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Dow Jones Announces Changes to Sustainability Index

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By Simon Walsh
Special Counsel | Global Litigation

By Timbre Shriver
Associate | Global Litigation

On December 9, 2022, S&P Dow Jones Indices (DJI) **announced** the results of its **2022 Dow Jones Sustainability Indices (DJSI) Annual Review**.

The top five worldwide additions by market capitalization added this year are: energy and petroleum multinational, TotalEnergies SE; Canadian Pacific Railway Limited; ratings agency, Moody's Corporation; energy exploration and production company Hess Corporation; and chemicals company, Dow Inc. The top five worldwide deletions by market capitalization are: the construction equipment manufacturer, Caterpillar Inc.; pharmaceutical and healthcare company, Sanofi S.A.; aerospace and defense technology company, Northrop Grumman Corporation; Zurich Insurance Group AG; and metals and mining company, Rio Tinto Group. All decisions are made pursuant to the **Dow Jones Sustainability Indices Methodology**.

Launched in 1999 as the first series of global sustainability benchmarks, the DJSI are float-adjusted, market capitalization-weighted indices that measure selected companies' sustainability performance using ESG criteria, including publicly available data information and "continuous controversy monitoring" of constituent companies.

In addition to the DJSI World, S&P Dow Jones also publishes regional and country sustainability indices, covering North America, Europe, Asia Pacific, Latin America, Korea, Australia and Chile, as well as an emerging markets index.

Taking the Temperature: According to DJSI, more organizations than ever before participated in the 2022 CSA, perhaps reflecting the significant and growing importance placed by multinational companies on obtaining and maintaining recognized

sustainability-linked ratings both for attracting investment and broader business reputation. The addition of TotalEnergies is noteworthy given the controversy sparked by its new planned pipeline, which would run from Uganda to the Tanzanian coast passing through many acres of farmland and the Murchison Falls National Park, a habitat that is dense with animal life. We recently reported on a French court's decision to dismiss an action filed by six French and Ugandan NGOs aiming to force the suspension of the project. The NGOs based their case to suspend the pipeline project on Article L. 225-102-4.-I of the French Commercial Code, the Corporate "Duty of Vigilance Act," which requires companies to establish a "Vigilance Plan" to "identify and prevent risks of severe violations of human rights and fundamental freedoms, health and safety of people and to the environment in their entire sphere of influence."

In a longer article published in October, we analyzed the decision to drop Tesla Inc. from the S&P 500 ESG index and used this as a point of departure to survey the ESG ratings marketplace and the ranking criteria used by leading ratings providers to arrive at their ESG scores. The article highlights significant issues with the existing ESG ratings marketplace. First, the fact that ratings providers use different methodologies often results in assigning divergent rankings to the same company. Second, a number of ratings providers group "E" and "S" together, or, at times, all of the different issues within each of these categories, which can obscure the rationale for a particular company's rating. The at times low correlation among ranking scores, the lack of granular information as to the basis of the rating, and, more generally, concerns around the transparency of ESG ratings processes have led some to question the value, or how to best make use, of ESG ratings.

There are concerns that sustainability ratings also suffer from a comparable lack of transparency. In the case of the DJSI, organizations that opt not to submit data through the CSA are evaluated on publicly available data. This potentially introduces bias in that companies choosing to participate will likely volunteer more favorable data to improve their results.

Regulators increasingly recognize the importance of the ESG-ratings marketplace and its various issues. Accordingly, authorities in the U.S., UK and EU are starting to develop rules in this area. In the U.S., the Securities and Exchange Commission (SEC) announced its plans to standardize climate-related disclosures by public companies which, it is hoped, will have a positive knock-on impact on the accuracy of ESG ratings, as we have discussed. In the EU, the European Securities and Market Authority (ESMA) is considering increased regulation of the ESG ratings sector. In the UK, the Financial Conduct Authority (FCA) has opined that low correlation among ESG ratings is not, in itself, harmful, provided that ratings providers are transparent about their methodology and the data they use and have robust governance processes. We have previously discussed that the FCA also created a group to develop a voluntary Code of Conduct governing ESG data and ratings providers to bring about greater transparency. The Board of the International Organization of Securities Commissions (IOSCO) has also published recommendations for ESG ratings providers. Industry bodies such as the International Financial Reporting Standards Foundation launched the International Sustainability Standards Board, with the aim of delivering a "comprehensive global

baseline of sustainability disclosures focused on the needs of investors and the financial markets.”