ESG into International Regulatory Compliance: Governance Considerations*, Paul Hastings International Regulatory Enforcement Blog (Jan. 26, 2021).

[62] *Id.*

[63] For example, in his 2021 letter to CEOs, Larry Fink asked CEOs to disclose "how their business model will be compatible with a net zero economy – that is, one where global warming is limited to well below 2ºC, consistent with a global aspiration of net zero greenhouse gas emissions by 2050. We are asking you to disclose how this plan is incorporated into your long-term strategy and reviewed by your board of directors." Larry Fink's 2021 Letter to CEOs (Jan. 2021).

[64] In his 2020 letter to CEOs, BlackRock's Larry Fink noted that "As I have written in past letters, a company cannot achieve long-term profits without embracing purpose and considering the needs of a broad range of stakeholders." Fink, Larry, A Fundamental Reshaping of Finance, Letter to CEOs (Jan. 2020).

Notes:


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