Values at Work: Sustainable Investing and ESG Reporting

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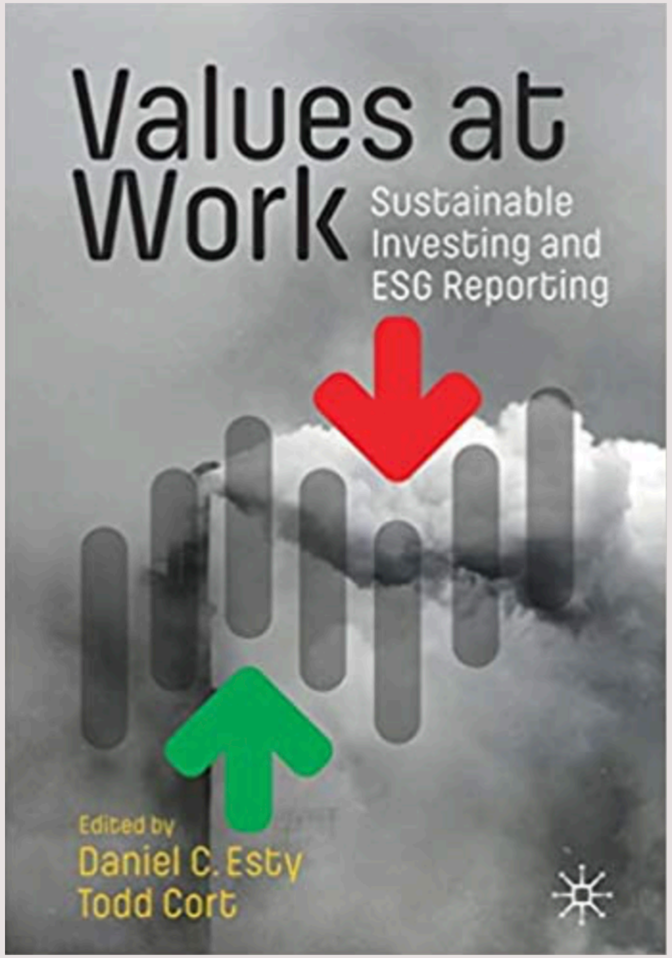


Extraordinary Times

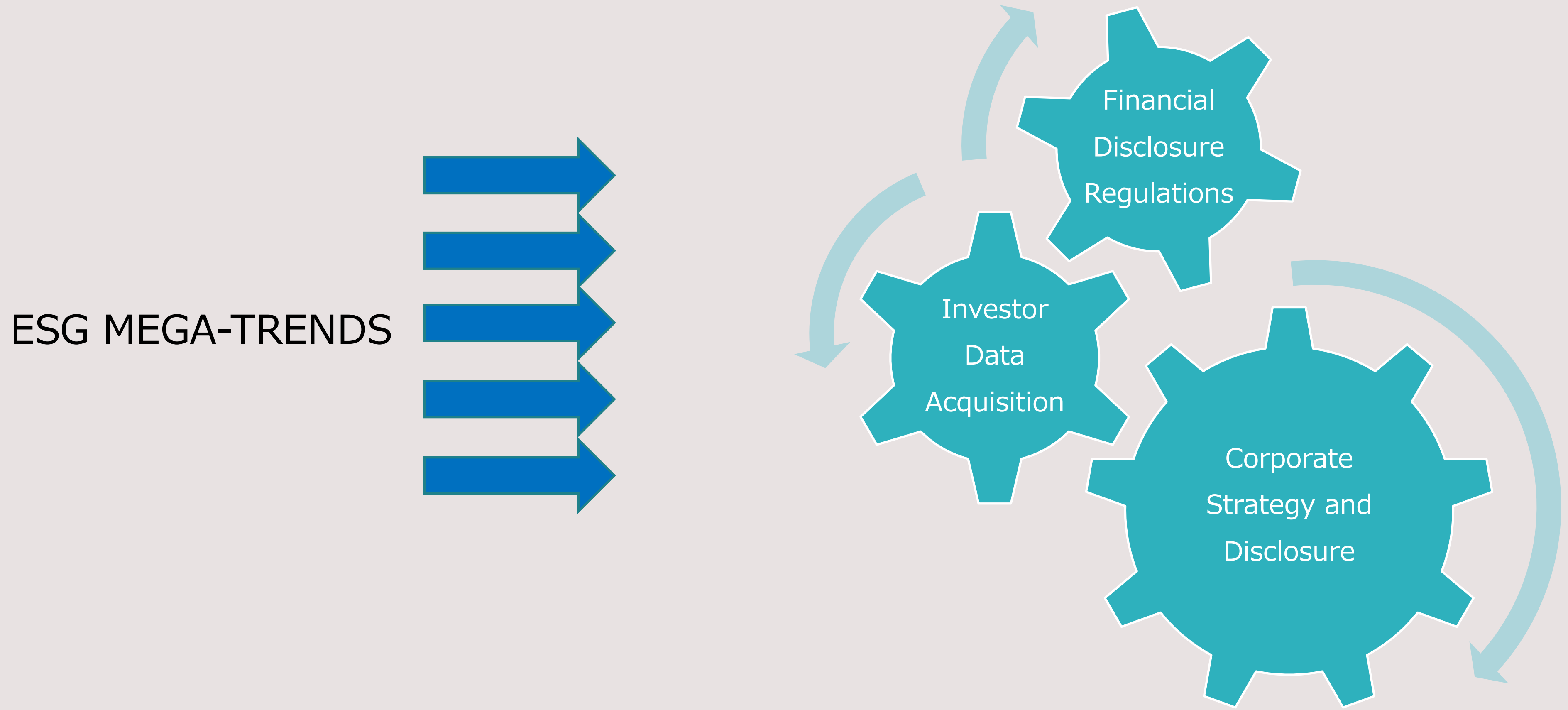
Sustainable Investments almost tripled from 2012 to 2018 from $13.3T to $30.7T (GSIA, March 2019)

Asset Manager announcements of ESG integration and “Net Zero” have hit the headlines over the last year (JPM, SSGA, BR, Vanguard, etc)

The TCFD has served as the ‘tip of the spear’ for expanding disclosure on financial risks and business strategy from ESG factors

The EU recently issued Non-Financial Reporting Directive (NFRD), Sustainable Finance Disclosure Regulation (SFDR) and EU Taxonomy for Sustainable Activities, followed by announcements from the SEC on review of materiality

Today's Discussion



Disclosing Climate Risks:
Evolving Standards and Regulations

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Growing Risk Awareness

April 2006 UN Principles of Responsible Investment started with 63 signatories (now > 1900).

Sept. 2015 Mark Carney spoke of the "Tragedy of the Horizon" in a speech at Lloyd's of London.

Dec. 2015 G-20's FSB created the Task Force on Climate-Related Financial Disclosures (the TCFD).

June 2016 BlackRock calls for a "consistent global framework" to "enable[] stakeholders and market participants to develop detailed ESG standards and best practice guidelines."

Climate Disclosure: TCFD Recommendations

Core Elements of Recommended Climate-Related Financial Disclosures

Governance
The organization's governance around climate-related risks and opportunities

Strategy
The actual and potential impacts of climate-related risks and opportunities on the organization's businesses, strategy, and financial planning

Risk Management
The processes used by the organization to identify, assess, and manage climate-related risks

Metrics and Targets
The metrics and targets used to assess and manage relevant climate-related risks and opportunities

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Moving from Awareness to Action

- Asset management firms, proxy advisors, and ratings agencies are purchasing and partnering with climate data firms
- Incorporating climate-related information into assessment platforms
- Committing to vote against boards that don't take action, requiring companies to disclose and make commitments
- Banks changing lending policies and reporting on their own climate impacts

Timeline of Investor and Bank Use of Climate Information

This is a work in progress. Please share relevant items you think we may have missed.

April 2006: The United Nations' Principles of Responsible Investment organization, starts with 63 signatories (now over 1900 signatories).

Sept. 2015: Mark Carney speaks of the "Tragedy of the Horizon" in a speech at Lloyd's of London.

Dec. 2015: The G-20's Financial Stability Board (FSB) established the Task Force on Climate-Related Financial Disclosures (the TCFD).

June 2016: BlackRock calls for a "consistent global framework" to "enable[] stakeholders and market participants to develop detailed ESG standards and best practice guidelines."

Jan. 2017: State Street tells boards it is focused on "environmental and social sustainability in areas such as climate change" and highlighted support for shareholder climate proposals.

March 2017: BlackRock says it may vote for shareholder climate proposals and against directors if companies don't adequately respond to engagement and says climate will be a priority for engagement in 2017.

June 2017: TCFD releases recommendations for climate disclosure.

June 2017: Institutional Shareholder Services acquires the investment climate data division of the South Pole Group, which provides investors and financial institutions with "data and analytics to measure the impact of climate change on portfolios."

Sept. 2017: Vanguard announces that it has voted against management in support of climate disclosures.

Nov. 30, 2020: Bank of America becomes the announce it will not finance oil and gas projec Goldman Sachs Group Inc., JP Morgan Chas Citigroup, Morgan Stanley, and Bank of Amer finance projects in the refuge. (see also, Bloo arctic drilling)

Dec. 9, 2020: New York State pension fund a fuels.

Dec. 11, 2020: CalSTRS joins an effort to ele ExxonMobil's board and is planning to accele light of the election of Biden.

Dec. 16, 2020: Lloyds of London issues first s policy changes regarding coal and other fossi

Jan. 2021: BlackRock CEO, Larry Fink's 202 commitments to a "goal of net zero greenhous describes metrics that BlackRock would use i companies were in compliance and a "heighte managed funds would use in dealing with nor BlackRock also released a 2021 Stewardship Voting Guidelines ahead of Larry Fink's letter to support shareholder proposals. BlackRock Stewardship Global Principles document its e articulate how they are aligned to a scenario i well below 2° C, consistent with a global aspi gas (GHG) emissions by 2050.

March 2021: BlackRock releases Investment Stewardship engagement priorities and specifies how it will engage on its net zero GHG emissions target expectations. BlackRock expects companies to have climate action plans and low carbon targets and will vote against boards who are not adequately addressing climate risks.

June 2021: An analysis of SASB-focused shareholder resolution votes finds significant success in these efforts, including support by BlackRock for a number of proposals. It also notes BlackRock's vote against a director due to the company's lack of climate disclosure.

See full timeline and other resources at: https://eelp.law.harvard.edu/climate-related-disclosure-and-financial-risk-management/

BlackRock 2021 Letter to CEOs:

- Disclose a plan for how your company will be compatible with a net zero economy by 2050
- TCFD should be adopted by public and private companies
- Outlined their own plan, including heightened-scrutiny model for investments in actively managed portfolios

2021 Engagement Priorities

Companies Responding

- Number committing to report in line with TCFD recommendations growing.
- Establishing emissions reduction targets, disclosing more metrics, and investing in new technologies.
- Making public policy commitments (i.e., methane, cars rules).
- Beginning to plan for surviving the energy transition.
- **Disclosure key to measuring progress on these commitments.**

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U.S. Disclosure Law for Public Companies

U.S. Securities Law Disclosure Requirements

- Requires disclosure of certain information
- Disclosure often limited to “material” information
- Prohibits false or misleading statements, even made outside of financial filings
- Not all material information must be disclosed (if not asked for)
- But must provide material information even if not requested if it is necessary to make the information requested not misleading

Material information is that which a ***reasonable investor*** is substantially likely to view as significantly altering the total mix of information made available.

SEC Climate Disclosure Guidance & Enforcement

SEC 2010 Climate Disclosure Guidance

- Emphasized existing reporting requirements
- Followed by minimal enforcement
- Resulted in little change in disclosure practices

2016 SEC Concept Release No. 33-10064

- Asked for comments on including ESG/climate in line-item requests
- Emphasized role of materiality in limiting disclosure
- Acknowledged “[t]he role of sustainability and public policy information in investors’ voting and investment decisions may be evolving”

Between 2016 and 2021, SEC resistant to action.

New Leadership at SEC

SEC: New Leadership, New Approach

- Acting Chair Lee named a Senior Policy Advisor for Climate and ESG
- Division of Corporate Finance to enhance focus on climate disclosure; review and revise 2010 guidance; start down path of potential regulation
- Division of Examinations included climate change in its 2021 examination priorities
- Division of Enforcement created a Climate and ESG Enforcement Task Force
- **March 15:** SEC opened a **90 day comment period** on climate change disclosures

A Climate for Change: Meeting Investor Demand for Climate and ESG Information at the SEC

Acting Chair Allison Herren Lee

Washington D.C.

March 15, 2021

Thank you, John [Podesta], and thanks to the whole team here at the Center for American Progress, for hosting me today. I've had the honor of serving as Acting Chair of the SEC for nearly two months now, and I appreciate the opportunity to reflect on the enhanced focus the SEC has brought to climate and ESG during that time, and on the significant work that remains. Along with shepherding the agency through the transition and supporting the work of the SEC staff, no single issue has been more pressing for me than ensuring that the SEC is fully engaged in confronting the risks and opportunities that climate and ESG pose for investors, our financial system, and our economy.

See full chart of federal financial regulator actions at: https://eelp.law.harvard.edu/climate-related-disclosure-and-financial-risk-management/

U.S. Regulators Took Diverging Paths During Trump Administration

Federal Reserve

- Studies systemic financial risks of climate change and participated in international fora before 2020
- **2020 Financial Stability Report** and **Supervision & Regulation Report** discussed climate change
- **Dec. 2020** joined Network of Central Banks and Supervisors for Greening the Financial System (NGFS)
- **Jan. 2021** created a Supervision Climate Committee
- **March 2021** created a Financial Stability Climate Committee

Commodity Futures Trading Commission

2020 Report on Climate Risks - Recommendations

- Incorporate climate-related risks into mandates and monitoring and oversight functions
- Research and assess bank, insurance, and other exposure to climate-related risks
- Actively engage their international counterparts
- Require financial players to address and disclose climate-related financial risks
- Pilot stress testing
- Specific recommendations for the CFTC and insurance regulators
- Consider disclosure rulemaking / improvements

March 2021 created a Climate Risk Unit

EBSA 2020 Rules

Nov. 2020, Financial Factors in Selecting Plan Investments:

- Cautioned against considering ESG factors in ERISA-covered plan investments, emphasizing financial outcomes over other considerations, restricted fiduciaries from offering ESG-themed funds as default options.

Dec. 2020, Fiduciary Duties Regarding Proxy Voting and Shareholder Rights

- Clarifies plan fiduciaries are not required to vote all proxies, votes they do make should be based on *pecuniary* factors only.
- Lists principles a plan fiduciary must consider when deciding whether to exercise shareholder rights, including not using plan assets to further "policy-related or political issues, including ESG issues."

March 2021, EBSA announced it would not enforce either rule, intends to revisit them

Comptroller of Currency "Fair Access" Rule

Jan. 14 2021, Fair Access to Financial Services Rule

- Banks must assess risk for individual customer rather than industry or category; requires banks to provide services offered to all lawful businesses in a market if it provides them to any; can't deny services by sector.
- Response to bank lending policies on oil and gas projects (including Arctic).

Jan. 28, 2021 OCC halts rule

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Summary Points

- **Climate change information is becoming material** for companies, even without new regulation.
- But absent regulatory guidance, the evolution of disclosures is **messy**, potentially more **legally fraught** for individual players, and **confusing**.
- **Biden climate agenda includes federal financial regulation**, a break from past practice.
- **Regulators are now taking action** on climate-related disclosures and risk management.

PRIVATE COMPANY ESG

(1) ESG DUE DILIGENCE
(2) POST-TRANSACTION ESG PROGRAM DEVELOPMENT
(3) ESG DATA: RATINGS AND METRICS

April 16, 2021

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Threshold Issue: Defined Terms

- "ESG" is a taxonomy that describes and categorizes certain nonfinancial factors that impact a corporation's bottom line.
- "Sustainability" refers to business resiliency – a result of the effective management of the nonfinancial factors included under the umbrella of ESG.
- Examples of factors included within ESG:

Environmental	Social	Governance
– Carbon emissions – Resource consumption and recycling – Toxic emissions and waste – Biodiversity and land use	– Human capital management – Diversity and Inclusion – Health and Safety – Supply chain labor standards	– Business ethics – Anti-corruption – Anti-money laundering – Privacy and data security

ESG "Exit Exam"

- ESG due diligence is becoming a standard component in exit transaction diligence.
- PE acquisitions, strategic acquisitions, and IPOs
- While ESG issues vary by industry, ESG due diligence is conducted regardless of industry.
- Companies are expected to have an appropriately tailored program in place.
- Private companies should prepare well in advance of the org meeting or negotiation of an LOI – a lead time of two years from exit is appropriate.

Example ESG Due Diligence Questions

- What does the Company consider to be the most relevant ESG risks and opportunities with respect to its business? Please describe the process the Company used in making this determination. What stakeholders were engaged in this process?
- What is management’s view of the overall maturity status of its existing ESG governance framework, including its policies, processes, and systems?
- Please describe the arrangements in place for monitoring and reporting ESG issues and performance to senior management/the board.
- How is corporate governance managed across the Company and its operations? Please provide details of any associated key policies.
- Please provide details of any significant projects/initiatives that have been implemented to improve environmental performance/standards/compliance at the Company, e.g., waste/energy projects that have resulted in carbon emission/consumption reductions and cost savings, enhanced communications to improve environmental awareness, etc.
- What is the Company’s human capital management strategy?
- How are diversity, equity, and inclusion addressed across the organization?

Post-Transaction Program Development: ESG Framework

- Establish Effective Oversight
- Prepare Appropriate Disclosures
- Address Commercial Requirements
- Develop a Strategic Plan for Stockholder Engagement
- Ensure Legal Compliance

Rise of ESG Data

ESG RATINGS:

ISS

MSCI

SUSTAINALYTICS

STATE STREET

ESG REPORTING STANDARDS AND FRAMEWORKS:

SASB — Sustainability Accounting Standards Board

TCFD | Task Force on Climate-Related Financial Disclosures

SEC DISCLOSURE REQUIREMENTS AND GUIDANCE:

- Human capital disclosure rule
- Forthcoming climate-related disclosure guidance

Orrick Private Company ESG Diligence

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Appendix: The Delaware Public Benefit Corporation

- Required to balance the pecuniary interests of the stockholders, the best interests of those materially affected by the corporation's conduct, and a specific public benefit or public benefits
- Required to produce a public benefit statement at least every two years
- Two PBC IPOs in 2020: Lemonade and Vital Farms
- Veeva Systems (~$40 billion market cap) became first public company to convert to a PBC in February 2021.