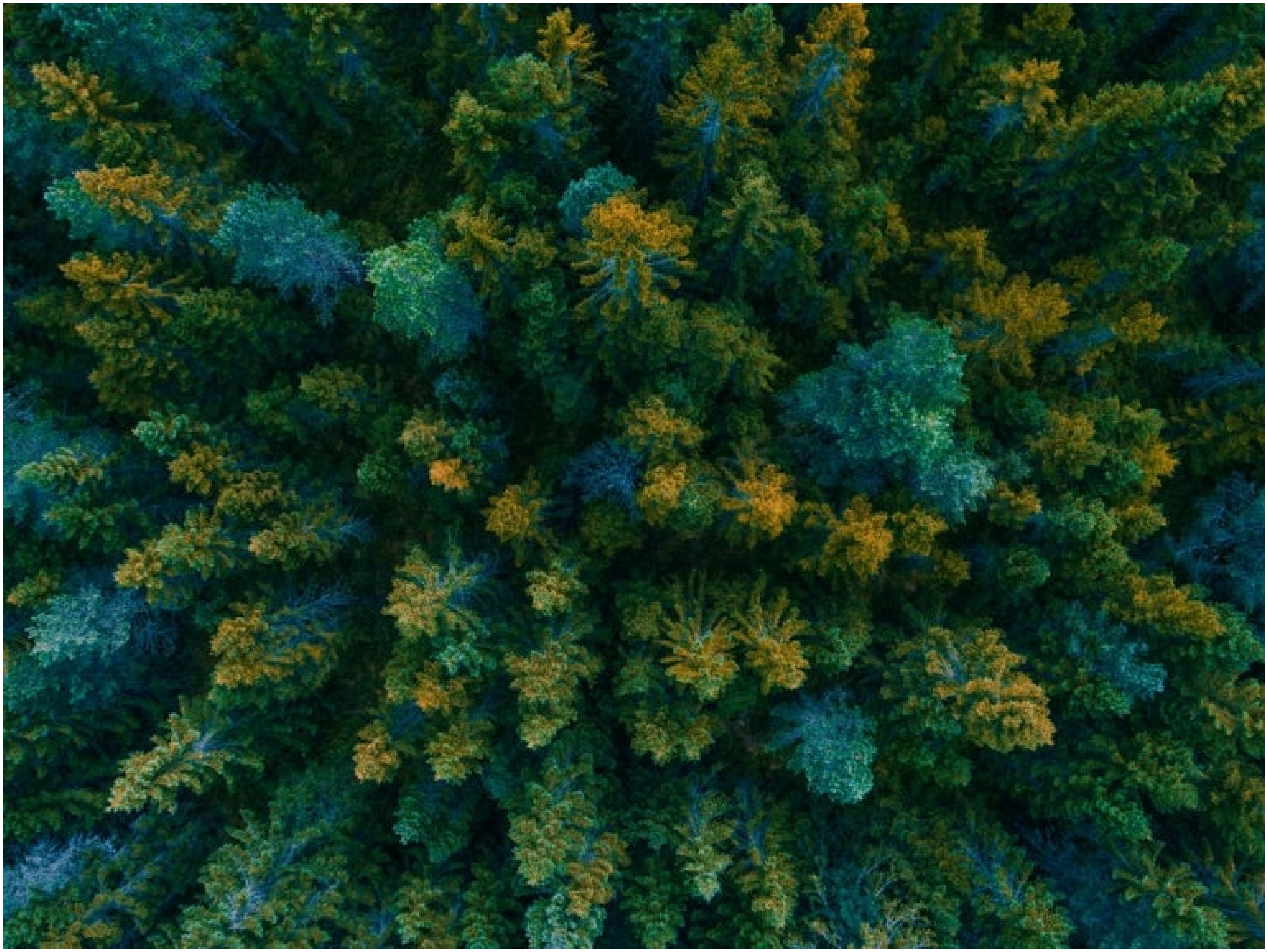

In the current political and business environment, companies are taking action to address a range of environmental and social issues.

Corporate attitudes have changed since the late 2010s, when environmental, social, and governance (ESG) arrived in the corporate world, largely driven by expectations from the investment stewardship arms of the world's largest institutional investors. Countervailing anti-ESG sentiments among certain groups have somewhat diminished investor engagements on ESG. But many companies nonetheless remain focused on sustainability efforts, including in response to legislation and regulation, customer and vendor relationships, and consumer and employee interest.

A Shift in Tone From Investors

In our 2020 Summer Sustainability series, we reported on institutional investor focus on sustainability. At the time, many large institutional investors were making public statements and establishing voting policies to encourage companies to promote long-term value through assessing, measuring, and addressing environmental and social risks and impacts.

Since that time, institutional investors have adjusted their tone and messaging. Our 2020 Update referred to BlackRock CEO Larry Fink's 2020 annual letter, which was heavily focused on climate-related risks and the importance of considering sustainability. In 2024, his annual letter mentions sustainability only once but continues many of the same overarching themes. A key theme continues to be the significant economic trend of the need for an energy transition. He observes that since 2020, the energy transition issue "has become more contentious in the U.S. But outside the debate, much is still the same. People are still investing heavily in decarbonization."

Politicization of ESG

The evolution of Mr. Fink's tone is consistent with a general trend for large asset managers. While companies have been focused on building their sustainability programs, the past few years have also seen politically motivated anti-ESG efforts aimed largely at investment managers and pension plan officials. For example, certain state attorneys general have sent letters to fund managers challenging their involvement in investor coalitions that have mounted efforts to encourage companies to reduce greenhouse gas emissions.

Several federal agencies have also implemented rulemakings that demonstrate an increasing politicization of regulations related to environmental and social issues. One example is the U.S. Department of Labor's (DOL) back and forth on how and whether Employee Retirement Income Security Act (ERISA) plan fiduciaries can consider climate change and other environmental, social, and governance factors in making investment decisions and voting at corporate shareholder meetings. The DOL implemented a final version of rule amendments in 2022, clarifying that ERISA does not prohibit fiduciaries from making investment decisions that reflect ESG considerations, depending on the circumstances. The U.S. District Court for the Northern District of Texas upheld the rules in the face of a challenge under the Administrative Procedure Act, but plaintiffs in that case have appealed the ruling.

The shifting winds of shareholder proposals for corporate annual shareholder meetings are another example of the increased politicization of ESG. Proposals focused on environmental and social topics have historically come from socially progressive backers asking companies to take a more active role in and provide additional reporting on these topics. In contrast, recent years have seen increasing numbers of proposals driven by conservative-leaning backers, which are typically cast as "anti-ESG." Proxy Analytics, which tracks shareholder proposals made at public companies, reports that anti-ESG proposals accounted for 14% of proposals voted on in the 2024 proxy season. As recently as 2021, less than 2% of proposals voted on were in this category.

Breaking Up "E," "S," and "G"

With the changing tone from investors and increasing politicization of the ESG concept, many companies are migrating away from the term "ESG." This development is welcome for many, as lumping these three concepts—environmental issues, social issues, and corporate governance—into a single term has never been a simple undertaking.

The "E" and the "S" have characteristics in common, although they represent issues that raise different types of risks and require different work to assess and address. Both include a range of issues that companies may consider addressing as part of their corporate strategy but that are not always core to improving the company's financial returns in the short term. The overarching message that many institutional investors have sought to convey, and that many companies have embraced, is that companies need to consider environmental and social issues as part of their strategy because many of these issues are likely to have lasting impacts on a company's long-term financial stability. Rather than "ESG," the concept that environmental and social impacts from corporate operations will affect a company's financial returns and ability to remain in business in the long term can better be labeled as "sustainability."

The "G" has always been different from the "E" and the "S." Corporate governance refers to processes, policies, and organizational structures that govern corporate decision-making. Including "G" in the term "ESG" reflects the idea that sustainability-related issues need to be built into corporate governance practices. Just as companies maintain processes and policies related to recordkeeping, internal controls, and board oversight for financial results and decision-making, governance structures are important for sustainability as well.

Sustainability Governance and Reporting

The importance of considering sustainability in corporate decision-making, governance practices that oversee sustainability efforts, and investor-facing reporting has become inescapable for most companies. Although many investors and companies are shifting away from the term "ESG," they have continued to incorporate sustainability into their businesses, strategies, and reporting. Governance & Accountability Institute, Inc. reported that in 2022, 98% of S&P 500 companies and 90% of Russell 1000 companies published sustainability reports, up from 90% and 65% in 2019, respectively.

There also continue to be legal and regulatory developments that require companies to take action and report on certain sustainability topics. These developments include:

- **Climate disclosure rules in the U.S.** In March 2024, the U.S. Securities and Exchange Commission (SEC) adopted rules and disclosure requirements for climate-related risks. The rules include greenhouse gas emissions disclosure requirements for certain larger companies, as well as governance, strategy, and financial disclosures related to climate-related risks, goals, and expenditures. Although the rules were slated to start phasing in as early as reporting for fiscal years beginning in 2025, they are currently suspended, pending litigation.
  In 2023, California also enacted climate disclosure laws. SB 253 will require thousands of businesses to measure and report on greenhouse gas emissions, beginning with reporting in 2026 for calendar year 2025. SB 261 will require a larger population of companies to report on climate-related financial risks and measures adopted to adapt to those risks.
- **European sustainability rules.** Many large United States-based companies are subject to climate-related disclosure requirements implemented by the European Union. The EU Corporate Sustainability Reporting Directive (CSRD) will require companies to prepare annual reports addressing actions and plans for a variety of sustainability topics. CSRD applies to certain large companies that are EU subsidiaries of non-EU entities.
  The EU also adopted the Corporate Sustainability Due Diligence Directive (CSDDD). CSDDD requires large companies to conduct specified due diligence to identify and address adverse human rights impacts and environmental impacts of their own operations, those of subsidiaries, and those in their supply chains. As with CSRD, CSDDD applies to some large non-EU companies with substantial operations in the EU.
- **Forced labor and supply chain diligence.** In addition to the CSDDD, various countries and certain U.S. states require companies to conduct and report on due diligence efforts to address forced labor and related issues in their supply chains. These due diligence requirements affect small and private companies in addition to large companies, as diligence efforts extend through companies' supply chains.
- **Cybersecurity.** In 2023, the SEC adopted final rules regarding cybersecurity risk management, strategy, and governance. The risk management disclosure requirements include detailed specifications regarding

risk management practices and the roles of the company's board and management in addressing cybersecurity threats.

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