Emphasis on ESG Continues into 2022

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Environmental, Social and Governance ("*ESG*") investing continued to grow throughout 2021 and this growth is expected to continue into 2022 as ESG investments are estimated to surpass $41 trillion in assets under management globally by the end of the year. ESG investing occurs when investors make investment decisions based on a company's environmental, social and governance policies and performance alongside traditional financial metrics. As investment firms, lending institutions, and individual investors are increasingly looking at ESG factors to identify material risks and growth opportunities, a number of trends are expected to emerge in the upcoming year. These include regulation of ESG disclosures, growth in green technology, renewable energy and infrastructure investments, and heightened standards associated with sustainable finance.

Regulation of ESG Disclosure

Regulation of ESG disclosures is expected to occur in 2022. In 2021, the Securities and Exchange Commission (SEC) announced that it would focus on regulation of ESG-related reporting and disclosure. In March, the SEC declared that ESG and climate change risk would be an examination priority in 2021 and thereafter the Commission created an ESG Task Force to focus on material gaps and misstatements in climate change disclosures. In August, the SEC issued comment letters to public companies seeking to understand the differences in ESG disclosures that the companies provided to investors and those that they voluntarily provided to reporting companies. Now, it appears as though the SEC is positioned to issue new and updated climate change rules in the first part of 2022. Reports are that the SEC's commissioners are in the process of finalizing new climate change disclosure rules and that the commissioners were split on whether to extend a company's climate change disclosure requirements to include not only the company's own greenhouse gas emissions (Scope 1 emissions), but those of its suppliers and partners as well (Scope 3 emissions). Any requirement to disclose a company's Scope 3 emissions will likely be more burdensome and costly. In addition, Scope 3 climate change disclosures could potentially open a company up to lawsuits for erroneous information. This is especially true in the current climate where ESG activism, and litigation, are on the rise. Some investors are nonetheless advocating for a higher level of climate change disclosures, arguing that broad disclosures are essential to their investing decisions.

The ESG disclosure rules ultimately adopted by the SEC in the United States could be similar to actions taken by European regulators. The Task Force on Climate-Related Financial Disclosures (TCFD) has developed a framework to help public companies and other organizations disclose climate-related risks and opportunities. Beginning in April 2022, the United Kingdom will require that over 1,300 of its largest companies and financial institutions disclose climate-related financial information using the TCFD framework. The European Union is reportedly finalizing its Corporate Sustainability Reporting Directive (CSRD), which was proposed in April 2021. The proposed CSRD, which applies to all large companies and all companies on regulated markets, requires fulsome sustainability reporting according to specified standards. Both the TCFD and the CSRD are to replace existing ESG disclosure frameworks and are aimed at making ESG reporting more consistent and helping investors understand their exposure to climate and other ESG risks.

In addition to new regulation by the SEC, at least one state is poised to take its own action on climate disclosure. In January 2022, the California Senate passed the Climate Corporate Accountability Act (SB 260), the first law in the United States requiring large companies to disclose their greenhouse gas emissions. The Act would apply to companies with revenues of $1 billion doing business in the State of California and require that they disclose their Scope 3 emissions on an annual basis. Before it becomes law, SB 260 must move through the state assembly. If passed there, it will proceed to the Governor for signature.

Growth in Green Technology/Renewables/Infrastructure

Areas of green technology, renewable energy, and infrastructure advancements are expected to present an opportunity for growth in 2022. The United States government is poised to make significant investment in climate adaptation in 2022 and beyond. In February 2021, the United States rejoined the 2015 Paris Agreement and committed to cutting its greenhouse gas emissions by 50% to 52% from 2005 levels by 2030. To further this goal, the Biden Administration has set a target of 100% carbon-free electricity by 2035, which is to be achieved through increasing clean energy sources and more efficient means of transmitting and storing energy.

The Infrastructure Bill passed by Congress in November 2021 is likely to further this agenda. Under the Infrastructure Bill, the federal government will invest $50 billion toward fighting climate change disasters and an additional $65 billion toward clean energy and grid-related investments. The Infrastructure Bill also includes significant funds allocated to passenger rail, electric vehicle infrastructure, electric school buses, port and airport infrastructure, clean drinking water access, and remediation of historically polluted sites. The government has already begun to allocate budgeted funds. Just last week, the Biden Administration unveiled a plan to award nearly $5 billion over five years to build thousands of electric vehicle charging stations with a goal of having 50% of all new vehicles sold in the United States be electric or plug-in electric vehicles by 2030. This goal is being bolstered not only through an infusion of cash into the electric vehicle sector, but also by updated vehicle emission standards and technological advancements. In November 2021, several automakers detailed plans to electrify large portions of their fleets through a combination of battery electric, fuel cell, and plug-in hybrid vehicles.

Heightened Standards in Sustainable Finance

As companies focus on ESG-related matters and growth opportunities, the market for sustainability-linked loans and bonds is expected to continue its growth trajectory into 2022. Lending institutions have set aside large sums of money designated for ESG purposes and borrowers will be looking to tap into these resources and take advantage of their benefits. Sustainability-linked loans, for example, are often issued either to finance a specific environmentally friendly project or to borrowers looking to improve their sustainability metrics relative to their industry peers. The loan proceeds themselves are not always required to be used to finance social or green projects, but the interest rate on the loans is commonly tied to the ESG performance of the borrower.

As more sustainability-linked loans are issued, lenders are heightening the standards associated with these types of loans. It is now common for lenders to issue loans at a lower interest rate in exchange for a borrower meeting certain Key Performance Indicators (KPI), which are correlated to ESG metrics. As sustainability-linked loans become more sophisticated, lenders and investors are conducting in-depth assessments of a borrower's KPIs to ensure that they are adequately ambitious, attainable, and measurable. More lenders are also now requiring that a borrower's KPIs are externally (as opposed to internally) verified, although there is not yet a universally agreed upon process or standard for ESG verification. Investor and lender diligence into areas such as water supply, sustainable packaging, greenhouse gas emissions, social metrics, and environmental justice, is also on the rise.

The ESG landscape is sure to continue to grow and shift during the coming months and years with regulatory developments, green growth opportunities, and clarity with respect to regulation and reporting. Chapman and Cutler LLP attorneys will provide updates as these changes take place.

For More Information

Please contact Kristin Parker, the Chapman attorney with whom you regularly work, or visit our ESG Counsel and Sustainable Finance resources at chapman.com.

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