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Expert Analysis Chapters

1 **ESG Oversight and Integration: Considerations for Boards**
David M. Silk & Carmen X. W. Lu, Wachtell, Lipton, Rosen & Katz

7 **ESG and UK Pension Schemes: A Matter of Governance?**
Andy Lewis & Jonathan Gilmour, Travers Smith LLP

11 **Activism Rising – The Role of Shareholders in Shaping ESG Strategy**
Iria Calviño, Silke Goldberg, Rebecca Perlman & Timothy Stutt, Herbert Smith Freehills

17 **ESG for Asset Managers**
Julien Bourgeois, Mikhaelle Schiappacasse, Nicholas DiLorenzo & Stanley Tiu, Dechert LLP

24 **U.S. Legal and Compliance Issues Relating to ESG for Private Fund Advisers**
Debra Franzese, S. John Ryan, Nicholas R. Miller & Jacob H. Wimberly, Seward & Kissel LLP

29 **The Dangers of Doing Good: Litigation Risks from Public ESG Statements and How to Mitigate Them**
Frank Taylor, Rachel Roosth, Rebecca Lawlor Calkins & Julie Firestone, Norton Rose Fulbright

35 **ESG Considerations in Project, Energy, and Infrastructure Finance**
Matthew H. Ahrens, Allan T. Marks, Pinky P. Mehta & Allison E. Sloto, Milbank LLP

Q&A Chapters

43 **Australia**
Herbert Smith Freehills: Heidi Asten, Timothy Stutt & Jacqueline Wootton

52 **Austria**
Wolf Theiss: Sarah Wared, Florian Kusznier & Claus Schneider

57 **Brazil**
TozziniFreire Advogados: Adriana Mathias Baptista, André Camargo, Clara Serva & Vladimir Miranda Abreu

64 **Canada**
Stikeman Elliott LLP: Vanessa Coiteux, Ramandeep K. Grewal & Catherine Grygar

76 **China**
DeHeng Law Offices: Harrison (Hui) Jia, Junbo Song & Candice (Xiaojuan) Tang

82 **Hong Kong**
Dentons: Vivien Teu & Jojo Ha

94 **India**
Trilegal: Harsh Pais & Jagrati Gupta

102 **Indonesia**
Bahar: Wahyuni Bahar, Fairuz Rista Ismah & Fresa Yuriza Litanto

109 **Ireland**
Maples Group: Peter Stapleton, Ronan Cremin & Jennifer Dobbyn

116 **Italy**
ADVANT Nctm: Riccardo Sallustio & Alessandra Stabilini
SustainAdvisory: Francesca Fraulo

126 **Japan**
Nagashima Ohno & Tsunematsu: Kiyoshi Honda

133 **Korea**
Kim & Chang: Hye Sung Kim & Kyung Shik Roh

140 **Luxembourg**
Maples Group: Michelle Barry & Johan Terblanche

146 **Mexico**
Galicia Abogados, S.C.: Carlos Escoto, Mariana Herrero, Marianela Romero Aceves & Lorena Kiehnle Barocio

154 **Netherlands**
De Brauw Blackstone Westbroek: Davine Roessingh, Casper Nagtegaal & Dennis Horeman

161 **Norway**
BAHR: Svein Gerhard Simonnæs, Asle Aarbakke & Lene E. Nygård

166 **Poland**
Wolf Theiss: Marcin Rudnik & Joanna Gąsowski

174 **Portugal**
SÉRVULO: Paulo Câmara, Guilherme Oliveira e Costa & Mariana Nunes Catalão

181 **South Africa**
Bowmans: Ezra Davids & Ryan Kitcat

190 **Spain**
RocaJunyent: Iñigo Cisneros

197 **Sweden**
Mannheimer Swartling Advokatbyrå: Patrik Marcelius, Cecilia Björkwall & Joel Palm

204 **Switzerland**
Schellenberg Wittmer Ltd: Christoph Vonlanthen, Lorenzo Olgiati, Giulia Marchettini & Fabio Elsener

211 **United Kingdom**
Macfarlanes LLP: Tom Rose & Rachel Richardson

221 **USA**
Wachtell, Lipton, Rosen & Katz: David M. Silk & Carmen X. W. Lu

ESG Oversight and Integration: Considerations for Boards

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Over the past several years, environmental, social and governance (ESG) issues have drawn increasing attention from investors, asset managers, shareholders, corporate leaders and the public. Over the past 18 months, the COVID-19 pandemic has exposed how improperly managed ESG risks can leave lasting reputational and bottom-line impacts on businesses. Mounting concern over climate change risks – as reflected in this year's proxy season and the growing regulatory focus on climate-related disclosures – further underscores the growing need for companies to identify, monitor and manage ESG risks and opportunities and to integrate ESG considerations into their medium- and long-term business strategy.

This chapter lays out considerations for boards in light of heightened expectations from investors and regulators with respect to ESG. Following a brief review of recent developments, this chapter examines (1) the evolving ESG priorities of investors, (2) the core features of an ESG-capable board, and (3) the role of the board in ESG disclosures, goal-setting and shareholder and stakeholder engagement.

ESG Developments in 2021

ESG in the United States has continued to pick up momentum from last year. Two recent developments are particularly notable: the uptick in interest from U.S. regulators on ESG disclosures and enforcement; and the increasingly vocal concerns of investors, as reflected in the most recent proxy season. These developments continue to reflect growing investor and broader public focus on how companies are addressing their ESG risks and demand for greater transparency and clarity on ESG disclosures.

On the regulatory front, this year saw a flurry of new ESG initiatives driven by the Biden Administration. In February 2021, President Biden issued an executive order requiring the federal government to drive assessment, disclosure, and mitigation of climate pollution and climate-related risks in every sector of the U.S. economy. The following month, the U.S. Securities and Exchange Commission (SEC) announced an all-agency approach to tackling climate change and other ESG risks and opportunities, which included, among other things, the creation of a Climate and ESG Task Force in the Division of Enforcement and the ramping up of enforcement on climate-related risks. The SEC is also undertaking a review of climate-related disclosures in public company filings, with proposals expected before the end of this year. The Federal Reserve has also signalled its concern about climate change's potential risk to financial stability and earlier this year set up a Financial Stability Climate Committee and a Supervision Climate Committee to monitor and address climate change-driven macroprudential risks. In October, the Financial Stability Oversight Council (FSOC), which consists of the heads of several U.S. financial regulators, published a report calling for new climate change-related disclosures, endorsing the core principals of the Task Force on Climate-related Financial Disclosures (TCFD) and recommending a variety of climate-related actions across the FSOC's regulatory agencies.

This year's proxy season also saw record levels of support for ESG proposals, both in the number of proposals voted on and the number proposals that received majority support. Major investors including BlackRock, State Street and Vanguard demonstrated increasing willingness to support ESG proposals, which were further buttressed by the support from proxy advisors ISS and Glass Lewis. Among the shareholder proposals that received majority support this year included proposals calling for reductions of scope 3 greenhouse gas emissions and proposals pushing for greater racial and ethnic diversity on boards and more comprehensive reporting on companies' diversity, equity and inclusion (DEI) efforts. In a new milestone for ESG activism, Engine No. 1, then a six-month-old hedge fund holding only a 0.02% stake in ExxonMobil, managed to oust three members of the Exxon board in a climate change-based campaign after gaining the support of BlackRock, State Street and Vanguard. On the other hand, activists successfully managed to force executive change at Danone amid concerns that the company's ESG initiatives had contributed to lagging returns.

The major ESG disclosure frameworks have continued to consolidate with major investors lending their support to standards developed by the Sustainability Accounting Standards Board (SASB) and TCFD. In April 2021, the Global Reporting Initiative (GRI) and SASB issued guidance to companies on how the frameworks can form complementary facets of a comprehensive ESG reporting framework. In June 2021, the International Integrated Reporting Council (IIRC) and SASB merged to form the Value Reporting Foundation, which is now working to further streamline reporting standards as ESG disclosures become mainstream.

As we mark almost two years since the start of the COVID-19 pandemic, many of the ESG issues such as workplace safety, human capital management, and racial DEI have evolved to become mainstay concerns of investors. As the pandemic continues to wear on, concerns regarding the global supply chain and geopolitical risks have also become headline risks. Several high-profile security breaches this year have also underscored the growing threat of cybersecurity risks in our new digital economy. Meanwhile, government regulators and both parties have continued to scrutinise Big Tech on issues relating to anti-competitive behaviour, product safety and data privacy concerns.

Looking ahead to the rest of the year, the biggest potential developments in ESG may be yet to come as we await the SEC's updated guidance on climate-related disclosures and as global leaders gather in Glasgow for the 26th United Nations Climate

Change Conference (COP26). The past year has already seen climate change-driven natural disasters of unprecedented scale occurring worldwide, and global leaders are under political pressure to implement steps to curb global carbon emissions. As BlackRock's Chief Executive Officer, Larry Fink, noted earlier this year, climate change will "spark a fundamental reallocation of capital". The continued growth in ESG investment has signalled that market has already begun to price in ESG risks. Any global agreements that come out of COP26 or from the SEC later this year could further propel a fundamental shift in how businesses recognise risk and allocate value.

While ESG sceptics remain and as concerns regarding greenwashing continue to spark debate on the validity of ESG, the mainstream investor view on ESG has largely moved beyond questions of ESG's value to questions regarding its role in the operations and strategic direction of companies. With ESG starting to underpin strategy and operations, investors and other stakeholders have turned their sights on the board, which is now expected to have a key role in guiding the company through ESG-driven change.

Evolving Investor Priorities in 2021

Effective management of ESG ultimately requires boards and management to assess the risks and opportunities specifically relevant to their businesses. In doing so, it is important as a starting point to consider and engage with the priorities of institutional investors. Social issues, particularly racial inequity, diversity and human capital management, and climate change remain as critical concerns among investors. Some of the important issues that have attracted investor attention and garnered an uptick in support during the most recent proxy season are highlighted below.

Climate Change, Net Zero and Say on Climate. Climate change risks and opportunities are wide-ranging and cover both physical and "transitional" issues, including the impact of new regulations, the risk of stranded assets, shifts in capital allocation, supply chain disruptions, and the reputational costs arising from failures to recognise and adapt to climate change. In August, the United Nation's Intergovernmental Panel on Climate Change's most recent report declared that human behaviour had already unleashed irreversible changes to the planet's climate system that presented a "code red" threat to humanity. The unexpectedly severe floods and wildfires that have swept across the globe have further drawn political pressure for governments to act before the climate crisis spirals beyond the limits of human intervention.

In light of the growing challenges posed by climate change, investor calls for better disclosure and management of climate-related risks have continued to grow: BlackRock has called for companies to "disclose a plan for how their business model will be compatible with a net zero economy" and "disclose how this plan is incorporated into your long-term strategy and reviewed by [the] board of directors". State Street has also declared climate change a "key systemic threat, representing both a strategic and business challenge for all companies".

During the past proxy season, nearly half of the climate-related proposals voted on received a majority of shareholder approval, compared to none only two years ago. Three major energy companies saw majority support for shareholder proposals that sought to cut scope 3 emissions. Proposals requesting reports on the financial impacts of the International Energy Agency's Net Zero 2050 Scenario also saw substantial support. In addition, the Children's Investment Fund Management's Say on Climate initiative (whereby companies solicit non-binding shareholder approval for the company's climate action plan) was also voted on at four companies.

Going forward, boards will be expected to work closely with management to assess, monitor, disclose and integrate climate-related considerations into the company's business model. Boards and management should be prepared to engage with investors on climate risks as part of the annual meeting cycle. As companies increasingly roll out net zero plans and other climate-related targets, expectations regarding board oversight of implementation and disclosure processes will also likely draw investor attention. As climate change reshapes the global economy, companies seeking to convert potential climate change risks into opportunities can be expected to look beyond the benchmarks of their peers towards first-mover challenges.

Diversity, Equity and Inclusion. The events of last year have elevated concerns regarding DEI and this focus has continued into 2021. A number of institutional investors, including Vanguard, State Street and AllianceBernstein, along with ISS, have announced their intent to vote, or recommend voting, against the chair of the nominating committee should the board fail to reflect racial diversity. But the focus has also shifted beyond the board into the ranks of senior management and the workforce more generally, with State Street, for example, announcing that beginning next year, it will vote against the chairs of compensation committees at S&P 500 companies that do not disclose their EEO-1 reports, which provide a standardised breakdown of workforce demographics across 10 employment categories.

During this past proxy season, proposals on board diversity saw some of the highest support in recent years, with three proposals receiving over 70% support. A large number of proposals calling for EEO-1 disclosures were also submitted, with the majority withdrawn after companies agreed to disclose EEO-1 data. Of the three proposals on EEO-1 disclosure that did go to a vote this year, two received over 80% support from shareholders. Six shareholder proposals calling for disclosure of the effectiveness of DEI programmes were also voted on and three received majority approval. In addition, approximately eight proposals calling for companies to undertake an independent racial equity audit to assess whether the company's policies, products and services contribute to discrimination were voted on, receiving on average approximately 31% approval.

Supply Chain Management. Prior to the pandemic, investor and public concerns regarding supply chains often focused on labour and compliance issues and environmental responsibility. The pandemic exposed the fragility of just-in-time supply chains, and the blockage of the Suez Canal earlier this year further underscored the vulnerability of global supply chains. While the concerns regarding supply chains during the height of the pandemic centred on the shortages of personal protective equipment, the current global supply chain woes combined with hikes in the price of oil have led to persistent shortages driving up the costs of consumer goods globally. While not all companies are equally affected by the current global supply chain crunch, investors will likely be keen to understand whether companies have made thorough assessments on their vulnerability to supply chain shocks and taken action to bolster resilience and adopt industry best practices.

Human Capital Management. As the pandemic continues to wear on, the past year has seen record levels of employee turnover and growing recognition among investors that a company's value is measured in part by the talent it is able to hire and retain. During the pandemic, companies were forced to immediately reassess their workplace safety protocols, develop strategies to facilitate remote work, and review their succession planning processes. In recent months, as the threat of the pandemic continues to subside, focus has shifted towards building corporate culture and purpose, addressing the growing epidemic

of employee burnout and assessing the effectiveness of talent management and retention initiatives. With the SEC now requiring companies to provide a description of their human capital resources and as the knowledge and service sectors of the economy continue to grow and compete for talent, boards and management should be aware of growing demand from investors for information and disclosure on the subject.

Cybersecurity Risks. The past year has seen a record number of criminal ransomware attacks that have resulted in, among other things, the shutdown of one of the largest pipelines in the United States, the breach of the data security systems of thousands of companies including U.S. government agencies, and the temporary shutdown of one of the largest meat suppliers in the world. The risk of targeted attacks from criminal groups, foreign intelligence services, and other bad actors has only increased with the mass shift to remote work arrangements, embrace of cloud-based operations and increased reliance on virtual commerce spurred by the pandemic. Institutional investors and proxy advisor firms are increasingly considering a company's cybersecurity defences as part of their review of governance and ESG performance, with some shareholders having issued shareholder proposals in response to damaging cyber incidents. Shareholder activists may also increasingly scrutinise cybersecurity defences following the spate of incidents this past year. Boards and management are increasingly expected to coordinate closely on oversight, management and reporting of cybersecurity risks, as well as crisis responses to cybersecurity incidents. Corporate cybersecurity incidents will need to take into consideration a company's supply chain, vendor and business partner relationships and other operating structures and models that could provide entry points into a future cyber attack.

Facets of an ESG-Capable Board

While the legal duties of boards have remained unchanged, investors and other stakeholders increasingly expect boards to play a pivotal oversight role on ESG matters and lay the strategic groundwork for integrating ESG into a company's operations and strategy. Board responsibilities include shaping corporate culture and purpose, reviewing disclosures on ESG performance, monitoring the integration of ESG into the company's business operations, and overseeing the process for identifying ESG risks and opportunities. As with other governance issues, major institutional holders and proxy advisors will hold directors accountable for their companies' performance on ESG. BlackRock will vote its proxies against directors of companies in instances where it believes the company and its board are not "producing effective sustainability disclosures or implementing frameworks for managing these issues". State Street has stated that it will vote against directors of companies that lag behind on ESG performance and fail to articulate plans for improving their companies' ESG performance. Best practices for an ESG-capable board include the following:

Company-Specific ESG Competency. The effectiveness of board oversight on ESG hinges on building ESG competency as it specifically relates to the company. As investor expectations on ESG continue to grow, boards are expected to understand and oversee the material ESG risks and opportunities affecting their company as well as the ESG expectations of their investor base, including issues raised during private engagements and gathered through stakeholder surveys. Boards should also be acquainted with the major ESG disclosure frameworks and take an active role in reviewing the company's public ESG disclosures.

Management is critical to shedding insights into how ESG intersects with the company's operations and identifying the challenges and opportunities on the ground. Boards can also leverage management to track industry developments and peer initiatives, which may provide the board with additional insights into best practices and evolving expectations of their role on ESG oversight. Engagement with key institutional investors and consultations, where appropriate, with outside advisors can provide insights into broader market trends, expectations and best practices.

Boards should also periodically evaluate their ESG competencies. Depending on the circumstances, boards may wish to consider adding directors whose expertise and background can enliven the board's analysis and discussion on ESG issues. Should boards adopt this approach, it is important to remember that ESG remains a dynamic subject and ongoing director education remains key.

Established ESG Oversight Framework. Boards are increasingly expected to articulate and allocate ESG oversight responsibilities, which oversight may occur at the full board level or among board committees. There is no one correct approach of how boards choose to allocate ESG oversight, and the board has full discretion to determine how responsibilities are allocated. Among the oversight responsibilities that boards will need to consider include oversight on ESG reporting and disclosure, identification and assessment of risks and opportunities relating to various ESG issues, and oversight of management's implementation and processes with respect to the company's ESG targets.

When deciding whether to allocate oversight responsibility to a new or existing board committee, boards should consider how best to align ESG oversight responsibility with core board competencies, whether the committee and its members have sufficient time in light of other responsibilities of that committee, and how best to prevent overlaps or gaps in committee responsibilities as ESG issues expand and evolve over time. In addition, boards looking to delegate ESG oversight responsibilities among multiple committees should also consider how best to prevent lags in reporting issues to the full board, so as to minimise sacrificing speed and agility in exchange for greater oversight and expertise. Boards and management should also consider the relationship of ESG disclosure to the company's general financial disclosures.

Allocation of ESG oversight responsibilities on the board will also be an iterative process: as boards accrue new insights into the ESG issues affecting their company and as investor and stakeholder priorities evolve, board responsibilities should be reviewed to address any blind spots and, where necessary, to reallocate the board's resources towards appropriate expertise and priority issues. The board's oversight of ESG should also evolve with the company's operations, business strategy and business climate. For example, the adoption of carbon reduction commitments and expansion of ESG reporting may necessitate additional board oversight. Likewise, strategic pivots into new industries, or significant acquisitions of new businesses and assets, should prompt a reassessment of the scope of board oversight of the related ESG issues.

Periodic Management Engagement. In recent years, as part of efforts to fully integrate ESG into business operations, companies have created ESG working groups composed of internal specialists. Such working groups help funnel information to the board, identify emerging company-specific trends and risks, and help implement the board's strategic priorities. Regardless of the scale of ESG issues affecting the company, the board should seek to ensure that a continuous feedback loop is in place with management that keeps the board informed of material ESG issues and ensures board directives become actionable responses. For example, in addressing risks related to workplace safety, the board and management should work together to understand how key statistics are collected, verified and

reported to the board, how vulnerabilities are identified and potential solutions found, how priorities and weaknesses identified by the board coalesce into action plans, and how to respond to stakeholder concerns.

The board also has responsibility for guiding management over the longer term and ensuring that management is allocating sufficient resources to realising longer-term ESG goals. Over the past few months, a number of companies have adopted net zero carbon reduction targets. With respect to these and other commitments, the board should monitor progress and the alignment of management's activities and incentives with the company's public commitments.

Aligning Compensation to ESG Performance. Currently, just over half of S&P 500 companies use ESG metrics in their executive compensation plans, most commonly in annual incentive plans, although the use of ESG metrics continues to grow. While the use of ESG metrics in incentive plans continues to evolve, the current most common approach is to use ESG metrics as part of a scorecard of non-financial or strategic objectives or as part of an individual performance assessment that is used to adjust incentive plan performance. Use of weighted metrics, as typically done for financial measures, is less common with ESG inputs, particularly when measuring performance on "E" and "S" issues. However, as the use and measurement of ESG metrics becomes more mainstream and as companies commit to longer-term ESG goals, we expect that ESG performance will play a growing role in incentive plans, including long-term incentive plans, and that boards will take a role in helping to establish appropriate metrics and targets.

Board Oversight of ESG Disclosures and Goal-Setting

ESG disclosures continue to be a focal point for regulators and investors, and boards should collaborate closely with management to ensure that public disclosures demonstrate that the company has conducted comprehensive assessments of its ESG risks and opportunities and has taken steps to integrate such considerations into the business goals and strategy. Disclosures should also be decision-useful to investors and data presented should be verifiable. As investors and other stakeholders use public disclosures on ESG performance to identify and engage with the company on their ESG priorities, companies will increasingly find their performance being compared against peers and industry leaders or against external benchmarks. Set forth below are key considerations for boards when evaluating their company's ESG disclosures.

Investor and Stakeholder Expectations. Perhaps one of the biggest challenges for boards and management will be addressing, responding to and managing investor and stakeholder expectations on ESG disclosures. Institutional investors have already made clear that they expect companies to disclose data – preferably raw quantitative data accompanied by contextual disclosure – to help them assess the ESG risks and performance of companies. As ESG disclosure frameworks continue to evolve, boards and management should stay attuned to the needs and demands of their investors and recognise that merely disclosing against one or more frameworks or meeting prescribed regulatory requirements, without illuminating decision-useful ESG data, could mean that the company's disclosures will fall short of investor and broader stakeholder expectations.

Boards and companies should also prepare themselves for the growing number of third-party ratings on their ESG performance, and tailor their company's public disclosures accordingly. Smaller investors, and other stakeholders who do not have the resources to formulate their own assessments of ESG performance among companies, rely on ESG service providers to inform their investment and engagement priorities. While it is not possible for boards and management to closely engage with all of the ESG participants, they should monitor how their company is rated by the most commonly used third-party service providers such as MSCI, Sustainalytics and ISS. In instances where the company's performance has been inaccurately reported, the company should take prompt action to identify and address the underlying causes (bearing in mind that certain check-the-box ratings systems proffered by ratings agencies may fail to contextualise performance or will over-penalise companies in the process of implementing changes, and it will be up to the company to provide reassurance to concerned stakeholders).

Materiality, Scenario Analyses and Assurance. Aside from the ongoing debates over what types of ESG metrics should be reported, questions regarding materiality, scenario planning and assurance also continue to pique investor interest. Among the major ESG disclosure frameworks, companies are required to disclose ESG metrics to the extent they are material to the company. However, what constitutes "material" information continues to vary from framework to framework and companies should be particularly careful in articulating such differences to their audience. Among the ESG disclosure frameworks, materiality can range from financial materiality (SASB) to stakeholder materiality (GRI). In addition, the SEC, which now requires companies to make disclosures on human capital metrics and permits the disclosure of other key performance indicators, asks companies to disclose information that would be important to a reasonable investor. Given the range of materiality standards, boards should be mindful of the potential legal implications of disclosures that may be viewed as potentially misleading or incomplete by investors. Appropriate disclaimer language can provide safeguards against potential litigation. Clear explanations illustrating the company's internal processes for arriving at materiality determinations is another way to help audiences parse through ESG disclosures.

Certain forms of ESG disclosures relating to long-term projections and scenario analyses also require additional attention from the board. Companies should take time to educate their audience about the assumptions and other limitations that underlie long-term projections. Boards should pay particular attention to such projections and analyses to not only help inform their strategic decision-making but also to ensure that information is presented in a manner that mitigates potential litigation concerns.

Finally, companies should consider the scope of third-party assurance that may be provided in connection with the public release of ESG data. It is increasingly expected that companies will provide either internal or independent verification and/or assurance for key portions of quantitative data (e.g., greenhouse gas emissions) disclosed in their public ESG reports.

Goal-Setting. When reviewing ESG disclosures (and taking stock of feedback from investors and other stakeholders), boards and management should consider how these public communications can be used to level set the company's ESG priorities and contextualise its progress on ESG. ESG disclosures in and of themselves can also help identify priorities, create opportunities to demonstrate leadership on ESG matters, and expose areas where the company may be lagging behind its peers.

The Board and Shareholder and Stakeholder Engagement

The ongoing shift towards stakeholder capitalism has drawn attention to stakeholder engagement. Stakeholder engagement asks companies to consider the interests of their stakeholders such as employees, suppliers, customers and local communities,

and some ESG disclosure regimes contemplate that reporting entities will engage directly with stakeholders to help identify material ESG topics. Unlike traditional shareholder engagement, which typically involves periodic in-depth meetings between investors and members of the board and management with a schedule determined by the annual meeting cycle, stakeholder engagement will also require companies to harness their investor relations platforms, marketing platforms, social media handles, public policy strategies, consumer research, focus groups and internal reporting processes. In some cases, the company's stakeholders may not seek to engage with companies through traditional, typically private, channels. Rather, concerns may be voiced through a wider range of channels, including mainstream and social media, public forums, and whistleblower hotlines. As a result, companies should implement processes for identifying emerging ESG concerns before they draw negative publicity and develop action plans for responding publicly to stakeholders.

When engaging with stakeholders, companies should also recognise that many are likely to focus on a narrower subset of ESG issues that directly affect their well-being and priorities. For employees, focus areas will be human capital management issues such as diversity and inclusion, workplace safety, pay equity and job satisfaction. For customers and suppliers, issues of concern will revolve around labour practices, regulatory compliance and supply chain resilience. It is also possible that certain stakeholders will also seek to use their influence to draw attention to issues that do not directly implicate their immediate interests but align with their broader values: stakeholders who wield greater influence over a corporate reputation, shape media coverage and impact market share, such as employees and customers, have already demonstrated their willingness to draw attention to climate change and poor labour practices. Unlike institutional investors, the priorities of stakeholders may not be directly or cohesively articulated – it is incumbent upon the company to proactively identify stakeholder concerns and build a culture and infrastructure that encourages dialogue between the board and management and internal and external stakeholders.

As stakeholders continue to gain stature and influence over corporate purpose and decision-making, conflict of priorities among stakeholders will inevitably arise. In such cases, the board – in the exercise of its business judgment – will be the arbiter of competing interests and, in doing so, will seek to identify which pathways best align with its corporate purpose and long-term value creation. Boards and management should acknowledge the concerns of stakeholders but also be transparent with stakeholders that their priorities may not necessarily mirror the priorities of the company.

* * *

The growth of ESG has transformed investor expectations of companies, their boards and their management on oversight, disclosure and goal-setting around ESG risks and opportunities. Today, there is growing recognition that companies that ignore ESG will face significant reputational and economic damage, as demonstrated by the impact of the current pandemic and the economic and social repercussions that have followed, and may miss valuable opportunities.

In the face of this new business environment, companies should prepare to integrate ESG into their operations and strategy. In the immediate term, steps towards integration include engaging with the priorities of investors and other stakeholders, building a strong governance framework that incorporates board oversight over key ESG issues, demonstrating ESG competence and leadership through public disclosures, and identifying new pathways to engage with the growing number of participants who will have sway over the company's perceived ESG performance and reputation. Investors will look to the board to help guide their company's transition into the new economy and as more capital flows to ESG, expectations of boards will continue to grow.

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1 Setting the Scene – Sources and Overview

1.1 What are the main substantive ESG-related regulations?

In the United States, the growing focus on ESG has thus far led to voluntary, market-led responses rather than new regulations. This stands in contrast to the European Union, where the European Commission has adopted specific prudential and conduct-based directives on ESG. However, the regulatory landscape in the United States will likely change in the coming months. This year saw a flurry of new ESG initiatives and proposals driven by the Biden Administration. In February 2021, the President issued an executive order requiring the federal government to "drive assessment, disclosure, and mitigation of climate pollution and climate-related risks in every sector of our economy". The following month, the U.S. Securities and Exchange Commission (SEC) announced an all-agency approach to tackling climate change and other ESG risks and opportunities, which included, among other things, the creation of a Climate and ESG Task Force in the Division of Enforcement and the ramping up of enforcement on climate-related risks. The SEC is also undertaking a review of mandated climate-related and other ESG disclosure in public company filings, with recommendations expected before the end of this year. The Financial Stability Oversight Council (FSOC), which is made up of the heads of several federal agencies including the Treasury, the SEC, the Federal Reserve Board and the Office of the Comptroller of the Currency (OCC), recently issued a report on climate-related financial risk that, among other things, calls for new disclosures, endorses building on the core concepts of the Task Force on Climate-Related Financial Disclosures (TCFD) and recommends a variety of actions regarding climate risk across the federal financial regulatory agencies.

In addition, the Department of Labor (DOL), which regulates private-sector employee benefit plans, recently proposed new rules expressly enabling Employee Retirement Income Security Act (ERISA) fiduciaries to consider ESG factors in investment decisions and to engage in proxy voting without the perception that fiduciaries need a special justification for the ordinary exercise of shareholder rights on ESG matters. At the state level, a dozen states have enacted or are poised to enact requirements to enhance diversity on boards, and a small handful of states, including California, Connecticut, Illinois, New Jersey, New York, Oregon and Washington, have leveraged regulation of their pension systems to advance sustainable investment. In addition, federal and state agencies have also long overseen disclosure relating to the environment, workplace safety and discrimination and harassment, minimum wages, environmental pollution and labour protections.

1.2 What are the main ESG disclosure regulations?

In the United States, there are currently no mandatory ESG disclosures at the federal level, although the SEC requires all public companies to disclose information that may be material to investors, including information on ESG-related risks, and requires disclosure of whether and how diversity is considered a factor in the process for considering director candidates. The SEC announced earlier this year that it intends to provide updated guidance on ESG disclosures. The updates are expected to be released later this year. In addition, the SEC has approved a change to the Nasdaq rules that will require most Nasdaq-listed companies to have, or explain why they do not have, at least two diverse directors on their boards. The new Nasdaq rules will also require disclosure of voluntary self-identified gender, racial characteristics, and LGBTQ+ status of a company's board.

In January 2020, the SEC stated that companies should identify and address "those key variables and other qualitative and quantitative factors that are peculiar to and necessary for an understanding and evaluation" of the business and, accordingly, material to investors in their Management's Discussion and Analysis (MD&A) disclosures. While not aimed specifically at ESG measures, nor mandating any new disclosures, the guidance references several ESG metrics (such as energy consumption and employee turnover) as examples of Key Performance Indicators that may be included in MD&A disclosures. The guidance included direction as to the type of textual disclosure that should accompany such metrics, including a clear definition of the metric and how it is calculated, a statement explaining its inclusion, and explanation on how management uses the metric in managing or monitoring business performance.

In August 2020, the SEC revised Regulation S-K to require new descriptions, where material to an understanding of the business, of (1) a company's "human capital resources", and (2) "any human capital measures or objectives that the registrant focuses on in managing the business (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)".

Shareholders have also used Exchange Act Rule 14a-8 to submit shareholder proposals requesting broader ESG disclosures. The 2021 proxy season continued to see an uptick in ESG-related proposals, particularly those relating to climate risks and diversity, equity and inclusion.

1.3 What voluntary ESG disclosures, beyond those required by law or regulation, are customary?

There are a number of voluntary ESG disclosure frameworks that provide guidance on disclosing ESG performance. Such frameworks include the Global Reporting Initiative (GRI), the Value Reporting Foundation (formerly the Sustainability Accounting Standards Board (SASB)), TCFD, and the Stakeholder Capital Metrics framework created by the International Business Council of the World Economic Forum (WEF) and the four major accounting firms. Overall, the current voluntary disclosure regime remains fragmented with disclosure frameworks varying in scope, depth and approaches to materiality. Nonetheless, investor and stakeholder interest in ESG has prompted increasing numbers of companies to disclose ESG performance, which disclosures are typically aligned with one or more voluntary ESG disclosure frameworks. BlackRock and State Street have encouraged companies to disclose against SASB and TCFD. Many companies have also reported against the GRI framework, either separately or together with SASB and/or TCFD. As investors continue to demand decision-useful and comparable data, a number of disclosure frameworks have also announced plans to collaborate on standardising disclosure standards.

1.4 Are there significant laws or regulations currently in the proposal process?

Growing policy momentum has created a greater focus on ESG outcomes and metrics. In the past two years, five bills have been brought before Congress covering ESG disclosures, climate risk disclosures, tax payment disclosures, human rights and shareholder protections. While none of these bills were passed, they signal growing regulatory interest in ESG.

Earlier this year, the SEC announced an all-agency approach to tackling climate change and other ESG risks and opportunities, which included, among other things, the creation of a Climate and ESG Task Force in the Division of Enforcement and the ramping up of enforcement on climate-related risks. The SEC is also undertaking a review of mandated climate-related and other ESG disclosure in public company filings, with recommendations expected before the end of this year.

The DOL has also proposed new rules expressly enabling ERISA fiduciaries to consider ESG factors in investment decisions and to engage in proxy voting without the perception that fiduciaries need a special justification for the ordinary exercise of shareholder rights on ESG matters. The proposed rules declare that a fiduciary's duties of prudence and loyalty may require consideration of the economic effect of climate change and other ESG factors, noting that "a prudent fiduciary may consider any factor … material to the risk-return analysis". In particular, investment consideration may include: (i) climate change-related factors, including the exposure to "physical and transitional risks" and the impact of government regulations; (ii) governance factors, including board and executive compensation, corporate avoidance of criminal liability and compliance with applicable laws and regulations; and (iii) workforce practices, including diversity and equal employment opportunity, worker training and labour relations. The DOL also proposes to change the existing "tie-breaker" test. The current rules require documentation that competing investments be economically indistinguishable before the fiduciary may consider collateral factors other than investment returns. The proposed rules would replace such requirements with a new standard enabling fiduciaries to consider collateral factors after prudently concluding that competing investment choices "equally serve the financial interest of the plan". Fiduciaries would still need to meet other requirements – such as ensuring that collateral benefits do not come at the cost of reduced returns or greater risk, and making appropriate disclosures to plan participants.

1.5 What significant private sector initiatives relating to ESG are there?

The most significant private sector initiatives on ESG to date have focused on ESG disclosures, with significant input from corporates and investors. SASB, TCFD and the WEF's disclosure frameworks are all privately led initiatives. GRI is a joint partnership between the United Nations and two non-profits, Ceres and the Tellus Institute. The private sector, notably institutional investors, have spearheaded thought leadership and defined best practices on ESG by setting engagement priorities centred on ESG issues and adopting proxy voting policies that seek to promote the integration of ESG into the operations and strategy of their portfolio companies. Corporate leaders have also helped reshape consensus on the purpose of corporations: in 2019, the Business Roundtable issued a statement redefining the purpose of the corporation to include a commitment to all stakeholders, *in lieu* of its previous position that the primary purpose of the corporation is to serve its shareholders.

2 Principal Sources of ESG Pressure

2.1 What are the views and perspectives of investors and asset managers toward ESG, and how do they exert influence in support of those views?

A growing number of investors and asset managers believe that ESG can have a material impact on the long-term performance of their investment portfolios and have integrated ESG considerations into their investment decision-making. Such investors also believe that companies that integrate ESG risks and opportunities into their operations and business strategy are more likely to deliver sustainable, long-term value to their shareholders and other stakeholders. To this end, investors and asset managers have pushed for standardised, comparable and decision-useful ESG disclosures to assist with their investment stewardship and to hold companies accountable for ESG performance. Many institutional investors also use private and public engagement and leverage their proxy vote decisions to advance their views. The most prominent institutional investors have also leveraged their thought leadership and public platforms to support the adoption of ESG disclosure frameworks, to support regulations that support ESG investing and to increase public awareness of ESG issues.

For example, BlackRock's Chairman and Chief Executive Officer, Larry Fink, has requested that its investee companies disclose in accordance with SASB (or similar) and TCFD's guidelines. BlackRock warned that it would "be increasingly disposed to vote against management and board directors when companies are not making sufficient progress on sustainability-related disclosures and … plans underlying them". Similarly, State Street Global Advisors announced that it had endorsed SASB standards, will use its proprietary "R-Factor" ESG scoring methodology to benchmark companies, and will begin to take voting action against companies that are ESG laggards. Public sector investors, such as CalPERS and the New York State Common Retirement Fund, have similarly integrated ESG into their investment decisions and engaged with companies to

improve sustainability, assessments of climate risks and workforce diversity, among other topics. In the 2021 proxy season, institutional investors lent their support to several ESG shareholder proposals and are increasingly exerting their proxy vote power to pursue their ESG priorities.

Activist investors have also increasingly leveraged ESG issues as part of their campaigns. In the 2021 proxy season, Engine No. 1 successfully unseated three ExxonMobil board members in a highly contested proxy fight centred on Exxon's carbon transition strategy. The Children's Investment Fund Management also launched several "Say on Climate" campaigns, which called on shareholders to ratify the company's climate transition action plans.

Support for ESG, however, is not universal. Some investors and academics have expressed concern that integration of ESG into investment decision-making and business practices may help hide poor management performance and reduce accountability.

2.2 What are the views of other stakeholders toward ESG, and how do they exert influence in support of those views?

Non-profit organisations, particularly those focused on sustainability, as well as intergovernmental organisations, notably the United Nations, as well as certain academics and think tanks, have lent their support and served as public platforms for promoting ESG. For example, GRI, one of the most prominent ESG disclosure frameworks, was conceived as a partnership between the United Nations Environment Programme, Ceres and the Tellus Institute. In addition, the United Nation's Sustainable Development Goals, together with the UN Global Compact and UN Principles for Responsible Investment, have provided frameworks and thought leadership on how companies and investors should approach and advance ESG goals. Over the past few years, the public has also become more vocal on climate change issues: thousands across the globe have taken to the streets to demand regulatory action on climate change, and employees from several large tech companies have banded together to demand that their employers take action to address climate change.

As noted above, the Biden Administration has become an important driver of ESG-related activity in the United States.

2.3 What are the principal regulators with respect to ESG issues, and what issues are being pressed by those regulators?

The SEC is the principal regulator of the public markets in the United States. The DOL, as the federal regulator of private-sector employee benefit plans, has also sought to regulate ESG. FSOC has proposed that other federal regulators and agencies, including the Federal Reserve Board, the OCC, the Federal Deposit Insurance Corporation, the SEC, the Commodity Futures Trading Commission and the Federal Housing Finance Agency, take new action on climate change data, disclosure and scenario analysis, including: (1) filing climate-related data and methodological gaps; (2) enhancing public climate-related disclosures; and (3) assessing and mitigating climate-related risks that could threaten the stability of the financial system.

In addition, state attorneys general have also been active in enforcing ESG-related matters, including disclosures of ESG risks and violations of state and federal environmental and employee health and safety regulations.

2.4 Have there been material enforcement actions with respect to ESG issues?

Material federal enforcement action on ESG issues has centred on fraud in connection with environmental and health and safety laws. In January 2016, the U.S. Department of Justice (DOJ) filed a complaint against Volkswagen, alleging that the company and six of its executives and employees had violated the Clean Air Act by falsifying emissions data and destroying evidence. Volkswagen pleaded guilty and paid US$2.8 billion in criminal penalties and US$1.5 billion in a separate civil settlement. Volkswagen executives were also indicted for participating in the fraud. In the fall of 2020, the DOJ settled criminal and civil investigations into Purdue Pharma that centred on violations of the Federal Food, Drug, and Cosmetic Act, the Federal Anti-Kickback Statute and the False Claims Act.

State attorneys general have led investigations into climate-related activities and disclosures of energy companies. In two of these cases, the New York Attorney General led investigations into whether the companies misled shareholders and the public regarding the links between their business activities and climate change. Peabody Energy settled investigations into its activities in 2015 by revising disclosures, but did not face any monetary penalties. In December 2019, a New York state court ruled that the New York Attorney General had "failed to establish by a preponderance of the evidence" that Exxon had violated the Martin Act, which enables litigation alleging shareholder fraud. State attorneys general, including in Connecticut, Hawaii and Vermont, have filed similar suits against energy companies, alleging that the companies violated the state's unfair trade practices law and deceived consumers about what the company knew about the impact of fossil fuels on climate change. Other states, and cities, have brought claims against fossil fuel companies on negligence, trespass and nuisance theories. Outside of climate change, multiple state attorneys general, as well as local governmental entities, settled suits brought against Purdue Pharma and the family that founded it, in connection with opioid abuse.

Earlier this year, the SEC announced an all-agency approach to tackling climate change and other ESG risks and opportunities, which included, among other things, the creation of a Climate and ESG Task Force in the Division of Enforcement and the ramping up of enforcement on climate-related risks.

2.5 What are the principal ESG-related litigation risks, and has there been material litigation with respect to ESG issues, other than enforcement actions?

State consumer protection and unfair business practice laws have been used to challenge environmental or sustainability performance, with many suits being filed during the past few years. Where these claims are based on misrepresentations in product labels or even in other company statements such as marketing materials, they have had some success, with several lawsuits surviving motions to dismiss and a few having settled. Claims based on omissions have not had apparent success to date, but this could change as ESG disclosures become mandatory and the pace of litigation quickens. These claims are usually brought as class actions, and California has been a popular venue to file such claims, under one or more of the following state statutes: the Consumer Legal Remedies Act; the False Advertising Law; and the Unfair Competition Law. To prevail, a plaintiff must show that the challenged statement is false or misleading and likely to deceive members of the public.

Securities litigation arising from claims of incomplete or misleading disclosures has emerged as a concern for companies looking to make ESG disclosures. While strike suits from

shareholders seeking to profit from forward-looking ESG disclosures may be inevitable, companies are generally able to shield themselves from civil liability under existing legal safe harbours. The Private Securities Litigation Reform Act of 1995 (PSLRA) established statutory safe harbours that protect forward-looking statements from private action under the Securities Act of 1933 and the Securities Exchange Act of 1934. The statutory definition of forward-looking statements covered under the PSLRA has generally been broadly interpreted and includes projections on future revenues and earnings, future plans and objectives of management, and discussions of future economic performance and financial conditions, as well as assumptions underlying future projections. In addition, the bespeaks caution doctrine provides common law protection for forward-looking statements that are accompanied by adequate risk disclosure to caution readers about specific risks that may materially impact the forecasts.

In addition to securities laws cases, a series of shareholder lawsuits litigated in the Delaware Court of Chancery have focused on allegations that boards have not properly overseen ESG-related risks. These cases have underscored the need for boards to monitor key risks and to document their monitoring efforts through minutes and other corporate records. A number of major technology companies have also been subject to recent lawsuits filed by employees alleging gender and race discrimination.

2.6 What are current key issues of concern for the proponents of ESG?

Among the chief concerns of proponents of ESG are (1) management of climate change risks, including adaptation to a low-carbon economy, (2) human capital management, particularly racial and gender diversity and inclusion in the workplace, and (3) questions around corporate purpose and how companies are serving the interests of all of their stakeholders. In light of the pandemic and other current events, concerns regarding employee welfare, supply chain resilience and regulatory compliance have also come to the fore, and privacy and cybersecurity issues remain top of mind.

Proponents of ESG also continue to view the currently fragmented ESG disclosure regime as an impediment to implementing transparency and accountability on ESG, and there remain significant efforts, most recently from the WEF, to rally issuers and investors around a single standardised, comparable and decision-useful ESG disclosure framework. While still somewhat on the horizon, proponents of ESG increasingly raise concerns with greenwashing in general and in particular with the efficacy of carbon offsets as a meaningful method of satisfying carbon-neutrality pledges, and on the impact of business activity on clean water and other natural resources.

3 Integration of ESG into Business Operations and Planning

3.1 Who has principal responsibility for addressing ESG issues? What is the role of the management body in setting and changing the strategy of the corporate entity with respect to these issues?

Well-advised boards and management collaborate closely to identify and oversee ESG risks and opportunities and to integrate ESG considerations into a company's business operations and strategy. While the legal duties of the board have not changed, investors and other stakeholders increasingly expect directors to assume responsibility for overseeing the management of ESG, including defining corporate purpose, ensuring that adequate processes are in place for monitoring, reporting and addressing ESG risks and opportunities, shaping long-term business strategy that takes into account ESG considerations, and aligning management incentives to foster the integration of ESG throughout the company's operations.

Management at all levels has an important role to play in the reporting of ESG risks and opportunities to the board, as well as integrating ESG into the company's day-to-day operations. The information and risk assessments generated by management can play an important role in shaping the board's perspective on long-term strategy and risk management. While some companies continue to address ESG within existing functions, such as legal and human resources, others have created dedicated roles to address ESG concerns within the company. For example, Chief Diversity Officers are increasingly common among organisations seeking to improve workforce diversity and inclusion. Other companies have created specialist internal taskforces on ESG.

3.2 What governance mechanisms are in place to supervise management of ESG issues? What is the role of the board and board committees?

While the board is tasked with overseeing the management of ESG issues, it retains discretion on how to allocate this responsibility. In some cases, depending on the needs and circumstances of the company, the board has delegated oversight responsibilities with respect to certain ESG issues to specific board committees, such as the audit or the nominating and governance committee. Other companies may find certain ESG risks and opportunities to be particularly salient as to deserve a dedicated committee (e.g., environmental health and safety or privacy committee). These board committees typically would be responsible for liaising with management and outside advisors on the applicable matters and reporting on the company's performance and progress to the full board.

3.3 What compensation or remuneration approaches are used to align incentives with respect to ESG?

There is growing interest in aligning compensation incentive structures with ESG goals and outcomes, particularly in the wake of the coronavirus pandemic. Currently, just over half of S&P 500 companies use ESG metrics in their executive compensation plans, most commonly in annual incentive plans, although the use of ESG metrics continues to grow. While the use of ESG metrics in incentive plans continues to evolve, the current most common approach is to use ESG metrics as part of a scorecard of non-financial or strategic objectives or as part of an individual performance assessment that is used to adjust incentive plan performance. Use of weighted metrics, as typically done for financial measures, is less common with ESG inputs, particularly when measuring performance on "E" and "S" issues. However, as the use and measurement of ESG metrics becomes mainstream and as companies commit to longer-term ESG goals, we would expect that ESG performance will likely play a growing role in incentive plans, including long-term incentive plans, and that the board will take a lead role in helping to establish the appropriate metrics and targets.

A 2020 study by Semler Brossy found that 62% of Fortune 200 companies included measures of ESG in their incentive

plans. The most prevalent ESG metrics involved customer satisfaction (48%), talent development (41%), and diversity and inclusion (38%). By contrast, climate-related metrics such as emissions and renewable energy were used by only 17% of companies. It is worth noting that while ESG metrics are frequently included in compensation discussions, these metrics are not often major factors in determining actual compensation. A 2020 Glass Lewis report noted that ESG metrics often have modest weighting, and in many cases are subsumed within qualitative or individual performance components of compensation plans. Across companies, the principal challenge in implementing ESG incentive goals is devising objective criteria for measuring performance that will be well received by shareholders and can stand the test of time.

3.4 What are some common examples of how companies have integrated ESG into their day-to-day operations?

Companies are increasingly setting and publicising ambitious goals on ESG. A number of recent initiatives have focused on sustainability and diversity. Several major technology companies, in particular, have embraced zero-carbon pledges: Amazon has committed to net zero carbon emissions by 2040; and Microsoft plans to be carbon negative by 2030 and, by 2050, to remove all carbon it has emitted since its founding in 1975. Apple has committed to have carbon-neutral supply chains by 2030. Increasing numbers of companies have also set targets on improving racial and gender diversity in their workforce, particularly on boards and among senior management. The focus on diversity and inclusion has intensified in response to the multiple cases of highly publicised, racially tinged police brutality that have occurred in recent months. Other efforts at ESG integration have included increased engagement with shareholders and other stakeholders to identify ESG concerns and priorities, and expansion of internal and external ESG reporting processes aimed to monitor progress and compliance with ESG goals. Companies are also re-examining how their executive compensation policies can be structured to align management incentives with ESG performance.

4 Finance

4.1 To what extent do providers of debt and equity finance rely on internally or externally developed ESG ratings?

ESG ratings, whether internally or externally developed, are used by providers of debt and equity financing to measure the ESG performance of borrowers. These ratings can play a role in sustainability-linked financing, where the loan terms are tied to the borrower's ESG performance. While sustainability-linked loans currently remain a small sector of the debt market, the volume of sustainability-linked loans has grown rapidly and will likely continue to grow in the coming years. As reliance on ESG ratings increases, links are already being drawn between ESG ratings and credit ratings. Several of the major credit ratings agencies have recently entered the ESG ratings space: in 2019, Moody's acquired a majority stake in Vigeo Eiris, a major ratings provider, while S&P acquired Trucost in 2016 and created the S&P Dow Jones ESG index earlier this year, which gives companies ESG scores. Morningstar took a 40% stake in Sustainalytics, another major ratings provider, in 2017.

4.2 Do green bonds or social bonds play a significant role in the market?

Green bonds and social bonds play a small but growing role in the U.S. markets, with Climate Bonds recording a doubling in the volume of green bond issuances year-over-year with US$227.8 billion issued in the first half of 2021. The United States does not have a regulatory system similar to the EU Taxonomy on Sustainable Finance or the EU Green Bond Standard, which sets performance thresholds for identifying environmentally sustainable economic activities and provides tools for verifying and reporting on green investment. While U.S. regulators have yet to follow their EU counterparts, private sector efforts are in place to promote standardisation and transparency on green bond issuances including a consultation draft released by the CFA Institute on ESG disclosure standards for investment products, including green bonds.

4.3 Do sustainability-linked bonds play a significant role in the market?

Sustainability-linked bond issuances have outpaced green bond issuances in the U.S. market in recent years, although such bonds remain a relatively small sector of the overall lending market. According to Climate Bonds, the first half of 2021 saw the sustainability-linked bond market segment growing to US$32.9 billion, representing 6% of total labelled debt issuance of US$496.1 billion for the period.

4.4 What are the major factors impacting the use of these types of financial instruments?

While still in its nascent stages in the United States, the growth of green and sustainability-linked bonds in recent years has been fuelled by growing interest among investors and companies looking to embrace ESG goals and to efficiently fund a transition to a green economy. Sustainability-linked bonds, in particular, provide investors and companies with the flexibility to invest in a wide range of projects while still capitalising on improvements in ESG performance. Increased transparency and standardisation in green and sustainability-linked bond issuances have also helped to fuel growth: the voluntary Green Bond Principles and Sustainability-Linked Bond Principles released by the International Capital Market Association have helped provide market participants with guidance on structuring, disclosing and reporting on green and sustainability-linked bond issuances. Newly adopted EU regulation on sustainable bond issuances will likely help to provide further increased transparency and standardisation on future issuances and draw even greater corporate and investor interest in these types of financings.

4.5 What is the assurance and verification process for green bonds? To what extent are these processes regulated?

Currently, in the United States, the assurance and verification processes for green and sustainability-linked bonds is largely guided by voluntary frameworks, such as the Green Bond Principles and Sustainability-Linked Bond Principles issued by the International Capital Market Association.

5 Impact of COVID-19

5.1 Has COVID-19 had a significant impact on ESG practices?

The COVID-19 pandemic has drawn significant attention to a number of "S" issues, notably issues relating to human capital management and diversity and inclusion, worker safety and well-being, and supply chain resilience. Employee health and safety, particularly among workers in essential industries, emerged as an immediate area of concern as the pandemic rapidly took hold of major U.S. cities. Growing awareness and concern over systemic racism has led to an increased focus on diversity and inclusion in who businesses hire, how they promote, where they invest, the suppliers they use, and the products and services they offer, as well as some high-profile corporate financial commitments to organisations focused on racial justice and community development. The disruptions and shortages that arose in the early days of the pandemic prompted companies to re-evaluate how to balance supply chain efficiency with supply chain resilience. Attention has also turned to executive compensation, with investors increasingly interested in how incentives can be aligned to ESG outcomes.

6 Trends

6.1 What are the material trends related to ESG?

Race to Carbon Net Zero: The continued push to "green" economies will present new opportunities and risks for companies and investors as they look to adapt to a low-carbon economy. Companies that are slow to adapt may face severe financial ramifications in the form of stranded assets and bear reputational costs as consumers continue to pivot to sustainability.

Disclosure to Integration: It is likely that ESG disclosure standards will continue to converge over time, providing investors with the standardised decision-useful data necessary to pinpoint ESG leaders and laggards. As part of that disclosure, companies, investors and other stakeholders are considering which metrics should require third-party verification or attestation. Attention is also being given to ESG integration, a trend that is likely to accelerate on the back of improved ESG disclosures providing both companies and investors greater clarity on ESG performance.

Growing Focus on Human Capital: Human capital issues will continue to attract investor and stakeholder attention as digitisation, automation and the growing globalised knowledge economy demand companies to be more agile and forward-leaning in shaping their future workforce. At the same time, companies will continue to juggle heightened expectations on diversity and inclusion in their workforce, particularly in senior-level management and on boards.

Vigilant Protection of Data: Data and cybersecurity have remained as top-of-mind ESG issues. Investors, companies and other stakeholders continue to focus on the critical risks posed in this area.

Updating Corporate Purpose: The ongoing shift toward stakeholder capitalism has prompted companies to re-examine their purpose and how they can achieve value for all their stakeholders. Looking ahead, stakeholders and investors will be looking to identify companies that have not advanced past the rhetoric.

Supply Chain Resilience: The COVID-19 pandemic has illustrated the fragility of many supply chains, and companies may need to re-evaluate how they balance supply chain efficiency with resilience. The shift toward a green economy, the impact of climate change, ongoing global trade tensions and pressure for reshoring have introduced new risks and uncertainties to be considered as companies rebuild their supply chains in the aftermath of the pandemic.

Compensation Tied to ESG Outcomes: As investor- and stakeholder-focus on ESG performance continues to grow, companies may face increased pressure to select and incorporate relevant metrics into compensation incentive structures. Improved ESG disclosures and standardisation of ESG metrics will likely create further impetus to tie compensation to ESG performance.

6.2 What will be the longer-term impact of COVID-19 on ESG?

The COVID-19 pandemic has accelerated many of the ongoing ESG trends while also reinforcing the importance of ESG. In the aftermath of the pandemic, investors and other stakeholders will want to know how companies approach systemic and critical incident risk management, and in particular, how they rebuild their internal policies and procedures and supply chains to anticipate future black swan events. Conversations around sustainability and adaptation to a low-carbon economy are also likely to gather pace as investors and the broader public link the pandemic with environmental degradation and draw parallels between the pandemic and climate change and the latter's potential to wreak an even more serious global calamity.

The pandemic has also accelerated the shift toward stakeholder capitalism by bringing into focus issues such as workplace safety and diversity and inclusion. The stark social and racial disparities that have been exposed amid the pandemic will likely increase demand for companies to adopt a corporate purpose that serves the interests of all its stakeholders and not just shareholders.

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