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March 10, 2023

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G20 Call for Global Common Framework to Finance Sustainable Development Goals

March 10, 2023

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At the recent **G20 Finance Ministers and Central Bank Governors Meeting** in Bengaluru, India, attendees called for the creation of a common global framework to facilitate financing the United Nations' Sustainable Development Goals (SDGs). The agreement reached at the meeting, held on February 24-25, 2023, calls for the G20's **Sustainable Finance Working Group (SFWG)** to develop an analytical framework for enabling finance for SDGs "with initial focus on nature-related data and reporting and social impact investing, taking country circumstances into consideration."

Originally launched in 2016 as the Green Finance Study Group and subsequently renamed the Sustainable Finance Study Group in 2018, the re-establishment of the SFWG was endorsed by the G20 Finance Ministers and Central Bank Governors on April 7, 2021. The **SFWG Terms of Reference** states that the "SFWG will identify barriers to sustainable finance and develop voluntary and inclusive options for aligning financing and policies to the goals of the Paris Agreement and Agenda 2030. The SFWG acknowledges that countries are at various points in their growth trajectories and avoids one-size-fits-all approaches."

The ministers also reaffirmed their commitments to the United Nations Framework Convention on Climate Change and the Paris Agreement, thereby agreed to work to limit temperature increases from pre-industrial levels to 1.5 degrees Celsius, as well as to the commitment made by developed countries at COP15 in 2009 "to the goal of mobilizing USD 100 billion climate finance per year by 2020 and annually through 2025 to address the needs of developing countries."

That financing goal, however, **remains elusive**. The attendees therefore recognized that "mobilization of timely and adequate resources for climate finance is needed for meeting ambitious net zero emission targets," and the resulting importance of obtaining financing from a variety of sources: "public and private, bilateral, and multilateral, including alternative sources of finance." The agreement calls for, among other things, "Multilateral Development Banks (MDBs) [to] play a key role in development financing," echoing statements made by U.S. Treasury Secretary Janet Yellen in a **February 9 speech**, where she called on MDBs to boost their financial capacity to meet the need for financing to address sustainability challenges.

Taking The Temperature: While short on specifics, the Summary and Outcome Document produced at the conclusion of the G20 Finance Ministers and Central Bank Governors meeting highlights at least three ongoing challenges. First, the pressing need for funds to finance mitigation and adaptation initiatives. This is not surprising given the near-constant focus (which we have discussed) on financing challenges, including at

last year's COP27 climate change conference in Egypt (where an agreement was reached to establish a dedicated fund to assist developing countries in responding to loss and damage caused by climate change) and the COP15 biodiversity conference in Montreal (where the main area of contention involved how to pay costs that will be incurred to realize the Global Biodiversity Framework's goals). Second, biodiversity increasingly is top of mind. The SFWG Terms of Reference state that "although focusing initially on climate," the "SFWG will remain open to address other sustainability risks, such as nature, biodiversity, water and social-related ones." We have commented on the increasing attention being paid by governments, regulators and issuers to nature-related issues and concerns, and the potentially material effects these issues could on companies' performance. Third, data-related issues remain problematic. As we have reported and the agreement recognizes, there are ongoing challenges associated with collecting and appropriately assessing climate-related data in a consistent way across industries and jurisdictions. The Summary and Outcome Document calls for a "cross-cutting focus on identifying and overcoming data-related barriers to scaling investments for climate action and SDGs."

President Biden Expected to Issue First Veto to Preserve DOL ESG Investment Rule

March 10, 2023

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President Biden **will likely issue** the first veto of his presidency after Congress passed a measure that would repeal a **Department of Labor rule** that allows retirement plan fiduciaries to consider ESG-related factors in investment decisions.

On March 1, Senators Jon Tester (D-MT) and Joe Manchin (D-WV) joined Senate Republicans in passing **H.J. Res. 30**, which provides that "Congress disapproves" of the DOL's ESG rule and that "such rule shall have no force or effect." Senator Tester **stated** that he disapproves of the DOL rule because "it undermines retirement accounts for working Montanans." Similarly, Senator Manchin **described** the rule as "prioritiz[ing] politics over getting the best returns for millions of Americans' retirement investments."

Before the bill passed, the White House **warned** that "[i]f the President were presented with H.J. Res. 30, he would veto it." The President defends the DOL rule as "reflect[ing] what successful marketplace investors already know – there is an extensive body of evidence that environmental, social, and governance factors can have material impacts on certain markets, industries, and companies." Now that the bill has passed both chambers, the only question is whether—or, more likely, when—the President will follow through on his promise to veto.

Taking the Temperature: While the passage of H.J. Res. 30 may be largely symbolic given President Biden's expected veto, it remains significant because, until now, the political battle over ESG investing has largely been waged at the state level. Recently, Republican state attorneys general sued the DOL over this same rule, claiming that the rule conflicts with ERISA fiduciary duties, is arbitrary and capricious, and exceeds the DOL's regulatory authority. States also continue to take conflicting positions on the propriety of consideration of ESG factors in investing. Florida Governor Ron DeSantis (R), for example, lauded Florida legislation intended to prohibit, among other things, fund managers working with state and local governments from considering ESG factors when making investment decisions. On the other hand, the new Arizona Attorney General, Kris Mayes (D), announced that Arizona will no longer investigate banks and other financial institutions over ESG-related investing. Despite the predominantly state-level battles to date, H.J. Res. 30 is not Congress' first foray into ESG-related debates: Republicans on the House Financial Services Committee recently established an ESG

Working Group to “combat the threat to our capital markets posed by those on the far-left pushing environmental, social, and governance (ESG) proposals;” U.S. Senate Banking Committee Ranking Member Pat Toomey (R-Pa.) requested that 12 ESG ratings firms share all non-proprietary methodologies used when calculating ESG ratings, “including the specific E, S, and G factors that you measure and how those factors are weighed;” and Republican members on the House Committee on the Judiciary have written a letter to the steering committee members of Climate Action 100+, Ceres and CalPERS, requesting documents and seeking information regarding antitrust compliance in connection with participation in the industry organization.

UK Pensions Regulator Launches Regulatory Initiative to Monitor Climate and ESG Non-compliance by Trustees

March 10, 2023

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On February 22, 2023, the UK's Pensions Regulator (TPR) **announced** the launch of a new initiative aimed at tightening regulation around ESG data published by trustees, as part of a wider campaign to assess whether trustees are properly discharging their ESG and climate change reporting duties. Among other things, TPR "is checking whether trustees of schemes with more than 100 members (unless exempt) have published a statement of investment principles (SIP) that details the policies controlling how a scheme invests, including consideration of financially material ESG and climate factors," and whether the SIP has been implemented. TPR also will seek to ensure that authorized schemes and those with relevant assets of £1 billion or more publish an annual report in compliance with requirements of the Taskforce for Climate-Related Disclosures framework. The regulator **previously published guidance** for trustees regarding climate-related governance and reporting. Trustees of schemes that fail to comply can be subject to an enforcement action and a fine of up to £50,000.

Taking The Temperature: The new initiative announced by TPR is in line with the increasing focus by the regulatory sector in the UK, such as by the Financial Conduct Authority (FCA), on the accuracy of statements related to climate transition plans and sustainability. More generally, we have previously commented on how the UK government and regulators have taken a number of recent steps to address climate issues. These include an assessment, commissioned by the Department for Business, Energy & Industrial Strategy, into how the UK might meet its net zero obligations "in a more affordable and efficient manner, one which is pro-business, pro-enterprise and pro-growth;" a proposed amendment to the UK's Financial Services and Markets Bill pursuant to which the Prudential Regulation Authority could be empowered to review appropriate risk weighting and capital requirements associated with a financial institution's exposure to fossil fuel exploration, exploitation and production; the issuance of guidance from the Competitions Markets Authority and the Advertising Standards Authority concerning the antitrust implications of industry climate collaborations and greenwashing, respectively; and the FCA's establishment of an ESG Advisory Committee tasked with supporting the FCA Board in "executing oversight of ESG-related issues relevant to the FCA as a corporate entity and as a regulator."

Reports Highlight Benefits and Challenges of Linking Executive Pay to ESG Factors

March 10, 2023

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Over the last three years, PwC and the Leadership Institute at the London Business School have studied the prevalence and efficacy of linking executive pay to ESG-related goals or targets. Their first two reports—**Paying well by paying for good**, on the "academic evidence around ESG in pay" (published in 2021), and **Paying for good for all**, on investors and senior leaders' "expectations and experience of linking pay to ESG" (published in 2022)—found that investors and executives overwhelmingly support linking pay to ESG-related targets, with 82% of senior leaders (most commonly leaders of U.S. public companies) having ESG targets as part of their compensation. The most common ESG targets are tied to a company's overall strategy and relate to employee engagement or health and safety issues (56% of targets, each), followed by targets relating to diversity and inclusion (41% of targets) and decarbonization (35% of targets). Companies have adopted these targets in large part to achieve long-term value, signal "a broader set of priorities" important to investors, and "encourage[] companies to set short-term targets to meet long-term goals, especially for sustainability areas like net-zero." However, there is not consensus among executives and investors on how to structure and implement incentives. This is likely because, although research shows a "strong alignment between shareholder value and ESG outcomes," evidence of that alignment only tends to appear after a period of 5 years or more, which is "longer than the typical 1 to 3 year performance periods of executive pay."

The most recent report, **Paying for net zero**, issued this year, details findings from a study of incentives linked to carbon targets in 50 of the largest European listed companies. The report reveals that the vast majority of the companies reviewed have adopted some form of carbon target in executive pay, and an even higher percentage met their targets. In 2022, payouts tied to carbon targets averaged 86%, with more than half of the companies reviewed paying 100% of the incentives.

However, the study analyzed these targets to determine whether pay incentives are meeting investor expectations by analyzing the targets against four criteria, namely, whether the targets:

(i) were **significant**, meaning "[a] separate and meaningful percentage of incentives linked to pay, so that management care about the measure;"

(ii) were **measurable**, meaning "[o]bjective and quantifiable targets, so that management are held to account;"

(iii) were **transparent**, meaning "[e]xternally clear and prospectively disclosed targets, so that the goalposts can't move;" and

(iv) **disclosed a link to long-term carbon goals**, meaning "[c]learly explained link between pay targets and stated carbon strategic goals, creating a clear bridge between the short and long term."

According to the study, "the measures [that companies] most commonly failed to meet relate to the weighting (which is frequently quite low), the transparency of targets (which are rarely prospectively disclosed), and their quantitative link to the company's stated long-term carbon reduction goals (which is often unclear)." Notably, the report found that the larger carbon emitters more often link executive pay to carbon emissions, which "suggests that focus[ed] investor engagement through, for example, the Climate Action 100+ ('CA 100+') group is having an impact." But the report also highlights the complexities of linking executive pay to carbon targets while offering suggestions for improvement.

Taking the Temperature: As the 2022 Paying for good for all report highlights, "investors and senior leaders agree on quite a lot," including "that a focus on ESG factors will generally lead to long-term improvement in financial performance and shareholder value" and that pay incentives will "help[] executives focus on short-term and non-financial factors that lead to long-term shareholder value but may conflict with short-term profit." These reports offer helpful data and practical guidance for boards adopting or implementing incentive pay tied to decarbonization or other climate-related goals.

Also, these findings evidence a seemingly widely-held view that ESG-related issues affect long-term shareholder value, and therefore, from a governance perspective, it is important for directors to consider and address ESG-related issues, despite (in the U.S.) the view often articulated from one side of the political aisle that consideration of these issues is inappropriate in various investment and other contexts.