2020 U.S. POLICYMAKER ESG PRIMER

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This ESG primer should be read together with our ESG Lexicon (see Annex A), which provides definitions of some of the key terms used in ESG reports, disclosures and regulations.

Refinitiv foreword

As the world continues to assess the impact of COVID-19, the pressure to prioritize sustainability in financial markets has remained paramount. In the months before the coronavirus pandemic struck, sustainable finance had briefly become the biggest issue in global business. Now, we have data that shows it remains a focus for investors.

ESG is not one thing, but an umbrella term for identifying sustainability impacts. ESG data can be used to help identify and quantify the impacts that companies have on wider stakeholders and the risks to the long-term financial and reputational health of a company, and can be used to identify company practices that are leading indicators of long term sustainable performance. In a study conducted by Refinitiv in December 2020, 88% of global institutional investors wanted more forward-looking ESG and sustainability data to be able to comply with planned regulations. In the same survey, 87% of respondents agree that climate change is already having a material impact on company equity values.

ESG is no longer in its infancy – robust analysis of ESG data has become a fundamental addition to quantification of risks and opportunities during the investment decision-making process. Investors understand ESG is not just about doing good for society, but in fact can deliver superior risk-adjusted financial returns, and this holds true across all asset classes. BlackRock is already expanding their range of ESG-exchange traded funds (ETFs)for individual investors. Meanwhile, UBS is now recommending sustainable portfolios to clients as its default position. Big players in Asia such as DBS, Standard Chartered and Kotak Mahindra Bank have been increasing their focus on sustainable investing too.

Investors, regulators and policymakers should all be well-informed of the sustainability risks to assets, and the macroeconomy, on environmental, social and governance issues. Climate impacts still dominate the field, but social and governance challenges are rising up the investors' priority list. It will be critical to understand what constitutes ESG, what data is already available and what data still needs to be collected, and what frameworks and standards exist. I hope this brief primer can act as a first step in that effort, and Refinitiv stands ready to partner with the U.S. government and regulatory community where data is needed most.

Sherry Madera

Sherry Madera

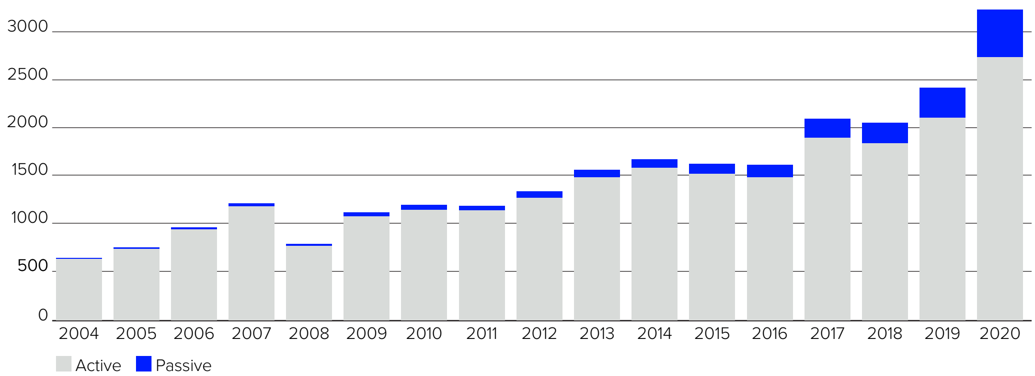
Introduction

"ESG" describes a set of environmental, social and governance factors used to evaluate investment and company impacts beyond traditional financial measures. ESG intersects with the concept of "sustainable finance," a term used to refer to the process of taking into account sustainability and ESG considerations when making investment decisions in the financial sector.

Interest on the part of investors and other corporate stakeholders in ESG matters has surged in recent years, and the current economic, public health and social justice crises have only intensified this focus. ESG also provides a range of business and investment opportunities. Net flows into ESG funds available to U.S. investors have skyrocketed, totalling $20.6 billion in 2019, nearly four times the previous annual record set in 2018, and inflows into responsible investment funds in the United Kingdom (UK) also reached record levels in 2020.[1] More than 70% of funds focused on ESG investments outperformed their counterparts in the first four months of 2020, and nearly 60% of ESG funds outperformed the wider market over the past decade.[2] Consumers and investors are placing a growing value on ESG, and corporate leaders have responded in a number of ways, including issuing comprehensive sustainability reports and expanding ESG disclosures in their annual reports, providing information to ESG rating agencies and publicly communicating ESG commitments.

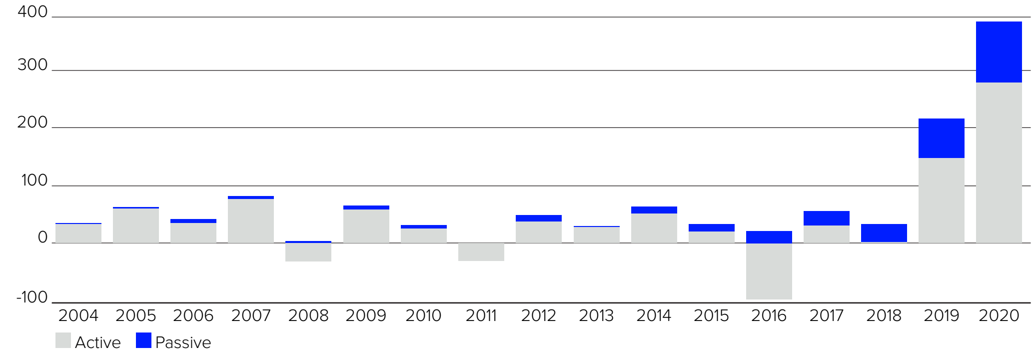
The U.S. Securities and Exchange Commission (SEC) has largely allowed ESG disclosures to be regulated by existing concepts of materiality, rather than impose new requirements specific to ESG. In contrast, the UK and the European Union (EU) have taken affirmative steps towards mandatory disclosures related to sustainable finance and new legislation on ESG issues, such as climate change and human trafficking. The international ESG regulatory landscape is rapidly evolving, and this primer is intended to provide U.S. policymakers with an overview of the key ESG terms, issues, players, regulations and industry recommendations.

Global asset under management ESG funds – active, passive



Mutual funds (including funds of funds) and exchange-traded funds (ESD billion)
Refinitiv Lipper at 30 November, 2020.

Global estimated net flows ESG funds – active, passive



Mutual funds (including funds of funds) and exchange-traded funds (ESD billion)
Refinitiv Lipper at 30 November, 2020.

ESG frameworks and standards: key players

As the prominence of ESG has grown, so too has the focus on disclosure in its many forms. Companies are increasingly seeking to burnish their ESG credentials and to respond to pressure from stakeholders regarding measurements of ESG outcomes. Through ESG disclosures, companies are able to describe how ESG affects strategy, performance, governance, compensation, their impact on their communities and so on. Over 80% of companies in the S&P 500 issue sustainability reports.[3] ESG disclosures are increasingly discussed in third-party analyses of ESG track records as well. Investors use this data to assess their ESG investments, and therefore consistent and comparable data is imperative to them. In the absence of international consensus regarding ESG disclosures, and given that U.S. and many international regulators have tended to provide only general guidance for voluntary disclosures, international and non-governmental organizations stepped in to create disclosure frameworks and standards. We describe below the principal disclosure regimes that have developed in recent years.

- **The Principles of Responsible Investment (PRI)** is a United Nations (UN)-supported international network of investors that launched in 2006, and now represents a group of over 3,000 signatories. Signatories to the PRI commit to adopt and implement its six aspirational principles (the "Principles"):
  - incorporate ESG issues into investment analysis and decision-making processes
  - be active owners and incorporate ESG issues into asset ownership policies and practices
  - seek appropriate disclosures on ESG issues by investee companies
  - promote acceptance and implementation of the Principles within the investment industry
  - work together to enhance our effectiveness in implementing the Principles
  - report on activities and progress towards implementing the Principles
- **The UN Sustainable Development Goals (SDGs)** were adopted by the UN General Assembly in 2015. The 17 numbered SDGs outline broad global goals, such as no poverty (Goal 1), zero hunger (Goal 2), gender equity (Goal 5), and climate action (Goal 13). The SDGs are accompanied by a total of 169 associated targets and 232 approved indicators. Many targets have been given a specific year (between 2020 and 2030) by which they should be achieved in order to meet the related goal, and the indicators specify the information that should be used to help measure compliance towards each target. The SDGs are viewed as a framework for shaping and prioritizing business strategy and associated reporting. Corporations often specify which SDGs their businesses prioritize, and sometimes detail the progress they have recently made with respect to such SDGs. Over time, the SDGs have also been incorporated in a growing number of ESG assessment frameworks. In June 2020, the UN Development Programme released new standards for consultation that aim to guide private equity fund managers and bond issuers in directing investments towards the SDGs
- The Task Force on Climate-related Financial Disclosures (TCFD) was established by the Financial Stability Board (FSB) following an initiative by the G20 in 2015 to focus on the financial impacts of climate change. The FSB launched the TCFD later that year to develop recommendations on climate-related financial disclosures needed by lenders, insurance companies and investors to make informed financial decisions. The TCFD published its final recommendations in June 2017.[4] The TCFD's disclosure recommendations fall into four thematic categories (governance, strategy, risk management, and metrics and targets), and identify supporting recommended disclosures, as well as guidance as to what type of information should be disclosed or considered for each recommendation. As discussed below, the UK recently announced its intention to move towards mandatory climate-related disclosures across all sectors of the UK economy by 2025, recommending that such disclosures align with the TCFD recommendations[5]
- **CDP Global (formerly the Carbon Disclosure Project)** is an international non-profit organization that has established an environmental disclosure platform that collects standardized information from companies on climate change and the use of natural resources such as water and soft commodities.[6] The platform is intended to allow companies, cities, states and regions to measure and manage risk and opportunities on climate change, water security and deforestation, with the goal of prompting investors, companies and local/regional governments to make the choices necessary for a sustainable economy

- **The Climate Disclosure Standards Board (CDSB)** is an international consortium of business and environmental NGOs that offers a framework for reporting environmental information with the same rigor as financial information.[7] This framework helps companies explain how environmental matters affect their performance, and show how they are addressing associated risks and opportunities to investors in annual or integrated reports. The CDSB seeks to benefit a range of stakeholders: investors, analysts, companies, regulators and accounting firms
- **The Global Reporting Initiative (GRI)** is an international independent standards organization, whose Sustainability Reporting Standards are reported to be the most widely-used standards for reporting on ESG impacts globally, and have been developed through multi-stakeholder contributions. GRI standards support both comprehensive reports and selected disclosures. GRI provides disclosure standards for companies to communicate their impact on critical sustainability issues, such as climate change, human rights, governance and social wellbeing. GRI focuses on creating standards and guidance to advance sustainable development, harmonizing the sustainability landscape, leading efficient and effective sustainability reporting and driving effective use of sustainability information to improve performance
- **The International Integrated Reporting Council (IIRC)** is a global coalition of regulators, investors, companies, standard setters, accounting firms, academics and NGOs.[8] The IIRC has established the Integrated Reporting Framework, which helps companies to produce a concise, investor-focused report that examines an issuer's performance and prospects through the lens of six "capitals" (financial, manufactured, human, natural, intellectual, and social and relationship). On November 25, 2020, the IIRC and the Sustainability Accounting Standards Board (SASB) announced their intent to merge into a single unified organization: the Value Reporting Foundation (VRF). The VRF will maintain the Integrated Reporting Framework. The merger is a response to market calls for a simplified and unified reporting landscape.[9]
- **The Sustainability Accounting Standards Board (SASB)** issues sustainability accounting standards to help public companies disclose material and decision-useful ESG information to investors in their mandatory filings, based on their industry, in line with the notion that under existing regulation, material information should be disclosed. SASB currently offers 77 different industry-specific standards. Approximately 58% of the companies that reported SASB metrics as of October 31, 2020 are domiciled in the U.S. Overall, the number of companies using SASB standards grew by 288% in 2020 as compared to the previous year.[10] The number of companies that use its industry-specific standards is expected to roughly double to 300 by 2021.[11] As noted above, SASB will be merging with the IIRC to become the Value Reporting Foundation.

In addition to the foregoing, there are an increasing number of other frameworks and standards. The sheer number of reporting standards and rating systems in the ESG disclosure landscape has created new challenges for companies, which may incorporate and be evaluated by multiple frameworks. In its 2019 Annual Report, the PRI noted that "the market is calling for greater coherence and consistency," and that asset owners have expressed a desire for the PRI to do more to drive better ESG data, including through convergence of reporting standards.[12]

In response to such calls, five leading standard setters for voluntary ESG reporting, namely GRI, CDSB, SASB, IIRC and CDP, issued a joint statement of intent in September 2020, announcing a commitment to working together to create a comprehensive corporate reporting system.[13] That same month, the International Financial Reporting Standards (IFRS) Foundation published a proposal to create a new, global Sustainability Standards Board,[14] which the UK and asset managers such as BlackRock have expressed support for. Shortly thereafter, the World Economic Forum's International Business Council, in collaboration with the "big four" accounting firms, released its recommended set of universal ESG metrics and disclosures to measure stakeholder capitalism, which they believe companies can report on regardless of their industry or region.[15] The creation of the VRF in November 2020 may also be a response to increasing ESG standard consolidation pressures.

ESG ratings

ESG ratings can be an important resource as investors seek to interpret and compare ESG information. The number of ESG ratings expanded in recent years, but unfortunately this has not led to greater market clarity, since the resulting ratings are often inconsistent or even conflicting. There are currently at least 125 organizations providing ESG ratings and research. Many are niche players in terms of the subjects they rate, the methodologies they use and the geographic concentration of the companies they rate. Major data providers and credit rating agencies are also entering this space. As Bloomberg stated in relation to S&P Global Inc.'s acquisition of RobecoSAM's ESG ratings business in late 2019, "credit rating companies are muscling their way into the burgeoning world of responsible investing, purchasing smaller outfits that provide (ESG) scores." The most commonly-used ESG ratings include: Morgan Stanley Capital International (MSCI); Institutional Shareholder Services Inc. (ISS); RobecoSAM; Sustainalytics; RepRisk AG; and Refinitiv.

Global perspectives

ESG in the European Union

The EU has taken a leading role in advancing ESG disclosure requirements across the full spectrum of sustainability topics. Some of the initiatives are focused largely on climate issues, while others address the broader sustainability landscape. In 2014, the EU adopted the Non-Financial Reporting Directive (NFRD), which requires "large companies" to disclose non-financial information on the way they operate and manage social and environmental challenges.[17] Since it was a directive, the requirements needed to be transposed into national law. In 2018, the EU set out an Action Plan on sustainable growth.[18] The action plan, among other things, contemplates guidelines on how companies should disclose climate-related information in line with the TCFD recommendations. In 2019, as part of the action plan, the European Commission issued further non-binding disclosure guidelines in the form of a supplement, which were intended for use by companies that fall within the scope of the NFRD.[19]

In November 2019, the EU adopted Regulation 2019/2088 on sustainability-related disclosures in the financial services sector (the SFDR),[20] which will require EU fund managers and non-EU fund managers marketing funds in the EU to make new disclosures related to sustainability. The regulations require new pre-commitment disclosures to be made to prospective investors, additional periodic investor reports and new disclosures on the fund manager's website. The SFDR contains principles-based requirements (Level 1 requirements) that will be supplemented by regulatory technical standards (RTSs), which will set out the Level 2 requirements. The first draft of RTSs was released in April 2020 and was set to be finalized by the end of 2020. The European Commission has said that high-level and principles-based requirements will still apply as of March 10, 2021, as planned, but the Level 2 requirements will be delayed until a later date, possibly January 2022 or later. U.S. fund managers that market funds in the European Union or establish an EU fund still need to prepare to comply with Level 1 requirements as early as March 2021.

The EU Taxonomy Regulation (available here) creates an EU-wide classification system for sustainable activities (the EU Taxonomy). The EU Taxonomy is a tool to help investors, companies, issuers and project promoters navigate the transition to a low-carbon, resilient and resource-efficient economy.[21] The EU Taxonomy Regulation's classification system defines environmentally sustainable economic activities, and outlines six environmental objectives: climate change mitigation; climate change adaptation; sustainable use and protection of water and marine resources; transition to a circular economy; pollution prevention and control; and protection and restoration of biodiversity and ecosystems. It provides that in order for an investment to be characterized as environmentally sustainable, the underlying economic activity must make a "substantial contribution" to at least one of the EU Taxonomy Regulation's six objectives and not cause any significant harm to any of the others (the "do no significant harm" principle). The EU Taxonomy Regulation follows the entry into force of the SFDR, and will therefore need to be incorporated in disclosures from March 10, 2021.

Also as part of the action plan, the 2007 Shareholder Rights Directive (SRD) was amended in 2017, resulting in what is commonly known as SRD II.[22] Most of its provisions were required to be transposed into national law by June 2019, and the implementing regulations became effective September 3, 2020. The SRD II aims to "encourage long-term shareholder engagement and to enhance transparency between companies and investors" in relation to both proxy voting and shareholder identification.[23] For example, SRD II requires insititutional investors and asset managers to publicly disclose an engagement policy that describes how they integrate shareholder engagement in their investment strategy, and requires proxy advisors to publicly disclose their code of conduct and information related to the preparation of their research, advice and voting recommendations, as well as any conflicts of interest.

ESG in the United Kingdom

The UK has been an early adopter of ESG regulations and guidelines. For example, it was the first country to set long-term, legally binding emissions reduction targets. The UK government was also one of the first countries to formally endorse the TCFD recommendations, and has taken a number of steps since to advance TCFD-aligned disclosures in the UK. For example, in April 2019, the Bank of England's Prudential Regulation Authority (PRA) issued a supervisory statement[24] in which the PRA made clear that it expected banks and insurers to reflect the "distinctive elements of the financial risks from climate change" in their disclosures.[25] A few months later, the UK government announced that as part of its Green Finance Strategy, all listed issuers and large asset owners would be required to make disclosures in line with the TCFD's recommendations by 2022.[26] In March 2020, the Financial Conduct Authority (FCA) published proposals requiring premium-listed companies to make new climate-related disclosures on a comply-or-explain basis,[27] which it recently confirmed will apply from January 1, 2021. On November 9, 2020, the UK became the first country to move towards mandatory climate-related disclosures when it announced its intention to require such disclosures across all sectors of the UK economy (including listed commercial companies, UK-registered large private companies, banks, insurance companies and pension schemes) by 2025.[28]

The UK has been particularly proactive with respect to ESG disclosure requirements focused on social matters. For example, Section 54 of the Modern Slavery Act 2015 (MSA) requires large commercial organizations, with business in the UK and an annual turnover of at least £36 million, to prepare a "slavery and human trafficking statement" in relation to the company and its supply chain every financial year, obtain sign-off by the board or senior management, and publish it on its website.[29] The legislation was the first of its kind in Europe and second internationally only to California's Transparency in Supply Chains Act. Another important social disclosure requirement in the UK is the Equality Act 2010 (Gender Pay Gap Information) Regulations 2017, effective April 2017, which require that companies with more than 250 employees report their gender pay gap figures.[30] The UK government also opened a public consultation on ethnicity pay reporting by employers that closed in January 2019,[31] so it is possible that ethnicity pay reporting disclosures could be mandated in the future.

With respect to the applicability of the SFDR and other EU initiatives following Brexit, it remains unclear to what extent the UK will remain aligned with ESG regulations drafted in Brussels following year-end. To date, the UK and the member states of the EU have operated in parallel on ESG matters. That said, a number of UK initiatives surpass minimum EU standards.

ESG in Asia

Asia comprises both emerging and developed markets, each replete with unique challenges in addressing ESG and economic growth. Asia generally lags behind Europe and the U.S. in ESG investing, but the region has shown tremendous potential.[32] Asia's largest pension or sovereign funds are moving towards increased ESG investments, such as Japan's Government Pension Investment Fund (GPIF), which is the largest pension fund in the world. Hong Kong and Singapore have pledged to become green finance hubs. Millennials, drawn to invest in opportunities with social impact, are poised to inherit 35% of Asia's wealth in the next five to seven years.[33] Additionally, China's Belt and Road Initiative (BRI) incorporated sustainability principles into its infrastructure projects, and the Asian Infrastructure Investment Bank announced an ESG Enhanced Asian Credit Portfolio.[34] In September 2020, Xi Jinping announced before the UN General Assembly a pledge that China would become carbon neutral before 2060.

Despite these positive steps, there is still room for growth. Governments set certain ESG standards, but lack mechanisms to enforce them, or companies set ESG goals then fail to gather metrics to show they are on the path to meeting them. The shifting and evolving landscape of ESG is an obstacle for newcomers to understand, and inconsistent penalties for inaction across Asian countries proves difficult for investors to trust that ESG principles will become actual practice.

ESG in Latin America and the Caribbean

The COVID-19 Pandemic has exposed the vulnerability of unsustainable infrastructure and fossil fuel reliance throughout Latin America and the Caribbean (LAC). Nonetheless, LAC nations are proving to be supportive of ESG policies. In 2019, Chile's dual-currency transaction program, and ESG infrastructure pipelines in Colombia, Chile and Brazil, cultivated and improved the region's green bond market issuances.[36] In April 2020, 13 LAC finance ministers joined the Coalition of Finance Ministers from Climate Action to help draft a green economic recovery for COVID-19.[37] One month later, the region issued $19.2 billion worth of green bonds.[38]

The private sector within the region has realized they need to be proactive and contribute more in investments towards ESG projects. BNP Paribas is becoming well known for its reputation as a sustainability lender across LAC; ESG investors are collaborating with LAC governments to pitch the use of Sovereign Wealth Funds (SWFs) or government-regulated pensions for green infrastructure projects. Overall, ESG investors are being more active within the emerging market.[39]

ESG in Canada

Since 2017, Canada has accelerated its adoption of ESG principles as institutional investors grow more confident with ESG integrated portfolio returns. Three separate surveys conducted by the Royal Bank of Canada found that Canadian institutional investors increasingly believe ESG integrated portfolios perform as well or better than non-ESG integrated portfolios.[40] Across Canadian firms, more than half of institutional investors look for companies that engage in robust disclosure with regard to worker safety, employment health benefits, workplace culture and other social factors.[41]

Although Canada has assumed a leading role in ESG regulation and portfolio integration, concerns about the unbalanced adoption of ESG principles remain. ESG integration practices in Canada are more prevalent among equity practitioners than their fixed-income counterparts, and Canadian investors see ESG analysis more as a spot risk assessment than an opportunity tool.[42] Furthermore, ESG principles are often integrated by portfolio managers with no ESG specialization, leading to unbalanced ESG considerations and understanding.[43]

Nonetheless, federal and provincial Canadian governments continue to endorse and pass ESG-related laws directed at firm transparency and pension regulation.[44] Increasingly, there is support across the country to move away from passive ESG regulation and focus instead on binding and culture-changing legislation. For example, the Modern Slavery Act was introduced in the Canadian Senate in late October.[45] Similar to the UK's MSA, the proposed act would require any company listed on a Canadian stock exchange or doing business in Canada (subject to certain thresholds[46]) to disclose in annual reports their policies to prevent and reduce the risk of forced labor or child labor in their production of goods.

U.S. ESG framework

Current SEC guidance

Under the current disclosure regime applicable to public companies listed in the U.S., there is no affirmative duty to provide disclosures on ESG matters. The SEC takes a principles-based, materiality-focused approach to disclosure that applies equally to ESG disclosures. While the SEC has not mandated disclosure of ESG considerations in periodic reports, it has issued guidance related to climate change and other ESG-related disclosures over the past decade.

- **Environmental matters.** The SEC issued guidance in 2010 that addressed how existing disclosure requirements could apply to climate-related issues, and called on companies to consider the materiality of factors such as the direct and indirect impacts of legislative and regulatory changes on operating and financial decisions, capital expenditures to reduce greenhouse gas emissions and the physical risks of climate change. In 2016, the SEC issued a concept release on business and financial disclosures, which touched on sustainability themes. The SEC has yet to act on the sustainability matters about which it requested comment (though according to an analysis of comment letters, two-thirds of the more than 276 non-form comment letters received by the SEC addressed sustainability-related concerns and over 80% of those letters called for improved sustainability information in SEC filings, with only 10% opposing SEC action)
- **Social issues.** Board diversity is not mandated for public companies under either SEC rules or stock exchange listing standards, and, like other ESG topics, the regulatory angle is rooted in disclosure. In 2009, the SEC required companies to disclose whether and, if so, how, a nominating committee considers diversity in identifying board nominees. If the board has such a policy, companies must also disclose how the policy is implemented and how the board or the nominating committee assesses the effectiveness of the policy. Since July 2020, activist investors have filed roughly a dozen shareholder derivative lawsuits against directors under the 2009 rule, alleging that companies made statements about their commitment to diversity that in actuality were either false or misleading. In 2019, the SEC issued two Compliance & Disclosure Interpretations (116.11 & 133.13) clarifying what disclosure of "self-identified diversity characteristics" of directors and director nominees is required. In addition, in August 2020, the SEC adopted changes to Item 101 of Regulation S-K that would add "human capital" as one of the topics to be disclosed, to the extant material, in SEC reporting company business narratives. Such information should include the number of persons employed and any human capital measures or objectives ("such as, depending on the nature of the registrant's business and workforce, measures or objectives that address the development, attraction and retention of personnel") that the registrant focuses on in managing the business
- **Governance matters.** In 2009, when the SEC adopted the disclosure rules on diversity, it also adopted disclosure rules covering various other governance matters. Then-chair Mary Schapiro noted that "by adopting these rules, we will improve the disclosure around risk, compensation and corporate governance, thereby increasing accountability (for officers and directors) and directly benefiting investors." The 2009 rule changes covered the relationship of compensation policies and practices to risk management; the background and qualifications of directors and nominees; legal actions involving a company's executive officers, directors and nominees; board leadership structure and the board's role in risk oversight; stock and option awards to company executives and directors; and potential conflicts of interests of compensation consultants

Regardless of the absence of mandatory ESG disclosure requirements from the SEC, it can be anticipated that a range of stakeholders, such as investors, insurance companies, lenders and regulators, will increasingly look to companies' disclosures to allow them to evaluate whether or not those companies have embraced ESG agendas. And, even in the absence of an affirmative duty to disclose, the substance of the information that companies do elect to report regarding their actions to identify and manage ESG risks and opportunities will be subject to the antifraud provisions of the securities laws and general considerations of materiality.

It is worth noting that there are voices within the SEC that would like to push ESG-related guidance further. SEC Commissioners Lee and Crenshaw have publicly expressed the view that the SEC must modernize its disclosure regime in relation to climate change. Commissioner Lee noted this was necessary in order to “ensure that financial institutions produce standardized, comparable and reliable disclosure of their exposure to climate risks.”[47] In May 2020, the Investor-as-Owner Subcommittee of the SEC’s Investor Advisory Committee recommended that the SEC establish disclosure policies on ESG topics.[48] Noting that the “use of ESG-related disclosures has gone from a fringe concept to a mainstream, global investment and geopolitical priority,” the Subcommittee recommended that the SEC update reporting requirements to “include material, decision-useful ESG factors,” though it did not endorse a particular ESG standard.

Other regulatory developments

Federal Reserve Board

Attention to the financial impacts of climate change may be reaching a tipping point within the Federal Reserve Board in 2020, as evidenced by its decision to apply to join the Network of Central Banks and Supervisors for Greening the Financial System and examine climate change risks in its twice-yearly financial stability report for the first time.[49]

Department of Labor

On June 23, 2020, the U.S. Department of Labor (DOL) proposed rules to clarify that fiduciaries under the Employee Retirement Income Security Act of 1974, as amended (ERISA), must evaluate and make investments on behalf of ERISA-based plans (Plans) solely on the basis of so-called "pecuniary factors," and may not take on additional risk or sacrifice returns to promote unrelated environmental, social and governance objectives.[50] A 30-day comment period followed, which drew 8,737 comments; approximately 95% of these comments opposed the DOL proposal.[51] Despite this public opposition, the DOL released the final rule on October 30, 2020, though it removed explicit references to ESG. Under the final rule, an ERISA fiduciary may base an investment decision on non-pecuniary factors only if it finds investment alternatives to be economically indistinguishable even after a careful evaluation in accordance with the rule. In such cases, however, the ERISA fiduciary must specifically document how it reached this conclusion as well as how the investment was otherwise consistent with a plan's purposes and the plan participants and beneficiaries' interests. This places additional administrative burdens on an ERISA fiduciary that it would not face with non-ESG-related investments.

Commodity Futures Trading Commission

An advisory committee to the Commodity Futures Trading Commission issued a report in September 2020 detailing the threats presented by climate change to the U.S. financial system.[52] The report found, among other things, that climate change will very likely affect "multiple sectors, geographies and assets in the United States" in rapid fashion.[53] The collision of varied risks could exacerbate stresses and instability, increasing the likelihood that multiple aspects of the financial system could be detrimentally affected. Key recommendations include, but are not limited to, establishing a fair price on carbon that is likely to reduce emissions, incorporating climate-related risks into federal financial mandates, integrating climate risk into balance sheet management and asset purchases, and integrating climate risk into federal fiscal policy, especially with regard to infrastructure, disaster relief and other rebuilding.[54]

Industry recommendations and other developments

Institute of International Finance (IIF)

In response to the calls for unified ESG disclosure standards mentioned above, the IIF has recommended that such a framework be flexible enough to accommodate for sustainable finance innovations but also prescriptive enough to allow for comparability. It can be further tailored to the needs of individual regions and markets.[55]

Global Financial Markets Association (GFMA)

Other industry recommendations have focused on sustainable finance objectives. To reach the global targets in the Paris Agreement and the UN SDGs, one study estimates that an additional $2.5 trillion through 2030 would need to be pumped into the global economy annually.[56] That said, another study found that bold climate action could yield at least $26 trillion in economic benefits through 2030.[57] Financial institutions increasingly market green, social and sustainable debt instruments, finance renewable energy projects and incorporate climate-related risks into product pricing models. The GFMA surveyed 22 of the largest globally active financial and capital market participants, and concluded that most agreed that regulatory bodies should adopt a policy-incentive approach to support sustainable finance and provide limited regulatory guidance on common definitions, frameworks and taxonomies.[58] Essentially, financial establishments should have enough latitude and lucid, comprehensive guidelines to develop creative solutions to pressing global issues.

Official Monetary and Financial Institutions Forum (OMFIF)

In a September 2020 report by OMFIF, in collaboration with Refinitiv, the independent central banking think tank found that the move towards sustainability is accelerating even as the global economy grapples with the consequences of COVID-19, and regulatory and industry emphasis has rebalanced away from principally environmental issues to a more holistic focus across the three ESG pillars. The report highlights a pervasive belief that clear and consistent ESG data will be critical to realign the financial markets towards sustainable development and help achieve sustainable development goals. While there has been significant progress in disclosure of information in relation to environmental and societal impacts over the past decade, this field is still young, with unrealized potential.

The Future of Sustainable Data Alliance (FoSDA)

An alliance among the World Economic Forum, the United Nations, Refinitiv, IIF, OMFIF and GFMA, among other global partners, launched FoSDA in January 2020, to help investors and governments identify and fill ESG data gaps (missing information related to a specific data point that is already being collected) and holes (missing data sets that are not collected at all or that are not available for analysis).[59] On December 10, 2020, FoSDA released its initial seven recommendations aimed at improving investment-grade sustainability data, to enable the achievement of the UN SDGs, Paris Agreement goals and a sustainable post-COVID recovery. FoSDA recommends that: regulators, governments and the financial industry map and address data gaps; move away from binary reporting and towards more metric-oriented reporting; increase focus on forward-looking data; standardize corporate ESG reporting; map sustainability taxonomies to underlying data; move away from singular data set focus; and build talent development and capacity in the sustainability data industry.[60] FoSDA's next steps include preparing a roadmap that will set out an action plan to advance these recommendations, and a more detailed report addressing key challenges in the ESG data space. FoSDA also plans to engage with regulators to gauge the availability of adequate ESG data sets to ensure compliance with regulatory requirements.

U.S. Chamber of Commerce

In a special report published by the U.S. Chamber of Commerce in mid-2020 on ESG issues, the authors found that the middle market economy recognizes broader ESG responsibilities, but continues to struggle with turning an ideal into habit.[61] Mid-market companies have an opportunity to differentiate themselves from the crowd, but must be willing to invest time and capital in an effort to adapt to the new environment and inspire stakeholder value.[62]

Business Roundtable

Business leaders have also supported more expansive views regarding the purpose of a corporation. In August 2019 the Business Roundtable, a non-profit organization comprised of corporate CEOs, released a new Statement on the Purpose of a Corporation (the BRT Statement).[63] The BRT Statement was signed by the CEOs of nearly 200 leading U.S. companies and identified shareholders as one of five key stakeholders – along with customers, workers, suppliers and communities. The BRT Statement supersedes prior statements that endorsed shareholder primacy (the idea that corporations exist principally to serve shareholders), and outlines a modern standard for corporate responsibility.

Nasdaq

In December 2020, Nasdaq proposed board diversity and disclosure requirements as a condition to continued listing. The proposal would create new Rule 5605(f), Diverse Board Representation, and new Rule 5606, Board Diversity Disclosure, which together would require (i) all companies listed on Nasdaq's U.S. exchange to publicly disclose diversity statistics regarding their board of directors and (ii) would require most Nasdaq-listed companies 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 an underrepresented minority or LGBTQ+. Foreign companies and smaller reporting companies would be permitted to satisfy this requirement with two female directors. The proposed rule changes are subject to public comment and SEC approval.

State developments

New York State Department of Financial Services (DFS)

DFS has paid particular attention to the potential risks of climate change on financial institutions. In 2019, DFS became the first U.S state banking regulator to join the Network of Central Banks and Supervisors for Greening the Financial System. In September 2020, DFS issued a letter to New York insurance companies that outlined DFS's expectations for the industry's management of financial risks from climate change. One month later, DFS issued a letter to DFS-regulated banks and non-bank institutions discussing the financial risks of climate change and outlining its expectations with respect to risk management processes, governance frameworks and business strategies.[64] While the letter imposes no deadlines, DFS-regulated institutions should consider how to address DFS's expectations, including its call for enterprise-wide risk assessments on the impact of climate change on the institution's risk factors, such as credit risk, market risk, liquidity risk, operational risk, reputational risk and strategy risk. DFS is the first U.S. regulator of financial institutions to publish expectations for regulated institutions in relation to climate change risk management.

State laws related to board diversity mandates or disclosures

State laws on board diversity have emerged in California, Maryland, Illinois, Washington and others in recent years. For example, California's Senate Bill 826 was signed into law in September 2019, requiring public companies that have a principal executive office in California to have at least one woman on their boards by the close of 2019. By the end of 2021, the law mandated that minimum requirements for the number of women serving on boards would be increased (if a board has six or more members, then at least three must be women; if a board has five members, then at least two must be women; and if a board has four or less members, then at least one must be a women). One year later, on September 30, 2020, Senate Bill 979 became law and expanded board diversity requirments to directors from "underrepresented communities" (which may include a person's membership in a specific racial community or the LGBTQ+ community) by the end of 2022. While these laws are subject to ongoing litigation, studies show that companies have acted on the diversity mandates and California company boards are experiencing a diversity boost.[65]

Closing

This year has proved to be a watershed for ESG. A confluence of social and economic factors, combined with the pervasive impact of the COVID-19 pandemic, has led to greater momentum for ESG investments, and has spurred companies to enhance their ESG disclosures and commitments. The regulatory environment is, in many ways, still catching up to global market developments.

1 *See* Greg Iacurci, "Money moving into environmental funds shatters previous record," CNBC (January 14, 2020), available here; Lucca De Paoli, "European ESG Funds Pulled in Record $132 Billion in 2019," Bloomberg (January 31, 2020), available here.

2 A study by Moneyfacts found that over the past year and during the coronavirus pandemic, the average ethical fund grew upwards of 4.3%, compared with an average 1.5% loss from non-ethical propositions. Financial Times, "Ethical investment remains a work in progress" (October 23, 2020), available here. JP Morgan's Multi-manager Sustainable Long-Short Fund, which is dedicated to ESG issues, gained almost 14% from February to November 2020. By comparison, Eurekahedge's index tracker found that the average hedge only rose 3% between January and October. Bloomberg, "JPMorgan's $150 Billion Unit Taps Hedge Funds for ESG Gains" (November 22, 2020), available here. Investment Association figures show the first three quarters of 2020 as having a 275% increase in cash going into responsible investment funds, compared to the same nine months in 2019, increasing from £1.9 billion to £7.1 billion. The investment boom is credited to increasing concerns over climate change and a growing number of millennial investors. Data from Morningstar also showed a record high, with global assets in sustainable funds hitting £930 billion in the third quarter of 2020. Financial Times Adviser, "ESG inflows quadruple in 2020" (November 5, 2020), available here.

3 Tom Quaadman, "The Role of ESG in the Business Community" (July 2020) (available here).

4 *See* TCFD, "Recommendations of the Task Force on Climate-related Financial Disclosures: Final Report" (June 2017), available here. For further discussion of the TCFD recommendations, please see our client memorandum (here).

5 United Nations Development Programme, Press Release, "UNDP launches standards for bond issuers and private equity funds seeking SDG impact" (June 16, 2020), available here.

6 *See* CDP, "Why disclose as a company" (available here).

7 *See* Climate Disclosure Standards Board, "CDSB Framework" (December 2019), available here.

8 IIRC, "The IIRC," available here.

9 Cision PR Newswire, "IIRC and SASB announce intent to merge in major step towards simplifying the corporate reporting system" (November 25, 2020), available here. For more on the Statement of Intent released earlier this year by CDP, CDSB, GRI, IIRC and SASB calling for simplified and unified reporting, see our prior client alert here.

10 SASB, Press Release, "SASB Publishes Translated Implementation Guidance for Companies" (November 19, 2020), available here.

11 Ross Kerber, "'Thanks Larry!' Green accounting project says BlackRock plug gave it a boost," Reuters (March 11, 2020), available here. Companies that currently report with SASB standards include industry leaders such as Barclays, Nike, Diageo and Kellogg.

12 Principles for Responsible Investment, "Annual Report 2019" (2019) (available here).

13 CDP, CDSB, GRI, IIRC and SASB, "Statement of Intent to Work Together Towards Comprehensive Corporate Reporting" (September 11, 2020) (available here). For more on the Statement of Intent, see our prior alert here.

14 The IFRS Foundation published a "Consultation Paper on Sustainability Reporting" in September 2020 (with comments to be received by December 31, 2020), available here. The consultation paper notes that "demand is growing for international coordination of an agreed set of sustainability-reporting standards. International standardization assists in providing a level playing field for companies that prepare reports and international comparability for investors."

15 World Economic Forum, News Release, "Measuring Stakeholder Capitalism: Top Global Companies Take Action on Universal ESG Reporting" (September 22, 2020) (available here).

16 Kramer, M. et al., "Where ESG Ratings Fail: The Case for New Metrics," Institutional Investor (September 7, 2020) (available here).

17 *See* Directive 2014/95/EU of the European Parliament and of the Council of 22 October, 2014, amending Directive 2013/34/EU as regards disclosure of non-financial and diversity information by certain large undertakings and groups (available here).

18 *See* European Commission, "Action Plan: Financing Sustainable Growth" (March 2018) (available here).

19 *See* Guidelines on non-financial reporting: Supplement on reporting climate-related information (available here), supplementing non-binding guidelines issued by the European Commission in 2017. Companies are encouraged to disclose information in accordance with widely-accepted reporting standards and frameworks, to maximize comparability for their stakeholders. To contribute to convergence at the EU and global level, these guidelines refer to a number of recognized reporting frameworks and standards. In particular, they incorporate the recommended disclosures of the TCFD, which are themselves aligned with other principal frameworks. The disclosures recommended by the TCFD are separately identified in the guidelines. In addition, the guidelines take account of the standards and frameworks developed by the GRI, the CDP, the CDSB, the SASB, the IIRC and the EU Eco-Management and Audit Scheme (EMAS). See also Frequently Asked Questions: guidelines on reporting climate-related information (available here).

20 The SFDR is available here. The covered entities would already be subject to regulation under existing EU regulations. The scope of the regulations is broad – sustainable investment is defined as:

> investment in an economic activity that contributes to an environmental objective, as measured, for example, by key resource efficiency indicators on the use of energy, renewable energy, raw materials, water and land, on the production of waste, and greenhouse gas emissions, or on its impact on biodiversity and the circular economy, or an investment in an economic activity that contributes to a social objective, in particular an investment that contributes to tackling inequality or that fosters social cohesion, social integration and labor relations, or an investment in human capital or economically or socially disadvantaged communities, provided that such investments do not significantly harm any of those objectives and that the investee companies follow good governance practices, in particular with respect to sound management structures, employee relations, remuneration of staff and tax compliance.

21 *See* EU Technical Expert Group on Sustainable Finance, "Financing a Sustainable European Economy: Technical Report" (March 2020) (available here).

22 Directive (EU) 2017/828 of the European Parliament and of the Council of 17 May 2017 amending Directive 2007/36/EC as regards the encouragement of long-term shareholder engagement, available here.

23 Id.

24 Bank of England Prudential Regulation Authority, "Supervisory Statement 3/19 (SS3/19): Enhancing banks' and insurers' approaches to managing the financial risks from climate change" (April 2019) (available here).

25 Id.

26 HM Treasury, "Interim Report" (here).

27 Financial Conduct Authority, Press Release, "FCA announces proposals to improve climate-related disclosures by listed companies" (March 6, 2020) (available here). The proposed rule requires commercial companies with a UK premium listing to "state whether they comply with the recommendations of the Financial Stability Board's Taskforce on Climate-related Financial Disclosures (TCFD) and to explain any non-compliance." Financial Conduct Authority, "CP20/3: Proposals to enhance climate-related disclosures by listed issuers and clarification of existing disclosure obligations" (March 6, 2020) (available here).

28 The Taskforce was established as part of the UK's 2019 "Green Finance Strategy." HM Treasury, "Interim Report of the UK's Joint Government-Regulator TCFD Taskforce" (November 2020) (available here); HM Treasury, "A Roadmap towards mandatory climate-related disclosures" (November 2020) (available here).

29 The legislation requires disclosure that demonstrates efforts to ensure that slavery and human trafficking are not taking place within the company or along its supply chain. See Home Office, "Guidance: Publish an annual modern slavery statement" (available here).

30 The Equality Act 2010 (Gender Pay Gap Information) Regulations 2017 (available here).

31 See UK Department for Business, Energy & Industrial Strategy, "Ethnicity Pay Reporting: Government Consultation" (available here).

32 Oliver Wyman and AVPN, "Driving ESG Investing in Asia: The Imperative for Growth" (2018) (available here).

33 Id. at 7.

34 Refinitiv, "Financing A Sustainable Future for Asia" (October 2019) (available here); Aberdeen Standard Investments, "ESG Investment in Asia" (September 2019) (available here).

35 Id. at 5-6.

36 Yevgeny Kuklychev, "ESG in Infrastructure: Building a Sustainable Future for Latin America" (March 2020) (available here).

37 Jo Bruni, "Special Report: LatAm ESG Set for Post COVID-19 Growth" (June 2020) (available here).

38 Id. at 4.

39 Aaron Weinman, "Latin American Borrowers Dial Up Sustainability Efforts" (October 2020) (available here); World Economic Forum, "How a Different Kind of Investment Could Transform Latin America" (November 2020) (available here).

40 David Milstead, "Canada Sees Growth in ESG Investing as U.S. Increasingly Rejects the Trend" (October 2020) (available here); James Langton, "Canadian Institutional Investors have High Hopes for ESG Portfolios" (October 2020) (available here); Stephen Little, "Appetite for ESG Accelerates During Pandemic: RBC Survey" (October 2020) (available here).

41 Appetite for ESG Accelerates During Pandemic: RBC Survey, at 2.

42 CFA Institute, "ESG Integration in Canada" (2020) (available here).

43 Id. at 32–33.

44 Joy Williams and Alisa Kincaid, "Is Canada's Current Approach to ESG Holding Us Back?" (September 2020) (available here).

45 Torys, "Modern Slavery Legislation Introduced In Senate: Canadian Companies To Report On Prevention Of Forced And Child Labour" (November 25, 2020), available here.

46 For companies that have Canada as a place of business, do business in Canada or have assets in Canada, the proposed Act will apply if, based on their consolidated financial statements, they meet at least two of the following conditions (for at least one of its two most recent financial years): (1) has at least CA$20 million in assets, (2) has generated at least CA$40 million in revenue or (3) employs an average of at least 250 employees.

47 Commissioner Allison Herren Lee, "Playing the Long Game: The Intersection of Climate Change Risk and Financial Regulation," Keynote Remarks at PLI's 52nd Annual Institute on Securities Regulation (November 5, 2020), available here. Commissioner Caroline Crenshaw has also expressed concern about the SEC's "failure to addresss climate change risk." See Commissioner Caroline Crenshaw, "Statement on the 'Modernization' of Regulation S-K Items 101, 103, and 105," (August 26, 2020), available here.

48 See Draft Recommendation from the Investor-as-Owner Subcommittee of the SEC Investor Advisory Committee Relating to ESG Disclosure (as of May 14, 2020), available here.

49 Reuters UK, "The U.S. Federal Reserve calls out climate change as a risk for the first time" (November 9, 2020), available here.

50 Department of Labor, News Release, "U.S. Department of Labor Announces Final Rule to Protect Americans' Retirement Investments" (October 30, 2020), available here.

51 Leslie P. Norton, "Some 95% of the Comments on the Labor Department's Proposed ESG Rule Oppose it, an Analysis Shows," Barron's (August 20, 2020), available here.

52 Climate-Related Market Risk Subcommittee, Market Risk Advisory Committee of the U.S. Commodity Futures Trading Commission, "Managing Climate Risk in the U.S. Financial System" (September 2020), available here. The CFTC report finds that a "major concern for regulators is what we don't know. While understanding about particular kinds of climate risk is advancing quickly, understanding about how different types of climate risk could interact remains in an incipient stage."

53 Id. at 2.

54 Id. at 6-9.

55 Institute of International Finance, "Building a Global ESG Disclosure Framework: a Path Forward" (June 2020) (available here).

56 Institute of International Finance, "Sustainable Finance Policy and Regulation: The Case for Greater International Alignment" (March 2020), available here.

57 Global Commission on the Economy and Climate, Press Release, "Bold Climate Action Could Deliver US$26 Trillion to 2030, Finds Global Commission" (September 5, 2018), available here.

58 Global Financial Markets Association, "Sustainable Finance Survey Report" (July 2019), available here.

59 FoSDA, "Future of Sustainable Data – Initial Recommendations" (December 10, 2020), available here.

60 Id.

61 RMS and U.S. Chamber of Commerce, "Environmental, Social and Governance (ESG) Special Report" (May 2020), available here.

62 Id. at 5.

63 Business Roundtable, "Business Roundtable Redefines the Purpose of a Corporation to Promote 'An Economy That Serves All Americans'" (August 19, 2019), available here.

64 New York Department of Financial Services, "Industry Letter – The Chief Executive Officers or the Equivalents of New York State Regulated Financial Institutions – Climate Change and Financial Risks" (October 29, 2020), available here.

65 Cooley PubCo, "New report looks at board gender diversity in California" (October 15, 2020), available here. Cooley's report finds that, "in 2018, nearly 30% of boards of public companies with principal executive offices in California (183 companies) were all male, while currently there are fewer than 15 of these companies with all-male boards (3%). Of the 5,225 board seats at these California companies, 766 were held by women in 2018, while 1,275 were held by women in June 2020 – an increase of 66.5%. The vast majority of women that have been added to these boards sit on only one corporate board in California, 119 serve on two and 18 serve on three or more boards in California. Accordingly, the study calculates that it includes 1,115 female directors."

Annex A

ESG terminology

ESG topics are now the subject of significant focus by asset managers, asset owners such as pension funds and insurance companies, and other investors, as well as by proxy advisory firms, index providers, regulators and rating agencies. We highlight below the topics commonly covered within the three categories of ESG and provide definitions of some of the key terms used in ESG disclosures, reports and regulations.

Topics commonly covered within ESG

Environmental	Social	Governance
• GHG emission • Biodiversity • Climate change • Renewable energy • Energy efficiency • Air quality • Water depletion or pollution • Resource depletion • Waste management • Ozone depletion • Changes in land use • Ocean acidification • Change to nitrogen and phosphorous cycles • Raw materials usage	• Human rights • Community relations • Labor relations • Diversity • Product quality and safety • Customer privacy • Data security • Employee health and safety • Supply chain management • Responsible sourcing • Employee engagement • Employee diversity/inclusion • Child, slave and bonded labor • Pay equity • Racial justice	• Business ethics • Corporate culture • Board diversity/composition • Shareholder rights • Executive compensation • Competitive behavior • Stakeholder interaction • Internal controls • Reporting practices • Response to legal/regulator landscape • Competitive behavior • Enterprise risk management • Crisis management • Political contributions and lobbying • Anti-bribery and anti-corruption measures

General investment considerations

Active ownership: An investment process that entails engaging with portfolio companies on ESG issues (e.g., by voting) to prompt changes in corporate action and/or policies. Also known as **stewardship**.

Corporate social responsibility (CSR)/corporate responsibility: A company's commitment to ESG over and above that which is mandated by law. CSR is generally thought to flow from a "duty of care," as a responsible corporate citizen to the full range of stakeholders.

ESG integration: The addition of ESG factors to traditional financial analysis on a systematic basis.

ESG investing: The consideration of ESG factors (typically pre-determined) alongside financial factors in investment decisions, which often includes screening (typically exclusionary screening). Also known as **sustainable investing, responsible investing or socially responsible investing**.

Ethical investing: Investment that is motivated not by broader ESG considerations (and the expectation that active management of ESG risks and opportunities will improve the long-term return of an investment in a company), but rather by alignment with a set of ethical values. Ethical investing is often considered a type of sustainable investing.

Exclusion: The intentional avoidance of investment in a company or business interest. Also known as **negative screening**.

Externality: A consequence (positive or negative) of an economic activity, which is experienced by an uninvolved third party.

Impact investing: Investments in companies, funds or organizations, the purpose of which is to solve social or environmental problems (by having a positive impact in ESG terms that is measurable).

Negative screening: Affirmatively excluding entire sectors, companies or countries from a portfolio, based on moral considerations of a defined set of investors or standards relating to human rights, labor practices and the environment. Also known as **exclusionary screening**.

Positive screening: Investment in companies that demonstrate positive ESG performance relative to peers.

Product life cycle management: Refers to the all-encompassing process of managing a product as it moves through each stage of its product life from inception, through engineering design and manufacture, to service and disposal of manufactured products.

Public Benefits Corporation (PBC): A corporation organized to produce public benefit(s) and to operate in a responsible and sustainable manner, balancing among: maximizing profit for shareholders; operating in the best interests of stakeholders; and the public benefit or public benefits identified in its charter. Under the Delaware General Corporation Law, for example, public benefits corporations are those "intended to produce a public benefit or public benefits and to operate in a responsible and sustainable manner."

Resource efficiency: Refers to the efficient and sustainable use of resources, particularly natural resources.

Shareholder primacy: A theory in corporate governance holding that the primary focus of a for-profit corporation should be to maximize shareholder value (e.g., shareholder profits).

Stakeholder: A stakeholder is any person, organization, social group or society at large that is impacted by a business, a project or a particular business decision. Stakeholders can include shareholders, employees, surrounding communities, creditors, investors, customers, governments, suppliers, labor unions and trade groups.

Sustainable finance: Any form of financial service that embeds ESG criteria into investment decision-making to benefit both the investor and society more broadly. The term can cover **green bonds**, **impact investing**, **active ownership** and **microfinance**, among other initiatives and activities.

Sustainable investing: See **ESG investing**.

Sustainability: There is no single definition of the term, and many may use it interchangeably with ESG. According to the UN World Commission on Environment and Development as set forth in its 1987 report (also known as the Brundtland Commission), sustainable development is "development that meets the needs of the present without compromising the ability of future generations to meet their own needs." The SASB, in its 2017 Conceptual Framework, starts with this definition and then notes that for the purposes of its standards, "sustainability refers to corporate activities that maintain or enhance the ability of the company to create value over the long term." SASB sustainability accounting "reflects the management of a corporation's environmental and social impacts arising from production of goods and services, as well as its management of the environmental and social capitals necessary to create long-term value. It also includes the impacts that sustainability challenges have on innovation, business models and corporate governance, and vice versa."

Environmental terms

Carbon finance: Finance and resources provided to projects that are generating or are expected to generate GHG emission reductions in the form of the purchase of such emission reductions, which are tradable on the carbon market.

Carbon footprint: A measure of GHG emissions.

Carbon-neutral: The state of making no net release of carbon dioxide to the atmosphere, especially through offsetting emissions by planting trees.

Carbon offset: An action intended to compensate for the emission of carbon dioxide into the atmosphere as a result of industrial or other human activity, especially when quantified and traded as part of a commercial program.

Carbon pricing: Costs associated with the emission of carbon dioxide, measured as a fee per ton of carbon dioxide emitted or an incentive for reducing emissions.

Cleantech/greentech: Environmentally-friendly technologies and practices. The term co-exists with terms such as “green energy” and “eco-technology.”

Conference of the Parties (COP): An annual conference of countries (and in the case of the EU, a block) that joined the UN Framework Convention on Climate Change (UNFCCC), which was adopted in 1992 and entered into force in 1994. The 2020 COP will be COP 26.

Decarbonization: Relates to the reduction of greenhouse gas emissions (particularly emissions of carbon dioxide).

Financial risks: Financial risks depend on the extent to which the transition/migration to a lower carbon future occurs. The principal financial risk arises from stranded assets; financial risks can also capture a range of risks flowing from changing expectations not only of consumers and customers, but also of shareholders. Financial (or liability) risks also can arise as a result of liability claims seeking compensation for damages due to climate change-driven events.

GHG: Acronym for greenhouse gas, which encompasses any gas that absorbs infrared radiation in the atmosphere, trapping heat and contributing to the so-called “greenhouse effect.” These gases include water vapor, carbon dioxide, methane, nitrous oxide, ozone, chlorofluorocarbons, ozone, hydrofluorocarbons, sulfur hexafluoride and perfluorocarbons.

Green bonds: Debt instruments created to fund existing or new projects with environmental and/or climate benefits.

Green investing: Investments in businesses that contribute to sustainable solutions, such as renewable energy, energy efficiency, clean technology, water treatment and resource efficiency, or low-carbon infrastructure.

Greenwashing: Overstating the extent to which an investment, enterprise, business practice, or product or service is sustainable, for competitive or other reasons.

Intangibles: Costs of natural hazards which are not, or at least not easily, quantifiable or measurable in monetary terms. Often expressed as “intangible costs” or “intangible assets.”

Low-carbon economy: Economy based on low-carbon power sources with lower output of GHG emissions. See “**Paris Agreement**.”

Net zero emissions: The point at which a country produces no GHG emissions, either because it has phased out all GHG emissions or has removed a sufficient level of carbon from the atmosphere to offset the GHG emissions it releases. Also referred to as **net zero carbon** or **carbon neutrality**.

Paris Agreement: The agreement reached at COP 21 (in 2015) in which parties agreed to limit warming to well below 2°C above pre-industrial levels and ideally 1.5°C. A plan by a party to take climate action (emission-reduction targets and plans, adaptation plans or other climate action goals) is known as a nationally determined contribution (or NDC); initially these NDCs were known as intended nationally determined contributions (or INDCs), but the “intended” was dropped as part of the Paris Agreement.

Physical risks: Physical risks encompass the consequences of an increase in both the frequency and the severity of extreme weather conditions that can damage assets, both physical as well as natural. Physical risks also affect humans through loss of life or injury. Physical risks can be triggered, for example, by specific weather events, such as hurricanes, tornadoes, wildfires, droughts and flooding. Physical risks can also be triggered by longer-term shifts in climate, such as changes in precipitation, extreme weather variability and sustained higher temperatures, leading to retreat of glaciers, rise in sea levels and chronic heatwaves.

Renewables: Sources of energy that are not depleted by use, such as water, wind or solar power.

Scope 1 to 3 GHG emissions: The three types of GHG emissions categorized by the GHG Protocol. Scope 1 emissions are direct emissions from sources that are owned or controlled by the reporting company, which includes on-site fossil fuel combustion and fleet fuel consumption. Scope 2 emissions are indirect emissions from the generation of electricity, heat, steam or cooling purchased by the reporting company. Scope 3 emissions cover all other indirect emissions that arise in a reporting company’s value chain, such as business travel, purchased goods and services, employee commuting, transportation and distribution of products, solid waste disposal and wastewater treatment.

Stranded assets: Assets that have suffered from unanticipated or premature write-downs, devaluations or conversion to liabilities. This can also refer to an asset that has become obsolete or non-performing.

Transition: A shift in policy, legal requirements, technology, business models, societal preferences or market forces targeted at a lower-carbon and more resilient economy. Often used in connection when assessing the risks and costs (transition risks and costs) associated with any such shift.

True cost: The concept of capturing the full cost of a good or service by factoring in the difference between the market price of such good or service and its comprehensive societal cost (e.g., factoring the cost of negative (and theoretically positive) externalities into the pricing of such good or service).

Social

Circular economy: An economy based on principles of keeping products, resources and other materials in use as long as possible, extracting the greatest value from them while in use, and then regenerating products, resources and other materials at the end of serviceable life. The ultimate goal is to eliminate waste and break the traditional (linear) cycle of make, use and dispose.

Civil society: Encompasses a spectrum of non-governmental actors (individuals and organizations) focused on social action. These actors can include, among others, non-governmental organizations (NGOs), online groups, social movements, women's groups, indigenous groups, faith-based groups, labor unions, social entrepreneurs, research organizations, and community-based and other grassroots groups. Civil society organizations are also referred to as **CSOs**.

Conflict minerals: Minerals that are mined where armed conflict and human rights abuses are rife. These include tin, tantalum and tungsten (derivatives of cassiterite, columbite-tantalite (coltan) and wolframite) as well as gold (also known as "3TG") sourced from the Democratic Republic of Congo and surrounding countries, which are not deemed "DRC conflict-free." To be DRC conflict-free, the extraction of the minerals cannot directly or indirectly have benefitted armed groups in the covered countries.

D&I and DEI: Diversity and inclusion or diversity, equity and inclusion broadly outline the efforts – programs and policies – that companies and organizations adopt to create a more welcoming environment and encourage representation and participation from a diverse group of people. Diversity and inclusion efforts generally focus on increasing the representation of women, people of color and members of the LGBTQ+ community, among others.

Fair trade: Arrangements designed to promote concerns for social, economic and environmental wellbeing of marginalized small producers, while not profiting at the expense of these producers. The World Fair Trade Organization (one of various international labeling organizations) lists 10 principles of fair trade: opportunities for disadvantaged producers; transparency and accountability; fair trade practices; fair payment; no child labor/forced labor; no discrimination/gender equality/freedom of association; good working conditions; capacity building; promote fair trade; and respect for the environment.

Kimberly process: A commitment to reduce the flow of "conflict diamonds" in the global supply chain. Conflict diamonds are rough diamonds used to finance wars against governments.

Modern slavery: Exploitation of people who are coerced into service or other forms of servitude, often with the threat of violence. Examples include bonded labor, forced marriage, human trafficking and organ trafficking.

Responsible supply chains: A term that broadly covers supply chain management, responsible procurement and supply chain engagement.

Social bonds: Debt instruments created to fund existing or new projects with positive social benefits; the "use of proceeds" of a social bond issuance are used for pre-specified social projects. Social bonds are sometimes also referred to as social impact bonds.

Social equity: Issues relating to the provisions of equal opportunities for minorities, LGBTQ+, women, individuals with disabilities and potentially other identifiable groups such as veterans.

Social washing: Statements or policies that make a company appear more socially responsible than it actually is.

Supply chain diversity: Broadening the sources of supply and manufacturing to reduce the dependence on a single supplier or manufacturer, or dependence on suppliers or manufacturers in a particular country.

Sustainability bonds: Debt instruments, the proceeds of which are earmarked to exclusively fund eligible projects, processes and technologies that have a positive environmental and/or social impact.

Trafficking: Recruitment, transportation, transfer, harboring or receipt of individuals by means of force, threat of force, coercion, or abuse of power or position of vulnerability, for the purpose of exploitation. Exploitation can include prostitution or other forms of sexual exploitation, forced labor or services, slavery or practices similar to slavery, servitude or the removal of human organs.

Measuring ESG

B Corporation: A for-profit company that B-Lab, a global non-profit organization, has certified to meet certain social and environmental performance standards. The certification assessment examines, for example, how a company's operations and business model impacts its workers, community, environment and customers, by looking at a range of issues, such as the company's supply chain, input materials, charitable giving and employee benefits.

CDP: Formerly the Carbon Disclosure Project, an NGO that supports companies and cities in disclosure of environmental impacts.

Coalition for Environmentally Responsible Economies (CERES): A non-profit organization based in the U.S. that comprises investors and environmental, religious and public interest groups. The coalition's purpose is to promote investment policies that are environmentally, socially and financially sound.

Equator principles: A risk management framework, adopted by financial institutions, for determining, assessing and managing environmental and social risk in projects. The framework is primarily intended to provide a minimum standard for due diligence and monitoring, to support responsible risk decision-making.

GIIN: Global Impact Investing Network, an NGO that works with impact investors to accelerate the scale and effectiveness of their investments.

GRI: Global Reporting Initiative, an NGO focused on sustainability reporting. GRI publishes the GRI Standards.

IIRC: International Integrated Reporting Council, which established the International Integrated Reporting Framework.

IIPC: Intergovernmental Panel on Climate Change, established by the UN Environment Programme and the World Meteorological Organization.

SASB: Sustainability Accounting Standards Board, whose mission is to help companies report on the sustainability topics that matter most to their investors. SASB states that it identifies financially material issues, which are the issues that are reasonably likely to impact the financial condition or operating performance of a company and therefore are most important to investors.

SDGs: Sustainable Development Goals, which describe a set of 17 goals (together with 169 targets) adopted in 2015 by the UN General Assembly as part of the 2030 Agenda for Sustainable Development, which builds on the Millennium Development Goals. As noted in the Agenda, the SDGs "seek to realize the human rights of all and to achieve gender equality and the empowerment of all women and girls. They are integrated and indivisible and balance the three dimensions of sustainable development: the economic, social and environmental."

TCFD: Task Force on Climate-related Financial Disclosures, created by the Financial Stability Board (FSB) to establish uniformity to climate-related risk disclosures by companies. In 2017, the TCFD published a set of recommendations for global companies on how to disclose climate-related financial risks, aimed at promoting more informed investment, credit and insurance underwriting decisions by companies and their investors. In February 2020, the TCFD announced that it had signed up more than 1,000 supporters of its recommendations, in its words, "signifying a major shift among market participants in acknowledging that climate change presents a financial risk."

UNEP Finance Initiative: A global partnership established between the United Nations Environment Program and the financial sector to draw up a global sustainability framework.

UNGC: United Nations Global Compact, which encourages businesses to adopt socially responsible and sustainable policies based on 10 principles, and to report on them.

UN PRI: United Nations Principles for Responsible Investment, consisting of six investment principles for integrating ESG principles into investment decisions. The PRI is also an independent NGO that is a leading proponent of responsible investing, based on the principles; it currently has over 3,000 signatories.

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