ESG? We’re doing that already, aren’t we?

Environmental, social, and governance (“ESG”) criteria are a set of standards for a company’s operations that socially conscious investors use to screen potential investments. Environmental criteria consider how a company performs as a steward of nature. Social criteria examine how it manages relationships with employees, suppliers, customers, and the communities where it operates. Governance deals with a company’s leadership, executive pay, audits, internal controls, and shareholder rights.

Source: Investopedia.com

Your ears may well have picked up on hearing mention of ESG – “Environmental, Social and Governance”. It’s a popular subject and currently the stuff of many a webinar and blog. Perhaps you thought, “Oh, that’s the new name for CSR.” Or, maybe you wondered, “Is this going to create more work for me and my team?” You may even have considered, “How can I leverage that to get more budget?”

ESG is, according to *Harvard Business Review*, “a shift in focus” from CSR. It is sometimes referred to as a “professionalization and financialization of CSR”. If your company isn’t currently tracking any ESG issue-related metrics or issuing an ESG annual report, then those are likely in the pipeline. But is it important for export compliance teams to understand this shift in focus? Or is ESG something that some other department will deal with? Well, apart from ESG initiatives having a high profile with boards and the C-suite due to the investment links, ESG intersects with trade compliance in some important areas, and where ESG and trade compliance approaches to environment, social and governance issues dovetail, they provide mutually beneficial tactics to achieve common goals.

ESGvolution

Customers, investors and even governments have taken an interest in ESG issues (for a brief history, see the box ”An ESG primer”). While there have been a number of influential multilateral statements and articles on the subject/concept over the past 15 years (see the box, “Helpful links”), most experts mark 2006’s UN Principles for Responsible Investing (“PRI”) as upping the game from CSR to ESG.

The PRI launched with six signatories in 2006 and that number has increased to 4,375 as at time of writing. Indeed, so important is ESG now being seen that the PRI annual report noted a 42% increase in the number of signatories in 2020/2021. Since 2006, *Harvard Business Review* has regularly published research showing that a commitment to shepherding environment and social issues and good governance practices by businesses creates value for shareholders, and other stakeholders including customers and employees. This is why it matters.

“The concept of ESG as applied to export controls and how to manage these risks is coming up more and more,” says Cristina Brayton-Lewis, a partner in law firm White & Case’s Global International Trade practice. “From an export compliance stand point, we’ve been seeing a shift from strict compliance to one that looks at the export compliance framework more holistically – not just considering license obligations, but also from an ESG and investor perspective. From whether the transaction complies with applicable laws to considering the broader context of the transaction.”

This holistic approach is gathering momentum around the globe. Trade compliance professionals are familiar with issues which fall under the umbrella of “social” – forced labor, human trafficking, human rights and national security issues. And so far as governance is impacted, many more companies paying more attention to how their technology or the end-user of their exports are viewed from an ESG perspective. It will have come as no surprise to readers of *ECM* that the US Commerce Department noted in a recent

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designation of an Israeli spyware company that "the action is part of the Biden administration's efforts to put human rights at the center of US foreign policy". And as we have reported previously, Germany's Supply Chain Due Diligence Act requires companies to ensure their supply chains are free of forced labor, human rights abuses and environmental degradation and this is expected to be followed soon by an EU law with similar aims.

With the push from investors, trade compliance managers will not be asked to be the sole arbiters of doing the right thing. Still, proponents of ESG have trade compliance in their sights. "You ignore all of this at your peril," says Alison Taylor, executive director of New York-based Ethical Systems, a non-profit that advises organizations on ethical practices in business. Taylor says, "There is a pressing need to ensure companies focus on their material, relevant issues and manage them. For some companies, export controls will be key and strategically relevant, for others different ESG issues will be much more important." Export compliance managers should keep in mind that one of the hallmarks of ESG thinking is doing more than the law demands. Says Taylor, "The argument is that you should be going beyond compliance and managing these issues and their risks voluntarily."

Intersection with export controls

IBM has been one of the companies at the forefront of managing social and governance issues around its technologies. The company sunset its own general purpose facial recognition and analysis software products in mid-2020 over potential concerns of racial bias when using the technology in law enforcement. It has had a Statement of Human Rights Principles for years, and regularly engages with the Department of Commerce on human rights concerns related to technology. The company calls its ESG issues, simply, "Responsibility"and the trade compliance team is involved.

"Ten years ago, I spent my time working on strictly trade regulations, implementing existing regulations and working with the US government on new regulations," says Ed Bond, IBM's Director, Export Regulation Office. "In the last 10 years, a third of the job has become more about human rights and sensitivity around transactions."

Reputation is important. Kevin Wolf, a partner at law firm Akin Gump, says that while the US government has not been shy about speaking out on human rights concerns, the added level of scrutiny from guidance and investors means that "there are companies that have to make decisions about whether something is legally permitted versus whether the company should sell to another company or location where there are human rights concerns."

ESG issues fall across different departments, and there are reports of increased inter-departmental collaboration within companies on them. This speaks to ESG being a holistic approach to business.

"We are seeing risk departments talking to one another and recognizing that you can't have siloed risk," says Stacey Mitchell, co-lead of Akin Gump's ESG and climate change group. "That's a distinction we have seen with CSR versus ESG. ESG is more baked into how the company operates."

Unsurprisingly, Mitchell notes that this development can create more work for compliance teams, so resource management is key. As compliance teams know, having adequate resources is a perennial concern. Still, there may be an upside with ESG. The demand from investors and customers for greater ESG diligence may mean more resources are made availabe. "The support for the work has increased due to capital markets demanding ESG disclosures," says Jessica Lynd, an Associate at White & Case in DC. "That will get compliance teams

An ESG primer

From the 1960s onwards, Corporate Social Responsibility ("CSR") was conceived as a charitable and philanthropic activity by businesses, but divorced from the core activities of the business, and viewed as part of public relations. The goal of these efforts was to deflect government regulation, by arguing that companies were best placed to manage their own social responsibility efforts.

In the 1980s and 1990s, concern over globalization and the environmental and social impact on developing countries by multinationals grew among companies with a lot of supply chain exposure (e.g., Nike, Gap, Home Depot, Walmart). These companies were targeted by activists and socially responsible investors and that led to the rise of ethical sourcing. Weak legal oversight in manufacturing countries meant, however, that the concern was more reputational than regulatory.

During the 1990s and 2000s, people started to talk more about "sustainability". This was primarily driven by the 1987 UN Bruntland Commission, which defined sustainable development as "meeting the needs of the present without compromising the ability of future generations to meet their own needs". The definition was thus broader than environmental responsibility, though the term "sustainability" is still often viewed as synonymous with only environmental efforts. Concerns were still very ethically driven during this period.

2006 was a key turning point, on two counts. After an influential 2006 *Harvard Business Review* article, the field started to pivot more to the "business case" and the idea of "creating shared value" – so a business should find activities that are *both* socially and environmentally responsible *and* make more money. This is what has ultimately led to ESG, which is sometimes described as the professionalization and financialization of CSR.

In 2006, a group of investors, sponsored by the United Nations, founded an organization called the Principles for Responsible Investment ("PRI" see: unpri.org) The PRI encourages investors to adopt its six principles for responsible investment, whose main aim is to understand the investment implications of environmental, social and governance ("ESG") factors. From here, ESG in the investment and business community has grown among investors and governments.

There's considerable debate over the ultimate goal of the ESG movement but the dominant frame right now is all about how ESG will make you more money, either because of better risk management or innovation. Investors have pivoted enthusiastically to ESG on the basis of these win-win arguments, though critics point out that market-driven solutions have limits.

Alison Taylor, Executive Director, Ethical Systems, Professor NYU Stern School of Business access to capital. Diligence is going further and can affect a company's ability to raise money, so there is more incentive to invest in compliance systems."

Ed Bond believes that trade compliance structures could set a path for managing ESG issues. At IBM, there are robust internal review mechanisms for potential transactions to determine if a product, end-users or some element of a transaction does not fit with the company's social and governance objectives. If an environmental issue comes up, team members know to send it to IBM's environmental team. Likewise, an AI issue will be refrerred to the AI ethics team. "Companies need to think about how you communicate and discuss things among previously silo'd functions," says Bond.

Pierfilippo Natta is a Senior Associate, in KPMG's International Trade & Customs Group. He says there is cooperation on internal review processes in many companies for ESG matters, with internal audit teams following up to make sure policies are being implemented. Natta says the shift to ESG has been driven by customers rather than regulators, often with an eye to the supply chain. "With ESG," says Natta, "companies have been maturing processes and policies to track the supply chain and know where products are sourced from or going to."

"Companies should look at legal compliance as the baseline and work from there to build additional policies and procedures related to ESG red flags," says Brayton-Lewis. She believes the days when companies can rely on a statement on their website being sufficient evidence of living up to principles are long gone. "Your website policy is not going to save you unless backed up in practice," she says.

Useful links

- The *Harvard Business Review* 2006 article: https://hbr.org/2006/12/strategy-and-society-the-link-between-competitive-advantage-and-corporate-social-responsibility
- The Bureau of Industry and Security Guidance on Promoting Human Rights and Democracy: https://www.bis.doc.gov/index.php/policy-guidance/promoting-human-rights-and-democracy
- UN Principles for Responsible Investment: https://www.unpri.org
- UN Sustainable Development Goals: https://sdgs.un.org/goals
- The Sustainability Accounting Standards Board (SASB) has identified the material ESG issues for all 77 industries in its classification system: https://www.sasb.org
- US Department of State Guidance on Implementing the "UN Guiding Principles" for Transactions Linked to Foreign Government End-Users for Products or Services with Surveillance Capabilities: https://www.state.gov/key-topics-bureau-of-democracy-human-rights-and-labor/due-diligence-guidance/
- IBM's Human Rights Principles: https://www.ibm.com/ibm/responsibility/ibm_humanrightsprinciples.html

Next steps now?

"We can think of the overall rise of interest in ESG as a reflection of very real things going on: the climate crisis, inequality, government dysfunction, shifts in values from young people," says Alison Taylor.

"With ESG frameworks, more companies are being called on by their various stakeholders to report and show transparency," notes Akin Gump's Mitchell. "The trend towards transparency will create the situation where ESG issues will be more at the forefront of investment and corporate reputation considerations."

Trade compliance teams would be well advised to pay attention to ESG if they are not already doing so. Expect human rights, forced labor and the use of technology that impinge on today's values to be an ongoing focus for export controls – as recent designations of spyware providers and ransomware facilitators and new regulations bear testament. ESG will not be a flash in the pan. It may well be time to sign up for the webinar. ■

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