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Episode title: ESG momentum, now under strain, faces changing landscape

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Natalie Runyon: My name is Natalie Runyon, director of ESG Content and Advisory Services and one of the Co-hosts of the show. Today I am joined by Lindsey Rogerson and Henry Engler. Thomson Reuters Regulatory Intelligence editors for Europe and North America, respectively. They are two authors for the newly released report ESG Under Strain. I am talking to them today about what has happened in the ESG landscape in the last year, what are the drivers of these changes and what companies can do to address this dynamic ESG landscape? Welcome to the show, Henry and Lindsey.

Henry Engler: Thank you.

Lindsey Rogerson: It's good to be here, Natalie.

Natalie Runyon: So, my first question relates to what has changed since the release of last year report on ESG, which I know was the first report that the Thomson Reuters Regulatory Intelligence team had put together. What's changed since the release of the report? And what are the drivers of those changes? Henry, can we start with you?

Henry Engler: Sure. Well, I would say number one the first major change is just the environment and the views about ESG. Last year when we launched our first report, as you mentioned, ESG was I would say embraced very strongly by most companies and regulators around the world and governments. Now there's been a distinct shift in the view of ESG. There's been a lot more criticism emerging about the goals that companies should be pursuing. You have certainly here in the United States, it's become much more polarized at the local state level. We've seen examples, plenty of examples of that. Even in Europe, in the UK, we've had senior banking executives publicly come out and question, you know, the viability of ESG and whether it's something that should, you know, be taken as seriously as it was, you know, and it has been up to now. So, you know, I would say first it's just the environment and then I think that there's also been some issues regarding how companies portrayed themselves and the risks that they face in terms of publicly saying that, you know, well, we're going to be net zero by 2050 and we have all these programs in place to deliver on those goals, but now we're finding out that there's not a lot behind those statements in in some cases. And so, the whole notion of greenwashing has really emerged and accelerated to an extent that we didn't see as much I think a year ago. So, that's a bigger risk for companies now in terms of their ESG policies.

Natalie Runyon: Could you just define “greenwashing” for those listeners who may not be familiar with that term?

Henry Engler: Sire, I mean very simply it's the risk that you face from regulators or activists regarding your public statements about your ESG policies. So, as I just mentioned if in fact, you're saying you plan to be net zero, you know, in terms of climate, in terms of your carbon emissions as an organization by, you know, a certain date people there are a lot more scrutinizing, I would say, in terms of trying to understand well, OK, you say that, but prove it. Show us how you, how you plan to transition from where you are today to there and if the answer is well, I really can't answer that specifically or I can't deliver a real robust transition plan then in effect, it's what we're now calling greenwashing. You're saying one thing, but you're not backing it up sufficiently with your actions.

Natalie Runyon: Got it. Thank you. So, Lindsey, let me ask you what's new from your perspective since the release of the first report in 2021 and what are some of the drivers?

Lindsey Rogerson: OK, so I'm sitting here in in the UK and obviously that's in Europe. And so, what is changed since the last, the first report is that the EU regulations have now landed. So, they are there, so they have bite, and we are seeing that impacting on firms. And the data that they have to produce, we are also seeing regulators really kicking the tires and interrogating the numbers and, you know, the European Securities and Markets Authority, which is Europe's listing agency, it did a big review of ESG statements and it sent a lot of them back and of course there is a, there is a cost involved with sending that back and actually also they could face fines and the way it works here is in Europe is the as the consent stuff back, but actually whether you get fined or you know, or any kind of penalties, that's just decided at the country level, so that will feed through. So, we you know, so we are seeing people really interrogating and where there is nothing behind that data you or where your data is just find to be so out of whack with the statements you are making we are we are seeing things. So, we mentioned in the report the example of Shell Oil who are told by Dutch court to basically go back and restate their transition plans because they were sued by an NGO called Client Earth, Shell had said there would be that their plans would see a 45% reduction in their admissions by 2030. The independent analysis suggest it was near 4%. Dutch courts agreed, but that's in the report. But there's uh, so what's happened since then is some Client Earth has now taken action against the Board of Shell because the board is appealing the Dutch ruling but also disagreeing with some bits of it and just choosing to ignore it in Client Earth view. And that's what the legal filing is about, and they are going after them under UK company law, Sections 172 and 17, which basically means that a board has to act in a way that the ongoing success and sustainability of business. So, these are you know really, really material actions that people are now taking and that's what is new this year. We are, we are, we are starting to see real people using the rules are being put in place in Europe and you know and also securities laws to hold people because when you're making these public statements on net zero they are you know they are they are they have they are binding behind you so you and that's what that's where we are now.

Natalie Runyon: Thank you for that. Something that's come up related to what you were saying, Lindsey, that that has come up in some of the interviews that I've done is around the litigation risk and you have a wider range of stakeholders, customers, investors, employees even, bringing, you know, litigation to companies based on the inconsistency between their public statements and what's really going on and one thing that is different is that some of those claims are moving the stock price right? Which is in turn I'm getting the attention of the board members. And so, you kind of have a multiplier effect going on with some of these actions spurring the attention of board members in particular. And then you know, now board members are being named and claims that are being made as in the example that you said was Shell.

Lindsey Rogerson: Yeah, absolutely. And I would expect to see a lot more of this as this filters through. What I want to be clear about is, and we're not in any way saying boards stop making transition statements because in certain countries, the UK being one, it is now a legal requirement that you have a transition plan. You know, so it it's not you know, you needn't think you can just avoid any of this by not having a transition plan or not publicly stating a transition plan. What you have to have is a robust data set and story to explain your journey and your planned journey and behind you, that's what you have to have and it's the people that don't have that and that are going to find themselves on the wrong end of a lawsuit or regulatory action.

Natalie Runyon: Yeah, 'cause I mean with all of the intensity of climate and the risks that are associated with that, it certainly impacts you know, long term operations and financial viability of companies. So, let me move to the second question, which is what are some of the key recommendations for corporations and the report? Lindsay, let me come to you with that question first and then Henry, I'll come to you next.

Lindsey Rogerson: OK, so what we are recommending in the report is that boards have ownership of this because you know as you know the shell example proves at the end of the day they're on, they're on the hook, or on the hook if they if they get it wrong. Supports need to have ownership of the transition plan of collecting the data that you are certainly you are going to need to produce for European regulations. And just to recap, the European regulations are extraterritorial, so they catch, if you have and if you have a shareholder who is a European financial institution, you are going to be asked for the state, these datasets that are there that are now required. Likewise, we are increasingly seeing and the central banks in Europe ask for more detail on when banks are lending, but they have checked the transition plans of thereof, the of the corporates they are lending to. So, if you have a European lender, you're also going to be caught by this, so you needn't think just by sitting in the states it doesn't apply to you. It actually does and likewise the Asian authorities are you know that there is some extraterritorial bite there as well. So, so that's the first thing I would say. And then data, you really have to have the data to support what you're saying. And after the board is set a strategy and started to look for a detour that's when it has to filter through and down through the company and I'm going to hand over to Henry now because he can explain the next bit.

Henry Engler: Sure. Well, I mean, some of the other things that we recommend for companies that are facing these kinds of issues is for them to be very careful about their public messaging process. And this is and this flows right into the whole greenwashing risk that they face. So, when you are making public pronouncements whether it's in you know in terms of, as we've discussed here, commitments to achieve reduction in your overall carbon emissions or if you are making statements about the products that you sell and, you know, those could be products consumer like products, I mean we've had cases here in the United States for example where large retail companies such as Kohl's and Walmart have been taken to court and fined by the Federal Trade Commission for selling products that supposedly are economic or eco-friendly and they have certain kinds of characteristics embedded in them when in fact they're not eco-friendly like the case with Walmart and Kohl's was regarding clothing that they were selling that was made from bamboo fiber and then it was found that it wasn't the case. And so, they had to pay a hefty fine for that. So, it's the messaging, it's the messaging not only from the very top in terms of your overall climate commitments or say your commitments to diversity that you're saying well, well, you know, we plan to have X number of women and people of color on our board by you know three to five years, you have to be very certain that you can deliver and achieve those, those commitments whether it's in terms of you know those high level goals or the products and services that you sell. So messaging is very important. And then tide to that, we also, you know, bring up the issue of reputational risk because you know when you are found not to have credible either transition plans in place to achieve your climate goals, or when you are found to have products that are not really what you say they are your reputation can be hurt, and so that's another warning that we've cited in the report.

Natalie Runyon: Though there are two other findings that I wondered if you could illuminate on. One of them was around data governance and then another one was around skills, and I know in particular in data governance, the accuracy of the data is a big concern and can be cause monumental problems, you know, upstream, you know as you think about the boards' oversight and one mistake in the data could cause, you know, major, major issues. So, I'm just curious if one of you could illuminate on the recommendation around data governance.

Lindsey Rogerson: Absolutely. So, to be fair, the data will it continue to improve. So, what, so over here in Europe we've had a go round in in our bank stress testing where you know the banks were allowed to kind of do their kind of best guess, but they had to, you know, evidence what their thinking was and so the regulators are learning as well and so you're far better to attempt to gather the data than just to say I'm not going to gather data. You need to explain your working, so if you have a number you need to be able to explain where you got that from. And as I said earlier, the SFDR has some quite descriptive calculations on how you have to produce the data required in Europe, but TCFD, which is a task force for climate related disclosures, it again is very helpful in telling people how to get up to these numbers. What I would say is the Shell example proves that people are checking those numbers and they're not the only ones. In the UK the Grantham Institute, which is part of the London School of Economics, is now going to have going to be checking all of the UK transition plans as they are produced and there are, you know, there are various other external auditing companies and so your data governance really has to be key and just be sure that you are giving the same information to everyone and you and so it needs to be centralized and needs to be controls around that so that you are not giving because you will be getting data requests from here, there and everywhere. And it's just a final one to fling in before I pass over to Henry to cover off skills is the ratings agencies are now also providing a check on this, you know, and so there's a lot of people checking your homework, so you really need to have a robust process around pulling your data together, checking your data and disseminating your data.

Henry Engler: Well, on the skills front, I think in short skills are in short supply when it comes to ESG for many companies. I mean, if you're a large organization, especially if you're a large financial institution like a JP Morgan or a Citigroup, you already have tons and tons of people working on these issues. You have, you know, groups that are dedicated to climate risk, diversity and social issues and it's all the way up the chain to the board level, but as you drill further down, I think that's where the problems arise, where you have smaller companies. Again, if you just stay with financial services, if you're a smaller bank or regional bank and you're facing the prospect in the not-so-distant future of having to tell the SEC what you're doing on climate risk and climate disclosures, well, you're probably scrambling, you're scrambling to find people who have some experience in this, and it's not that easy because as the regulations continue to evolve that requires companies to have people who were able to understand the issues and know how to pull everything together, such as data governance, what Lindsey was just describing. So, there's a real skill shortage, difficult to know how to handle that. I think in some cases we've seen where companies are taking the people that they have already in House and using them to train new people within the organization and then there are some I think Lindsey and Europe, I think there are some governmental schemes as well that are seeking to help companies when, you know, in terms of giving the right, the right people on board.

Natalie Runyon: Yes, and hopefully because of issues that have come up in the context of "quiet quitting" or the "great resignation", employees are really looking for career development opportunities and this is one of those areas where companies could potentially invest in retraining, right? So, the last question that I wanted to ask was just around what's on the horizon in 2023? Henry let's start with you.

Henry Engler: Sure. I think, well, here in the United States, the biggest issue that's on the horizon is the Securities and Exchange Commissions climate disclosure proposals. They're out there. They were vetted by the public. The SEC has been inundated with public comment letters. They're digesting them now, reviewing them, and they will then put forward a final proposal either, you know, by the end of this year or early next year. And once that comes out then that will unleash a lot of reaction and commentary and across all industries, because this will affect all companies, they will have to be able to report on what their emissions are, what they call scope one and scope two, but also, and this, this remains to be seen whether the SEC will stick with their initial requirement on what's called scope three emissions, which are the emissions of your suppliers. So, that is perhaps one of the biggest challenges or most controversial parts of the original proposal. So, for American companies, that certainly is the biggest, biggest thing on the horizon, you know, as we go into 2023 and I would just the second thing that we'll have to keep an eye on is just the political, politicalization of ESG. And as we've seen over the last year, it's become you know, a lightning rod for, you know, certain political groups and in states that are run by, you know, conservative Republican governors and legislators, it's an issue that they feel very strongly about. And so, that's another thing I think we have to, you know, watch as we get into 2023.

Natalie Runyon: And I'm hearing once the climate related emissions guidelines our rules are finalized the SEC is going to be quickly looking at human Capital Management, and specifically diversity, equity and inclusion.

Henry Engler: That's right.

Natalie Runyon: Lindsay, what's on the horizon from your perspective?

Lindsey Rogerson: So, a couple of things very quickly. So, there is an attempt to come to produce a kind of global reporting standard. So, that's the international Sustainable Standards Board. So, they come their consultation has is recently closed and they will be producing some guidelines and that will feed into IOSCO which is the International Securities Regulator, Association of regulators basically if they support it that will, you know, that will help kind of with this standardization basically. And so that's what investors and everybody is, are crying out for is a standardization. And so, that's a big one to watch. The next thing is carbon credits. You're going to be hearing a lot about this at COP27. Obviously, the green light was given to develop these at COP26 last November. There are an array of people literally chomping at the bit to get these out of the way, but I would, you know, we've been talking about reputational risk on this podcast and you really, really need to know what you're buying if you're going to mitigate your climate risk for the time being while you do all those things to bring down the risks internally and, you know, within your business. If you're going to use carbon credits, you really need to be sure what you're buying and you know, you really have to be, because a lot of them have turned out in the past to be out and out frauds and there is work afoot to basically back-to-back, sorry back look back at all of the existing ones to see whether they're credible or not, you know, so there's just there's huge reputational risk in inheriting this. I'm not, I'm not saying I expect we will see the use of these grow. I mean there's been various predictions from McKinsey and you know et cetera on the on the growth on these, but you would just urge caution if you're jumping into the carbon credit thing to know what you're buying. And the final thing I would say on the horizon is just we're going to see more of these learning from other experiences out there and just when companies are putting together their

ESG strategies and transition plans, I mean just learn what it's got other people into hot water and check that you are also not doing likewise and yeah, so that's it from.

Natalie Runyon: Well, thank you so much Lindsey and Henry. I know that we could have spent one podcast episode each on you know standardization, the findings or expectations from the SEC guidelines on how to address the gaps in talent and on data governance themselves, right? So, but we're going to leave it right there. I really appreciate your time today. I really appreciate all of the effort that you put into writing and drafting the new ESG report entitled ESG Under Strain. You can get that on the Thomson Reuters Institute website at tr.com/institute. Again, thank you Henry and Lindsay and we will see you next time.

Lindsey Rogerson: Thank you.

Henry Engler: Thank you.

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