# ESG:
# The New Market Space

## Atlantic Union Bank

Elisabeth A. Wilson

# The Rise of ESG

# Environmental, Social, and Governance (ESG)

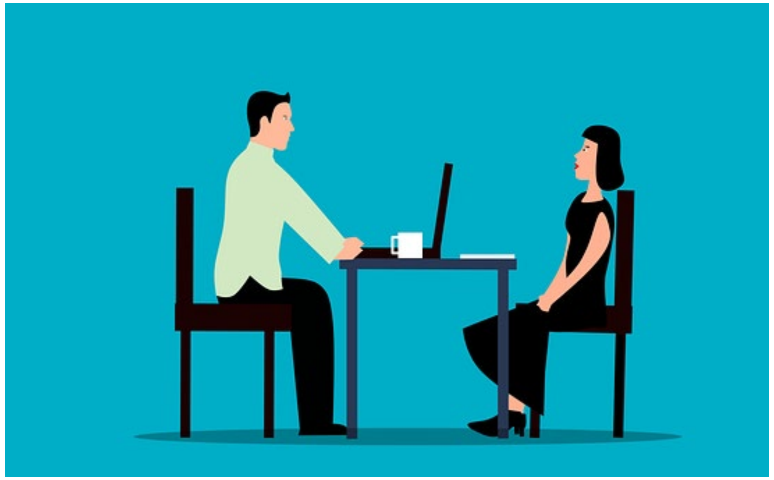
- **Environmental, Social, and Governance (ESG)** criteria and subsequent reporting are leveraged to gauge a company's sustainable, environmental, ethical, and socially conscious investment and business practices

# Environmental, Social, and Governance (ESG)

- In 2021, ESG rose to prominence as an emerging risk across the financial industry due to:

- E: The **COVID-19 Pandemic**/increased instances of devastating **natural disasters**
- S: Unprecedented **social change** in 2020
- G: A hot topic since the **Great Recession**/ ongoing **reputational concerns** for banks

# Environmental, Social, and Governance (ESG)



- **The Great Resignation** and the **War on Talent**

- Prospective hires want to be aligned with companies that **uphold and exhibit their values**

# Environmental, Social, and Governance (ESG)

- **The Great Wealth Transfer**

- Increased **environmental and socially conscious** shareholder, investor, and consumer awareness

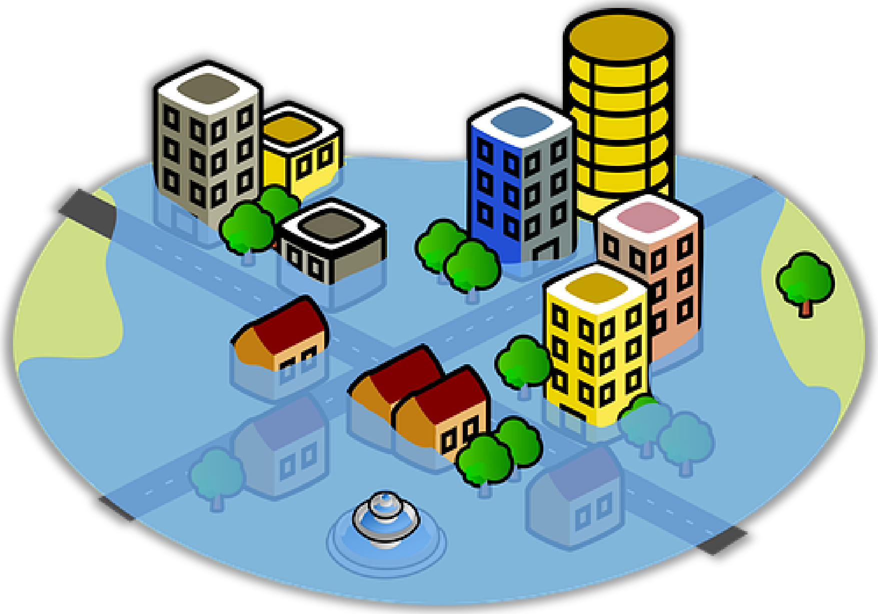
# Environmental, Social, and Governance (ESG)

- How an institution approaches ESG is suddenly a **demarcating factor** in what may draw a much-desired reputational bonus—or less-positive scrutiny

# (E)nvironmental

# Environmental, Social, and Governance (ESG)

- **E**(nvironmental):
  - Climate change vulnerability
    - Physical Risk (Acute/Chronic)
    - Transition Risk



- **Note:** In 2022, the United States sustained **$165 billion** worth of climate-related disaster damage

# Environmental, Social, and Governance (ESG)

- Financing environmental impact

- Energy efficiency

- Greenhouse Gas (GHG) emissions
    - Scope 1, 2, 3 emissions

# ESG: The Regulatory Landscape

# Environmental, Social, and Governance (ESG)

- Development of proposed **climate change-related regulatory guidance** was prioritized by various agencies as of 2021:

**November 2021** — International Sustainability Standards Board/Technical Readiness Working Group introduce Climate-related Disclosures Prototype

**November 2021** — Basel Committee on Banking Supervision issues proposed Principles for the Effective Management and Supervision of Climate-Related Financial Risks

**December 2021** — The OCC issues draft Principles for Climate-Related Financial Risk Management for Large Banks

**December 2021** — Jerome Powell states the Federal Reserve may align future climate change guidance with the OCC and other banking agencies

# Environmental, Social, and Governance (ESG)

- And into 2022…

**February 2022** — FDIC announces addressing Financial Risks Posed by Climate Change as a key 2022 priority

**March 2022** — SEC proposes standardized Climate-Related Disclosure rules

**March 2022** — FDIC issues proposed Statement of Principles for Climate-Related Financial Risk Management for Large Financial Institutions

**March 2022** — ISSB introduces two proposed standards for general sustainability and climate-specific disclosure requirements

# Environmental, Social, and Governance (ESG)

- Still going in 2022…

**June 2022** — Basel Committee on Banking Supervision finalizes its Principles for the Effective Management and Supervision of Climate-Related Financial Risks

**September 2022** — The Federal Reserve announces its pilot climate scenario analysis exercise for six of the U.S.'s largest banks

**December 2022** — The Federal Reserve unveils its Principles for Climate-Related Financial Risk Management for Large Financial Institution

# Environmental, Social, and Governance (ESG)

- In **2023**…

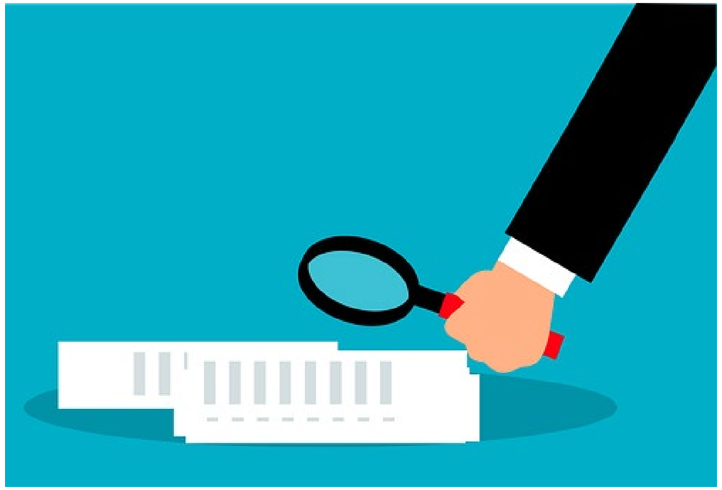
- The SEC proposed Climate-Related Disclosure rules anticipated for finalization by **April**

- The ISSB has announced it will solidify its two finalized frameworks (IFRS S1 and IFRS 2) in **June**

# SEC Climate-Related Disclosure Rules

# Environmental, Social, and Governance (ESG)

- Previous proposed climate change-related disclosure regulatory guidance is very general and high-level



- The OCC, FDIC, Federal Reserve, and Basel align but do not provide one, two, three step expectations

# Environmental, Social, and Governance (ESG)

- The SEC proposed its Climate-Related Disclosure Rules, to an extent, **remove ambiguity**

- The SEC provided tangible guidance that all publicly-traded companies will be expected to adhere to in future:
  - Report on **Scope 1, 2, and 3 greenhouse gas emissions**
  - Disclose **material climate change-related risk exposures**

# ESG Legal Challenge & Legislation

# Environmental, Social, and Governance (ESG)

- **Lawsuits** are anticipated to challenge the SEC's final Climate-Related Disclosure rules


- Individual states (Kentucky, Texas, and West Virginia) have enacted **legislation banning state and local entities from doing business** with financial institutions engaged in ESG practices or that refuse to invest in certain energy sectors such as oil, gas, or coal

# Environmental, Social, and Governance (ESG)

- On the back of the Supreme Court's June 2022 ruling in West Virginia vs EPA, the newly Republican-held U.S. Congress has instituted a **Financial Services Committee Republican ESG Working Group**

- The group has specifically announced its intent to, "combat the threat to our capital markets posed by those on the far-left pushing environmental, social, and governance (ESG) proposals."

# Environmental, Social, and Governance (ESG)

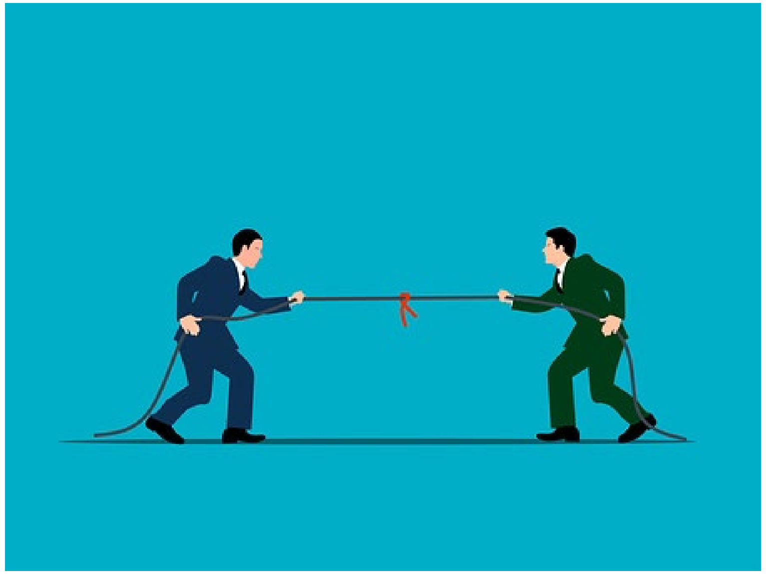
- Financial institutions are now **caught in the middle** regarding ESG and climate change:

  - Evolving regulatory expectations

  - Emerging anti-ESG legislation

  - Mounting pressure from shareholders, investors, and consumers

  - Expectations from stakeholders in seat and prospective talent



# Environmental, Social, and Governance (ESG)

- As a result, financial institutions run the risk of:

- **Greenwashing**: **Overstating** their ESG practices
- **Greenhushing**: **Underreporting** their ESG strategies in order to avoid additional scrutiny
- **Greensquelching** (copyright pending E.A. Wilson):

  Failure to **appropriately incorporate ESG** into corporate initiatives due to prescriptive, patchwork anti-ESG legislation

## S(ocial)

# Environmental, Social, and Governance (ESG)

- **S**(ocial):
  - Diversity, Equity, and Inclusion (DEI)
  - Human capital
  - Talent Strategy
  - Employee Health and Wellbeing

# Environmental, Social, and Governance (ESG)

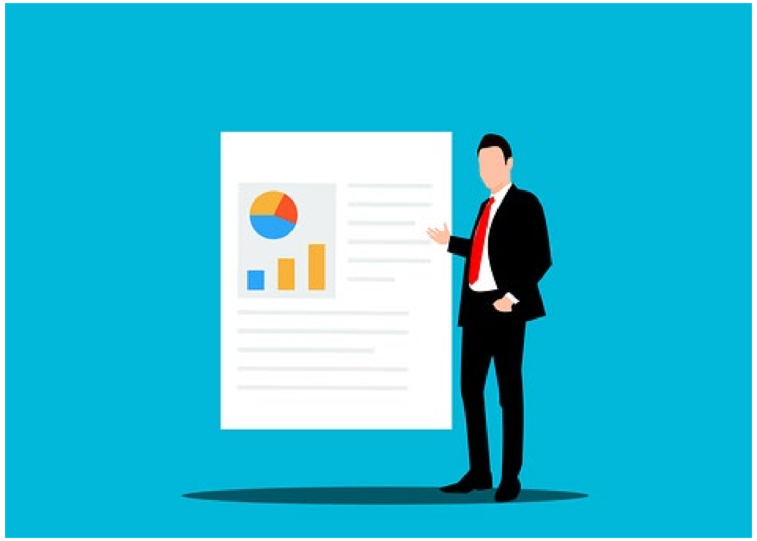
- Data Protection, Security, and Privacy
- Diverse Suppliers (Third Parties/Fourth Parties)
- Community Relations
- Customer Engagement
- Responsible Investment

# Environmental, Social, and Governance (ESG)

- There is currently **heightened regulatory focus** on:
  - Cyber Risk Management
  - Third Party Suppliers/Vendors
  - Overdraft Fees

# Environmental, Social, and Governance (ESG)

- Social poses potential significant reputational consequences
- Financial institutions need to ensure they avoid the perception of:

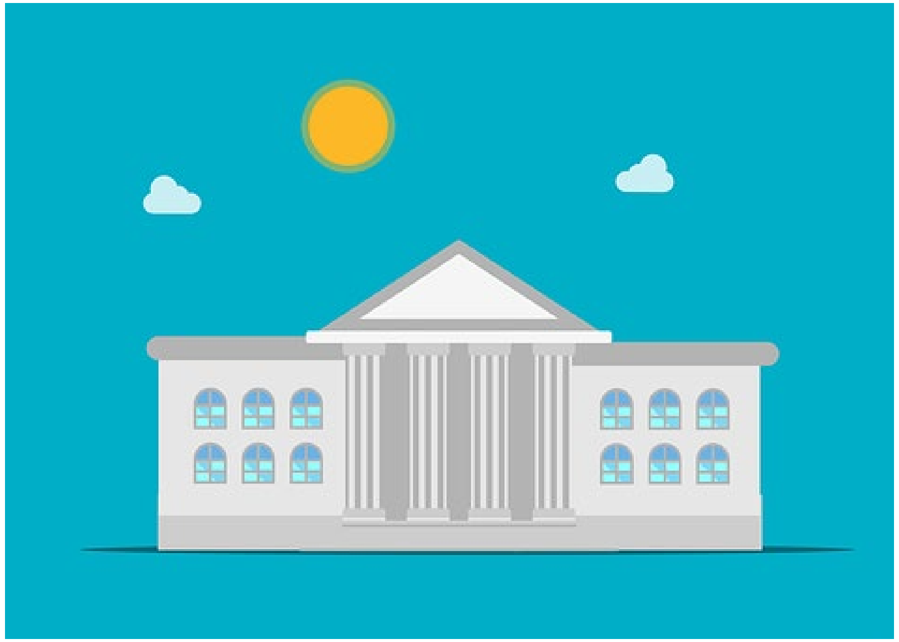


- Social Washing: **Over-promotion and indefensible statements** regarding a company's social and diversity practices

# G(overnance)

# Environmental, Social, and Governance (ESG)

- **G**(overnance):
  - Board Governance
  - Board Diversity
  - Business Ethics
  - Executive Compensation



# Environmental, Social, and Governance (ESG)

- Risk & Crisis Management
- Litigation Risks
- Financial and Accounting Transparency
- Full and Honest Financial Reporting and Disclosures

# Environmental, Social, and Governance (ESG)

- **December 1, 2020:** NASDAQ announces its **Board Diversity Rule**
- **August 6, 2021:** Approved by the SEC

- **December 31, 2023:** Disclose **one diverse director** (or why they have none)
- **December 31, 2025:** Disclose **two diverse directors** (or why they have none)

- **Note:** NASDAQ's diverse director definition is "one who self-identifies as female and one who self-identifies as either an underrepresented minority or LGBTQ[IA]+"

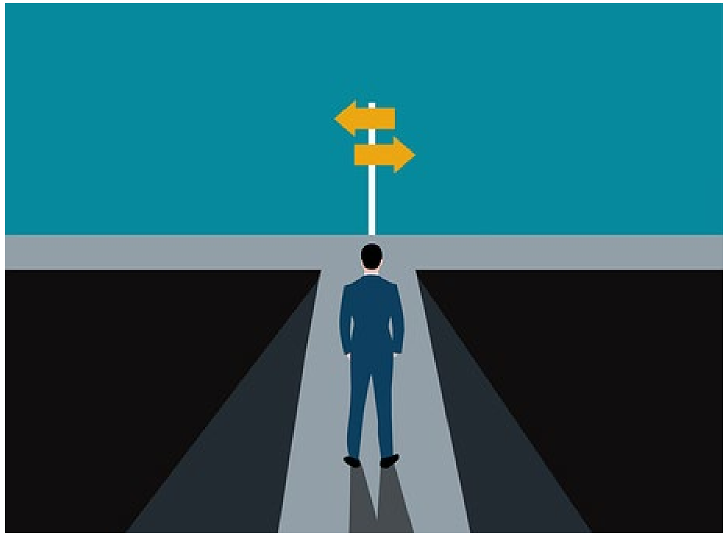
# Environmental, Social, and Governance (ESG)

- At the end of the day, **Governance** is simply doing good business

# ESG: How?

# Environmental, Social, and Governance (ESG)

- Given rapidly evolving regulatory expectations, it is not too early for a financial institution to begin **crafting its ESG journey**

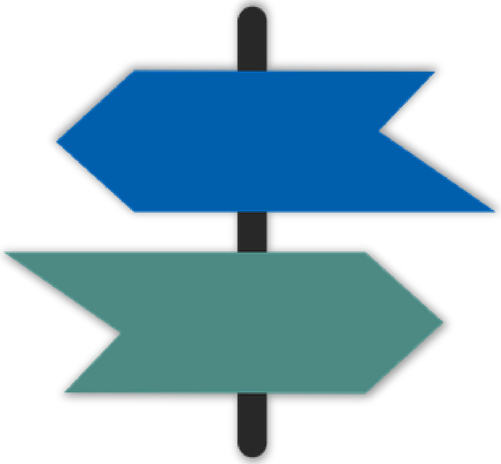


# Environmental, Social, and Governance (ESG)

- Widely accepted and adopted best practices:
  - Task Force on Climate-related Financial Disclosures **(TCFD)**
  - Sustainability Accounting Standards Board **(SASB)**
  - Network for Greening the Financial System **(NGFS)**

# Environmental, Social, and Governance (ESG)

- Other commonly utilized best practices include:
  - Carbon Disclosure Project (CDP)
  - Greenhouse Gas Protocol
  - Global Reporting Initiative (GRI)



# Environmental, Social, and Governance (ESG)

- **TCFD** and **proposed regulatory guidance** are stressing similar factors for **climate change-related** guidelines:
  - Governance
  - Policies/Procedures
  - Strategic Planning
  - Risk Management
  - Metrics, Targets, Reporting
  - Scenario Analysis

# ESG: The New Market Space

# Environmental, Social, and Governance (ESG)

- Shareholder, investor, and consumer focus will continue to shape the course of ESG **no matter the regulatory outcome**

    - Financial institutions are positioned to **make a substantial impact**—on climate change, social inequality, and ethical standards— they have a chance to move the needle

- And **moving the needle** in a more positive direction is what world-weary consumers want

# Environmental, Social, and Governance (ESG)

- ESG is a concept already inherent in a financial institution's prime directive:
  - Preserve and support the **communities we serve** to ensure they thrive

  - Promote equality to give everyone a fair shot at the **American Dream**
  - Safeguard our institutions by **doing good business** in a safe and sound manner

# Environmental, Social, and Governance (ESG)

- ESG, evolving regulatory guidance, and consumer expectations offer institutions new **opportunity** to:


  - **Market** to customers and prospective talent
  - Develop **products** that give them the edge
  - Foster **meaningful relationships** with consumers who need guidance around their financial future
  - Lead and evolve methodologies to better position their companies—and their customers—**to meet the challenging years ahead**

# Environmental, Social, and Governance (ESG)

- ESG is the **new market space** and one financial institutions should continue to corner

# ESG: Questions