Key Takeaways – ESG Center

How Companies Can Address ESG Backlash

Roundtable for ESG Center Members Held Under the Chatham House Rule. Generously sponsored by Teneo.

Thursday, April 13, 2023

Opposition to ESG is in the news. For most US companies, it has had only a modest impact to date, but it is not going away and is likely to gain momentum in the coming years. The Conference Board held a Chatham House Rule Roundtable on How Companies Can Address ESG Backlash—convened jointly by the ESG Center, the Marketing & Communications Center, and the Human Capital Center.

At the roundtable, 202 executives, directors, and others from 107 leading companies discussed: (i) the current scope and state of ESG backlash and what the future may hold; (ii) the impact of ESG backlash on companies; and (iii) strategies used to address ESG backlash and reduce the risk of it in the future.

Lead participants in the discussion included:

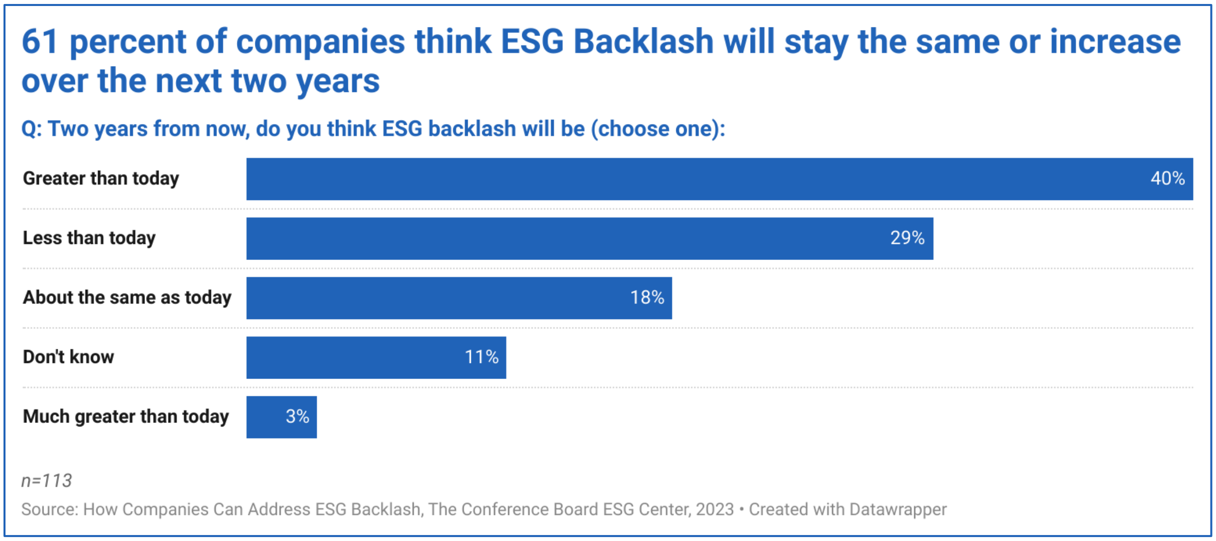
- **Wes Bizzell,** Senior Assistant General Counsel and Managing Director of Political Law & Ethics Programs, **Altria**
- **Matt Filosa,** Senior Managing Director, **Teneo**
- **Michael Garland,** Assistant Comptroller, Corporate Governance and Responsible Investment, **NYC Comptroller**
- **Betty Huber,** Partner**, Latham & Watkins**
- **Lisa Maull,** Sustainability Communications Director, **Boeing**
- **James Momon,** Chief Equity Officer, **3M**
- **Sam Olens,** Former Attorney General of Georgia; Partner, **Dentons**
- **David Robinson,** Executive Vice President and General Counsel, **The Hartford**

The key takeaways from the roundtable are below.

The Current Scope and State of ESG Backlash and What the Future May Hold

1. **"ESG Backlash" is an umbrella term that encompasses several different strains of opposition to ESG, including healthy skepticism, philosophical opposition, and opportunism.** It also comes with different degrees of intensity—ranging from a diminishment of tailwinds for DEI initiatives at one company to existential threats to a business model at others.

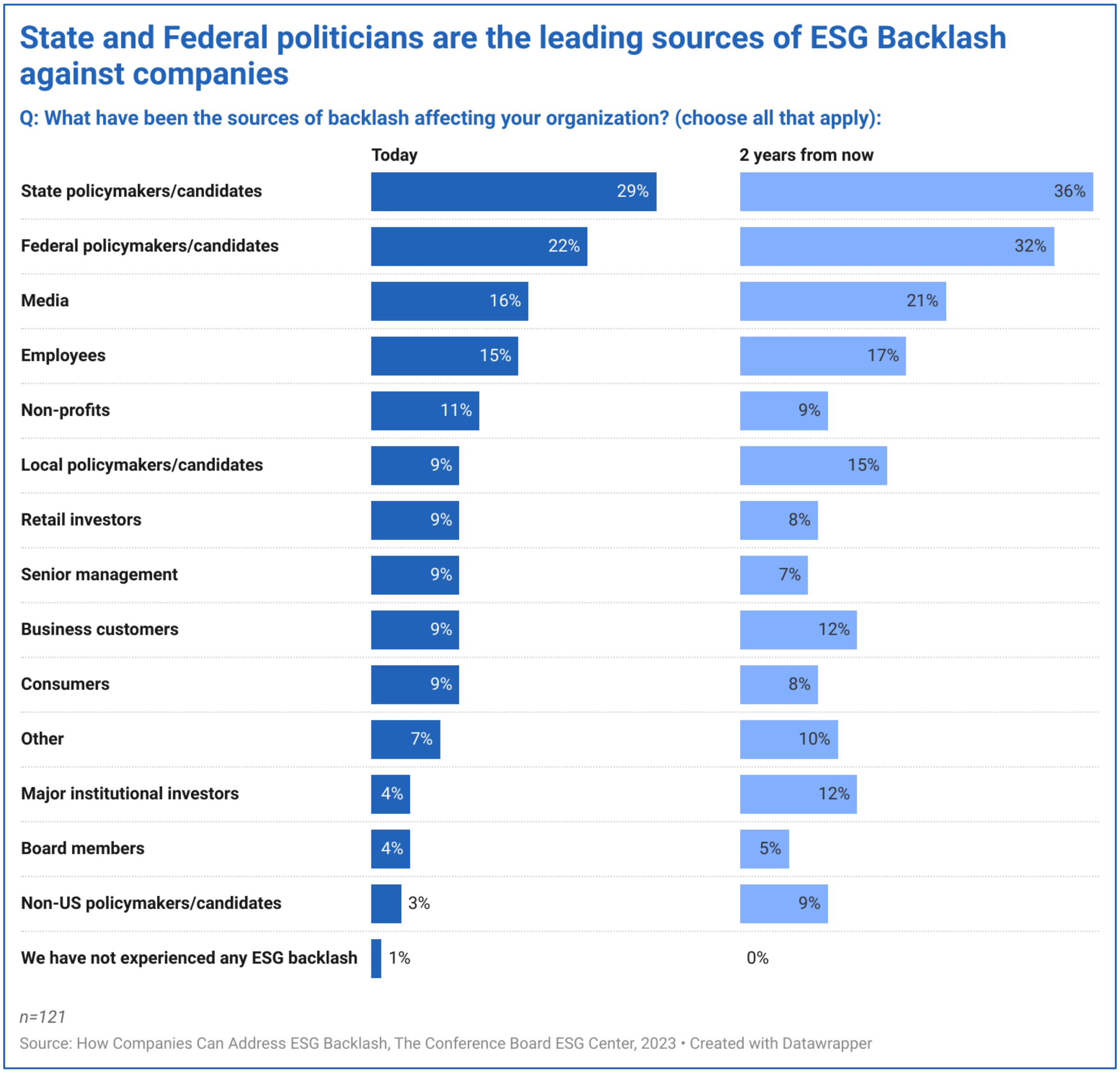
2. **We are in the early stages of ESG backlash. Based on a survey of 125 firms, only half of all companies have experienced backlash.** Most companies surveyed expect opposition to increase.



3. **While it includes overall opposition to ESG, most backlash is focused on social and environmental issues.** What is bringing ESG opposition to a new level, however, is the way that "S" and "E" issues touch an emotional chord—and politicians tap into and fuel that emotional reaction. Some of the emotionally and politically charged topics include racial equality, LGBTQ+ rights, and gun regulation. Environmental issues can also become emotionally heated political issues: the shift to renewable energy will bring about job losses in certain industries and is viewed as yet another threat to the way of life in certain regions of the US.

4. **There is currently less opposition towards what companies are doing in governance**. There has always been some opposition to "G" initiatives, often at the board and management level. This opposition has been based on different views of the appropriate roles of the board, management, and shareholders (e.g., proxy access) and based on the lack of empirical evidence to support certain governance changes (e.g., separation of Chair / CEO roles). Today, "G" opposition also exists within companies, though sometimes at an unspoken level: such as towards increasing board diversity.

5. **Federal and State-level politicians are the primary drivers of ESG backlash affecting companies.** This is part of a broader challenging political environment for US business, in which anti-corporate views are exacerbating long-term polarization, volatility, and declining trust in government. Given the political appeal of denunciations of "woke" capitalism and opposition to big business within the voters of both parties, ESG opposition is likely here to stay.

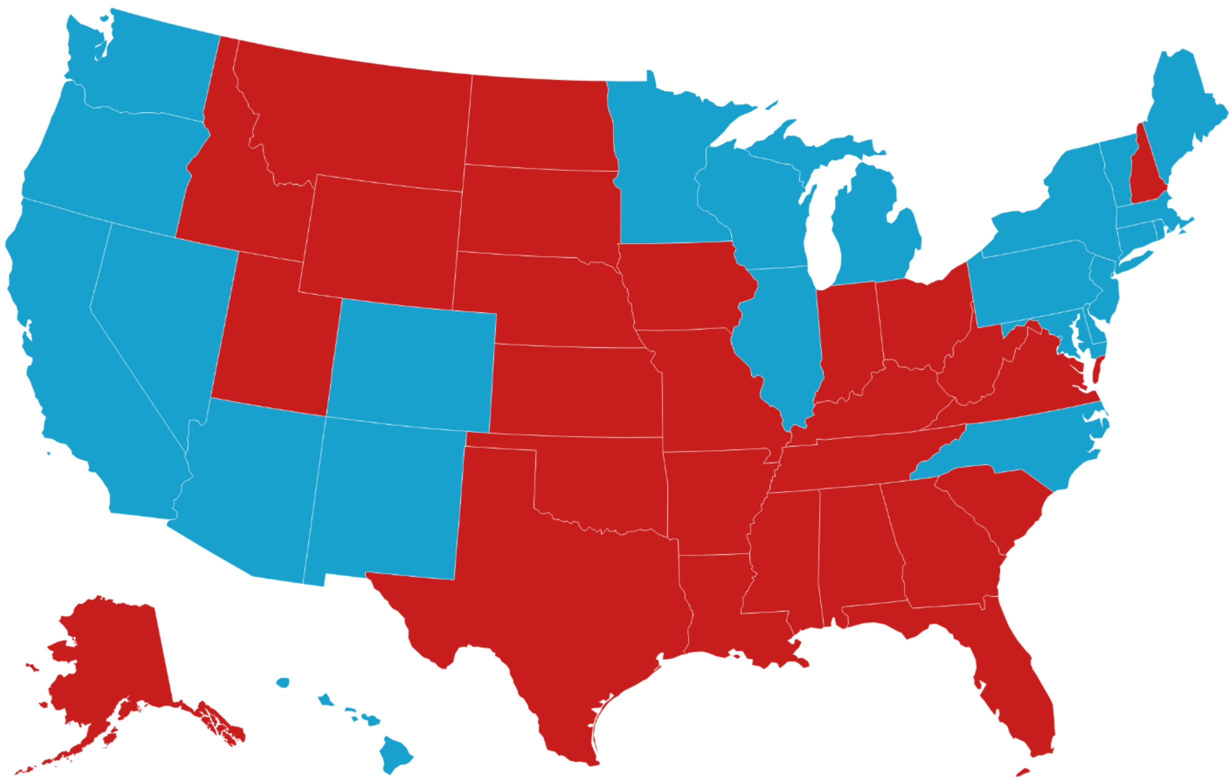


6. **State attorneys general are significant players in ESG backlash.** State attorneys general have been a rising national legal (and therefore political) force since the landmark Supreme Court decision of *Massachusetts v. EPA* (2007), which granted them greater ability to bring lawsuits against the Federal government. Some recent examples:
    - 24 state attorneys general are suing the US Department of Labor to overturn a rule that authorizes retirement plans to consider nonfinancial (i.e., ESG) factors when administering trust assets.
    - 24 state attorneys general sent an open letter to the US Municipal Securities Rulemaking Board, challenging its request for information on ESG practices in the municipal securities market.
    - 21 state attorneys general submitted comments on the SEC's proposed new climate disclosure rules, stating that they are problematic and will "add onerous reporting requirements for investment funds with no rational justification."
    - 21 state attorneys general sent an open letter to 53 asset managers with $40 billion or more in assets, warning that they are pushing political goals through ESG investing rather than acting in the best fiduciary interests of their clients.

- 19 state attorneys general sent an open letter to BlackRock, stating that the asset manager is "using the hard-earned money of our states' citizens to circumvent the best possible return on investment, as well as their vote."
- 21 state attorneys general sent an open letter to proxy advisory firms ISS and Glass Lewis, warning that they have made "several commitments that may interfere with [their] ability to honor [their] legal obligations."

27 Republicans and 24 Democrats are currently in office as State Attorneys General, including the District of Columbia.

State Attorneys General are elected in all US States, with the exception of Alaska, Hawaii, New Jersey, and Wyoming.



Map: How Companies Can Address ESG Backlash, The Conference Board ESG Center, 2023 • Created with Datawrapper

7. **The greatest risk to companies is that anti-ESG (and anti-business) policies will be codified at the state (and potentially federal) level.** This will likely exacerbate the trend of the US dividing into the red and blue states of America and, potentially, into red and blue economies.

8. **Employees are a source of opposition.** At the board and senior management levels, leaders may appreciate the need to focus on ESG but can be frustrated by burdensome disclosure requirements and the threat of over-regulation. Leaders may also be frustrated by how a discussion of ESG topics (if not done correctly) can draw attention away from traditional core business strategy and performance. Of course, if done right, ESG will be integrated into those discussions. Across the wider employee base, there are persistent undercurrents of resistance towards ESG issues (especially divisive social issues) within many companies.

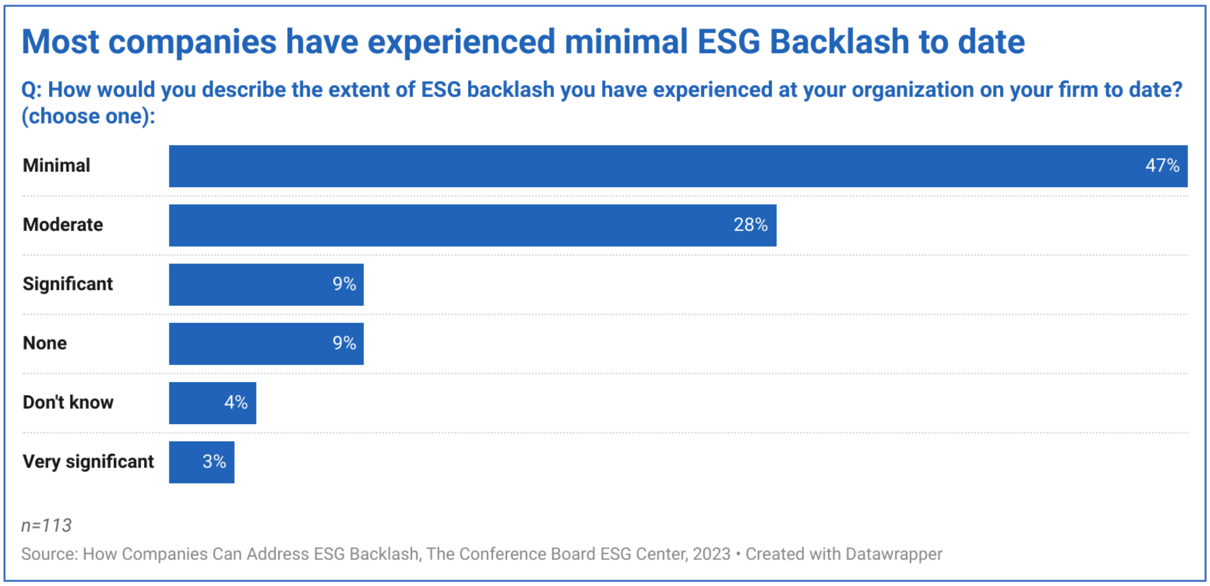
9. **ESG opposition has also been fueled by economic uncertainty and downturn since 2022**. While ESG funds outperformed the market at the outset of the pandemic, the underperformance in early 2022 of

sustainable investing funds has diminished the association between ESG and shareholder value and fueled a populist argument that ESG investing negatively impacts stock returns and retirement savings.

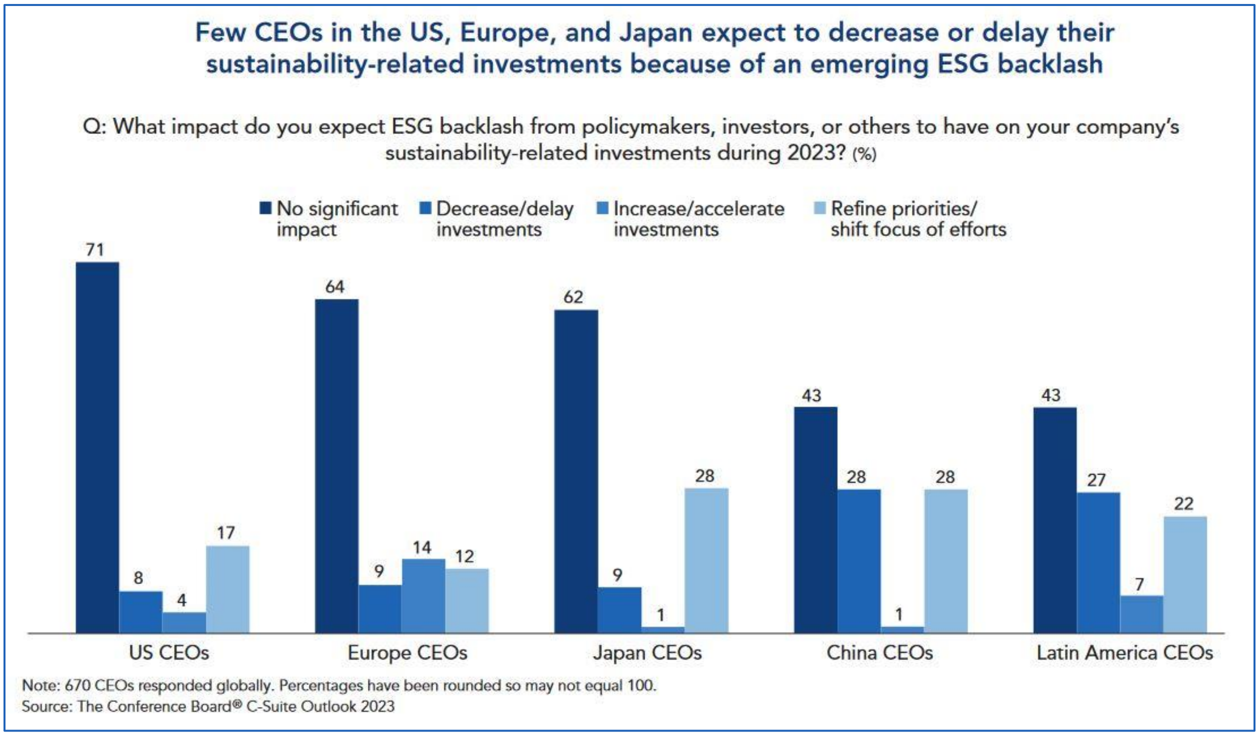
10. **ESG backlash has been strongest in the US, but opposition to ESG will likely develop and take shape internationally in the future**. While in some regions (notably Europe) investors and companies are more concerned about political pressure from *failing to act* on ESG, backlash may be fueled globally by common trends of anti-business or populist sentiment, declining trust in government, and emotional reactions to social and environmental issues.

The Impact of ESG Backlash on Companies

11. **To date, ESG backlash has had a modest impact on companies.**



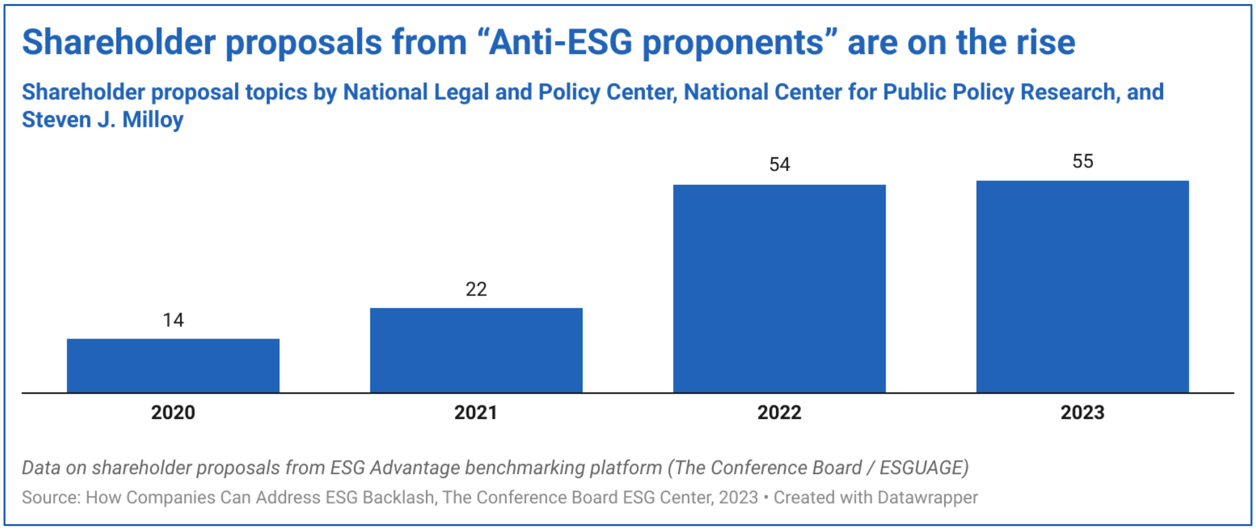
12. **The majority of CEOs globally and in the US are not curtailing their sustainability-related investments because of ESG backlash, according to The Conference Board's C-Suite Outlook survey.** A significant minority are, however, refining their priorities or shifting their focus, including 17 percent of US CEOs.



13. **ESG opposition can affect companies that have not been specifically targeted or publicly criticized**. It can cause boards and executives to hesitate and employees to question whether ESG and DEI initiatives are going to remain as priorities.

14. **ESG backlash is not gaining significant support among institutional or retail investors.** To be sure, there are investors such as Strive Asset Management who explicitly position themselves against a perceived bias in the "big three" institutional investors (BlackRock, Vanguard, and State Street). There are also shareholders that submit "anti-ESG" proposals. But, as discussed below, neither group has gained significant support among the broader investor population.

15. **Shareholder proposals by "anti-ESG" entities have not gained traction on key environmental and DEI-related social issues**, but they have attracted support for proposals related to political spending, lobbying, and governance.

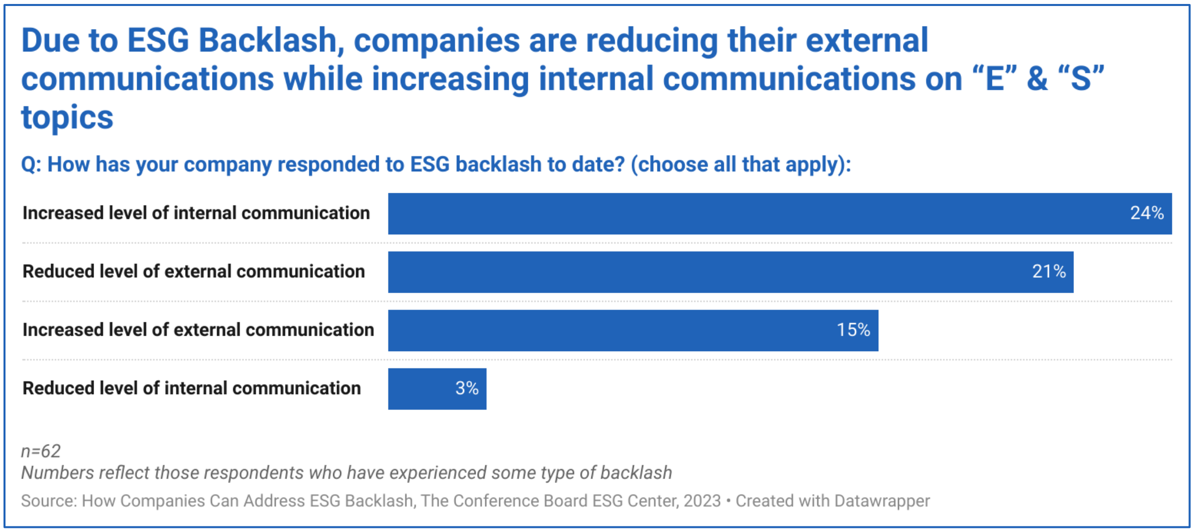


16. **ESG backlash can have significant real-world implications for how companies address societal issues**. Recent examples include credit card companies pausing plans to use a “merchant category code” for gun stores following opposition from state attorneys general. Gun control groups have been lobbying financial institutions for several years to assign a code for gun stores, which can then be used to flag suspicious purchases and potentially prevent mass shootings.

Strategies Used to Address ESG Backlash and Reduce the Risk of it in the Future

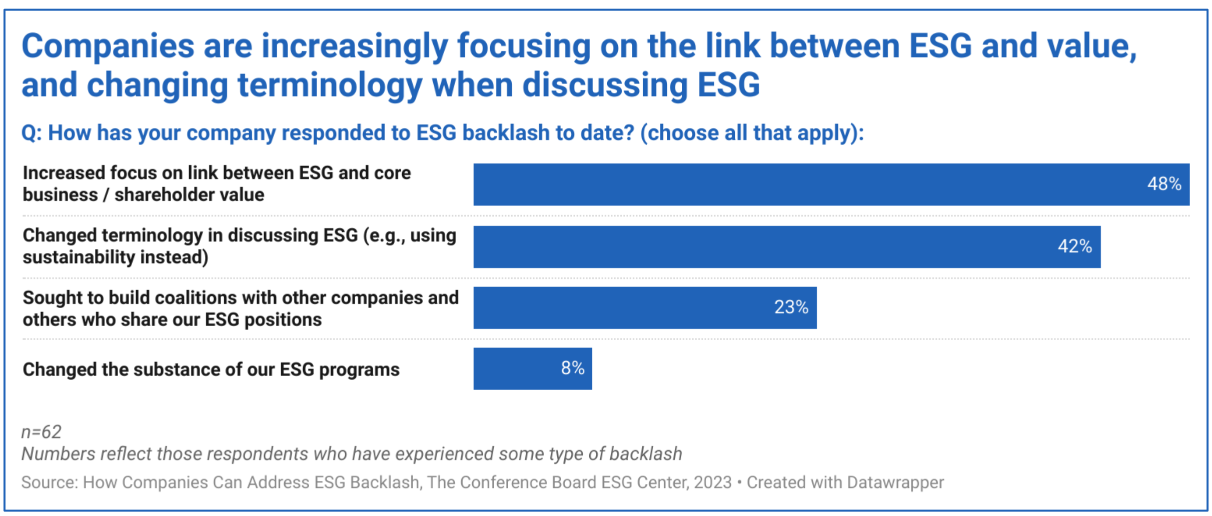
17. **ESG backlash can be a clarifying moment for companies**. It can cause companies to re-evaluate their ESG strategies, priorities, and commitments. This requires companies to engage the board and senior management in a candid discussion of whether the company is still “in” on ESG and multi-stakeholder capitalism and, if so, in what ways. Importantly, companies need to avoid reacting emotionally and instead focus on the empirical evidence for and against ESG performance and impact. Neither side of the ESG debate should operate in a fact-free environment.

18. **ESG backlash can help sharpen how companies talk about ESG.** Thus far, companies are responding to ESG backlash by *reducing* their level of external communications on “E” & “S” topics. This may be a mistake. While companies may not weigh in on every social issue, there are a lot of people who are now learning about ESG for the first time, and companies should view this as an opportunity to tell their story.

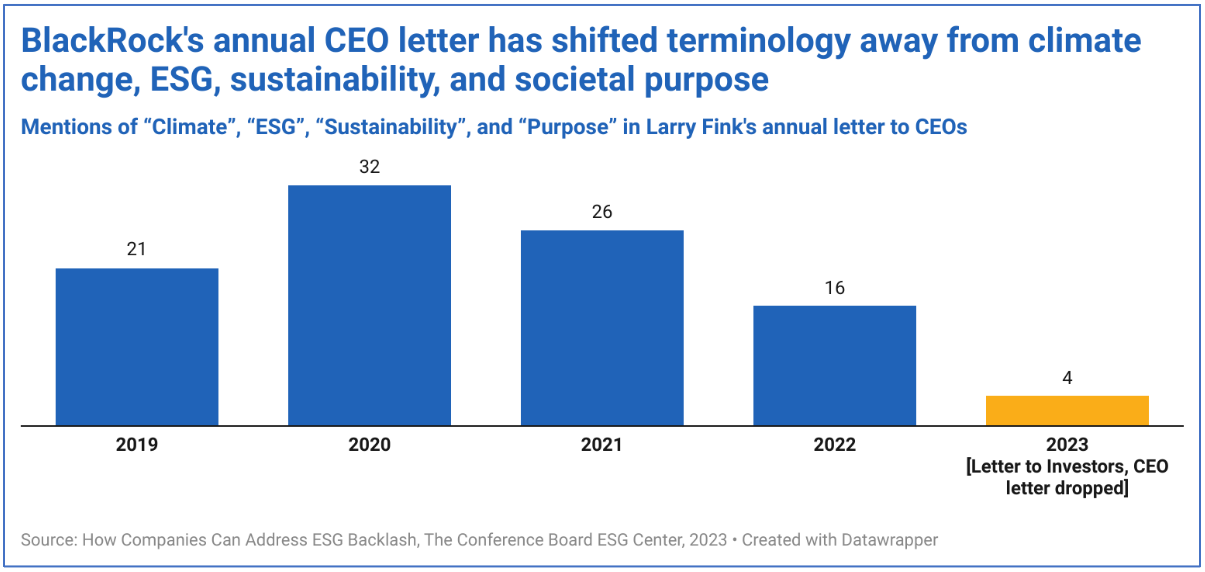


19. **Companies are also responding to backlash by tying ESG more closely to core business strategy and making a stronger case for ESG in economic terms**. As shown in the chart below, focusing on how ESG is integral to the company's past and its future business strategy can make clear that its commitments are about creating value, not just a set of values.

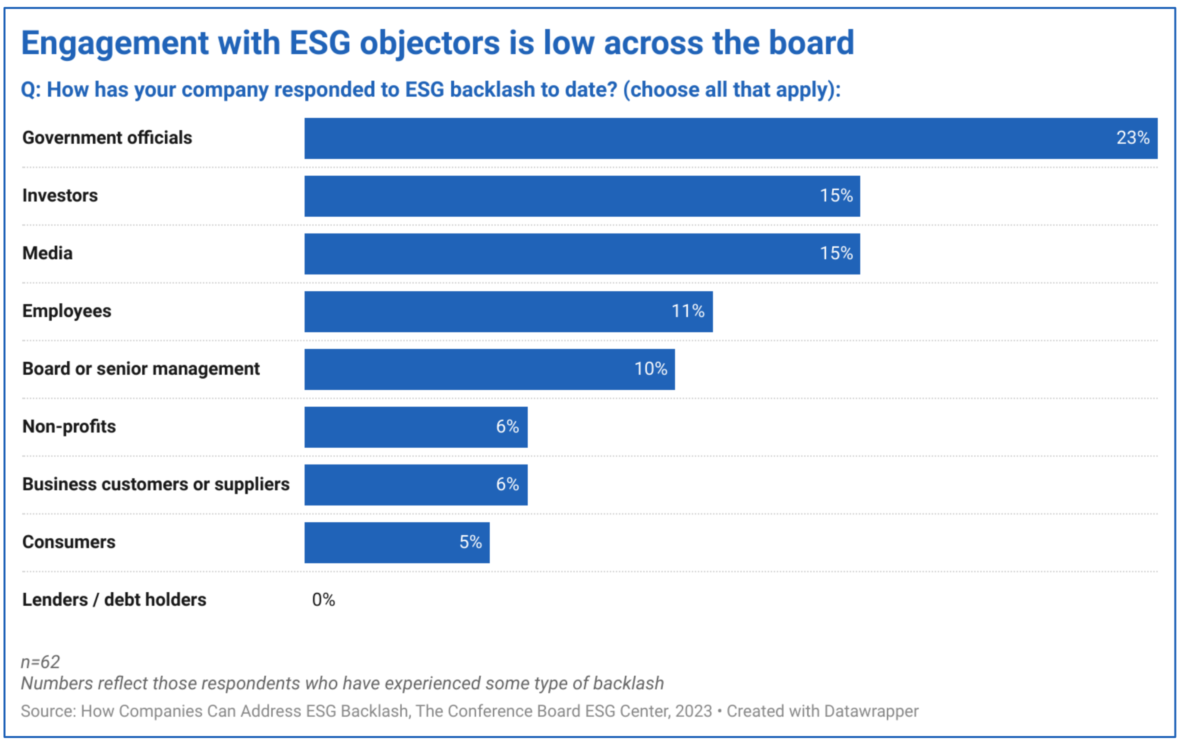
20. **A significant minority of companies are also changing their terminology when discussing ESG, such as referring to "sustainability" instead**. ESG tends to resonate better with investors, while sustainability is often more understandable to employees, customers, and policymakers.



21. **Companies, however, should avoid dramatic shifts in how they talk about ESG issues.** A dramatic change, especially if not explicitly acknowledged or explained, can lead others to assume the company is caving into political pressure or was not serious about ESG in the first place: thereby damaging credibility in the long run.



22. **Given that the greatest risk may come from state legislation and regulation, companies should ensure that they are devoting sufficient resources at the state policy level.** This means tracking state initiatives in real time. It also involves in-person, one-on-one, private conversations with state attorneys general and other key officials to proactively explain the company's position. Our survey results indicate that there is significant room for improvement in this regard:



23. **When pulling back on ESG and sustainability investments due to economic or business considerations, it is important to clearly communicate the rationale behind it.** Otherwise, reduced commitment to ESG may be interpreted as caving into backlash. For example, it has been speculated that

Vanguard's decision to exit the Net Zero Asset Managers (NZAM) initiative was due to political pressure in the US. If a company is adjusting its strategy, changing its commitments, reducing its level of investment, or exiting partnerships, it needs to explain the business rationale for doing so.

Majority of US CEOs expect no significant impact on sustainability investments from an economic slowdown or recession. Almost half of CEOs in China expect to decrease or delay investments. Larger companies see less impact than smaller firms

Q: An economic slowdown or recession will have the following impact on your company's sustainability (ESG)-related spending in 2023:

	Global CEOs	Global C-suite	US CEOs	Europe CEOs	Japan CEOs	China CEOs	Latin America CEOs	Less than $100 million	$5 billion and above
No significant impact	38%	34%	55%	44%	38%	18%	25%	32%	60%
Decrease/delay investments	25%	22%	17%	18%	20%	48%	22%	26%	15%
Increase/accelerate investments	6%	8%	3%	9%	6%	2%	11%	6%	6%
Refine priorities/shift focus of efforts	31%	35%	25%	29%	36%	32%	42%	37%	19%

Source: The Conference Board® C-Suite Outlook 2023

24. **While coalitions and alliances are important for mitigating the impacts of backlash, companies should be mindful of antitrust risk and ensure that any collaboration has a clear, procompetitive rationale.** For example, some in the US House of Representatives have begun a probe into whether Climate Action 100+ is violating antitrust laws. In general, the antitrust risk is low, but companies should ensure that collaboration is not anticompetitive by reducing the quality of goods, output, or increasing the price.

25. **Trade associations are important allies for getting out your story on why environmental and social issues matter, as well as (when appropriate) challenging anti-ESG legislation**. State banking associations have recently pushed back on anti-ESG legislation targeting financial institutions in Kentucky, Mississippi, Montana, and North Dakota.

26. **It can be very helpful to enlist small businesses as an ally when explaining the company's case for ESG.** Much of the anti-ESG sentiment is directed at large firms. There are over 33 million small businesses in America, which combined account for 99.9% of all US businesses. Small business is consistently found to be the most trusted institution in America.

27. **Companies may benefit from refreshing their sustainability materiality analyses and ensuring they are informed by both pro- and anti-ESG stakeholder perspectives**. When assessing stakeholder expectations as part of a materiality analysis, companies should ensure they are considering a sufficiently broad spectrum of stakeholders to blind spots. The Conference Board has previously noted that while traditional materiality analyses can be a useful tool in sorting through 200+ ESG topics, companies should focus on a full strategic analysis when determining ESG priorities.

28. **Companies have an opportunity to help rebuild the political center and address the structural factors that fuel a sense of alienation from political and economic systems.** Strengthening confidence in and the effectiveness of governmental institutions will help mitigate the excesses of ESG backlash and facilitate shifting responsibility for addressing social issues from the business back to the government, where they can be more appropriately addressed.

29. **ESG Backlash is not going away, but it should be kept in perspective.** Companies should not lose sight of the powerful pro-ESG regulatory and market forces. Indeed, the coming months will see a confluence of these factors with the expected release of SEC's final climate disclosure rules, the finalization of the EU's Corporate Sustainability Reporting Directive (CSRD), approval of a Corporate Sustainability Due Diligence Directive (CSDD), and further sustainability standard-setting by the International Sustainability Standards Board (ISSB). Along with these developments, companies can expect both government procurement officials and business partners to increase their usage of environmental and social factors in their spending decisions. And while stockholders, employees, and consumers are not monolithic, a strong ESG profile is likely to continue to be important for companies competing in the markets for capital, talent, and goods and services.