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Sustainability & ESG Year in Review: Key Takeaways

This client alert, part of a series focused on environmental, social and governance ("ESG") disclosure and regulatory developments, should be read together with our ESG Lexicon, available here, which provides definitions of some of the key terms used in ESG reports, disclosures and regulations.

2020 ESG Trends

In a year overshadowed by the Covid-19 global pandemic, many questioned whether the momentum ESG experienced leading up to the crisis was sustainable, or if companies would decide to focus on other priorities. That concern was laid to rest when the pandemic was followed rapidly by protests focused on racial and social injustice and other unrest, and ESG initiatives continued to be prominent in both the public and private sectors. ESG has proven to have genuine staying power with an array of very influential stakeholders, including governments, investors, employees, activists, NGOs and related constituencies taking up the mantle. We examine some of the key trends in ESG investments, reporting standards and regulatory regimes during 2020:

- *Commitments* – A confluence of social and economic factors and a growing awareness of the implications of climate change, including among asset managers and investors, led in 2020 to greater focus on ESG themes among stakeholders, spurring companies to enhance their ESG disclosures and commitments, increasing both their visibility and scrutiny.
- *Diversity, Equity and Inclusion* – Awareness of the economic and social value of diversity, equity and inclusion rose dramatically in 2020, as stakeholders pushed for greater attention to the "S" of ESG.
- *Regulation* – EU and UK regulators in particular sharply increased their focus on ESG-related disclosures, including the financial risks that could arise due to climate change.
- *Reporting Consolidation* – 2020 saw accounting and other industry leaders respond to calls to simplify and consolidate today's inconsistent and competing ESG reporting frameworks and standards.

ESG by the Numbers

≥1 woman director on all S&P 500 boards

Every S&P 500 board now has at least one woman director. Of all S&P 500 directors, 28% are women, up from 26% in 2019 and 16% in 2010. Moreover, 59% of all new independent directors are women or diverse men.[1]

44% of total US inflows are from BlackRock's sustainability products

Some 71% of US net inflows through Q3 2020 have been directed to passive sustainable funds, with BlackRock's three sustainability iShares products attracting over $13.4 billion (44% of total US inflows). This contrasts with European funds, where over 70% of total net inflows have gone to active sustainable funds.[2]

47% of ESG proxy proposals received significant support

2020 saw a significant increase in support for ESG proxy votes by investors. Nearly half (47%) of all environmental- or social-related proposals for US companies received *at least* 30% support. Between 2010-2017 levels of support for similar proposals never exceeded 30%.[3]

52 companies disclose EEO-1 reports

Fifty-two companies now disclose their Employer Information Report EEO-1, considered the "gold standard" of workforce gender, racial and ethnic disclosures. An analysis by JUST Capital found that 20 new companies began disclosing their EEO-1 reports in 2020, but approximately 70% of companies in the Russell 1000 Index still disclose no information on workforce race or ethnicity.[4]

70% of ESG funds outperformed peers

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.[5] Moreover, according to a Fidelity International report, stocks with high ESG ratings outperformed the benchmark in 2020, while stocks with poor ESG performance significantly underperformed. The same report also showed stocks with improving ESG performance outperformed those with deteriorating ESG performance by 4.7 percentage points.[6]

77% of Fortune 100 companies disclosed ESG-related initiatives and commitments

Voluntary disclosures by companies are increasing. In 2020, 77% of Fortune 100 companies included information on human capital and environmental initiatives and commitments in their proxy statement disclosures.[7]

100 companies have launched or are developing impact-weighted accounts

Roughly 100 large companies currently have or are in the process of creating "impact-weighted" accounts, which report the impacts the organization has on society in monetary terms alongside financial accounts. One such example is Danone, which released a "carbon adjusted" EPS figure.[8] LafargeHolcim's 'Integrated Profit & Loss Statement' measures the company's positive and negative financial impact, socio-economic impact, environmental impact, and impact on suppliers.[9] And SK Group includes in their annual sustainability report measures of the positive and negative social value generated alongside economic performance.[10]

$30.7 billion net inflows into US ESG funds

Net inflows[11] into ESG funds available to US investors skyrocketed, totaling $30.7 billion through the first three quarters of 2020, shattering record inflows set in 2019, representing a roughly 50% increase from 2019. European ESG funds saw net inflows of $61.1 billion in Q3 alone, with sustainable funds attracting 40% of all inflows. Globally, net inflows into ESG funds surpassed $190 billion through Q3 2020.[12]

$17.1 trillion invested with sustainable mandate

A 2020 study from the SIF Foundation (The Forum for Sustainable and Responsible Investment) found that roughly one in three dollars invested in the United States — or $17.1tn — has a sustainability mandate.[13]

Commitments

As the markets collapsed in early March, some predicted that companies would retreat from their ESG engagements and focus on financial returns and, in some cases, survival. Instead, ESG engagement and commitments mushroomed.[14] In 2020, three concurrent crises – the Covid-19 pandemic, the Black Lives Matter movement, and the wildfires in Australia and along the western coast of the United States – provided propellant for shifts in stakeholder demands and corporate action. For example, consumers called on the fashion industry to address modern slavery issues,[15] and shareholders pushed energy companies to better align their activities with the Paris Agreement.[16]

Nike promised to eliminate the use of hazardous chemicals throughout its supply chain and to fully disclose its suppliers' factories.[17]

Gap joined Textile Exchange's 2025 Sustainable Cotton Challenge and the US Cotton Trust Protocol in furtherance of their pledge to source 100% sustainable cotton by 2025.[18]

Starbucks set a goal to achieve Black, Indigenous and people of color representation of 30% or more at all corporate levels and 40% or more of all retail and manufacturing roles by 2025.[19]

JPMorgan Chase committed $30 billion over the next five years to advance economic opportunity in Black and Latinx communities.[20]

Walmart pledged $100 million over the next five years to create a center on racial equity.[21]

Apple announced its business and manufacturing supply chain will be carbon neutral by 2030.[22]

Ford stated it intends to be carbon neutral globally by 2050.[23]

Target fortified a commitment to its employees by increasing its starting wage to $15 an hour and providing additional health benefits; Target invested $1 billion more in its work force in 2020.[24]

BMW will tie executive pay to its climate goals of reducing C02 emissions by millions of tonnes a year by 2030.[25]

Diversity, Equity and Inclusion

- In 2020, stakeholders increasingly sought more engagement, transparency, data and analytics around social issues. While the "E" issues remained incredibly important, 2020 catapulted "S" issues to the forefront.

- Activist investors filed nearly a dozen shareholder derivative lawsuits alleging that companies made false or misleading statements about their commitments to diversity. Many companies announced new public commitments to board diversity or linked executive compensation to diversity targets.[26] California passed a law requiring publicly held companies headquartered in the state to increase the diversity of their boards by 2023.[27] Industry standard bearers also weighed in, as proxy advisory firms ISS and Glass Lewis adopted voting policies that will effectively push larger public companies to increase diversity on their boards by 2022,[28] and Nasdaq proposed board diversity and disclosure requirements as a condition to continued listing (see our client alert here).[29]

Regulation

Around the globe, ESG regulation continued to evolve:

- In April 2020, the European Supervisory Authorities sent out draft regulatory technical standards ("RTSs") that provided guidance on how disclosure obligations should be met. The consultation sets out proposals for content, methodology and presentation of ESG disclosures at the AIFM and the AIF level, as well as for the DNSH principle under the Taxonomy Regulation (see our client alert here). The final RTSs have been delayed, and are not likely to apply until January 2022 (see our client alert here).

- Climate change disclosures were a chief focus of international regulators in 2020.

  - The New York State Department of Financial Services became the first US regulator of financial institutions to publish expectations for regulated institutions in relation to climate change risk management (see our client alert here).

  - The Federal Reserve examined climate change risks in its twice-yearly financial stability report for the first time,[30] and announced it had formally joined the Network of Central Banks and Supervisors for Greening the Financial System.[31]

  - The United Kingdom announced its intention to require such disclosures across seven key sectors of the UK economy by 2025, along with a roadmap to achieving its recommendations (see our client alert here).[32]

Reporting Consolidation

Significant steps were taken in 2020 to heed the calls for unified ESG reporting frameworks and standards. In September and November 2020 alone:

- Five leading standard setters for voluntary ESG reporting – the Global Reporting Initiative (GRI), Climate Disclosure Standards Board (CDSB), Sustainability Accounting Standards Board (SASB), International Integrated Reporting Council (IIRC) and CDP Global (formerly the Carbon Disclosure Project) – issued a joint statement of intent, announcing a commitment to create a comprehensive corporate reporting system (see our client alert here).[33]

- The International Financial Reporting Standards (IFRS) Foundation published a proposal to create a new, global Sustainability Standards Board.[34] 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 (see our client alert here).[35]

- The IIRC and SASB announced their intent to merge into a single unified organization: the Value Reporting Foundation (VRF).[36] The VRF will maintain the Integrated Reporting Framework.

ESG Insights from *Paul, Weiss* Roundtables and Webinars

At a time of foment and debate over ESG standards and board responsibilities, *Paul, Weiss* brought ESG thought leaders together numerous times to plumb the most important trends in 2020 and discuss expectations for 2021.

In the second half of 2020, *Paul, Weiss* hosted six virtual roundtables and webinars focused on ESG, particularly as it intersects with the legal sector. These sessions collectively brought together over 1,000 senior executives, academics and industry leaders, including general counsels, corporate secretaries, board members, heads of sustainability and ESG, and DEI experts from a broad cross-section of major corporations, universities and ESG organizations. The panels tackled a host of topics, from trends in sustainable finance and FinTech, to the transition to the Biden administration, to what it means to "live the values" of ESG. Featured speakers shared their insights on the trends that gained in prominence in 2020, and what they expect to see 2021.

During October's "Spotlight on the 'G' in ESG: Societal Shifts Collide with Traditional Corporate Governance" roundtable, Nasdaq corporate secretary Joan Conley shared that, in 2020, the convergence of the coronavirus pandemic, the economic crisis and the racial justice movement spurred conversations about addressing inequalities in the workforce. Joan opined that the E and S have become as prominent as, if not more prominent than, the G in ESG.

ESG as an expression of corporate values. Speakers frequently highlighted the importance of corporate values in driving ESG initiatives. Georgetown Law Professor and FinTech expert Chris Brummer noted that, "the values of a more diverse and international and younger demographic is going to change... how people do business. When you express certain kinds of values earlier, your longer-term value proposition is going to be stronger."

Importance of engaging with stakeholders. During a September Securities Industry and Financial Markets Association (SIFMA) webinar, SVB Financial Group General Counsel Michael Zuckert said the best way for lawyers to get up to speed on ESG issues is to be "really good at listening" and to understand what your employees, your investors and other stakeholders are telling you.

Beth Sasfai, Chief ESG Officer at Verizon, echoed Zuckert's sentiments when she discussed Verizon's decision to use the SASB standards for disclosure early last year. "We spent time engaging with our institutional investors, asking basic questions like: What reporting frameworks are most useful to you for investment decision-making purposes?... Where do you prefer we report our ESG-related information?... The feedback we gained through investor engagement helped us determine that focusing on the SASB framework made sense for Verizon."[37]

Looking Ahead

The one thing that is certain is there will be change. As Michelle Greene, President of the Long-Term Stock Exchange stated, "we are entering a new type of era." Given President-elect Biden's promise to rejoin the Paris Climate Agreement and other early indications of his administration's approach to ESG, as well as increasingly prescriptive sustainability-related regulations coming out of the European Union and the United Kingdom, 2021 is likely to bring a wave of new ESG proposals and regulations. Companies around the world, and particularly those with international footprints across multiple jurisdictions, should closely monitor ESG regulatory developments and develop a strategy for potential escalations in disclosure requirements. *Paul, Weiss* Chairman Brad Karp said he believes that “the SEC will likely standardize disclosure terms related to ESG. We’re likely to see increased ESG enforcement and regulatory activity across industries. If I’m a general counsel or chief legal officer, I would try to get ahead of these issues so that my company is not caught flat-footed as this new reality takes hold.” Former Attorney General Loretta Lynch suggested that, in 2021, “you are going to see scrutiny that goes beyond regulatory scrutiny to environmental justice, to racial inequality and ESG more broadly. Certain industries that may have been seen as contributors to systemic inequality may want to look at their role in undoing that inequality.”

Investors can be expected to demand more disclosure regarding ESG-related investments to spot and avoid instances of greenwashing or social washing.[38] Moreover, EU regulations that require EU fund managers and non-EU fund managers marketing funds in the EU to make new disclosures related to sustainability will become effective in 2021 (see our client alerts here and here), adding further market pressure towards enhanced ESG disclosures.

To the extent 2020 can be described as the year the market embraced the significance of ESG, we anticipate that a key theme for ESG in 2021 will be accountability. Since more and more companies expanded their ESG commitments in 2020, stakeholders will be looking for data that demonstrates progress towards those commitments.

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This memorandum is not intended to provide legal advice, and no legal or business decision should be based on its content. Questions concerning issues addressed in this memorandum should be directed to:

Mark S. Bergman
+44-20-7367-1601
mbergman@paulweiss.com

Ariel J. Deckelbaum
+1-212-373-3546
ajdeckelbaum@paulweiss.com

Victoria Forrester
+1-212-373-3595
vforrester@paulweiss.com

Brad S. Karp
+1-212-373-3316
bkarp@paulweiss.com

Scott P. Grader
+1-212-373-3284
sgrader@paulweiss.com

Frances F. Mi
+1-212-373-3185
fmi@paulweiss.com

David G. Curran
Chief Sustainability/
ESG Officer
+1-212-373-2558
dcurran@paulweiss.com

ESG Counsel Larcy Cooper, ESG Associate Sofía D. Martos and ESG Practice Attorney Madhuri Pavamani contributed to this Client Memorandum.

1 SpencerStuart, "2020 U.S. SpencerStuart Board Index," available here.

2 Morningstar, "Global Sustainable Fund Flows: Q3 2020 in Review" (October 2020), available here.

3 Kosmas Papadopoulos, Rodolfo Araujo and Simon Toms, "ESG Drivers and the COVID-19 Catalyst," *Harvard Law School Forum on Corporate Governance* (December 27, 2020), available here; ISS Voting Analytics.

4 Kavya Vaghul, "A Small Fraction of Corporations Share Diversity Data, but Disclosure is Rapidly on the Rise" (December 17, 2020), available here.

5 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 fund 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 a 275% increase in cash going into responsible investment funds during the first nine months of 2020, compared to the same period in 2019, increasing from £1.9 billion to £7.1 billion. The investment boom is attributed to increasing concerns over climate change and a growing number of Millennial investors. Data from Morningstar also showed global assets in sustainable funds hitting £930 billion in the third quarter of 2020, a record high. Financial Times Adviser, "ESG inflows quadruple in 2020" (November 5, 2020), available here.

6 Fidelity International, "Putting sustainability to the test: ESG outperformance amid volatility" (November 2020), available here.

7 Steve W. Klemash, Rani Doyle and Jamie C. Smith. "Four ESG Highlights from the 2020 Proxy Season," *Harvard Law School Forum on Corporate Governance* (August 23, 2020), available here.

8 Richard Barker, Robert G. Eccles and Geroge Serafeim, "The Future of ESG is … Accounting?" *Harvard Business Review* (December 3, 2020), available here. Information on Danone's "Carbon adjusted" EPS is available here.

9 LafargeHolcim, Integrated Profit and Loss Statement (IP&L) (2019), available here.

10 SK Group, SK Hynix Report (2020), available here. Social value measurement includes, but is not limited to, the positive impact from employment, dividends, tax payments, environmental performance, direct social contributions and donations, and volunteer work.

[11] Net inflows are all the monies flowing into a company/fund/investment vehicle through new investments, less divestments or other outflows.

[12] Morningstar, "Global Sustainable Fund Flows: Q3 2020 in Review" (October 2020), available here; Greg Iacurci, "Money Moving into Environmental Funds Shatters Previous Records," *CNBC*, (January 14, 2020), available here.; Casey Wagner and Claire Ballentine, "Record Flows Pour into ESG Funds as their "Wokeness" is Debated," *Bloomberg*, (October 25, 2020), available here.

[13] Michael Martin, "ESG: a trend we can't afford to ignore," *Financial Times* (November 26, 2020), available here.

[14] Gillian Tett et al, "What We Got Right – and Wrong – in 2020," *Financial Times* (December 23, 2020), available here.

[15] Cherida Patterson, "Slavery is Still Happening Today, and the Proof is in Your Closet," Swaay (August 25, 2020), available here.

[16] Rob Berridge, "How Climate Proposals Fared During the 2020 Proxy Season," GreenBiz (September 14, 2020), available here.

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[18] Sarah George, "Gap Targets 100% Sustainably Sourced Cotton by 2025," Edie Newsroom (December 9, 2020), available here.

[19] Starbucks Press Release, "Starbucks Announces New Commitments to Advance Racial and Social Equity," (October 14, 2020), available here.

[20] JPMorgan Chase Press Release, "JPMorgan Chase Commits $30 Billion to Advance Racial Equity," (October 8, 2020), available here.

[21] Joseph Guzman, "Walmart CEO Pledges $100 Million to Address Systemic Racism," The Hill (June 5, 2020), available here.

[22] Leo Kelion, "Apple's 2030 Carbon-Neutral Pledge Covers Itself and Suppliers," BBC (July 21, 2020), available here.

[23] Ford Motor Company, Press Release, "Ford Expands Climate Change Goals, Sets Target to Become Carbon Neutral by 2050," Ford Media Center (June 24, 2020), available here. In addition, the list of companies setting net-zero emissions targets continued to grow to more than 1,500 companies, representing a combined revenue of over $11.4 trillion. *See* UN Climate Press Release, "Commitments to Net Zero Double in Less Than a Year," (September 21, 2020), available here.

[24] Shelley E Kohan, "Target is Doing the Right Thing By Investing Heavily in Employees and Customers," Forbes (June 18, 2020), available here.

[25] Yahoo Finance, "BMW vows to tie executive pay to climate goals," (July 27, 2020), available here.

[26] Christoph Rauwald, "Volkswagen to tie top executives' bonuses with hitting ESG targets," Forbes (December 19, 2020), available here. Charlie Hodkinson-Ashford, "Making Sustainability Pay: Company Examples of ESG Incentives," Corporate Citizenship (May 28, 2020), available here.

[27] Michal Lev-Ram, "California's Board Diversity Law Led to 670 Board Seats Filled By Women, Report Finds," Forbes (October 13, 2020), available here.

[28] Shaun Bisman, Bonnie Schindler, "Biggest Proxy Firms Issue 2021 Policy Updates," Directors & Boards (December 10, 2020), available here.

[29] Alexander Osipovich, Akane Otani, "Nasdaq Seeks Board Diversity Rule That Most Listed Firms Won't Meet," WSJ (December 1, 2020), available here.

[30] The financial stability report includes a section titled, "The Implications of Climate Change for Financial Stability," which focuses on "how climate change, which increases the likelihood of dislocations and disruptions in the economy, is likely to increase financial shocks and financial system vulnerabilities that could further amplify these shocks." Board of Governors of the Federal Reserve System, "Financial Stability Report" (November 2020), available here.

[31] Board of Governors of the Federal Reserve System, Press Release, "Federal Reserve Board announces it has formally joined the Network of Central Banks and Supervisors for Greening the Financial System, or NGFS, as a member" (December 15, 2020), available here.

[32] The UK "roadmap" presents a five-year timeline of planned or potential regulatory actions or legislative measures across seven categories of organizations: listed commercial companies; UK-registered large private companies; banks and building societies; insurance companies; asset managers; life insurers and regulated pension schemes; and occupational pension schemes. The UK Government expects a significant portion of mandatory requirements to be in place by 2023.

[34] 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 standardisation assists in providing a level playing field for companies that prepare reports and international comparability for investors."

[35] World Economic Forum, News Release, "Measuring Stakeholder Capitalism: Top Global Companies Take Action on Universal ESG Reporting" (September 22, 2020), available here. The WEF et al believe companies can use this set of universal ESG metrics and disclosures for reporting purposes regardless of their industry or region.

[36] SASB, Press Release, "IIRC and SASB Announce Intent to Merge in Major Step Towards Simplifying the Corporate Reporting System," (November 25, 2020), available here.

[37] SASB, "Verizon: Sending A Strong Signal to Investors," (October 20, 2020), available here.

[38] Greenwashing is overstating the extent to which an investment, enterprise, business practice, or product or service is sustainable for competitive or other reasons. Social washing is statements or policies that make a company appear more socially responsible than it actually is. *Paul, Weiss* ESG Lexicon (2020), available here.