

# International **Comparative** Legal Guides



## Environmental, Social & Governance Law **2021**

A practical cross-border insight into ESG law

**First Edition**

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## 1 Setting the Scene – Sources and Overview

### 1.1 What are the main substantive ESG-related regulations?

The main substantive ESG-related regulations are (i) the Sustainable Finance Disclosure Regulation (Regulation (EU) 2019/2088), (ii) the Taxonomy Regulation (Regulation (EU) 2020/852), (iii) the Low Carbon Benchmark Regulation (Regulation (EU) 2019/2089), and (iv) the European Union (Disclosure of Non-Financial and Diversity Information by certain large undertakings and groups) Regulations 2017 as amended, which transposed into Irish law the Non-Financial Reporting Directive (Directive 2014/95/EU).

### 1.2 What are the main ESG disclosure regulations?

The main ESG disclosure regulations are the Sustainable Finance Disclosure Regulation (Regulation (EU) 2019/2088), the Taxonomy Regulation (Regulation (EU) 2020/852) (including the regulatory technical standards), and the Low Carbon Benchmark Regulation (Regulation (EU) 2019/2089).

### 1.3 What voluntary ESG disclosures, beyond those required by law or regulation, are customary?

Voluntary disclosures beyond those required by law or regulation include the consideration of principle adverse impacts of investment decisions on sustainability factors. The voluntary regimes with respect to ESG include the Global Reporting Initiative, the Financial Stability Board's Task Force on Climate-related Financial Disclosures, and the Sustainability Accounting Standards Board. In order to improve disclosure in respect of ESG matters, companies are increasingly looking to issue sustainability reports prepared in accordance with the Global Reporting Initiative's Sustainability Reporting Standards. In addition, certain ESG-related regulations have introduced voluntary disclosures; for example, the Low Carbon Benchmark Regulation has introduced two new categories of low-carbon

benchmarks, namely: (i) a climate-transition benchmark; and (ii) a specialised benchmark that brings investment portfolios in line with the Paris Agreement regarding the goal to limit the global temperature increase. The categories are voluntary labels designed to assist investors who are looking to adopt a climate-conscious investment strategy.

### 1.4 Are there significant laws or regulations currently in the proposal process?

In addition to the ESG disclosure regulations noted above, there are several OTHER legislative proposals in various stages of the EU's legislative process which will be effective from 2020 onwards, including the Non-Financial Reporting Directive, an EU Green Bond Standard ("EU GBS"), the EU Ecolabel, Corporate Governance, the Solvency II Directive (2009/138/EC), and Credit Ratings. In addition, the European Commission has published six initiatives on sustainable finance in banking and financial services. The six draft acts will require the integration of sustainability risks and factors into the frameworks for the Undertakings for Collective Investment in Transferable Securities Directive (2009/65/EC), the Alternative Investment Fund Managers Directive (2011/61/EU), the MiFID II Directive (2014/65/EU), the Solvency II Directive (2009/138/EC), and the Insurance Distribution Directive (EU) 2016/97.

### 1.5 What significant private sector initiatives relating to ESG are there?

There are a number of significant private sector initiatives relating to ESG. In Ireland, the prominent private sector initiative is the Sustainable and Responsible Investment Forum ("SIF Ireland"). SIF Ireland is a national platform to advance responsible investment practices across all asset classes, and it aims to raise awareness of responsible investment nationally, bringing together policymakers, asset owners, asset managers and other investment intermediaries to stimulate and advance the growth of responsible investment practices in Ireland. SIF Ireland also aims to grow the market by increasing understanding, acceptance and demand for sustainable investments.

## 2 Principal Sources of ESG Pressure

### 2.1 What are the views and perspectives of investors and asset managers toward ESG, and how do they exert influence in support of those views?

Investors are increasingly looking to align their investment decisions with their personal priorities. Investors are now not only focused on financial returns but also on non-financial outcomes. Investors are seeking to invest in companies that have the capabilities to both achieve and maintain strong financial and ESG performance. Asset managers are embracing ESG in order to align stakeholders' interests and avoid short-term investments and results, in return for long-term incentives aligning investment practices with social responsibilities and principles in order to meet investor demands. Investors are also recognising the potential for ESG factors to affect the valuation and performance of companies they invest in, and this has resulted in investors pressuring companies to increase the amount of information disclosed to investors on ESG-related matters.

### 2.2 What are the views of other stakeholders toward ESG, and how do they exert influence in support of those views?

ESG and sustainable finance is an area that is continuously evolving and growing to meet the expectations of a wide number of stakeholders, including shareholders, policymakers, regulators and central banks. Within the EU and Ireland, new regulatory frameworks are being introduced to address and support the European Commission's revised Action Plan on Sustainable Finance. This includes a number of regulations outlined above, including the Taxonomy Regulation, the Sustainable Finance Disclosure Regulation, the Low Carbon Benchmarks Regulation and the supporting secondary legislation with regard to the delegated acts also outlined above. There are also a number of matters in progress, including the development of the EU GBS, the EU Ecolabel for financial products, and updating corporate financial reporting under the Non-Financial Reporting Directive. This is in addition to the European Green Deal, the European Commission's plan to make the EU's economy sustainable, which sets out an action plan to boost the efficient use of resources by moving to a clean, circular economy, restoring biodiversity and cutting pollution with the aim of the EU being climate neutral in 2050 with the proposed European Climate Law, which turns the political commitment into a legal obligation. Furthermore, shareholders have placed increasing pressure on companies with respect to social and governance issues, including gender and racial diversity on boards, requiring companies to adopt policies, and enhanced disclosure with respect to ESG matters.

### 2.3 What are the principal regulators with respect to ESG issues, and what issues are being pressed by those regulators?

The principal financial regulator in Ireland is the Central Bank of Ireland. The Office of the Director of Corporate Enforcement ("ODCE"), whose mission is to improve the compliance environment for corporate activity in the Irish economy by encouraging adherence to the requirements of the Companies Acts, and bring to account those who disregard the law, is also a key regulatory body in addition to the Irish Auditing and Accounting Supervisory Authority. More broadly

within the EU, bodies including the European Commission and bodies such as the European Securities and Markets Authority ("ESMA"), the European Banking Authority, the European Insurance and Occupational Pensions Authority (the Joint Committee of the European Supervisory Authorities), and the Technical Expert Group (the "TEG") are the principle regulators with respect to ESG issues. The key issues being pressed by these bodies are the renewed sustainable finance strategy and the action plan on financing sustainable growth, which includes the following: (i) developing an EU classification system for environmentally sustainable economic activities; (ii) developing EU standards (such as the EU GBS) and labels for sustainable financial products (via Ecolabel) to protect the integrity and trust of the sustainable finance market; (iii) fostering investment in sustainable projects; (iv) incorporating sustainability in financial advice; (v) developing sustainability benchmarks; (vi) sustainability in research and ratings; (vii) disclosures by financial market participants; and (viii) sustainability in prudential requirements, strengthening sustainability disclosures by corporates and fostering sustainable corporate governance and promoting long-termism.

### 2.4 Have there been material enforcement actions with respect to ESG issues?

At the broader European level, there have been a number of material enforcement actions with respect to ESG issues regarding issuers whose securities are admitted to trading on a regulated market. Investors are also increasingly demanding reliable and relevant disclosure on ESG factors. ESMA, the EU securities markets regulator, published its annual report on 2 April 2020 on enforcement of corporate disclosure. The report presents the 2019 activities of ESMA and of European accounting enforcers when examining compliance of financial and non-financial statements provided by European issuers. In light of the increased importance of companies' ESG disclosures, European enforcers increased their enforcement activities on non-financial information in 2019, leading to examinations of 937 non-financial statements or 35% of the total estimated number of issuers required to publish a non-financial statement – a significant rise compared to the 819 examinations undertaken in 2018. These examinations brought about 95 enforcement actions, constituting an action rate of 10%.

Unusually within the EU context, the European enforcer in Ireland under the Transparency Directive (Directive 2004/109/EC) and the Accounting Directive (Directive 2013/34/EU), namely the Irish Auditing and Accounting Supervisory Authority, does not have powers relating to non-financial statements. Rather, the implementing legislation in Ireland (S.I. No. 360/2017) in respect of Article 19a (non-financial statement) and Article 29a (consolidated non-financial statement) of the Accounting Directive designates the ODCE as having such powers of enforcement. To date, there have been no reported enforcement actions by the ODCE in this regard.

### 2.5 What are the principal ESG-related litigation risks, and has there been material litigation with respect to ESG issues, other than enforcement actions?

The principal litigation risks arise from shareholder activism and related investor claims against companies and their directors, particularly in relation to materially false or misleading ESG disclosures or representations made in prospectuses or investor reports. This could give rise to claims in contract

(breach of contract and misrepresentation), tort (negligence, negligent misstatement and fraud) as well as under statute (for example, section 1349 of the Companies Act 2014 provides for civil liability for loss and damage relating to misstatements in prospectuses). The Central Bank (Supervision and Enforcement) Act 2013 has created a broad statutory cause of action for damages suffered by any customer of a regulated financial service provider as a result of a failure to comply with any obligation under financial services legislation.

To date, there have been limited reported decisions by the Irish Courts in relation to ESG issues. Nonetheless, the trend of ESG-related litigation, which has arisen elsewhere, is likely to surface to some degree in Ireland in the near future. The prevalence of such claims by groups of investors or consumers in Ireland may be tempered somewhat as, unlike other jurisdictions that have seen a rise in such litigation, especially the U.S., Ireland does not currently have a formal class action procedure. While in certain circumstances it may be open to a party to bring a test case, whereby there are multiple claims arising from the same circumstances and a select claimant's case is heard, or a representative action, whereby a claimant brings a case on behalf of a group that shares the same interest, these procedures are restrictive and do not facilitate group claims as efficiently as the class action system that exists in the U.S. Such barriers should be significantly alleviated for consumers by the approval of the EU Collective Redress Directive, which is expected to be formally approved by the European Parliament and Council later in 2020. This will provide for a more accessible and cost-efficient framework for consumer class actions in Ireland and across the EU in relation to breaches of EU law.

A further factor that has likely contributed to the increase in such litigation in other jurisdictions is the availability of litigation funding. However, the funding of litigation by third parties without any *bona fide* interest in the litigation remains prohibited in Ireland.

The Irish Courts are likely to be receptive to claims concerning ESG issues, particularly in relation to environmental aspects. This is evident from the Irish Supreme Court's decision in August 2020 in *Friends of the Irish Environment CLG v The Government of Ireland & Ors* where it quashed the Irish Government's National Mitigation Plan, its statutory plan for tackling climate change, on the basis that it did not contain the requisite specificity required under the Low Carbon Development Act 2015, which provided for the approval of plans by the Irish Government to address climate change. The Supreme Court observed that climate change was undoubtedly one of the greatest challenges facing all states and that it was already having a profound environmental and societal impact in Ireland.

## 2.6 What are current key issues of concern for the proponents of ESG?

The key issues for the proponents of ESG are a lack of transparency and reporting standards. In addition, a lack of consistency with respect to the regulations to be implemented to date. For example, the proposed regulatory technical standards to supplement the Disclosure Regulation requiring a mandatory disclosure template. However, the draft regulatory technical standards have not included this template; rather, it notes that the European Supervisory Authorities would commence developing it after the consultation process, making it unlikely to be available until late Q4 2020, at the earliest. Indeed, a recent letter from the European Commission to two industry trade organisations has suggested a potential delay to the implementation to part of the Disclosure Regulation. As such, the requirement

for financial market participants to make declarations on how they integrate sustainability considerations – Level 1 – is still expected to come into effect on 10 March 2021. However, a second layer requiring much more detailed disclosures – called the Level 2 regulatory technical standards – is likely to be postponed to the end of 2021. This will undoubtedly cause difficulties for financial market participants looking to build out their Disclosure Regulation compliance infrastructure ahead of the 10 March 2021 implementation date. Another concern is the discrepancies and uncertainty with regard the implementation of the Disclosure Regulation and the Taxonomy Regulation.

## 3 Integration of ESG Into Business Operations and Planning

### 3.1 Who has principal responsibility for addressing ESG issues? What is the role of the management body in setting and changing the strategy of the corporate entity with respect to these issues?

Senior management has an essential role in addressing an organisation's ESG issues and for assessing the potential impact of such ESG issues on the organisation's operating model. The key issue for management bodies is to identify ESG themes that are emerging as industry drivers ahead of their competitors in order to gain competitive advantage. This requires management bodies to identify the various stakeholders, their incentives and the matters that may bring about change with respect to ESG, including obtaining insight in respect of the companies' social or environmental impact. By connecting business goals with the demands of investors with respect to ESG issues and differentiating from competitors, companies can increase revenue and gain competitive advantage. In order to set and change the strategy of a corporate entity with respect to ESG matters, management bodies should adopt strategic practices to establish accountability structures for ESG, identify and create a corporate purpose and culture, and enhance investor transparency. Management bodies play a key role and are responsible for ensuring a company's mission is achieved.

### 3.2 What governance mechanisms are in place to supervise management of ESG issues? What is the role of the board and board committees?

The structures and processes in place to supervise management of ESG issues depends on the nature and scale of the company. Boards play an important role in driving ESG development within their companies, and board oversight on ESG issues can help businesses better manage their ESG-related risks and opportunities. This includes a board's oversight responsibilities. Boards also play an essential role in assessing an organisation's environmental and social impacts and understanding the impact of ESG issues on the organisation's operating model. Boards have a crucial role to ensure companies are aware of, and are able to navigate, the ever-changing landscape and exercise oversight in this respect; such oversight should be informed, strategic and aligned with the company's business model to create long-term value. The board will also play a role in identifying the issues as well as evaluating and recommending steps to be taken with respect to ESG issues.

Investors are increasingly turning towards the boards of companies for accountability. Key performance indicators ("KPIs") are also in place to supervise the management of ESG

issues, used as a tangible measurement to quantify the extent to which a company is achieving its goals. Investors expect board members to be competent in the area of ESG matters.

With regard to providing oversight and supervision in this area, consideration should be given to allocating oversight responsibilities to consider (i) which activities should be overseen by the board and those that should be delegated to a committee, for example, a sustainability committee, which could include providing guidance to management, (ii) disclosure of information with regard to information that should be shared between the board and management including, for example, KPIs and metrics in order to understand the importance of certain ESG issues, and (iii) ESG as part of the board's oversight and strategy by incorporating ESG initiatives into the overall company strategy, and establishing metrics to include ESG initiatives to assess these performance indicators against the overall company strategy and ensuring oversight of ESG integration.

### 3.3 What compensation or remuneration approaches are used to align incentives with respect to ESG?

Compensation or remuneration incentives can be used to align executive compensation with shareholder interests with respect to ESG; examples of such policies include paying bonuses only when shareholder return targets are reached for a number of years in succession. The desired outcome being that the company will increase transparency for shareholders and create more responsible standards for achieving company growth over executive pay. One approach used to align incentives with respect to ESG is to have bonuses depend largely, or solely, on executives' success in respect of strategic opportunities related to sustainability, while continuing to monitor and disclose aspects of ESG performance, and insisting on seeing ESG metrics to ensure executives act responsibly, mitigate risk and comply with regulations. Compensation committees can use their discretion to adjust pay after the facts for sustainability performance in these areas. In order to integrate ESG issues into executive pay, companies should firstly adopt a clear process for identifying appropriate ESG metrics that relate to sustainable shareholder returns and company strategy. Linking ESG metrics to a reward system in a manner that forms a substantial component of the overall remuneration framework, and integrating ESG targets within a particular time frame that corresponds with the business strategy, will ensure that such ESG factors are used to incentivise high performance.

### 3.4 What are some common examples of how companies have integrated ESG into their day-to-day operations?

ESG is fast becoming an inextricable part of how companies do business. The individual elements of environmental, social and governance are interconnected. A common example of how companies have integrated ESG into their day-to-day operations includes building reward systems that link performance with ESG metrics and tying this in with employee compensation. This in turn may lead to the attraction of, and retention of, talent. In addition, with regard to social issues such as insufficient diversity of talent and gender inequality, companies have addressed this through their recruitment process, putting in place committees and policies to ensure there is sufficient diversity. Environmental matters have also been integrated into the day-to-day operations of companies by reducing the amount of energy and resources used by companies.

## 4 Finance

### 4.1 To what extent do providers of debt and equity finance rely on internally or externally developed ESG ratings?

Issuers of debt and equity finance rely on both internally and externally developed ESG ratings and not just financial data in order to add value by both improving performance and reducing volatility returns. In the past decade, there has been a significant increase in the use of ESG information in the investment process with providers of debt and equity finance and investors alike, recognising that ESG ratings have real value in driving investment performance. ESG ratings can complement existing factors such as liquidity, volatility and performance. Investors are increasingly considering a company's ESG rating when making investment decisions. Companies that produce low ESG ratings can be subject to criticism, whereas companies that produce high ESG ratings may lead to an increase in investor demand and investment flows.

### 4.2 Do green bonds or social bonds play a significant role in the market?

Green bonds play a significant role in the marketplace. They tend to be used for financing or refinancing only green projects or assets and are structured to increase sustainable investing for investors created to fund projects that have positive environmental and/or climate benefits. Green bonds provide transparency for investors on the green projects that are being financed or refinanced and provide investors with an opportunity to be engaged in corporate environmental strategies, while providing bond markets with the opportunity to have an impact on green finance, in particular climate change mitigation finance.

### 4.3 Do sustainability-linked bonds play a significant role in the market?

Sustainability-Linked Bonds ("SLBs") play a significant role in the market as they are designed to drive the provision of information needed to increase capital allocation to such financial products. SLBs aim to further develop the key role that debt markets can play in funding and encouraging companies that contribute to sustainability. SLBs are any type of bond instrument for which the financial and/or structural characteristics can vary depending on whether the issuer achieves predefined sustainability/ESG objectives. Issuers of SLBs commit explicitly to future improvements in sustainability outcome(s) within a predefined timeline.

### 4.4 What are the major factors impacting the use of these types of financial instruments?

The Sustainability-Linked Bond Principles ("SLBPs") provide guidelines relating to SLBs, including disclosure and reporting guidelines, and are a major factor impacting the use of these financial instruments. The SLBPs are applicable to all types of issuers and any type of financial capital market instruments. The SLBPs are voluntary for issuers and their advisors in structuring, disclosing and reporting on SLBs that outline best practices to incorporate forward-looking ESG outcomes and promote integrity in the development of the SLB market, as well as providing issuers with guidance on the key components

involved in SLBs. The SLBs emphasise the recommended and necessary transparency, accuracy and integrity of information that will be disclosed and reported by issuers to stakeholders. The SLBs have five core components: selection of KPIs; calibration of sustainability performance targets (“SPTs”); bond characteristics; reporting; and verification.

#### 4.5 What is the assurance and verification process for green bonds? To what extent are these processes regulated?

Industry-accepted Green Bond Principles developed by the International Capital Market Association (the “ICMA”) ensure such “green bonds” or “sustainable bonds” meet the rules of the respective principles formulated by the ICMA. There are also standards such as the Climate Bonds Standard & Certification Scheme, an investor-focused organisation that seeks to mobilise investors, industry and government to catalyse green investments at the speed and scale required to avoid dangerous climate change and meet the goals of the Paris Climate Agreement. The Certification Scheme allows investors, governments and other stakeholders to identify and prioritise “low-carbon and climate-resilient” investments and avoid “greenwashing”. In addition, following the establishment of the TEG on sustainable finance in 2018 by the European Commission, the TEG has made recommendations to establish the EU GBS. The TEG has proposed that any type of listed or unlisted bond or capital market debt instrument issued by a European or international issuer that is aligned with the EU GBS should qualify as an EU Green Bond. The TEG has also published the “EU Green Bond Standard Usability Guide” (the “Guide”), which offers recommendations from the TEG on the practical application of the EU GBS. The Guide aims to support potential issuers, verifiers and investors of EU Green Bonds. The TEG proposes that the use of the EU GBS remains voluntary, and builds on market best practices such as the Green Bond Principles developed by the ICMA. [At present, issuers having an EU Green Bond voluntarily verified by an external verifier has become common practice. Guidance on voluntary verification has been available thanks to ICMA’s Guidelines for External Reviews. The EU GBS builds on these foundations while formalising it and requiring additional processes. It institutes mandatory prior verification of the alignment of Green Bond issues. The TEG has recommended that oversight and regulatory supervision of external review providers eventually be conducted via a centralised system organised by ESMA.]

## 5 Impact of COVID-19

### 5.1 Has COVID-19 had a significant impact on ESG practices?

COVID-19 has had a significant impact on ESG practices. It has been the first test of whether investors and asset managers alike are truly dedicated to sustainable investments and ESG, or if ESG is just another case of greenwashing or PR spin. COVID-19

has increased investor focus in ESG, highlighting the role that good businesses and practices play in society and emphasising the direct link between social responsibility and investing. ESG practices have aided companies throughout the crisis, and investors are increasingly looking towards sustainable investment strategies when making investment decisions. Companies that focus on ESG practices are more likely to be resilient in the face of a crisis such as COVID-19 if they are managed for the long term in line with societal megatrends. In addition, COVID-19 is likely to increase the efforts of boards with regard to governance and disclosures, and how companies address governance factors is likely to impact businesses going forward.

## 6 Trends

### 6.1 What are the material trends related to ESG?

The inflows in ESG products are increasing with the launch of new funds, as well as the repurposing of non-ESG funds, and this has continued despite the impact of COVID-19. In the fixed income market, green bonds are the fastest-growing market. Asset managers are increasingly looking to integrate ESG factors in portfolio selection. In addition, socially responsible and ESG exchange-traded funds have become an increasingly popular area of focus for investors and asset managers alike. Following COVID-19, new opportunities may arise for categories of impact funds such as health and wellbeing as key areas of the response to the pandemic. COVID-19 seems to be further widening the scope of strategies.

### 6.2 What will be the longer-term impact of COVID-19 on ESG?

Early indicators show that COVID-19 is accelerating the demand for sustainable investing, introducing a renewed focus on climate change and requiring both asset managers and investors to focus on a sustainable approach to investing. As a result of the impact of COVID-19 on the global economy, policymakers and investors are looking at alternative investments, including those relating to climate change. COVID-19 may be pivotal for ESG investing alongside traditional financial investing in the long term. Recent studies have highlighted the fact that investors see COVID-19 as increasing investor awareness in other areas such as climate change which should have a positive impact on ESG, particularly in the long term. The COVID-19 crisis is likely to increase the measures taken by boards and markets to factor in systematic risk, including disclosures related to ESG. COVID-19 has led to enhanced scrutiny from investors in respect of ESG metrics. ESG products have performed strongly relative to non-ESG products during the market downturn, and it is expected that investors will add these relative performance metrics to their asset selection preference. To date, with respect to investment funds, much of the focus has been on the environmental products, but the impact of COVID-19 on society is likely to see growth in social impact funds.



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Vertical Agreements and Dominant Firms