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Earth Day Series 2022: Environmental, Social & Governance Part 2 - The Birth of Environmental, Social and Governance as a Sustainability Metric

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On Friday, April 22, the United States and the rest of the world will recognize Earth Day 2022. With "Invest in Our Planet" as its theme, Earth Day 2022 focuses additional attention on Environmental, Social, and Governance (ESG) as an important metric for evaluating activities that may impact human health or the environment. This is the second in a series of publications by Bradley's Environmental Law team in recognition of Earth Day 2022. In the first article, we looked back at the more than 50-year history of Earth Day and the progress that has been made in addressing environmental issues in the U.S. In this second article, we will discuss the birth of the ESG metric and the current status of various efforts to standardize the way ESG issues are measured. The final article will provide practical guidance on how to establish or refine an ESG program.

In 2000, the United Nations established the Global Compact as a non-binding organization of corporations, cities, foundations, and other entities committed to implementing sustainability principles and supporting the goals of the UN. Currently, there are over 800 participants in the U.S. and 15,000 global participants. Members of the Global Compact commit to operate in a manner that meets fundamental responsibilities in the areas of human rights, labor, environment, and anti-corruption. The fundamental responsibilities create the Ten Principles of the Global Compact and were derived from Universal Declaration of Human Rights, the International Labor Organization's Declaration on Fundamental Principles and Rights at Work, the Rio Declaration on Environment and Development, and the United Nations Convention Against Corruption.

In 2004, the Global Compact published "Who Cares Wins – Connecting Financial Markets to a Changing World," and the ESG measurement was born. According to the report, "[t]he institutions endorsing this report are convinced that in a more globalized, interconnected and competitive world the way that environmental, social and corporate governance issues are managed is part of companies' overall management quality needed to compete successfully. Companies that perform better with regard to these issues can increase shareholder value by, for example, properly managing risks, anticipating regulatory action or accessing new markets, while at the same time contributing to the sustainable development of the societies in which they operate. Moreover, these issues can have a strong impact on reputation and brands, an increasingly important part of company value." This report also provided a list of key recommendations represented by the following diagram:

In 2015, the UN agreed to a plan called “Agenda 2030.” Seventeen Sustainable Development Goals (SDGs) were established as part of the Agenda 2030 plan and include a number of aspirational goals (e.g., no poverty and zero hunger) and others that are less defined (e.g., affordable and clean energy and climate action). A number of these goals are reflected in the Biden administration’s focus on environmental justice initiatives and climate change. For example, earlier this month, EPA released an “Equity Action Plan” designed to implement President Biden’s Executive Order 13985 and assess whether underserved communities and their members face systemic barriers in accessing benefits and opportunities through the federal government.

The increased focus on ESG issues also has led to more interest on how such issues are measured and reported, particularly for publicly traded companies and financial institutions. In March 2021, the Securities and Exchange Commission (SEC) requested public comments in 15 different areas designed to solicit public input on how climate disclosure information should be reported and evaluated. Also in March 2021, the SEC announced the creation of a Climate and ESG Task Force in the Division of Enforcement. The task force was directed to develop initiatives to proactively identify ESG-related misconduct – particularly in the accuracy of climate-related disclosures and statements regarding the screening of investments based upon consideration of ESG issues.

In March 2022, the SEC proposed a rule requiring publicly traded companies to disclose climate-related information, including climate-related risks that are reasonably likely to have a material impact on business, results of operations or financial conditions and certain climate-related financial statement metrics in a note to their audited financial statements. The comment period for the proposed rule closes on May 20, 2022. According to the SEC’s press release, disclosures would be required regarding “(1) the registrant’s governance of climate-related risks and relevant risk management processes; (2) how any climate-related risks identified by the registrant have had or are likely to have a material impact on its business and consolidated financial statements, which may manifest over the short-, medium-, or long-term; (3) how any identified climate-related risks have affected or are likely to affect the registrant’s strategy, business model, and outlook; and (4) the impact of climate-related events (severe weather events and other natural conditions) and transition activities on the line items of a registrant’s consolidated financial statements, as well as on the financial estimates and assumptions used in the financial statements.”

Whether the proposed rule is adopted, it is clear that ESG issues will continue to evolve and play an important role in how organizations respond to broad interest in climate-related activities. Next week we will discuss a framework for developing or refining an ESG program and address steps that may be taken to develop an ESG strategy.

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