

Charting a Course Through ESG Challenges: Perspectives From the US, the UK and Europe

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Article

On Tuesday, Apr. 18, Kramer Levin presented a hybrid program, “Charting a Course Through ESG Challenges: Perspectives from the U.S., the U.K. and Europe.” Moderated by Kramer Levin partner Andrew Otis, the event was co-sponsored by Simmons & Simmons and designed for financial firms, including asset and investment managers, funds, and corporates.

In case you were unable to attend, below is a summary of key takeaways from the three-part panel discussion.

Part I: Key ESG regulatory developments

The first panel covered cross-border regulatory issues. The speakers were Kramer Levin partners Marissa Holob, **Reid Feldman** and Andrew Otis with Simmons & Simmons partners Benedikt Weiser and Sonali Siriwardena.

U.S.

There is a consensus among many investors and at the federal level that environmentally and socially conscious investments yield greater returns over the long run. However, there is an anti-“woke” backlash among some politicians and state legislators who view these concerns as political issues and ESG programs as the imposition of liberal priorities through nondemocratic means.

ERISA fiduciaries have unique considerations when determining whether, and to what extent, climate change and other ESG factors can be factored into their investment-related decisions. The Department of Labor’s position has changed from time to time. It recently finalized regulations, [Prudence and Loyalty in Selecting Plan Investments and Exercising Shareholder Rights](#), which replaces a 2020 regulation and allows ERISA fiduciaries to consider the economic impacts of climate change and other ESG factors when making investment-related decisions, subject to and in accordance with their fiduciary duties. This rule is currently being challenged in the courts.

When final, proposed [SEC climate disclosure rules](#) will require public filers to disclose climate risk, climate management and greenhouse gas emissions as well as audit and report on how that risk was assessed. Rule opponents argue that it would require nonreporting entities to track emissions and that it goes beyond the SEC's legal authority. The final rule will likely be subject to litigation.

EU

In general, Europe is further along in terms of issuing guidance related to ESG, enacting 57% of new regulations (the U.S. provides 19%).

The panel noted that the extensive EU legislation now on the books, and other planned measures, are designed to reorient economic activity to become “environmentally sustainable.” This concept, defined in the Taxonomy Regulation, includes not only combatting climate change but also meeting criteria relating to bodies of water, pollution, a circular economy, biodiversity and such matters as human rights/workers' rights, anti-corruption, taxation and fair competition. For example, the recently enacted [Corporate Sustainability Reporting Directive](#) requires companies to report detailed information on the extent to which their activities meet these standards. Other legislation mandates disclosure requirements for funds and other financial products. These disclosure requirements, along with sector-specific limitations on activities deemed incompatible with ESG goals, are likely to have far-reaching effects on economic behavior.

U.K.

The U.K. has asserted its independence from EU rules by issuing its own [Sustainability Disclosure Requirements](#) to clamp down on “greenwashing.” The requirements include the investment labels “Sustainable Impact,” “Sustainable Focus” and “Sustainable Improvers,” which don't fully align with U.S. categories.

The landscape in the U.K. includes litigation against the board of directors of Shell Corp., alleging that it failed to manage the material and foreseeable risks climate change would have on the company — essentially, that it had not prepared a net-zero strategy in line with the Paris Agreement. This is the first time such ESG-related litigation has been brought.

Part II: Risks of litigation and congressional investigations

The second panel consisted of Kramer Levin partner Andrew Otis; Kramer Levin counsel Laurie Rubenstein; and Simmons & Simmons partner Sonali Siriwardena.

U.S.

Panelists expect several House committees to take an active oversight interest in ESG issues this congressional session. With different parties controlling the two houses of Congress, the House majority will have little ability to enact its legislative priorities, but it will have significant incentive to hold hearings and conduct investigations that will amplify messages on which many 2024 congressional and presidential campaigns will be run. Such hearings can sometimes be surprisingly effective at influencing outside behavior, as well as the way in which agencies implement their rules or pursue enforcement actions.

ESG-focused investing — and disclosure of ESG risks — is anathema to those who embrace anti-“woke capitalism” views. As a result, some House committees have already expressed interest in pursuing the issue — for example the House Financial Services Committee established an ESG Working Group and the House Judiciary Committee initiated an investigation into claims that climate groups pushing ESG are committing antitrust violations. It is hard to know precisely who will be targeted beyond federal agency representatives.

If a fund or company receives a congressional request for information, it should seek counsel before responding — it may be hard to discern what lies behind the request, and properly managing the response can mean the difference between working quickly and well with a committee and getting sucked into a lengthy, costly and unpleasant investigation. It is important to know that even if a committee’s majority is anti-ESG investing, other committee members likely will want to disseminate positive messages that reflect the value of ESG investing, and it would be important to work with them.

ESG enforcement is a priority for the SEC. One area of focus is “greenwashing” — companies overstating or misrepresenting their ESG accomplishments or investment strategies. Since 2021, the commission has pursued at least a half dozen cases based on a company’s lack of internal controls or measurable standards for decision-making and follow-through on ESG claims and commitments.

In response, companies need to have procedures in place to ensure compliance with any stated ESG objectives and documentation supporting any ESG claims. In addition, companies must continually assess the impact of climate-related risk on the results and operations of the business and whether and when such risk requires disclosure.

Europe

As with U.S.-based companies, Europe-based companies should avoid being flag bearers and exercise care in marketing their ESG credentials. Regulators are watching and using enforcement as necessary. More aggressive investigations and enforcement are expected

in the next 12 – 18 months. Companies need to set out what they plan to do, have policies and programs to support that, and then provide evidence of how they achieved those goals.

Part III: Responding to regulation and risks

The final panel featured Kramer Levin partners Jamie Kocis, Yasho Lahiri, Alexandre Omaggio and Andrew Otis with Simmons & Simmons partner Benedikt Weiser.

This panel discussed the question of how an investment qualifies as “green” in the absence of regulation or SEC guidelines. Currently, people use [green bonds principles](#), which encompass use of proceeds, project evaluation, management of proceeds and reporting (ideally done by an outside party to confirm benefit to the climate or energy savings). The key takeaway here is that if you say you’re going to do something, you have to do it. Don’t overpromise. Build in metrics and processes, and then document your work and its impact.

On the investment management side, there is an increased demand for metrics, reporting and proving assertions. Outside parties are proliferating to certify companies’ ESG claims (although a panelist predicted this work will likely fall to nonprofits in the future). With so much more data produced and reported, the industry will see more digitalization of fund operations. Also, reporting requirements will influence whether fund managers classify their funds as Article 9, Article 8 or Article 6.

Private equity (PE) funds now employ ESG officers for risk management, who support the funds’ investment teams for the application of ESG principles at each step of an investment process (due diligence prior to letter of intent, management of portfolio, exit). PE transactions require more assessment in light of the ESG principles, and ESG due diligence is now a key matter.

ESG undertakings from companies and managers (such as compliance with ESG principles, ESG action plan and reporting) are increasingly included in the legal documentation supporting the investment. KPIs need to be put in place to ensure the monitoring of compliance by portfolio companies in accordance with the investor’s ESG policies and requirements.

Finally, a growing number of PE funds, in particular impact funds (Sustainable Finance Disclosure Regulation Art. 9) are linking a portion of the general partner’s compensation to performance of the portfolio companies on ESG issues.