JS HELD

PERSPECTIVES

Crosscurrents: J.S. Held's Environmental, Social & Governance Observations

Our perspectives feature the viewpoints of our subject matter experts on current topics and emerging trends.

INTRODUCTION

Environmental, Social and Corporate Governance ("ESG") data collecting and reporting are among the fastest changing, most highly watched, and most complicated corporate obligations today. Interestingly, in the United States, there is currently no specific SEC ESG driver (subject to other more general SEC obligations) for the obligation, but there may be soon, depending on how the Securities and Exchange Commission's ("SEC") proposed rule plays out. Chairman Gary Gensler observed that "investors are looking for consistent, comparable, and decision-useful disclosures around climate risk," and, when there is not a clear regulatory driver, the SEC "should step in when there's this level of demand for information relevant to investors' investment decisions."[i] We must wait to see where the SEC lands with its requirements around ESG reporting; meanwhile, over 90% of the S&P 500 and 70% of the Russell 1000 published some sustainability data In 2020[ii]—reporting which is in no way standardized or consistent.

WHY IS THERE SUCH AN INTEREST IN THE ESG DATA?

There are two issues driving the increased interest in ESG data: 1) societal demand and 2) risk avoidance. Societal demand has two components, investor demand[iii] and consumer demand.[iv] Investor demand drives companies' desire to report ESG, with a reported 10% of fund investments worldwide going into ESG funds.[v] Additionally, investment houses have recognized the demand for ESG-related funds. For example, when BlackRock launched its U.S. Carbon Readiness Transition Fund in 2021, the fund raised a staggering $1.25 billion in a single day. With the increase of benefit corporations[1] tapping into consumer wishes, ESG data and consistent reporting will be important to convert socially conscious shoppers into customers, an obvious benefit to the reporting company.

RISK AVOIDANCE

While societal demand is certainly an important driver for companies investing in ESG data and reporting, the greatest benefit may come from risk avoidance. The World Economic Forum conducted a survey of its members (results shown in Figure 1.2 below) finding that of the Top 10 economic risks, environmental issues accounted for 5 of the Top 10 in both likelihood and impact over the next 10 years.[vi] Similarly, the Financial Stability Oversight Council recognized that climate-related economic costs and risk are both expected to increase.[vii] In addition to governmental and quasi-governmental recognition that ESG data can predict risk, investors[viii] and companies[ix] are beginning to understand that ESG data can be a powerful analytical tool.

FIGURE 1.2

Long-Term Risk Outlook

Top 10 risks by likelihood and impact over the next 10 years

[1] A "B" Corp is a for-profit corporation that commits to create a material positive impact on society and the environment from the business and operations of the corporation. Like a traditional corporation, it pursues profit for the benefit of its shareholders, but a benefit corporation must also report on how it pursues a positive social environmental impact. In Delaware it is referred to as a Public Benefit Corporation.

Global Shapers

Likelihood	Impact
Extreme weather	Biodiversity loss
Biodiversity loss	Climate action failure
Climate action failure	Water crises
Natural disasters	Human-made environmental disasters
Human-made environmental disasters	Extreme weather
Water crises	Weapons of mass destruction
Data fraud or theft	Natural disasters
Involuntary migration	Food crises
Social instability	Infectious diseases
Cyberattacks	Cyberattacks

CURRENT STANDARDS & REPORTING

After recognizing the need to collect ESG data, companies need to identify the type of data to collect. As referenced by Chairman Gensler above, consistent and comparable requirements are needed. There are several excellent ESG standards; European Financial Reporting Advisory Group Sustainability Reporting Board (EFRAG), Global Reporting Initiative (GRI), International Sustainability Standards Board (ISSB), and Sustainability Accounting Standards Board (SASB) are the most frequently utilized. The National Association of Securities Dealers Automated Quotations (Nasdaq), recognizing the lack of consistency between the available voluntary standards, has made its "best guess" regarding where ESG reporting lands between investors and Nasdaq companies and published its own voluntary initiative. With the variety of available standards, and large/institutional investors formulating their own data requests to companies, there is significant cost associated with being asked to collect data and report it under more than one of the ESG standards. The SEC proposal to harmonize the data collection and reporting into a single requirement has the potential to reduce that cost, but once investors and companies travel down one of the available ESG paths, it may only result in duplicative efforts whereby a company reports separately for regulatory purposes and for investment purposes.

CONCLUSION

ESG will continue to be fast changing, highly watched, and complicated. Investors and consumers want consistency in the reporting, and regulatory bodies are moving toward harmonized rules. We at J.S. Held will continue to watch the development at the SEC and see how the market reacts once the anticipated regulatory obligation is established.

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iii. IFAC – Investor Demand for Environmental, Social, and Governance Disclosures

iv. https://hbr.org/2021/03/an-esg-reckoning-is-coming

v. https://www.forbes.com/sites/jacobwolinsky/2022/03/28/esg-is-the-third-wave-of-change-in-asset-management-after-graham-and-mpt/?sh=2f52ce631604

vi. World Economic Forum Global Risks Perception Survey 2019-2020.

vii. https://home.treasury.gov/system/files/261/FSOC_20220728_Factsheet_Climate-Related_Financial_Risk.pdf

viii. See Footnote 7, SEC Proposed Rule, The Enhancement and Standardization of Climate-Related Disclosures for Investors.

ix. E.g., Chevron's 2021 Sustainability Report highlights the use of Marginal Abatement Cost Curves to provide Chevron with a method to identify and prioritize the most promising GHG abatement opportunities company-wide.