Ep. 44: An ESG Roadmap for Business

March 26, 2021

Jose Garriga: Hello and welcome to *OnAir with Akin Gump*. I'm your host, Jose Garriga.

ESG or environment, social and governance, is one of the hottest topics in boardrooms and government offices on both sides of the Atlantic, as stakeholders, boards and investors engage the topic of corporate social responsibility.

We have with us today two of the heads of Akin Gump's ESG group: Washington, D.C.-based partner Stacey Mitchell and London partner Amy Kennedy. They'll be discussing ESG from the U.S. and international perspectives, looking at its growth and the areas where it is making a difference in how business does business, and examining how the clients they serve are looking at ESG.

Welcome to the podcast.

Stacey, Amy, thank you both for making the time to appear on the show today, and over to you.

Amy Kennedy: Thanks, Jose. So, Stacey, starting this conversation, from your perspective, what really is ESG?

Stacey Mitchell: Thanks, Jose, and thanks, Amy. ESG is really a reference to a decision-making that takes into account environmental, social, and government considerations. Other names for it, and Jose alluded to these in his opening, include corporate sustainability, corporate social responsibility or corporate responsibility. These factors, historically, have been characterized as qualitative rather than readily quantifiable. However, increasingly there's evidence that there is a nexus between sustainability, or performance on these ESG issues, and financial performance. As one study put it, it's the confluence of values and value.

If you look back a decade or more, these issues weren't baked into the operation and decision-making of a company or a business. To the extent that they were considered, it was to do good, and it was done so by acting philanthropically. That's really changed, and, so, another way to think of ESG is part of an overarching compliance program, where adoption of these socially responsible practices helps entities avoid liabilities from a range of risks, legal, reputational or operational.

One last point, Amy, of increasing importance and interest, certainly, is risk associated with climate change. Sometimes you'll hear discussion of climate as distinct from ESG disclosure and considerations, but, generally speaking, climate is but one of the E or environmental issues that an entity must consider. But Amy, I'd really love to hear how that compares to your view, taking on a more international perspective of it.

Amy Kennedy: Sure, thanks, Stacey. I entirely agree with your analysis there; I think ESG is evolving rapidly into having a really prominent role in the way companies communicate with, as, Jose, you said, customers, employees, shareholders, investors, regulators, the list of virtually every other stakeholder just goes on. And as you'll note, the ESG vocabulary really is a sort of outgrowth, if you will, from the corporate social responsibility framework that then enables companies to assess their impact across a number of issues, and, therefore, accordingly, take action.

I think, interestingly, from my perspective, many companies look for ESG initiatives that align with their environmental and social impact goals in the communities where they do business, locally. So, it really can be as much about local targets and initiatives and not just those which are perhaps sectoral or more geopolitical and driven from a global perspective. Leading on from that, one thing that's, I guess, a curious point for me is, why are we really seeing so much in relation to ESG at the moment, and why does the world suddenly seem to care about it? Stacey, have you got a view on that?

Stacey Mitchell: I do. I completely agree with you, Amy, that it is this interesting matrix of global view as well as really local. I think, with respect to why now, it definitely feels, in some ways, that ESG has burst onto the scene, at least in the U.S. But a level set for our listeners, it's been 15 years since the first report on this that's really well recognized, entitled Who Cares Wins, it's been 15 years since that was published, initially making the business case for environmental social governance.

But you're right: Alignment on the value proposition of ESG topics has evolved pretty quickly over the last couple of years, and all stakeholders, from shareholders to investors, employees, have been increasingly viewing commitment to ESG, really, as brand differentiators. Interestingly, studies show that Americans base purchasing decisions on their values, and that they're willing to spend, at least in one study, they found up to 20% more on environmentally sustainable products. So, this is really coming to the fore here.

If I take a moment and look, just about a year ago when the world was beginning to grapple with the COVID pandemic, I think it was a little bit of an outstanding question whether ESG would continue to have traction and grow. And as it turns out, I think it was one of a host of events that impacted the U.S. in particular that has amplified the importance of ESG here. On the S front, the social front, COVID called into stark focus how the companies were dealing and caring for their human resources. Also on the S front was the death or the murder of George Floyd that ignited a racial reckoning here in the United States and really brought into question a whole host of social responsibility questions there.

Then finally, the environment and climate came into focus with a series of storms in the South, each one of which was a hundred-year storm, all the while the western portion of the U.S. was on fire, and all of these events being aligned with or associated with climate change. Then I think layered on top of that, we had our presidential race that was, at least on the Democratic side of the party, really centered on the question of focusing on climate change, and we certainly have a President today who is focused on this. Those are my thoughts, Amy, on why it seems to be gaining interest in the U.S. But I would be remiss in this conversation if I didn't note that ESG has been more prominent in the U.K. and in Europe for some time now, so I'd be interested to hear your view of why now in Europe and how that differs?

Amy Kennedy: It's an interesting question, I think many of the issues you raise, we appreciate absolutely and in parallel have certainly been an accelerator for the U.K. as much as the U.S. And I think it's difficult not to acknowledge that the S and the G elements have increased through the rather obvious global focus of the last year, the pandemic, and have perhaps caught up with the more traditional focus on the E that you mentioned earlier. I think more generally, and as you say, I think that perhaps because the Europeans and the U.K. have been slightly ahead, has been the real differentiator in terms of the focus on companies and stakeholders almost getting ahead of the game in terms of why ESG is important. And they've now really started to look for real commitments and assess material and measurable outcomes.

Why is that? I think, really, it's in part because the stakeholders themselves across the spectrum have become more attuned to ESG. This isn't an initiative which is driven from the bottom up. This isn't an employer or a customer or a consumer who just cares about an element of this thing called "ESG" and is desperately trying to push forward an initiative in their organization. This is the direction from the top, this is from the fund manager, from the asset manager, from the equity investor, from the prospective debt investor. It's the person looking at value creation and seeing an opportunity to capitalize. That has just meant that from our perspective, things have really accelerated.

Of course, on the flip side of that, the ESG metrics are now increasingly being made accountable. Whether that's through full disclosure and reporting frameworks—some of which I'd like to ask you about, actually, Stacey, and discuss—or informal ones. ESG has started to require that real commitment and accountability, and not just for climate change, and perhaps that's inevitable as you say anyway, but also for that S and G as well. With a clear sense in the market, even informally I think, that companies receive credit for transparency in thinking, thought leadership, and now ESG.

Only yesterday I received a client alert-style email from a client themselves that I wouldn't really typically associate in perhaps the ESG sector if you will, not that ESG has a sector, but certainly not in the E sector, proudly noting certain achievements in the climate change space and what they had supported through the last year. Stakeholders are competing for ESG column inches, if you will, and that's a real accelerator. I think on that, though, this is one of the challenges. I think, or one of the reasons, in part, we're having this conversation today, Stacey, which is that there is a huge alphabet soup out there of the various disclosure frameworks and the various initiatives for ESG. Is that something, Stacey, you could talk through?

Stacey Mitchell: I'd be happy to. And you're right, I think disclosure is really what the consumers of this area are looking for. And you're right, it's a complete alphabet soup, and we would be here probably through later tonight if we went through all of them. I just want to hit on a handful of them and certainly the leading frameworks. Something to keep in mind as I go through these, and I'm sure you're aware of it, is that a number of these frameworks, there's a lot of momentum for consolidation amongst some of them, and collaboration amongst a lot of them, and I'll talk a little bit about that. With that goal of ultimately having some sort of standardization in the transparency so that there's really an ability to compare apples with apples, if you will.

I will talk about the GRI or the Global Reporting Initiative first, in part because they were the first to publish global standards. They are predominantly designed to provide information to a really wide variety of stakeholders, and, therefore, they include a broad array of topics and a more flexible framework. Companies under the GRI, they report contextual information according to three universal standards.

There is the GRI 101 or the foundation, which actually helps a company identify the topics that are material for that company. The second is the GRI 102 or the general disclosures, where a company, through following these procedures, disclose their contextual information on these material topics. And then the third is the GRI 103, which is entitled management approach, and it helps guide the company through reporting on how they manage the material topic. The other layer I'll put there is that on the self-identified material topics, there's disclosure along three broad topic areas, including economic, environmental and social. That's an overview of GRI.

The next one is the Sustainability Accounting Standards Board, or SASB. This was modeled after the Financial Accounting Standards Board, which I'm sure our listeners are well familiar with. SASB standards are designed more to provide information to investors and, therefore, focus even more so on financially material sustainability issues. SASB has 77 different industries, and they have a materiality map. The way that the standards are broken down, they're organized, in the first instance, around sectors that are further broken down into industries.

For example, consumer goods is a sector, and then industries within that sector include the broad array from apparel and footwear, appliance manufacturing, building products and e-commerce, and within each industry, they're structured as follows. There's disclosure topics. So, for each industry-specific disclosure, there'll a minimum set of topics that reasonably likely to constitute material information, and then a brief description of how management or mismanagement of each topic could affect value creation. There are accounting metrics that are both quantitative and qualitative, and intended to measure performance on each topic. The standards also include guidance on definition, scope, implementation, compilation and presentation. Then there are activity metrics that quantify the scale of a company's business and are intended for use in conjunction with accounting metrics to normalize the data and facilitate comparison.

Turning now to one, the Task Force on Climate-Related Financial Disclosures or TCFD. This was established by the Financial Stability Board at the request of G20 finance ministers and central bank governors to establish recommendations for consistent voluntary climate-related financial risk disclosures in public annual financial filings. The goal again, just like the others, is to bring some sort of uniformity, in this instance, to climate related financial disclosures. TCFD facilitates informed investment credit and insurance underwriting decisions and does so to avoid market stability concerns that can arise from mispricing of assets or misallocation of capital when information is either unavailable or unusable.

TCFD has four recommendations that relate to governance, strategy, risk management, and metrics and targets. The principles that underpin TCFD’s recommendations all inform climate-related financial reporting, including disclosing information that's relevant, specific, clear, understandable and verifiable. They should also be consistent over time and presented in a way that makes them comparable, again, to disclosures of other companies in that same sector, industry or portfolio.

I mentioned at the outset that some of these different framework entities are trying to work together. As part of the Corporate Reporting Dialogue Better Alignment Project, SASB and GRI have put together a report entitled Driving Alignment in Climate-Related Reporting that actually maps alignment between TCFD recommendations and that particular organization's standards. There is really a lot of information out there, how to use these together. And what we've really come to see is that entities may focus on either GRI or SASB predominantly, but they will still use a hodgepodge of those two, and then, certainly, layer on top of that, the TCFD.

The one other entity I want to talk about is the UN Principles for Responsible Investing or UNPRI, and that is really a little bit of a different color because it was developed for investors, and it was developed by investors. It is a voluntary and aspirational set of investment principles that offers a menu of possible actions for incorporating ESG issues into investment practice. There are six key principles, but they include an acknowledgement of the duty to act in the best long-term interest of beneficiaries as a fiduciary, and the recognition that ESG factors can affect the performance of investment portfolios. Also, UNPRI really requires investors to be active in the context of ESG and to think about it when they're investing and engaging with the entities in whom they invest.

That is a quick overview of the key alphabet soup reporting framework. Anything you wanted to add to that, Amy? Or thoughts you had on any of those?

Amy Kennedy: Thanks, Stacey. I think my thoughts are, every time I hear that list, I'm just glad that there is this global momentum really behind consolidation and collaboration with some sort of goal, having a sector global standard, because you really are weaving and navigating between those various frameworks. But it is also just to note that, at the moment, they are applied globally as well, and, so, the issues you're facing, obviously, are those that are impacted in the European and the U.K. as well.

When we're looking in terms of the ESG angle from our own practices, Stacey, where do you see ESG featuring most prominently? Is it in corporate clients, fund clients? How do you apply those frameworks in your practice?

Stacey Mitchell: My answer is “yes” to that. We really are seeing it across the host of clients that the firm has. We work with corporate clients and our funds clients that are really starting to make this decision to jump into this voluntary reporting and to consider before they do that – to be thoughtful in advance of that – to evaluate both the opportunities and the risks associated with ESG reporting. We will work through with our clients, and let's take a corporate client, help them understand how reporting can give them a competitive edge. It also allows them the opportunity to evaluate how they measure up in this context against their peers. Then, actually, also to consider the legal risk associated with making false or misleading disclosures or promises that really can't reasonably be anticipated to be met. For those clients, we're helping draft or refine ESG policies or goals, we're assisting them in setting up internal infrastructure or initiatives to enable them to meet the commitment, and to roll it out throughout their organization or their entity. If you don't do so, then the likelihood that you are going to succeed is pretty low.

And, clearly, what happens as we are doing this and pulling ESG policies and programs together, in the context of that, we are identifying gaps or risk areas. And, actually, that is a “good”, of course, because that allows us and the entity to get ahead of potential, either legal, reputational or operational risk.

For our funds clients, we're helping them more in the context of either a diligence with a new acquisition or a new portfolio company, as well as on decisions on the credit lending side. And then, with particular focus on climate, we're working with clients at the intersection of the existing GHG [*greenhouse gases*] regulations and then the evolving drive towards these voluntary targets, e.g., net carbon-neutral by a certain year. I mean, that's certainly getting more and more traction. And helping clients recognize whether that aspirational goal is one that they ought to be even articulating, if it's one they can meet. And sometimes helping them recognize that it is better to have a less lofty goal, but one that you can actually achieve. We, obviously, additionally, assist in compliance strategies. We also are assisting with carbon emissions trading offsets and certifications and then ongoing basis monitoring and verifying emissions reduction strategy. How about you Amy? How is it impacting your practice, specifically?

Amy Kennedy: Thanks Stacey. I mean I love hearing how many touch points ESG has, more generally, for you, quite fascinating really. As a humble finance lawyer, I think that the focus for me has been twofold, I suppose. First, if I think about the direct instruments, the concept of green or sustainability-linked loans and bonds have been around for some time now, globally. Green loans and bonds, the principle feature of which is that the proceeds of the loan or the bond are used for so-called “green purposes.” So, obviously, a discussion about what that means and how that gets quantified, but there has to be a green purpose to it.

And secondly, sustainability-linked loans and bonds, which is really where the pricing of that underlying instrument may be linked to the borrower's performance against a predetermined sustainability-linked performance indicator. That's where we do plunge into those frameworks and standards to see the testing, and how we can actually rightly link. These are products which investors are increasingly interested in, all the reasons we were mentioning generally about the prominence and the rise of ESG, but we're seeing it in the credit markets, the private placement space, also into the fund financing world as well.

I think, in addition to those products, if you will, more generally, the concept of disclosure of ESG factors in the debt markets has been a real hot topic, certainly in my practice in the last 12 months. I certainly don't want to give away the excitement of one of our future ESG podcasts, but looking at it more generally, it really is about assessing the level of disclosure required by a company, borrower, issuer, and how that is applied across the spectrum, whether that's a small-cap company, a large-cap company, and across a myriad of sectors.

And why are we seeing this disclosure? Well, largely for the points we've raised before: the developing regulatory framework, the drivers to disclosure, the Taxonomy directive [*Regulation (EU) 2020/852*], but also market and investor pressure as well, the top-down approach that I mentioned earlier. And once there starts to be a price tag applied, or the possibility of a pricing incentive, potentially, then, of course, things start to gain more prominence. As you can imagine, this has an impact for the underlying entities, of course, but for finance, for acquisition, M&A-related diligence processes, and also ongoing compliance with ESG policies and other such metrics.

So, it’s an exciting time in the finance world, from my perspective. And I think, just before you conclude, Stacey, I'll also note that, just outside the practice-specific area, I really see ESG hitting on our diversity and inclusion in the workplace procurement policies and procedures. I was interviewing a candidate at the end of last year, and they asked me what our firm ESG policies are. In that respect, ESG is really just pervasive throughout our working environment as well.

Stacey Mitchell: You're exactly right, and there's a lot to be said that, really, a strong ESG proposition is attracting the best candidates in the employment market, absolutely. Really it is. I think we're just on the leading edge of what's going to happen in this area, and I'm really excited about it and excited to be talking to you about it today. And, actually, really appreciated hearing the context of, as you maybe did with me, my hearing how it's impacting your work.

For those that are listening, thanks for tuning into this first ESG 101 podcast. As a tickler, in our upcoming webinar, Amy and I will be joined by our partner Ezra Zahabi, who will talk in greater detail about what's happening in the EU and the U.K. from a regulatory perspective. She'll discuss the new EU ESG disclosure requirements and the European ESG themes, including the SFDR and its implementation, and other ESG rules that are coming up the pipeline. We'll also discuss what are becoming near-weekly developments on this topic in the U.S., with a focus on the SEC and consider whether what's happening and what has happened in the U.K. and EU, is a harbinger for things to come in the U.S.

Jose Garriga: Thank you, Amy and Stacey. Listeners, you've been listening to Akin Gump partners and ESG group co-heads Amy Kennedy and Stacey Mitchell. Thank you both for making the time to appear on the show today and sharing your thoughts and perspectives on what you have identified and shared with our audience as being a very hot topic across a very wide variety of sectors and industries.

And thank you, listeners, as always, for your time and attention. Please make sure to subscribe to *OnAir with Akin Gump* at your favorite podcast provider to ensure you do not miss an episode. We're on, among others, iTunes, SoundCloud and Spotify.

To learn more about Akin Gump and the firm's work in, and thinking on, ESG matters, look for “ESG” at the Experience and the Insights & News tabs at akingump.com, take a moment to read Amy and Stacey's bios on the site and then visit our new *Speaking Sustainability* blog, which features our lawyers’ thinking and analysis on all matters ESG-related.

Until next time.