Stuck in the Middle with ESG:

What Companies Can Expect in 2025 & Beyond

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After a much-anticipated election cycle in the U.S., Republicans will take over the White House and control both chambers of Congress. This shift in power will significantly impact ESG initiatives. While it is too early to determine precisely what those impacts will be, we present our view of the most likely scenarios and how companies can begin to prepare. One thing is certain: staunch ESG proponents and opponents will continue to clash, placing companies squarely in the middle of the ongoing debate.

1. **Rollback of the SEC's ESG agenda.** The Securities and Exchange Commission's (SEC) climate disclosure rule is currently being litigated, and a Republican-led SEC will likely seek to further delay and/or unwind the rule. Similar disclosure requirements for companies doing business in California also face legal challenges but remain intact for now, potentially mitigating the impact of any rollback of the SEC's climate rule. Human capital management and board diversity disclosure rules on the SEC's forward agenda are also unlikely to be pursued by a Republican-led SEC. If these disclosures are rolled back, companies should expect ESG disclosure advocates to submit more shareholder proposals seeking increased disclosures on these issues.

2. **Greater scrutiny of company DEI programs.** While the 2023 Supreme Court's Students for Fair Admissions rulings focused on higher education, conservative campaigns to end corporate DEI programs have landed on company doorsteps this year. As a result, many companies have conducted legal reviews of their DEI programs and communications. New challenges to DEI initiatives are expected under the next administration, including the reinstatement of an executive order against "divisive topics" in DEI training for contractors and possible action from the Department of Labor to change federal policies. In addition to the risk of another shift in the legal landscape, the Trump administration is expected to appoint vocal critics of DEI, such as Elon Musk, Vivek Ramaswamy and Stephen Miller, to federal positions. Companies should prepare for the campaign against DEI to become more public and challenging as advocates, including employee groups, nonprofits and investors, press companies to stand firm with prior commitments.

3. **Revisited attacks on proxy advisory firms and ESG shareholder proposals.** The SEC may resume its prior initiatives to rein in the perceived power of proxy advisory firms like ISS and Glass Lewis. Rules requiring proxy advisors to eliminate corporate advisory services and/or allow companies to review their reports ahead of official publication may also be revisited. ESG raters could also be affected by these initiatives. Other regulation that could limit the number of ESG shareholder proposals will likely be considered, such as higher minimum share ownership requirements for proponents and expanded grounds for companies to exclude ESG proposals. If shareholder powers become more limited, companies should expect proponents to adjust tactics, such as launching more "vote-no" campaigns against directors and/or Say on Pay votes, as well as single-issue proxy contests.

4. **Increased pressure on companies from pro-ESG coalitions.** Pro-ESG coalitions such as As You Sow, CERES and the Interfaith Center on Corporate Responsibility have announced that they will continue to pressure companies to further advance their ESG initiatives. Companies may face increased pressure from both sides of an issue, even with defections from some large U.S. institutional investors as well as some European and Canadian investors. For example, companies may receive shareholder proposals to continue their ESG initiatives while also receiving anti-ESG proposals. Companies should expect continued challenges in balancing key stakeholder interests amid increased pressure from both pro-ESG and anti-ESG advocates via private engagement, public pressure and shareholder proposals.

5. **A fragmented ESG disclosure landscape.** Irrespective of the change in federal power, thousands of U.S. companies will continue to be required by the European Union's Corporate Sustainability Reporting Directive (EU CSRD) to provide robust ESG disclosures. This will create an uneven playing field for consumers of ESG information and impact company ESG strategies. For example, institutional investors may have sufficient ESG information from a company that falls under EU CSRD requirements but lack ESG information from a company that does not fall under the EU CSRD. Companies without robust ESG information will likely face pressure from institutional investors to disclose more.

6. **Possible changes to executive compensation disclosures.** The new administration may seek to simplify executive compensation disclosures and roll back certain requirements, such as the recently implemented Dodd-Frank clawback rule, to help alleviate the reporting burden on companies. In addition, companies that disclose ESG goals within their executive incentive pay programs could receive greater scrutiny, particularly those that disclose tying pay to diversity goals. Although requirements may shift, investors and proxy advisory firms may react negatively to any rollback of pay disclosures. Additionally, the new administration could have a dampening effect on the frequency and impact of pay-related litigation, such as the Delaware court ruling that nullified Elon Musk's 2018 pay package.

7. **State lawmakers taking on a bigger ESG role.** There is speculation that as the new administration eases up on ESG regulations and rolls back DEI programs, State Attorneys General and other federal officials that are in Democratic states will seek to file lawsuits and take a more active role. Notably, State Attorneys General in California and New York could take on the role of ESG defenders.

8. **Impact on mergers and acquisitions.** The markets are already factoring into small and mid-cap stock prices the expectation that they will be targeted by larger companies, as the federal government's willingness to intervene in mergers will decrease significantly. Companies that successfully acquire small and mid-caps may need to incorporate them into their own Governance, ESG and DEI structures and ensure compliance with the EU CSRD, California climate disclosure laws and other regulations. Similarly, small and mid-cap companies that are suppliers to global corporations will be asked to report this information regardless due to CSRD.

9. **Increasing importance of shareholder engagement.** Investors will be eager to understand how these fundamental shifts will impact ESG and DEI programs within their portfolio companies. U.S. investors may have a very different perspective than European investors. With off-season shareholder engagement underway, companies should not deviate from the values expressed in their sustainability reports, as these statements are on-record, signed by the CEO and leadership of the company. As the new administration's policies play out, companies can respond to changes by communicating them in proxies, ESG reports, websites, earnings calls and social channels.

10. **Fewer ESG mentions on earnings calls.** Over the past year, companies have increasingly reevaluated their ESG communications strategies, especially during earnings calls. Under a Trump administration, there is expected to be less emphasis on sustainability and DEI-related policies. As regulatory pressures around ESG issues arise, companies may prioritize other financial and operational topics. The polarization of ESG may lead many companies to avoid further public discussion on contentious topics to steer clear of potential backlash. Going forward, earnings calls are expected to feature less ESG-related content, as they primarily focus on short-term performance and have limited time to address issues beyond financial metrics.

Conclusion

Before determining whether to adjust their ESG communications strategies, companies should take inventory of what they have already disclosed to ensure appropriate messaging of any changes. This inventory should include corporate filings as well as communications on company websites and social channels. Companies should also continue engaging with key stakeholders to understand their evolving expectations regarding ESG. Revisiting a company's ESG materiality assessment may provide valuable input into ESG strategies and serve as a defense for company ESG focus areas. Finally, companies should ensure that ESG Reports, proxy statements, annual reports and other documents are aligned to address any adjustments. It is crucial to analyze the potential consequences of any changes to ESG disclosure, taking into account institutional investor pressure and the incoming Republican-led White House and Congress.

For the latest trends in 2024 US sustainability report disclosures, please see recent pieces:

- Stand by ESG? Our Annual State of U.S. Sustainability Reports
- The State of Sustainability in 2024: DEI Will Survive
- The State of Sustainability in 2024: Canadian Sustainability Reporting is at a Turning Point

Authors

Martha Carter
Vice Chair & Head of Governance Advisory
martha.carter@teneo.com

Matt Filosa
Senior Managing Director, Governance & Sustainability
matt.filosa@teneo.com

Faten Alqaseer
Senior Managing Director and Co-lead of DEI
faten.alqaseer@teneo.com

Sean Quinn
Senior Managing Director, Governance & Sustainability
sean.quinn@teneo.com

Kensey Biggs
Managing Director & Head of U.S. Corporate ESG
kensey.biggs@teneo.com

Sydney Carlock
Managing Director, Governance & Sustainability
sydney.carlock@teneo.com

Diana Lee
Senior Vice President, Governance & Sustainability
diana.lee@teneo.com

Rose James
Senior Associate, Governance & Sustainability
rose.james@teneo.com

Heidi Park
Senior Associate, Governance & Sustainability
heidi.park@teneo.com

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