

Episode 20: The ESG Evolution: Trends, Strategies, and Legal Insights

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Richard Schwartz

Hi Sarah.

Sarah Touzalin

Hi Richard.

Richard Schwartz

Welcome to Coffee Talk with Benefits, a podcast brought to you by Seyfarth Shaw's Employee Benefits and Executive Compensation department.

Sarah Touzalin

As your hosts, Richard Schwartz and I, Sarah Touzalin, will interview a member of the Seyfarth Employee Benefits and Executive Compensation department or an outside expert in the Employee Benefits world. In each episode, we'll discuss interesting, tricky, and sometimes amusing issues that come across our desks all over a cup of coffee. On this episode of Coffee Talk with Benefits, we're joined by Ameena Majid Seyfarth's Impact and Sustainability partner, and also the co-chair of the firm's Impact and Sustainability Client practice. Ameena is also a tenured partner in our Employee Benefits and Executive Compensation department. So Ameena, welcome to the podcast. We're very excited to have you here today. How about we kick off with you just telling us a little bit about yourself and your practice?

Ameena Majid

Sure thing, thank you for having me, both Sarah and Richard, it's a pleasure to be here. So I have a bit of a varied practice. My first love is employee benefits and executive compensation. So I do get to work with a number of fiduciary committees on their governance practices and some of that expertise, and also my interest in, you know, what we call the impact and sustainability practice that many people call the ESG practice, that started to be of interest to me. And there was an interest around clients and companies wanting to understand and maybe broaden their practices into the ESG space. So I started to advise whether it was from a governance standpoint or a policy standpoint. And then that led to the creation of one of the early ESG Client Services practice that I co-lead with Gina Ferrari, one of our securities litigators. And then my last hat, if you will, is I also serve as the firm's impact and sustainability partner. So I look at these issues through a company perspective. So I bring a very perspective to the topic today.

Sarah Touzalin

Well, it sounds like you're the perfect person to be talking about this with us today, so we're excited to have you here for our listeners. I think it'd be helpful if we could just sort of start at the beginning. I

know ESG is a mystery to many. Can you just start with an explanation of what is ESG and what are sort of the hallmark characteristics?

Ameena Majid

Yeah, so ESG stands for environmental, social and governance. So broadly, I would say ESG can think about it through two main principles, which is what sort of brought the topic into the mainstream, and that was both accountability and transparency, and companies were being asked to look at their practices under these environmental and social arenas in terms of how they affect the execution and resiliency of their business strategy, and that that requires both a top down and bottom up approach, which is where governance comes in play, and to do it effectively. Companies were being asked to assess both impacts and environmental social elements, kind of from two perspectives. The main one is, what are those impacts of various ESG topics on the business so more of a financial lens. And the other which could possibly contribute to some of the mystery is, what are the impacts that a business has with respect to environmental and social topics on society, so that societal lens, those are referred to as the outside in and inside out perspective, but ultimately, it was connected to a business strategy.

Richard Schwartz

So Ameena, why has ESG, all of a sudden, become such a priority for companies?

Ameena Majid

Yeah, so that takes us back to about 2020 I should say where ESG actually has been around for various forms. But 2020 is when we thought ESG really takes center stage for a few reasons. The one that the first two actually probably most relevant today for our conversation today, is the institutional investors influence. Institutional investors are there to protect, and have a fiduciary duty to protect and see that companies are still driving the value of their organizations, and a lot of that value comes from intangible assets, whether it be talent, brand, reputation, intellectual property. And it kind of understood, when you think about ESG as a framework, that ESG could influence the value of those intangible assets. So there were a lot of asks from institutional investors of companies to talk about their practices around those topics that though, coincided with a lot of social interest at the time. So there was a lot of events highlighting social inequalities, and companies really started to come out with statements around DEI in particular social issues. And the third thing that we saw was global supply chain disruption, because we saw that with the pandemic. So it called into question, how strong are our supply chain so that companies could weather some of these disruptions? And that's really the push. Behind ESG coming center stage.

Sarah Touzalin

So, I mean, it sounds like there's a lot, a lot of different sort of considerations at play here. How do you see companies approaching ESG and sort of, what different factors influence the corporate strategy?

Ameena Majid

Yeah, with strategy sometimes, I think one is first looking at where a company fits in the larger ecosystem, you know, where what's their industry? What's their geopolitical pressures or stakeholder interests at play? So ESG is not a public company issue. It both applies to public companies and private companies. So they'll probably approach it a little differently. Public companies are under a lot

more scrutiny for obvious reasons, but that's our starting point, you know, where did the company sit in the ecosystem? What pressures are they facing? And then that will often drive looking at what relevant, what we talked about, relevant, ESG factors relate to mission critical matters, you know, and the reputation and their financial impact, because it's pretty well decided that a board should have oversight over ESG factors, whether it be related to their mission critical matters or just because it's been, you know, raised as an issue that's important to the reputation of the company. And then there are broader stakeholders. So it's, you know, whether they're, you know, a consumer goods company, they'll probably take a, you know, take stock of employees, sentiment, customers, suppliers, communities, all of those stakeholders can really influence the factors that rise to looking at how those implicate companies, strategy of essentially making money.

Richard Schwartz

So, Ameena, what do we mean by ESG investing with respect to an individual, or how does it fit within the context of a retirement plan?

Ameena Majid

So with companies being more transparent around their initiative and taking into account more of a shareholder or customer or employee perspective, there are a lot of investors that maybe want to invest in companies where they are looking at how looking at these factors. And I always think of ESG investing as a term that covers probably about four types of investing. And first you have your traditional ESG investing, and that probably relates the most to our space of retirement plans. And that I would define as ESG factors, are those additional considerations to traditional risk factors. You know, how are they used to manage financial risk, build resiliency, ensure long term shareholder value, and that's, that's the view advanced by the institutional investors. And then I would say that, and then you move into kind of a couple of those, where you have, you don't have a binary situation, you know, you have impact investors who are focused on societal impact, understanding that businesses have a really great ability to impact our society and the environment. So they're maybe wanting to invest in companies that address those environmental challenges or promote social goods, so there could be a willingness to sacrifice returns. And that's where I think the two really get start getting a little blurred in our space. Then you have two more. One is Faith Based Investing. So those that want to comply with the tenants of a particular faith typically comes up with Muslim investors who want to adhere to Sharia investing, then you have Value Based Investing, which is on the same spectrum as faith based, but there's maybe looking at broader exclusions, like renewable energy or no private prisons. So it's, it's much more value based, you know, more themes that are important.

Sarah Touzalin

How do you think the corporate ESG goals and policies that you've mentioned influence, sort of the evaluation of investment funds that are used under a 401, K plan or a pension plan?

Ameena Majid

Yeah, when we're talking with public company, you know, if they're taking the perspective of ESG factors as part of their business strategy, and integrating with business strategy, whether it's reducing their carbon footprint or it's focusing on human rights in the supply chain, you know, those are part of their goals. They engage with institutional investors when they're included in an index, whether it's

passive or actively managed, and investment managers are looking at those, you know, and we move into base of retirement funds, we have a lot of investment managers that may adhere to the UN principles of Responsible Investing when they're looking at their investment policy or processes, you know, they're incorporating ESG criteria into their evaluation processes as an additional financial risk. I think Richard and I have sometimes had different experiences here. What you know, where I've sat in committees and investment managers have typically spoken to how they take ESG considerations into account, and you start getting into a questionable territory. What does that mean? Terms of how they're evaluating the financial returns of those investments. So I would say that that's where you start seeing that tie in.

Sarah Touzalin

Yeah, that's an interesting point. So then what, what sort of conversations do you typically recommend that committees be having with investment advisors or investment managers? With respect to ESG.

Ameena Majid

I think first and foremost is getting it on the same page as to what ESG means. We don't have a clear definition of it. We're, you know, especially in the US, we have such a movement, a pro ESG movement, and the anti ESG movement, and that has infiltrated the retirement space, for sure, and I've had the experience with committees or with treasuries where they won't necessarily touch it. They'll be like, Nope, no, ESG, etc, etc, but they're really thinking about it as like a social issue, and their investment managers aren't really thinking about it that way. So I think one, it's important to get on the same page as to what ESG means, and how, if an investment manager is looking at it as a financial perspective or an additional financial character, you know, how does that look from their investment processes? Number two, and how does it influence their ultimate decision, you know, and whether they would make the same decision, perhaps, if they didn't take those into account. And I think that's the critical part for our area, because there's certainly a sense that ESG is non financial.

Richard Schwartz

And this leads me naturally to the question of what the regulatory landscape, what's that look like with respect to employer sponsored retirement plans?

Ameena Majid

Yeah, well, right, right now it seems perhaps stable at the moment. We did just get I would actually, let's step back, because the regulatory approaches, we know they varied with different administration, but I think it's always fundamentally been around rhetoric, if you know the definition of ESG investing is if it's not being viewed as ESG factors contributing financial risk, and it's more on the side of impact investing or faith based. I think regardless of the regulations in place, that's always been considered inconsistent with a risk of fiduciary duty. I think that's true regardless of administration, but the rhetoric has caused consternation from time to time. So 2015 you know, economic value of ESG was considered, but with the cautious approach that was the Democratic administration, then with the Republican administration, we had the term pecuniary factor, and that pushed us into more of a binary phase where it seemed like you couldn't think about ESG, and now we've landed with the most recent regulations that were challenged in court, upheld appealed, and now we just got the decision on Valentine's Day where the district court of the Northern District of Texas actually upheld them, really

concluding that the tiebreaker test is not about out of alignment with Ethan, and you can't really come at the expense of financial return. So here I would put the case of being in the column of A pro ESG case.

Sarah Touzalin

Nice. And so what do you think we could see with the current Trump administration's approach to ESG?

Ameena Majid

Well, they definitely have an anti ESG stance, and I still think it to be determined. You know, with the regulations being upheld, we don't know whether those will be challenged. There was recently a letter put forth by a number of state financial officers asking the SEC and the DOL to issue guidance and rulemaking that prohibits using plan assets to advance political or social agenda. Go back to our ambiguous ESG definition, and that was advanced after, you know, the Northern District of Texas upheld the DOL regulation, so we'll see whether that happens or not, whether they're effective at that. But at the same time, you know, the new EDFA head, he's expressed views that there isn't an ESG problem in 401 K plans, you know, and it's a political issue that doesn't really have space here. So there's, you know, who knows where that view leads us. And then I would say similarly, or maybe finally, I would say, right now, investment managers are in the hot seat. They have been for a long time, and the current administration is really targeting them through SEC rulemaking and trying to take action with guidance that hampers their ability to engage with companies on ESG matters, and that's where I think it'll have maybe a trickle down in to our space.

Richard Schwartz

So, there was another court case out of Texas regarding plans investment scheme and how ESG fees. Filtered into that. What can you tell us about that?

Ameena Majid

That case, I would actually direct our listeners. I think there's a great blog by the new EBSA head, Daniel Aronowitz, with which hopefully I said his name correctly. And there was some good highlights he had in there, you know, which was, there's no ESG investing problem in 401 K and ESG investing is not prohibited. And I thought that was good, because it's on point. And the takeaways I feel from that case is sticking to the fundamentals. And the fundamentals in ERISA is always process. The defendant in the case was able to survive on process and robust processing, which is the hallmark, and I think the most important thing, the other thing to maybe think about, which we do anyway, and many of our clients do this, is always looking at your composition in your committee, and noting whether maybe just being a little looking at whether those on the committee, Not only just whether they're a good fit for that committee, but also whether they maybe manage any third party relationship that the committee may have as well, just to sort of put aside any perceived conflict of interest. So I don't think the case is earth-shattering for our practical day to day governance of our committees, and that's my take.

Richard Schwartz

That's really interesting. Very interesting. This has been a great discussion, Ameena, we both Thank you very much for this, and I, I suspect we'll be hearing more about ESG investing under the new administration

Ameena Majid

We think so. So thank you for having me.

Sarah Touzalin

Thanks so much, Ameena. Please join us for our next episode, where we will be talking to Ada Dolph, a partner in the ERISA Litigation department, about some recent litigation involving defined benefit pension plans.

Richard Schwartz

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