CADWALADER

November 8, 2022

November 8, 2022

Table of Contents:

- Regulation: COP27 Commences in Egypt
- ESG Ratings: Senator Toomey Again Writes to ESG Rating Firms on Disclosure of Methodology
- Disclosure: ISSB Will Require Companies to Use Climate-related Scenario Analysis and Consider SASB Standards
- Investing: Funds to Allow Individual Shareholders Greater Say in Proxy Voting

Regulation: COP27 Commences in Egypt

November 8, 2022

Regulation

By Jason Halper
Partner and Co-Chair | Global Litigation

By Duncan Grieve
Special Counsel | White Collar Defense and Investigations

On Sunday, the UK passed the COP27 presidency to Egypt, which will host COP27, the 2022 United Nations Climate Change Conference, in Sharm El-Sheikh, with 50,000 attendees, including 110 heads of state, policy-makers and NGOs. The conference will continue until November 18. Discussions at COP27 are occurring against the backdrop of the global energy impact caused by the war in Ukraine, the latest World Meteorological Organization report showing that the global average temperature in 2022 was around 1.15°C higher than pre-industrial levels, and increasingly vigorous calls by developing nations for wealthier countries to fund future climate mitigation investments and to compensate for loss and damage. The stated areas of focus for the COP27 President, Sameh Shoukry, Egyptian Minister of Foreign Affairs, are:

- Mitigation: limit global warming to below 2°C and work to keep the 1.5°C target alive.
- Adaption: urge all parties to demonstrate political will to capture and assess progress towards enhancing resilience and assist the most vulnerable communities.
- Finance: make significant progress on the issue of climate finance while moving forward on all finance-related items on the agenda.
- Collaboration: turn the outcome of COP26 in Glasgow into action and commence with its implementation in order to achieve tangible results.

In his opening address, Shoukry stated: “We’re gathering this year at a time when global climate action is at a watershed moment. Multilateralism is being challenged by geopolitics, spiraling prices, and growing financial crises, while several countries battered by the pandemic have barely recovered, and severe and depleting climate change-induced disasters are becoming more frequent. COP27 creates a unique opportunity in 2022 for the world to unite, to make multilateralism work by restoring trust and coming together at the highest levels to increase our ambition and action in fighting climate change. COP27 must be remembered as the ‘Implementation COP’ – the one where we restore the grand bargain that is at the centre of the Paris Agreement.”

ESG Ratings: Senator Toomey Again Writes to ESG Rating Firms on Disclosure of Methodology

November 8, 2022

ESG Ratings

By Jason Halper
Partner and Co-Chair | Global Litigation

Last week, U.S. Senate Banking Committee Ranking Member Pat Toomey (R-Pa.) wrote follow-up **letters** to 12 ESG ratings firms requesting that recipients preserve material potentially responsive to requests made in an earlier September 20 letter. According to a **press release** from Senator Toomey, as of November 3, six companies had yet to respond at all or "provided incomplete responses."

In the **September 20 letter**, Senator Toomey requested that the 12 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." He also requested disclosure of sector-specific methodologies, including information on how the scope of industry sectors is determined.

The letter states that "the use of ESG factors in capital allocation has become an issue of increasing bipartisan interest to Congress and regulators," and concludes by stating that "given the above concerns and increased bipartisan interest in conducting oversight of the ESG industry, it is crucial that your firm provide the information I requested on September 20."

Taking the Temperature: As described in detail in our recent Clients & Friends Memo on ESG ratings, U.S. legislators are not the only group finding it challenging to understand how to effectively use ESG ratings, with asset managers and others attempting to wade through ratings from hundreds of providers using a variety of sources of data, methodologies, and formulae to arrive at their ultimate ESG scores. Ratings firms present their data using different scales—some using letter rankings with others providing numerical scores—causing difficulty when trying to perform one-to-one comparisons between ESG ratings firms. Some ratings firms rely solely on publicly available information as their source data, whereas others rely on questionnaires and feedback from companies directly, which may include material information not otherwise available to the public, in addition to information that is publicly available.

As a result, industry regulation is possible. In the EU, for instance, the European Securities and Market Authority announced that it is considering increased regulation of the ESG ratings sector. In the UK, the Financial Conduct Authority has opined that low correlation among ESG ratings is not, in itself, harmful, as long as ratings providers are transparent about their methodologies and the data they use and have robust governance processes. The Board of the International Organization of Securities Commissions has also published recommendations for ESG ratings providers. The

common theme across regulators and industry bodies is a push toward increased transparency. More consistency would benefit investors and companies focused on sustainable initiatives. Another approach might be for ratings providers to unbundle and separately assess companies according to their "E," "S," and "G" policies (some ratings providers, such as S&P, do currently provide disaggregated information), thereby supplying investors with more targeted assessments and, therefore, more useful information. Ultimately, ESG ratings firms can enable consumers of that information to effectively utilize the ratings only by offering greater transparency regarding the inputs to the rankings and how those inputs are assessed and weighed.

Disclosure: ISSB Will Require Companies to Use Climate-related Scenario Analysis and Consider SASB Standards

November 8, 2022

Disclosure

By Duncan Grieve
Special Counsel | White Collar Defense and Investigations

On November 1, the **International Sustainability Standards Board (ISSB) confirmed** companies will be required to utilize climate-related scenario analysis "to report on climate resilience and to identify climate-related risks and opportunities to support their disclosures." The ISSB is also planning to provide guidance regarding "what is meant by the term 'climate-related scenario analysis.'" In a somewhat unexpected move, the ISSB will not mandate the use of scenario templates produced by the Network for Greening the Financial System, which have been widely adopted by central banks. Instead, such 'off-the-shelf' scenarios may be considered a "useful resource" and companies should, at a minimum, carry out a qualitative form of scenario analysis as the basis for their resilience analyses. The ISSB said it would "build on the [Task Force for Climate-related Financial Disclosures] guidance, specifying that scenario analysis must be applied [by] setting out the required approach that is scalable to an entity's circumstances."

Additionally, on November 3, the **ISSB met** to review various proposals designed to "enhance interoperability with other international and jurisdictional sustainability-related standards." The ISSB confirmed that in meeting ISSB's general sustainability requirements, companies will be required to consider Sustainability Accounting Standards Board (SASB) Standards "because SASB Standards provide disclosures across a range of sustainability matters that have been designed with an investor focus and as industry-specific disclosures are fundamental to ISSB's approach to meeting investors' information needs."

In a **press release**, Emmanuel Faber, ISSB Chair, commented that: "We are convinced that the industry-based approach used to develop the SASB Standards is a market-validated model for the development of decision-useful and cost-effective sustainability disclosure standards. . . . Further enhancing and evolving the SASB Standards will be a priority for the ISSB, as embedding the industry-based approach in the work of the ISSB is essential to delivering Standards that support investors' assessments of enterprise value across a broad range of sustainability issues."

Taking the Temperature: As with ESG ratings, the abundance of disclosure frameworks coupled with a lack of consensus regarding what disclosure is required, questions about whether and how to use scenario analyses, and the standards by which to measure sustainability metrics all leave issuers in a difficult position. Greater disclosure may satisfy regulators and investors, but leave companies open to potential challenges for misstatements given the lack of a unified market approach. On the other

hand, opting for less disclosure threatens adverse market and regulatory reactions and is not guaranteed to ward off challenges based on alleged omission of material climate-related information. While there is no perfect solution as we wait for a growing consensus to emerge, in the U.S. or globally, companies and their boards can mitigate these risks by: (i) enhancing climate-related expertise at the board and senior executive levels; (ii) aligning enterprise risk and opportunity assessments and emissions measurement with leading frameworks and general governance best practices; (iii) ensuring that reasonable bases exist for climate-related disclosures and that such bases are contemporaneously documented; and (iv) appropriately qualifying public statements regarding potential future developments.

Investing: Funds to Allow Individual Shareholders Greater Say in Proxy Voting

November 8, 2022

Investing

By Sara Bussiere
Associate | Global Litigation

Several major asset managers last week announced plans to expand programs providing investors with greater say over how their shares are voted, some of which announced similar plans for some individual index fund shareholders. **Vanguard**'s pilot program will commence in early 2023, with Vanguard intending to offer "a number of proxy voting policy options for individual investors" in several of its equity funds. For **BlackRock**, this program will only be available, at least initially, to UK index fund investors. BlackRock's CEO, Laurence Fink, **announced** in a letter that it was "working with a digital investor communications platform in the UK to enable investors in select mutual funds to exercise choice in how their portion of eligible shareholder votes are cast."

In his letter, Fink stated: "While many asset owners are pleased to have our stewardship team serve as a bridge between them and the companies they are invested in, others want the choice to actively participate in proxy voting. That's partly being driven by the public debate around issues that can impact the value of companies and how different asset owners choose to navigate them." These changes follow BlackRock's announcement last year that it would give certain institutional clients invested in index funds, such as pension funds, a say on how their shares are voted. Since this change, institutions comprising a quarter of the assets eligible for the program have chosen to participate.

Taking the Temperature: Such "pass through" voting represents a potentially significant change for public companies, which may going forward have to address many more constituencies when seeking to obtain majority shareholder votes. Today, a meaningful percentage of outstanding shares in public companies is held by large institutional asset managers, such as Blackrock, Vanguard, and State Street, giving these firms significant sway over the outcome of shareholders' votes. That, in turn, has led to greater scrutiny of their voting decisions on climate-related and other issues, resulting in calls for potential regulation and igniting "ESG backlash" in the form of certain financial institutions being subject to criticism (and being barred from certain states' pension fund asset management business or municipal securities underwriting) for being "anti-energy" or not sufficiently supportive of the fossil fuel industry. Relinquishing some of this control could reduce scrutiny of these managers' approaches to climate change. And, from a governance perspective, it is hard to argue against permitting the beneficial owners of securities managed by large institutions to have greater input into how their shares are voted. But only time will tell whether the impact of pass-through voting lives up to its potential. It takes time to become

sufficiently informed about the underlying issues on which shareholders are asked to vote, and investors may choose to continue to permit asset managers to undertake that effort and vote for them. Institutions that are not as well-resourced as the largest asset managers may resist incurring the costs involved with pass-through voting. Moreover, the programs do not permit beneficial owners to vote their shares directly, but instead to offer input, such as the ability to select among proxy voting policies. Fink observed that given the current stockholder ownership system, "offering voting choice more widely to individual investors will take the combined efforts of policymakers, regulators, fund boards, asset managers and other participants in the proxy voting system." However, if such investor-led voting becomes widely adopted, even at the high level of investors indicating policy preferences, it could have a substantial impact on the voting and governance landscape for public companies, including in areas as widely debated and significant as climate change.