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# Sustainability & ESG: 2021 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.*

## 2021 ESG Developments

In the aftermath of the initial effects of the Coronavirus pandemic, many wondered if the key ESG issues brought to light in 2020 would be pushed aside in the new year. Instead, as we expected, ESG issues assumed greater prominence and consideration by regulators, employees, customers and other stakeholders in 2021. Organizations increasingly incorporated ESG factors into their general operations and governance. Some companies have chosen to focus on ESG because of investor or board pressure, others to protect themselves from the scrutiny of regulators, shareholder and activist investors, and others in preparation for increased government regulation. 2021 saw unprecedented records of investments in ESG, reported disclosures by major organizations, and filings of shareholder proposals. Rulemaking and reporting standardization was also a major focus throughout the year, as regulators increasingly made ESG considerations part of their agendas. Other prominent trends included:

- *Compliance* – As interest in ESG has ramped up over the past year, compliance has been top of mind for investors, regulators and other stakeholders. They desire to see that companies are not just talking the talk, but are also walking the walk and meeting their ESG objectives. Regulators are looking for gaps between what companies claim in their filings and what their actual practices are. Many organizations have come under fire during the last year for accusations of misrepresenting or exaggerating the sustainable nature of their products or investments. In 2021, US and global regulators launched greenwashing investigations into a number of major organizations, a trend expected to continue in the new year.[1] In this era of heightened scrutiny, good compliance is key to long-term success.

- *Diversity, Equity and Inclusion (DEI)* – Following the racial justice movement sparked in the summer of 2020, DEI continued to be a priority for organizations and regulators over the past year. The SEC has indicated that DEI rulemaking is a priority for the administration and in August approved Nasdaq's board diversity rules. Focus on DEI at the corporate level continues to be primarily on Board and C-Suite level diversity; though certainly not to the exclusion of the broader employee pool.

- *Shareholder Activism* – Shareholder groups are increasingly pressuring companies to further ESG objectives. This proxy season saw record-breaking support for shareholder proposals relating to environmental and social matters, with 34 proposals receiving majority shareholder support, up from the previous record of 21 supported proposals in 2020.[2] In November, Microsoft shareholders approved a shareholder proposal with 78% approval which asked for sexual harassment claims to be transparently addressed through independent investigations and reporting.[3]

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1 Bloomberg, "Regulators Intensify ESG Scrutiny as Greenwashing Explodes" (September 1, 2021), available here.

2 Bloomberg Green, "The World's Biggest Investors Get Louder About ESG" (June 9, 2021), available here.

3 Business Wire, "Investors Cast Majority Vote Pressing for Sexual Harassment Accountability at Microsoft Annual Meeting" (November 30, 2021), available here.

## ESG by the Numbers

Assets in US sustainable funds totaled more than **$330 BILLION** as of September 2021, **1.8 times** the amount from the 3rd quarter of 2020. (Source: *Morningstar*)

By June 2021, there were globally **169 ESG shareholder proposals** in the 2021 annual general meeting season, which had garnered average support of almost 34% of shares voted. In comparison, only 171 resolutions were filed in the whole of 2020, with support averaging less than 29% of shares voted. (Source: *Bloomberg*)

In 2021, ESG issues have been discussed in close to **20%** of global corporate earnings calls. (Source: *MarketWatch*)

**150** companies in the S&P 500 cited the term ESG during their earnings calls. (Source: FactSet)

Globally, sustainable fund assets reached **$3.9 TRILLION** in the third quarter. (Source: *Reuters*)

In 2021, **34** regulatory bodies and standard setters in 12 markets undertook official consultations on ESG. (Source: MSCI)

In 2021, **95%** of S&P 500 companies have made detailed ESG disclosures using CDP, SASB, GRI, TCFD and/or IR standards and published them online. 74% of S&P 500 companies have referred to CDP, 72% to SASB, 66% to GRI, and 48% to TCFD in their reports. (Source: Center for Audit Quality)

The 2021 Federated Hermes ESG Investing Survey, a survey of US investment professionals, found that: (Source: Federated Hermes)

**81% of investors consider ESG factors** in their investment process and

**38% of institutions have ESG considerations** in their investment policy statement.

**54% of investors believe better ESG practices** by companies **result in stronger returns/valuations** over time.

**69% of institutional investors believe responsible investing will be a positive for global climate** concerns.

**63%** The public has consistently maintained that corporate leadership is the driving force behind just business behavior. A survey by JUST Capital found that the majority of respondents (**63%**) believe CEOs of large companies have a responsibility to take a stand on important societal issues. (Source: JUST Capital)

## Regulatory Developments

While ESG disclosures in the US are currently largely voluntary, globally, new regulations increasingly take ESG concerns into account, particularly in Europe and the UK. In recent months, the domestic and international regulatory environment seems to be shifting, moving ESG disclosures from a voluntary business initiative to a mandatory legal one in some jurisdictions. We anticipate that regulators will continue to sharpen their focus on ESG in the coming months and years.

### US Executive, Regulatory and Legislative Developments

Following President Biden's inauguration in January 2021, there has been significant movement by the US on key ESG issues and regulation, in particular around disclosure of ESG risks. Focus has primarily been on the "E" of ESG, including climate change and

carbon emissions, mobilizing a government-wide effort across multiple branches of government and federal agencies – spearheaded by the SEC – to accelerate US commitments and initiatives on sustainability.

*The Executive Branch*

- On January 28, the Biden Administration paused a rule proposed in the final days of the Trump Administration that would have required banks to provide quantitative measurements to support decisions not to lend to industries like oil and gas or firearms, allowing the next Comptroller of the Currency to review it.[4]

- On May 20, President Biden issued an Executive Order on Climate-Related Financial Risk, calling on the federal government to take concrete steps to mitigate physical and transitional risks of climate change, including a review of climate-related disclosures (see our client alert here).

- On November 2, the US announced new methane regulations from the Environmental Protection Agency and Pipeline and Hazardous Materials Safety Administration as part of the Global Methane Pledge initiative launched at the UN Climate Change Conference (COP 26) in Glasgow.[5]

- On December 8, President Biden issued an Executive Order on Catalyzing Clean Energy Industries and Jobs Through Federal Sustainability, directing the US government to achieve net-zero carbon emissions by 2050 through billions of dollars of spending on a combination of electric vehicles, clean power and upgraded buildings.[6]

*US Securities and Exchange Commission (SEC)*

- On March 4, the SEC announced the creation of a Climate and ESG Task Force in its Division of Enforcement focused on "identifying any material gaps or misstatements in issuers' disclosure of climate risks under existing rules" and which represents a Division-wide effort to develop initiatives to proactively identify ESG-related misconduct (see our client alert here).

- On March 15, the SEC requested public input on climate change disclosure rulemaking.[7] The comment period closed on June 14, 2021 (see our client alert here).

- On April 9, the SEC's Division of Examinations published a Risk Alert highlighting observations of deficiencies and internal control weaknesses from recent examinations of investment advisers offering products, including private funds, whose investment strategies incorporate ESG factors (see our client alert here).

- On June 11, the SEC's Office of Information and Regulatory Affairs released their Spring 2021 Unified Agenda of Regulatory and Deregulatory Actions and indicated that rulemaking on "disclosure relating to climate risk, human capital, including workforce diversity and corporate board diversity, and cybersecurity risk" is a priority for the agency.[8]

- On August 6, the SEC approved Nasdaq's board diversity requirements, which will apply to all Nasdaq-listed companies, including non-US issuers, smaller-reporting companies and controlled companies (see our client alert here).

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[4] Office of the Comptroller of the Currency, News Release, "OCC Puts Hold on Fair Access Rule" (January 28, 2021), available here.

[5] The White House, "Joint US-EU Press Release on the Global Methane Pledge" (September 18, 2021), available here.

[6] The White House, "Executive Order on Catalyzing Clean Energy Industries and Jobs Through Federal Sustainability" (December 8, 2021), available here.

[7] US Securities and Exchange Commission, Statement, "Public Input Welcomed on Climate Change Disclosures" (March 15, 2021), available here.

[8] US Securities and Exchange Commission, Statement, "SEC Announces Annual Regulatory Agenda" (June 11, 2021), available here.

- On September 22, the SEC's Division of Corporation Finance issued a sample comment letter reflecting comments on climate disclosure that the Staff may issue when reviewing companies' public filings. The issuance of these comments reflects the SEC's increased scrutiny of climate disclosures, and follows the call by then Acting Chair Allison Herren Lee in February 2021 for the staff of the Division of Corporation Finance to "enhance its focus on climate-related disclosure in public company filings." (see our client alert here).

- On November 3, the SEC Division of Corporate Finance issued a staff guidance letter that will make it more difficult for issuers to exclude shareholder proposals that raise issues with significant social and environmental impact (see our client alert here).

*Commodity Futures Trading Commission (CFTC)*

- On March 17, the CFTC announced the establishment of a Climate Risk Unit to address climate-related risk and transition to low-carbon economy (see our client alert here).

*US Department of Labor (DOL)*

- On October 14, the DOL published proposed amendments to its "investment duties" regulation rule that would clarify that ESG factors may be appropriate considerations for ERISA Plan fiduciaries when making investment or proxy voting decisions on behalf of ERISA Plans (see our client alert here).

*US Congress*

- On June 16, the US House of Representatives passed H.R. 1187, the Corporate Governance Improvement and Investor Protection Act. If passed into law, this would require public companies to provide more comprehensive ESG disclosures in financial statements (e.g., metrics tied to greenhouse gas emissions, fossil-fuel-related assets and other risks posed by the changing climate and compensation information regarding executive officers and employees) and require the SEC to report on shareholder collective action and small business ESG compliance.[9] The bill was received in the Senate and referred to the Committee on Banking, Housing and Urban Affairs.

**Global, Intergovernmental and Standards Developments**

Globally, there has been significant movement around ESG regulation and disclosure requirements. We highlight below some key decisions from the last year:

- On July 29, the EU announced a proposal that would regulate the green bond industry. This proposal is the first of its kind and would create standardization in terms of what qualifies as a green asset and how those assets can be packaged.[10]

- Announced by July 27, Sustainable Finance Disclosure Regulation (SFDR), Corporate Sustainability Reporting Directive (CSRD), and green taxonomy regulations in the EU have made it clearer what ESG metrics companies will have to report on, and greatly expanded ESG requirements as a part of company annual reports.

- From October 31 to November 12, COP 26 led to major announcements and declarations from numerous countries including:[11]

  – A renewed deforestation pledge with 109 signatory nations, including the US;

[9] Congress.Gov, "H.R.1187 – Corporate Governance Improvement and Investor Protection Act" (June 8, 2021), available here.

[10] SP Global, News Release "Proposed EU standard seeks to bring clarity to ballooning green bond market" (July 29, 2021), available here.

[11] United Nations, News Release, "Outcomes of the Glasgow Climate Change Conference" (November 12, 2021), available here.

- An announcement from the UK that major public companies will be required to make ESG disclosures in line with the TCFD framework;
- A pledge from 46 nations to decarbonize by 2030 (2040 for smaller economies); and
- A pledge from 103 nations to reduce methane emissions by 30% from 2020 levels by 2030, including the US.

- On November 3, the International Financial Reporting Standards (IFRS) Foundation announced the International Sustainability Standards Board (ISSB), in consolidation with the Climate Disclosure Standards Board (CDSB) and Value Reporting Foundation (VRF), and publication of prototype disclosure requirements. The announcement came during the COP 26 conference, and is intended to make ESG reporting more uniform across industries.[12]

- Starting January 1, 2022, Singapore will require a series of ESG disclosure proposals for issuers, including plans for mandatory climate and board diversity reporting. Mandatory climate reporting will be based on Task Force on Climate-Related Financial Disclosures (TCFD), on a "comply or explain" basis beginning in 2022. The diversity proposals include requiring each issuer to disclose a board diversity policy along with targets, accompanying plans and a timeline, as well as a description of how the combination of skills, talents, experience and diversity of directors in the board serves the issuer's needs and plans. [13]

## The Need for ESG Education

Lawyers play a key role in helping organizations to match their practice with purpose. As organizations increasingly consider ESG factors, it is critical that their in-house counsel understand, and have outside counsel well versed in, the relevant regulatory and reputational risk associated with developing and implementing sustainability and ESG initiatives. The practice of ESG is mostly not codified law and does not have legal precedent, requiring lawyers to adapt new ways of practicing in order to meet these new challenges. In order to appropriately advise organizations and protect them from downside risk, the legal community should continue to adapt, develop the necessary expertise and make ESG education a priority. Learning the language of ESG, including the myriad standards, frameworks, rating agencies and key performance indicators, opens the door for legal counsel to bridge the gap between the traditional practice of law and the current needs of modern business. Because increased interest in ESG at the corporate level has resulted in increased scrutiny by investors and regulators, oversight may no longer be able to be relegated entirely to IR, communications and non-legal teams. Lawyers may consider taking an active role on these issues and applying the same rigor that they do to other disclosure and compliance issues to ESG.

## Looking Ahead

While most media focus centers on the "E" pillar of ESG, we anticipate that 2022 will see an increase in attention to vulnerabilities in the social and governance pillars. Areas General Counsel and other executives may want to focus on include:

- *Internal Education and Compliance* – Stakeholders are increasingly going after corporate claims that they, or their investment products, are positive from a DEI or human rights standpoint and the challenges will focus on what boards and management are doing to govern the myriad claims they make. Demands will continue to increase for more transparency in the governance of these claims and what companies do to address gaps or problems. Adversaries are leveraging sophisticated quantitative and qualitative data and technology tools to challenge corporations and claims of greenwashing are expected to be on the rise.

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[12] IFRS, News Release, "IFRS Foundation announces International Sustainability Standards Board, consolidation with CDSB and VRF, and publication of prototype disclosure requirements" (November 3, 2021), available here.

[13] Singapore Exchange, News Release, "SGX mandates climate and board diversity disclosures" (December 15, 2021), available here.

- *DEI and Human Rights Audits* – Third-party audits of key "S" issues such as human rights, racial equity, supply chain and compliance are expected to be more common in 2022 as well, as stakeholders increase pressure on organizations to undertake these assessments.

- *Board Oversight* – Board education and oversight will continue to be a major theme for companies in 2022. Getting the board up to speed on ESG issues and clearly communicating ESG goals, targets and other plans can help align management's ESG goals with shareholder and wider-market expectations.

- *SEC Developments* – The SEC is expected to issue guidance around ESG disclosures including climate, human capital management and cybersecurity early this year, and companies will need to work quickly to understand how these new regulations impact their operations and reporting requirements.

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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:

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