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Regulation: Rollback of ESG Investing Restrictions

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Regulation

The US Department of Labor (DOL) has sent a final rule to the White House for review that will allow retirement plan fiduciaries to consider ESG factors in their investment decisions. The amendment aims to uphold the policies established in the "Climate Crisis" **executive order** issued by President Biden in January 2021. The Acting Assistant Secretary for the Employee Benefits Security Administration praised the rule by stating that it "will bolster the resilience of workers' retirement savings and pensions by removing the artificial impediments—and chilling effect on environmental, social and governance investments—caused by" the prior rule. The change has met opposition from some in Congress, with Rep. Virginia Foxx, R-N.C., and Rep. Rick Allen, R-Ga., the minority leaders of the Education and Labor Committee, claiming that the changes were part of a "radical climate change and pro-union boss agenda" and that the " financial interests of workers and retirees should never take a backseat to the whims of the green lobby and big labor."

Taking the Temperature: On the one hand, the DOL rule is simply another aspect of the Biden Administration's overall attempts to address the impacts of climate change, which includes requiring government agencies to consider climate-related issues in their decision making. The rule also likely reflects current practice for many retirement plan investment managers. After all, climate change impacts can create material investment risks and opportunities, and investment managers, in order to discharge their obligations on behalf of retirement plans, need to able to freely consider those impacts if they deem it appropriate in making investment decisions. On the other hand, the divergent reactions to the DOL rule highlight the increasingly politicized nature of climate change in the investment industry, as illustrated by decisions by some states' financial officials to ban certain financial institutions from government transactions because of the financial firms' perceived views on financing or investing in oil and gas projects. The ongoing schism over how climate change issues should be appropriately handled by the investment community is unlikely to subside any time soon and leaves asset managers in the position of having to walk a very thin line among those on different sides of the question.

Governance: ISS Benchmark Survey Results on Climate

October 14, 2022

Governance

By Peter Malyshev
Partner | Financial Services

On October 10, Institutional Shareholder Services (ISS) published the results of its annual **Global Benchmark Policy Survey**, which included questions on ESG topics. A significant majority of respondents stated that they would consider there to be a material governance failure if a company, that is considered to be a significant contributor to climate change, is not providing adequate disclosure with regard to climate-related oversight, strategy, risks and emissions-reduction targets. 79% of shareholders said board directors should be removed if the businesses fail to report in line with the Recommendations of the Financial Stability Council's Task Force on Climate-Related Financial Disclosures. Furthermore, a majority of investor respondents agreed that company boards of significant greenhouse gas emitters would not be discharging their duties if they fail to take steps to address emissions. ISS received a total of 417 responses to the survey (205 from investors and affiliated organizations and 212 from non-investors).

Taking the Temperature: The survey responses highlight the importance of the quality and thoroughness of issuer disclosure and increasing scrutiny on boards of directors and senior management in addressing climate change risks and opportunities. The survey results also confirm what appears to be a growing consensus for disclosure consistent with TCFD recommendations, as opposed to aligning with other disclosure frameworks. This includes the need for boards of directors and officers to proactively address enterprise-wide climate and social impact matters now, regardless of possible future government agency rulemaking, such as the Securities and Exchange Commission's proposed climate disclosure rule. In one sense, this is simply another aspect of directors' well-settled fiduciary duties. But there are unique challenges in this area given the dynamic nature of climate change and social impact issues and the magnitude of their potential impacts on companies.

Taxonomies: EU Platform on Sustainable Finance Publishes Final Report on Minimum Safeguards

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Taxonomies

By Duncan Grieve
Special Counsel | White Collar Defense and Investigations

On October 11, the EU Platform on Sustainable Finance (PSF) published a **final report** on minimum safeguards under the Taxonomy Regulation Articles 3 and 18. Climate-related taxonomies classify businesses or products according to whether they should be considered sustainable. While several jurisdictions have published taxonomies, the EU's Taxonomy is well-developed and influential. The Regulation requires that environmentally sustainable economic activities meet minimum safeguards involving specified international human rights requirements, and offers recommendations on assessing compliance with these minimum safeguards. According to the report, an economic activity's sustainability should be considered with reference to processes for compliance with human rights (including workers' rights), anti-bribery and corruption, and fair competition. The report also examines the connection between these minimum safeguards and other EU climate-related regulations that we have **previously discussed**, including the Sustainable Finance Disclosure Regulation, the near-final Corporate Sustainability Reporting Directive (CSRD), and the anticipated Corporate Sustainability Due Diligence Directive (CSDDD). The PSF, however, is an expert advisory group established to assist in the development of sustainable finance polices; thus, while the report will inform further regulation , it is not binding on the European Commission.

Taking the Temperature: The report highlights a view that there are close connection among the Environmental and Social components of ESG. While as part of their fiduciary duties boards and management need to consider how it is appropriate for a company to address social impact issues, there is a risk that tying those issues with climate-change matters confuses consideration of both. The potential for confusion can be seen in the ESG ratings industry, where a company may receive a relatively lower overall rating based on social issues even though it is environmentally friendly, or vice versa. Without minimizing or ranking the relative importance of E, S or G, each of these areas is sufficiently important, complex and challenging on its own that discrete analysis of each — or of sub-topics within each — will promote better and clearer decision-making and investor understanding.

Investing: State treasurers remove $1 billion from investment manager over ESG concerns

October 14, 2022

Investing

By Sara Bussiere
Associate | Global Litigation

A large institutional investment manager has lost over $1 billion of assets under management in Republican-controlled states unhappy with the company's consideration of ESG issues in investment decisions and perceived activism in the space. South Carolina state treasurer, Curtis Loftis, stated his intention to withdraw $200 million from BlackRock by the end of the year. Louisiana treasurer, John Schroder, said last week he was withdrawing $794 million from BlackRock. Utah's treasurer, Marlo Oaks, stated he had already liquidated $100 million in BlackRock funds, and Arkansas reportedly pulled $125 million this year. BlackRock manages 5 of the top 20 US sustainable funds by assets. Loftis stated that "So much of it does not help the people it is supposed to help" and that "Poor people, historical minorities, are having money and services diverted from them for these globalist, leftist ideas." In a letter, Schroder stated that "I'm convinced that ESG investing is more than bad business; it's a threat to our founding principles: democracy, economic freedom, and individual liberty" and that "It threatens our democracy, bypasses the ballot box and allows large investment firms to push political agendas." BlackRock has responded with several open letters and also with the recent publication of a website page **'Setting the record straight'** where it states, among other things, "We do not dictate how clients should invest; we offer a wide array of choice."

Taking the Temperature: As noted in our first post today, the topic of ESG investing is increasingly becoming a political battleground, with primarily Republican state investment officials criticizing, and withdrawing funds from, fund managers who have supported taking ESG factors into account. But as Blackrock's Chairman Laurence Fink said in his 2022 letter to CEOs, consideration of climate change or social impact factors in making investment decisions is not "woke;" rather, "climate risk is investment risk," as are social impact considerations. "We focus on sustainability not because we're environmentalists, but because we are capitalists and fiduciaries to our clients." Indeed, as we have discussed, the asset management industry has been leading the charge for greater issuer disclosure of climate risk because of the potential for such issues to have a material impact on the performance of a business. Putting aside the at-times political nature of the discussion, there is a real question whether it is even possible for investment managers to discharge their duties to clients without considering the potential impact of climate change.

Investing: Switzerland Issues Green Bond

October 14, 2022

Investing

By Jason Halper
Partner and Co-Chair | Global Litigation

By Simon Walsh
Special Counsel | Global Litigation

The Swiss government announced the completion of its inaugural green bond issuance, raising CHF766 million ($USD766 million). These funds will be utilized to support environmental goals in areas including clean transportation and biodiversity. The offering was oversubscribed, generating nearly $1 billion in bids. The Swiss government stated that it intends to issue green bonds on a regular basis, with planned issuance volumes of several hundred million Swiss francs per year. Switzerland has adopted a climate strategy to reach net zero emissions by 2050, as well as an plan to preserve biodiversity, ecosystems and genetic diversity.

Taking the Temperature: This new bond issuance shows that the demand for green investment products continues to grow, both from investors and issuers with specific ESG goals. It is critical that regulators catch up with the financial market and provide clear and consistent guidance on green investments to help both reduce investor confusion and the risk of unsuitable investments being made under the auspice of sustainable finance.