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What is ESG?

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1. Introduction

Environmental, social and governance (ESG) considerations have seen an exponential rise in prominence in recent years. Initially brought into focus within the asset management and investment community, ESG concerns have since broadened to become a focal point for a diverse array of stakeholders, including corporations, policymakers, courts and the general public across the world. The COVID-19 pandemic has only served to amplify this trend, spotlighting specific ESG issues related to the pandemic, while also perpetuating the global re-evaluation of corporate purpose.

This shift in perspective was encapsulated in August 2019, when the Business Roundtable released a statement redefining the purpose of a corporation,[1] including the promotion of an economy that serves all citizens, as opposed to shareholders only.

Nevertheless, the rapid development of ESG has not been without its challenges. Complex trade-offs involving global equity and energy security have fuelled scepticism as to the efficacy and merit and value of ESG as a concept, scepticism which has been louder in certain jurisdictions and regions than others. However, as with any evolving and maturing idea, it is to be expected that ESG will face numerous challenges, and be required to adapt and adjust over coming years.

This handbook aims to explore some of these challenges, while also highlighting areas where ESG is poised to develop further. It seeks to provide a comprehensive overview of the current market landscape, offering insights into the dynamic interplay between ESG factors and the broader socio-economic environment.

2. What is ESG?

ESG is an umbrella term which represents the non-financial factors that

1 "Business Roundtable Redefines the Purpose of a Corporation to Promote 'An Economy That Serves All Americans'" (Business Roundtable, 19 August 2019), www.businessroundtable.org/business-roundtable-redefines-the-purpose-of-a-corporation-to-promote-an-economy-that-serves-all-americans.

investors, businesses and other stakeholders consider in their investments, analyses and decision-making processes. In the investment community, ESG has largely supplanted CSR (corporate social responsibility), which represents a firm's sustainability efforts and its practices and policies which seek to have a positive impact on the environment and on society in general. ESG was originally created by the financial sector to quantify and measure firms' sustainability practices, but recent years have seen a growth in the breadth and number of stakeholders showing interest in ESG, and companies are now focusing on these issues from a reputational perspective and as part of their social licence to operate.

While different people and different institutions have varying definitions of exactly what issues fall within the scope of ESG, environmental factors typically involve a firm's impact on the environment, such as carbon emissions and resource usage. Social factors relate to how the firm treats stakeholders such as its employees, local communities, customers and society in general. Governance factors include: a firm's policies and procedures; its ability to avoid corruption, bribery and other fraud; and the independence and structure of its board of directors. Different ESG factors may be more relevant for some industries and firms than for others, and the importance of certain factors may change over time. In recent years, corporate stakeholders have increasingly focused on climate change, DEI (diversity, equity and inclusion) and a firm's health and safety measures in light of the COVID-19 pandemic.

Although there is no universal definition of what qualifies as ESG, factors include but are not limited to the elements in Figure 1.

3. Why does ESG matter?

The legal landscape is rapidly evolving to reflect the importance of ESG considerations, with regulatory frameworks around the world developing to incorporate ESG principles. Non-compliance can lead to significant repercussions, as evidenced by the proliferation of ESG-related enforcement actions and private litigation. In the United States, for instance, the Dodd-Frank Act of 2010 as amended, the Foreign Corrupt Practices Act of 1977 as amended and recent SEC proposals underscore the necessity of ESG disclosures, ranging from supply chain transparency to climate risk and greenhouse gas emissions. Similarly, in the United Kingdom and Europe, the development of ESG taxonomies and the European Union's recent roll-out of the Corporate Sustainability Reporting Directive (CSRD) are the latest harbingers of the transition from soft law to hard law in ESG matters, with stringent disclosure requirements and cross-jurisdictional mandates becoming the norm.

ESG performance can also be an important determinant in an entity's ability to secure financing. Investors and financial institutions, stewarding trillions in capital, increasingly prioritise ESG metrics when assessing the risk and growth

Figure 1. What qualifies as ESG?

Environmental	Social	Governance
• Climate change and greenhouse gas (GHG) emissions • Energy efficiency • Resource depletion, including water and raw materials • Waste and pollution • Deforestation • Biodiversity	• Human rights and working conditions (including slavery and child labour) • Diversity, equity and inclusion (including anti-discrimination) • Impact on local communities, including indigenous people • Conflict zones and conflict minerals • Health and safety • Customer privacy and security	• Corporate governance and oversight • Risk management • Executive pay • Fraud, anti-bribery and anti-corruption controls • Political lobbying and donations • Board independence, diversity and structure

potential of investments. The surge in sustainable investments and the prevalence of ESG reporting among S&P 500 and Russell 1000 companies[2] reflect the financial sector's increasing focus on such issues. Entities with robust ESG strategies may find it easier to attract investment, as they are perceived to be better prepared to navigate future challenges and capitalise on opportunities. Conversely, those with poor ESG records may face divestment and a shrinking pool of willing investors.

Nevertheless, the complexity of the ESG landscape is compounded by the diverse perspectives of its stakeholders, with each participant group, jurisdiction and market bringing its unique view to bear on what exactly 'ESG' entails. What constitutes responsible environmental conduct, social responsibility, or effective governance can vary significantly from one country to another; influenced by cultural norms, legal systems, economic priorities and societal expectations. For example, the emphasis on environmental issues might be more pronounced in countries severely affected by climate change, while social issues such as labour rights might take precedence in regions with a history of labour exploitation. Similarly, governance concerns may differ in markets with

2 From the G&A Institute "2023 Sustainability Reporting in Focus" report, 98% of S&P 500 and 90% of Russell 1000 publish sustainability reports.

varying levels of regulatory enforcement and transparency standards. The challenge lies in navigating the variegated definitions of the 'E', the 'S' and the 'G', and the potential for conflicting regulatory demands.

Stakeholders, ranging from consumers and employees to regulators and non-governmental organisations, also bring unique viewpoints to the table, influencing "why ESG matters" on a case-by-case basis. A consumer group's focus on ethical sourcing may drive a company's social ESG efforts, while investor pressure for transparency and accountability may shape governance initiatives. As such, entities must traverse this landscape with a nuanced and adaptable ESG approach, tailored to the specificities of each market and stakeholder group they engage with.

The very presence of these complexities stands testament to the fact that ESG considerations have become an enduring feature of the global business landscape. Stakeholders must cultivate a deep and actionable understanding of ESG, not only to mitigate risks and fulfil legal obligations, but also to harness opportunities for sustainable growth and long-term value creation.

4. Overview of *The Global ESG Handbook*

This handbook is structured to provide a holistic view of ESG issues, guiding readers through each component and their interconnections. The flow of the book aims to build a comprehensive understanding of ESG, starting with foundational concepts and moving towards more complex applications and global perspectives.

In the first part of the book, the chapters provide a comprehensive overview of the ESG landscape, illustrating the relevance, application and significance of these principles across the contemporary business world. "Energy transition and climate issues" by Andrew Angle, Aiste Brackley and Mark Lee from ERM, addresses the global shift toward renewable energy, highlighting both the challenges and opportunities this transition presents. This is applied in practice in the chapter "Addressing human rights risks in global supply chains" by Mariana Abreu, Ian Barclay and Stuart McLachlan of Anthesis Group and Amandine Bressand of ISEAL, which tackles managing sustainable supply chains across a range of topics, from ethical sourcing and labour rights to the environmental repercussions of supply chain operations, emphasising the critical role of due diligence and the transformative power of technology in fostering transparency and accountability.

In "The S in ESG", Sarah Fortt and Betty Huber from Latham & Watkins turn the spotlight on the social aspects of ESG. They dissect how companies are addressing pressing issues such as human rights, employee relations, community impact and the pursuit of diversity and inclusion. This discussion sets the stage for "ESG reporting" where Fortt and Huber are joined by James Bee, Paul Davies and Michael Green, offering a comprehensive look at ESG disclosure practices. They outline the existing frameworks and standards, the role of third-party assessments and the ongoing challenges companies encounter in delivering meaningful ESG information to their stakeholders.

The next chapters maintain this focus on the relevance of ESG considerations for key stakeholders. In "ESG corporate issues: shareholder activism", Elina Tetelbaum and Carmen Lu from Wachtell, Lipton, Rosen & Katz, alongside Desi Baca, Lawrence Elbaum and Patrick Gadson from Vinson & Elkins in "Shareholder activism: case studies", explore the growing influence of investors in shaping corporate environmental and social policies. This theme of ESG integration continues in "ESG corporate issues: M&A" with Rachel Barrett, Dearbhla Cantwell and Vanessa Havard-Williams from Linklaters examining how ESG considerations are becoming increasingly integral to the mergers and acquisitions process, from due diligence to valuation and post-merger integration.

The book then shifts to specific practice areas, to build an understanding of the real-world industry application of ESG considerations. Paul Davies and Michael Green from Latham & Watkins, in "ESG in private equity", analyse how ESG criteria are being incorporated into investment decisions within the private equity sector. They discuss the motivations, measurement challenges and the sustainable benefits that ESG-focused investing can yield. On the finance side, Helene Banks, Gregory Battista, Patrick Gordon and Meghan McDermott of Cahill Gordon & Reindel, in "The basics of ESG finance", introduce readers to the financial products and services designed to support ESG objectives, including innovative instruments that fund sustainable development and reward ESG achievements. This focus is further expanded in "Global obstacles and opportunities for regulated financial institutions" by Nicola Higgs, Anne Mainwaring and Gary Whitehead from Latham & Watkins, who delve into the regulatory environment of ESG in the financial sector, discussing compliance challenges and the potential for regulatory harmonisation.

The book then presents a mosaic of ESG global perspectives, with insights from Robin Hulshizer and Sophie Lamb KC looking at global litigation trends; Edward Kempson, Chidi Onyeche, Kathleen Teo and David Ziyambi from Latham & Watkins on Africa; Farhana Sharmeen, also from Latham & Watkins, on Asia; Christine Covington and Kate Gill-Herdman from Corrs Chambers Westgarth on the Australia and New Zealand region; and Milenko Bertrand-Galindo, Paula Errázuriz Sotta and Bernardita Salvatierra Riquelme from Bertrand-Galindo Barrueto Barroilhet on Latin America. Each author provides a regional analysis of ESG challenges and initiatives, reflecting the diverse approaches and developments across continents.

Lastly, the book assesses the way in which the market is responding to these shifts in the ESG terrain. In "ESG in the insurance sector", Daniela Bergs and Thomas Kelly from Howden examine how the insurance industry is responding to ESG, developing aligned products and managing associated risks. Kristina Wyatt from Persefoni, in "How technology is transforming ESG reporting", highlights the role of technology in enhancing ESG data collection, analysis and reporting, thereby improving ESG performance. The final chapter, "What's next for ESG? Leading perspectives on the future development of ESG", considers forward-looking perspectives on ESG, with contributions from: Reena SenGupta (RSGI Limited); Ruth Knox and Sabrina Zhang (Paul Hastings); Helene Banks and Gregory Battista (Cahill Gordon & Reindel); Glenn O'Halloran (Howden); Jonathan Friedman (Anthesis Group); Aiste Brackley (ERM); and Cornelia Gomez (General Atlantic). The chapter identifies the drivers of change and sets expectations for the evolution of ESG strategies and practices from various sector-specific angles, including the legal sector, insurance, finance and private equity.

5. Conclusion and looking forward

The multifaceted nature of ESG requires a multidisciplinary understanding. It cuts across diverse areas such as environmental law, energy regulation, corporate governance and anti-corruption measures. Practitioners in this evolving field must be adept at juggling various considerations, often simultaneously, to ensure that their organisations or clients not only comply with current standards but are also well-positioned for future developments.

This handbook aims to be a valuable resource for those navigating this complex ESG terrain, offering guidance and insights to help balance the many 'spinning plates' of ESG practice.

This chapter 'What is ESG?' by Paul Davies is from the title *The Global ESG Handbook: A Guide for Practitioners*, published by Globe Law and Business.

https://www.globelawandbusiness.com/books/the-esg-handbook