

## ESG Essentials: What You Need To Know Now

### Episode 16 – ESG Backlash

**David Colvin:** Hey everybody. Welcome back to the latest episode of Fox Rothschild's ESG podcast, ESG, What You Need to Know Now. I'm your host, David Colvin, Co-Chair of the firm's ESG Practice Group, and today I'm pleased to be rejoined by my fellow co-chair and partner Karen Davis, to talk about the proverbial ESG backlash and the future of the ESG movement.

Welcome back to the podcast, Karen.

**Karen Davis:** Great to be back, David.

**David Colvin:** So Karen, just to level set for our listeners and to provide some context for the discussion. The ESG backlash that's been in the news and covered by the media is not insignificant. It's gaining steam. And just to provide a little more a little more context for that.

So, in 2023 alone, we know that 165 anti-ESG bills had been introduced across 37 different states and most of those bills are focusing on prohibiting state agencies from doing business with investment firms that utilize so-called ESG funds or screen out from their investments specific industries such as oil and gas, for example.

There was a recent survey of more than 125 corporations, half of which have annual revenues north of \$10 billion, where 61% of those CEOs said they expect this ESG backlash to continue or increase over the next two years. It's been well publicized that Larry Fink, CEO of BlackRock, who's been a champion for ESG in many respects has said that he won't use the term ESG anymore because it's become too politicized.

And some see that as a retreat from ESG, but I think Mr. Fink in his comments has made clear that BlackRock's not changing its position on ESG, but instead is simply changing the way it looks and talks about environmental, social and governance issues. So, let's talk about the backlash.

But before we do that, I need to make a short disclaimer that Fox and its ESG Practice Group, we don't take a position on ESG as being "good" or being "bad" or being somewhere in between. Fox is here, and its group is here, to counsel and advise clients on any number of ESG-related issues, including conducting gap analyses, reviewing public disclosures and public statements and sustainability reports. And that includes also advising and counseling clients on the risks presented by the current ESG backlash as just one aspect of the counseling and advice we provide to clients. So with that disclaimer in mind, Karen, can you talk a little bit more specifically about the ESG backlash, particularly in the United States and what you're seeing and hearing.

**Karen Davis:** Sure, happy to. So, as you mentioned David, there's really been a groundswell of backlash and it garners a lot of media attention. There've been a number of state governments and state attorney generals who have proposed or passed laws or issued letters to discourage companies from

considering ESG factors when making investment decisions and from pursuing ESG objectives. The scope of these efforts is very wide-ranging.

It includes targets such as insurance companies, investment firms, law firms, CEOs and proxy advisory firms, to name a few. And it's not just coming from state governments. For example, earlier this year, Congress voted to overturn a U.S. Department of Labor rule issued in December 2022 that allowed pension plan funds to consider ESG factors in the investment process.

But the Department of Labor rule was saved by President Biden, who used his first veto to defend the rule. So there is, there's a lot of backlash and as you indicated it seems to be growing rather than diminishing and it's something that companies really need to identify and prepare for.

**David Colvin:** When we acknowledge, obviously, that the backlash is real and it's hard given the, as you said, the scrutiny that it receives from the media. It's difficult really to know how much impact it's having on the movement and on companies' efforts to become more sustainable in their operations and to respond to stakeholders, whether they be their investors and shareholders, or whether they be their employees or whether they be their customers.

It's hard to really gauge how much of an impact it's having, but what impact are you seeing from the backlash in terms of how companies are reacting and changing or not changing how they're doing business?

**Karen Davis:** Well companies appear interested in staying out of the fray. And one way they are doing this, as you mentioned in the introduction, is they are using different terminology and avoiding the use of the phrase ESG, but they do not appear to be fundamentally changing their underlying conduct or strategy.

So, for example, instead of saying ESG, a company may use the term sustainability instead. And there have been some studies on the impact of backlash, and it's not identified as a major obstacle to implementing effective ESG programs. For example, there was a recent study by the Diligent Institute that asked about obstacles to ESG progress and only 2% of the respondents identified ESG backlash as an obstacle.

The need for better insight around how their ESG goals linked to overall company strategy was identified as the biggest obstacle. Nearly 50% of the respondents identified that as an obstacle. So I see companies breaking ESG into its component parts and talking about each part independently. For example, rather than using the term ESG, a company may talk about how flooding or fire risks pose a threat to a significant company asset, or how the company is implementing supply chain diligence to mitigate the risk of forced labor in its supply chain, or the steps the company has taken to strengthen its corporate governance. So those are all components of ESG and the trend appears to be to address and discuss the issues individually rather than an ESG bundle.

Another area where I see a lot of growth is that companies are really making the case for how ESG goals align with their overall business strategy and are intended to enhance shareholder and stakeholder value.

**David Colvin:** So fair to say then that in terms of what you're seeing, not only with the clients that you represent and assist, but just in monitoring this issue as I know you do, companies are really not, it's almost back to what I said about Larry Fink and BlackRock. Companies aren't necessarily changing what they're doing from a strategic perspective in terms of they're still making part of the company's strategy reducing its impact on the climate, for example, making sure that there's adherence to good human rights standards and that there's no forced labor within their supply chains, et cetera. They're just not calling it out, what seems to be now this radioactive term, ESG – radioactive in some circles, not in others using the term ESG.

So it's not that ... you're not seeing the companies are fundamentally retreating from what would otherwise be described as the ESG movement.

**Karen Davis:** That's right. I think it really is more of an issue of terminology, and also you know, sort of how it is viewed and how it is integrated into the company, recognizing that it's important that ESG initiatives fit into the overall business strategy and are intended to enhance shareholder and stakeholder value, that these initiatives are not rising out of any kind of personal preference or agenda, but are tied to the overall business strategy. And you know, I really, I see the trend continuing.

I think companies will continue to place focus and rigor on their ESG program and how they report out progress. Again, I see a lot more emphasis on integrating ESG strategies into overall business strategies and a lot of emphasis on how companies will develop and enhance their methods to collect and verify appropriate environmental and social metrics.

One example of that is that in 2019, only 20% of companies surveyed had full board oversight of ESG, and this year the number is up to 49%, so it's a pretty significant jump. You know, consumer and stakeholder demand for ESG programs and progress continues to remain high, but there's also a growing body of legal requirements.

So you know, in these areas, it's not optional for a company to pursue the ESG initiative, it's a legal requirement.

**David Colvin:** Right. And just by way of example, you're foreshadowing the SEC's final approval of its climate disclosure rule, which we do expect based on what we're reading in the press to come out at some point in early October.

We obviously have the draft proposal, but we expect it to be finalized in October. And that particular rule, along with all the legal requirements that are contained in it, will have an impact, you know, no question about it, a significant impact and some might say an overwhelmingly burdensome impact on publicly traded companies in terms of what they need to disclose and the data that they need to gather and unearth and analyze and then present with respect to the impact on the climate in the areas in which they do business, not just at the very specific level of where their operations are, but throughout their supply chain. And I agree with you, that's, those are, if that rule gets passed that's an aspect or that's an issue that companies aren't gonna have a choice about whether to follow or not.

They will have to do so if they intend to remain a publicly traded company. So, I guess what I'm hearing is, you don't see, in terms of the future of ESG if you have your crystal ball out, you don't see it changing

fundamentally. But in terms of how it's discussed and how it's referenced and, I mean, the various factors, whether they be an environmental, social or governance factors, the companies will be a little bit more specific and a little more circumspect in how they talk about the issues and where they focus their strategies – obviously for publicly traded companies, all designed to deliver financial return and financial growth and financial benefit to its shareholders and also then responding to consumer and employee demand as well.

**Karen Davis:** Yes, I think that's what the trend is indicating. And in addition to the U.S. SEC climate risk disclosure rules, and you know, also recently the SEC released its cybersecurity disclosure rules. Another area where I think sustainability or ESG will be driven by legal requirements is coming out of the EU Corporate Sustainability Reporting Directive, which is an EU law, but it will apply to many U.S. companies depending on a number of factors. For example, the CSRD is expected to directly impact about 10,000 non-EU companies, many of which are U.S. companies.

The first companies to be in scope would be EU subsidiaries of U.S. companies if they meet certain criteria. And those reporting obligations, which are pretty broad in terms of what needs to be tracked and reported, that would begin in 2025 for reports due in 2026 and then later on for U.S. companies that have significant business in the EU and meet other criteria. Beginning in 2028 for reporting year 2029, those U.S. companies will need to meet and report out on the detailed CSRD obligations for the entire organization. And then even for U.S. companies that are not in scope of CSRD, if they have customers who are in scope, those U.S. companies are going to need to provide ESG metrics and data to their customers so their customers can meet their legal obligations.

So I think, if nothing else, just the legal obligations that will apply will support greater and greater attention on developing ESG programs going forward.

**David Colvin:** Well, I think this is an issue that, that you and I will continue to stay focused on and will continue to monitor, and I think, you know, maybe in next quarter or the quarter or thereafter, you know, we'll get back together and we'll see where things stand.

But I think we'll leave it there for today. Thank you very much for taking the time to share with our audience your thoughts on the backlash and where ESG is headed as a movement or maybe I should say, where sustainability is headed as a movement. And to all of our audience members, thank you so much for taking the time to listen.

We will be back to you with our latest episode in due course. Until then, everybody stay safe and stay well. Thanks so much.

**Karen Davis:** Thanks David.