ESG 101

Information for the Forest and Wood Products Sector

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Executive Summary

In 2004, the term ESG — referring to environmental, social, and governance — emerged from the financial industry's efforts to formalize sustainable investment. By 2020, ESG was in the headlines when Larry Fink, CEO of BlackRock, one of the global investment community's most prominent voices managing about US$10 trillion in global assets, named ESG as a priority in annual letters.[1, 2] Increasingly, ESG-related disclosures are being considered by investors across sectors and companies, including the forest and wood products sector.

Defining ESG

ESG - "ESG" stands for environmental, social, and governance. ESG investing is a way of investing in companies based on their commitment to one or more ESG factors. It is often also called sustainable investing, socially responsible investing, and impact investing. (Source: SEC, 2022)

There are many reasons investors, businesses, and other actors within the financial sector are motivated to develop and advance ESG strategies. These reasons can be grouped into motivations related to (1) reducing or avoiding risk and (2) increasing or identifying opportunity. Investments with greater ESG exposure could be associated with higher risks related to liabilities, future regulation, or stranded assets. In terms of opportunity identification, investors are looking to identify the next big thing in a new product or emerging market that may offer a greater long-term return. ESG evaluation systems aid in identifying risks and opportunities and can be a contributing factor for attracting investment and for recruiting and retaining employees.

The development of ESG has evolved over the past twenty years from voluntary efforts, corporate pledges, and third-party initiatives to actions being taken by regulatory bodies and agencies. There are some indications that moving investment toward sectors with lower ESG risks could benefit the forest and wood products sector. Forest and wood product companies provide robust and diverse environmental benefits, support local communities, and have decades of experience with responsible governance structures, including certification and supply chain assurances.

In 2022, the US Securities and Exchange Commission (SEC) announced intentions for a ESG disclosure framework with increased climate-related reporting for companies and impacts to funds and advisors.[3] The European Union (EU) has also released draft reporting standards, expected to be adopted in June 2023.[4] Current government proposals focus on establishing consistent requirements for publicly traded companies, but it is reasonable to expect that private companies will be impacted by these developments. Companies not directly linked to financial markets have begun to use ESG frameworks to address and get recognition for responsible corporate actions.

[1]("Larry Fink CEO Letter") https://www.blackrock.com/us/individual/larry-fink-ceo-letter

[2]("BlackRock 2020 Client Letter") https://www.blackrock.com/us/individual/blackrock-client-letter

[3]("SEC Proposes Rules to Enhance and Standardize Climate-Related Disclosures for Investors") https://www.sec.gov/news/press-release/2022-92 and ("SEC Proposes to Enhance Disclosures by Certain Investment Advisers and Investment Companies About ESG Investment Practices") https://www.sec.gov/news/press-release/2022-46

[4](First Set of draft ESRS. EFRAG.) https://efrag.org/lab6

Many investors expect ESG-related disclosure rules to be finalized and an implementation program to start in 2023.[5] The new rules would require public companies to disclose risks that are "reasonably likely to have a material impact on their business, results of operations, or financial condition".[6] There is evidence of strong investor support for the new disclosure rules.[7]

Moving toward greater oversight and structure for ESG investment through regulatory mechanisms is an improvement that is needed in the marketplace. The forest and wood products sector has the opportunity to engage with high levels of financial expertise to ensure the resulting approaches benefit forests, renewable products, progress toward a more circular economy, and the health and wellbeing of workforce and communities. However, there is also reason to be highly concerned about the short- and long-term impacts of ESG efforts. There are competing, inconsistent, and highly variable approaches in the marketplace today. It is not clear at this time that the forest and wood products sector is well-enough understood, positioned, or represented in the financial industry to ensure positive outcomes from ESG initiatives.

The forest and wood product sector's prior work related to risk assessment methodologies, assurance systems, and advancing sustainability can be applied and amplified to enable effective and beneficial ESG-related investment. By engaging in ESG-related initiatives, connecting with policymakers and regulatory agencies, highlighting effective solutions, and listening to our audiences - from workforce to investors - the forest and wood products sector can realize benefits from ESG-related trends.

Examples of ESG factors in forestry investing:

Environmental

- Water use and availability, and the broader impact on watersheds.
- Pollution (such as through pesticides and the impact on soil quality).
- Positive and negative climate impact.
- Planting and harvesting techniques, and resource management.
- Protection of biodiversity and ecosystems.

Social

- Land rights (acquisitions, tenancy and use of land).
- Relationships with local communities and other key stakeholders.
- Labour standards, including health and safety.
- Supply chain custody, particularly regarding illegal logging.

Governance

- Anti-bribery and corruption standards.
- Quality of management plans and systems.
- Grievance mechanisms available to key stakeholders.

Source: PRI Association. 2019. ESG factors in forestry investing. https://www.unpri.org/forestry/esg-factors-in-forestry-investing/4392.article

[5]("Upcoming SEC climate disclosure rules bring urgency to ESG data strategy planning") https://www.reuters.com/legal/legalindustry/upcoming-sec-climate-disclosure-rules-bring-urgency-esg-data-strategy-planning-2023-01-30

[6]Ibid

[7]("Analysis shows that investors strongly support the SEC's proposed climate disclosure rule") https://www.ceres.org/news-center/blog/analysis-shows-investors-strongly-support-secs-proposed-climate-disclosure-rule

Background

In December 2004, the report "Who Cares Wins"[8] was released by The Global Compact. The report provided: "Recommendations by the financial industry to better integrate **environmental, social and governance** issues in analysis, asset management, and securities brokerage" — and the term "ESG" was created.

The 2004 report was developed by twenty international financial institutions from nine countries with total assets under management of over US$6 trillion. The final report was endorsed by more than 25 institutions. As stated in the report:

> *Endorsing institutions are convinced that a better consideration of environmental, social and governance factors will ultimately contribute to stronger and more resilient investment markets, as well as contribute to the sustainable development of societies.[9]*

The emergence of ESG can be described as an effort led by the financial sector with a goal to increase stability and de-risk investment markets. The recommendations in the "Who Cares Wins" report include development of mechanisms that require or incentivise companies to disclose information impacting their investment potential. The recommendations from the report include roles for many different financial market actors from analysts, to companies, investors, and regulators (Figure 1).

Figure 1. Recommendations and roles to better integrate ESG in markets

Source: "Who Cares Wins", The Global Compact, December 2004.

As shown in Figure 1, ESG was anticipated to create change throughout the investment markets. Specific recommendations for financial institutions included a strong ESG commitment at the board and senior management level. Companies were asked to take a leadership role in ESG policy implementation and standardized reporting. Governments and agencies were asked to consider sustainable development in the investment of pension funds. Regulatory frameworks were recommended to require minimum disclosures and accountability on ESG issues. At the time of the report, emphasis was placed on participation in voluntary ESG reporting initiatives while also recommending that: *"...other self-regulatory organizations, professional credential-granting organizations, accounting standard-setting bodies, public accounting entities, and rating agencies and index providers should all establish consistent standards and frameworks in relation to environmental, social, and governance factors."[10]*

An additional formative report for the development of ESG is the "Freshfields Report".[11] The report investigated the concern for legal conflicts with ESG, for example whether it is compatible with the fiduciary duties of trustees.[12] The report published in 2005 addressed the question: *Is the integration of environmental, social, and governance issues into investment policy (including asset allocation, portfolio construction and stock-picking or bond-picking) voluntarily permitted,*

[8]Who Cares Wins: Connecting Financial Markets to a Changing World. 2004. The Global Compact. https://www.unepfi.org/fileadmin/events/2004/stocks/who_cares_wins_global_compact_2004.pdf

[9] Ibid

[10]Ibid. Also note that the "Who Cares Wins" initiative included additional reporting from 2004-2008. See: https://documents1.worldbank.org/curated/en/444801491483640669/pdf/113850-BRI-IFC-Breif-whocares-PUBLIC.pdf

[11]A legal framework for the integration of environmental, social and governance issues into institutional investing. 2005. Produced for the Asset Management Working Group of the United Nations Environment Programme Finance Initiative (UNEP FI). October 2005. Prepared by Freshfields Bruckhaus Deringer. https://www.unepfi.org/fileadmin/documents/freshfields_legal_resp_20051123.pdf

[12]Sandberg, Joakim. "Socially Responsible Investment and Fiduciary Duty: Putting the Freshfields Report into Perspective." Journal of Business Ethics 101, no. 1 (2011): 143–62. http://www.jstor.org/stable/41475890.

legally required, or hampered by law and regulation; primarily as regards public and private pension funds, secondarily as regards insurance company reserves and mutual funds?

The 2005 Freshfields Report examined nine jurisdictions, including the United States and Canada.[13] With respect to investment regulations in the United States, the report concluded, *"...there appears to be no bar to integrating ESG considerations into the day-to-day process of fund management, provided the focus is always on the beneficiaries/purposes of the fund and not on unrelated objectives."*[14] For a longer excerpt from the report addressing the United States, see Appendix A. [15]

The Freshfields Report concluded that: *"...the links between ESG factors and financial performance are increasingly being recognised. On that basis, integrating ESG considerations into an investment analysis so as to more reliably predict financial performance is clearly permissible and is arguably required in all jurisdictions."* By establishing a legal basis for incorporating ESG into investor portfolios, the Freshfields Report contributed to mainstreaming responsible investment.[16]

In 2006, the United Nations' Principles for Responsible Investment (PRI) report was published and invited investment companies to sign on to the principles. From an original list of 63 signatories at its release, as of June 2019, there were 2,450 signers representing over US$80 trillion in assets under management (AUM)[17], and as of December 2022, there are 5,319 signatories representing US$121 trillion of AUM.[18] This is over five times the annual GDP of the US.[19] The six Principles for Responsible Investment provide specific actions for incorporating ESG issues into investment practice.

The 6 United Nations' Principles for Responsible Investment (PRI)

- Principle 1: We will incorporate ESG issues into investment analysis and decision-making processes.
- Principle 2: We will be active owners and incorporate ESG issues into our ownership policies and practices.
- Principle 3: We will seek appropriate disclosure on ESG issues by the entities in which we invest.
- Principle 4: We will promote acceptance and implementation of the Principles within the investment industry
- Principle 5: We will work together to enhance our effectiveness in implementing the Principles.
- Principle 6: We will each report on our activities and progress towards implementing the Principles.

Source: https://www.unpri.org/about-us/what-are-the-principles-for-responsible-investment[20]

[13]Jurisdictions examined in Freshfields Report 2005: France; Germany; Italy; Japan; Spain; the UK; the US; Australia; and Canada. https://www.unepfi.org/fileadmin/documents/freshfields_legal_resp_20051123.pdf

[14]A legal framework for the integration of environmental, social and governance issues into institutional investing. 2005. Produced for the Asset Management Working Group of the United Nations Environment Programme Finance Initiative (UNEP FI). October 2005. Prepared by Freshfields Bruckhaus Deringer. https://www.unepfi.org/fileadmin/documents/freshfields_legal_resp_20051123.pdf

[15]A new Freshfields Report has been recently released and examines 11 jurisdictions (including the US). The report A Legal Framework for Impact: sustainability impact in investor decision-making (2021) has a detailed examination of the US legal context available here: https://www.unepfi.org/publications/a-legal-framework-for-impact-sustainability-impact-in-investor-decision-making/ (pp 510-547)

[16]("History of responsible investment at UNEP FI – United Nations Environment – Finance Initiative") https://www.unepfi.org/investment/history/

[17](Atkins, 2020) https://www.forbes.com/sites/betsyatkins/2020/06/08/demystifying-esgits-history--current-status/?sh=c5c40d92cdd3

[18]https://www.unpri.org/signatories/signatory-resources/signatory-directory and https://www.unpri.org/signatories/signatory-resources/quarterly-signatory-update Accessed Feb 13, 2023.

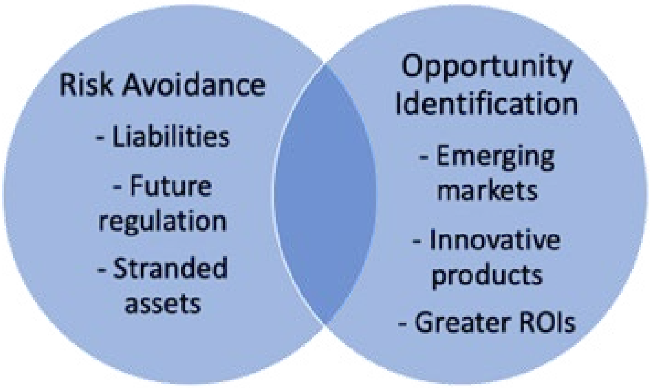
[19]US annual GDP is approximately $23 trillion. https://data.worldbank.org/indicator

[20]Also see: the PRI Investor Reporting Framework addressing the elements of reporting, including what to report on for asset owners and investment managers (https://www.unpri.org/reporting-and-assessment/what-to-report-on/3204.article). Article about recent PRI updates and anticipated further guidance: https://www.unpri.org/reporting-and-assessment/release-of-the-2023-reporting-framework-and-updates-on-accountability/11073.article

Motivations for ESG

There are many reasons investors, businesses, and other actors within the financial sector are motivated to develop and advance ESG strategies. These reasons can be broadly grouped into motivations related to (1) reducing or avoiding risk and (2) increasing or identifying opportunity (Figure 2). Investment opportunities with greater ESG exposure could be associated with higher risks related to liabilities, future regulation, or stranded assets. For example, an industry with high negative environmental impacts could be liable for long-term pollution clean-up from their operations, may face more stringent air or water emission restrictions over time, or could even be banned or excluded from the market entirely and result in investor assets being locked-up in non-operational facilities that can't be re-sold. In terms of opportunity identification, investors are looking to identify the next big thing in a new product or emerging market that may offer a greater long-term return on investment (ROI).[21] ESG evaluation systems aid in identifying risks and opportunities for investors and businesses.

Figure 2. Motivations for ESG Investing



Source: Dovetail Partners, 2023.

Frameworks for ESG

There are a number of frameworks for integrating ESG into an investment strategy or for a company to engage ESG motivated investors. These frameworks take a variety of approaches, provide standards and metrics for ESG reporting or disclosures, and have direct relevance to the forest and wood products sector. Three examples are briefly described below.[22]

The Global Reporting Initiative (GRI): Established in 1997 to create an accountability framework for companies to display their responsible environmental business practices. GRI began implementing the term ESG in 2009. Investors, businesses, and governments use GRI's ESG framework in expressing impacts such as climate change, human rights, governance, and social well-being. The first GRI sector standard was launched in 2021 for oil and gas. In 2022, GRI established standards for coal, agriculture, aquaculture, and fishing. There are also GRI standards for reporting on specific impacts, including procurement practices, materials, energy, biodiversity, diversity and equal opportunity, non-discrimination, and rights of Indigenous people.[23]

The Sustainability Accounting Standards Board (SASB, now part of the IFRS Foundation[24]) : Began in 2011 to develop standards so "investors could compare performance on critical social and environmental issues, and capital could be directed to the most sustainable outcomes." SASB has developed 77 industry-specific ESG standards, including many related to forests and wood products. For example, there are SASB standards for Building Products and Furnishings, Household and Personal Products, Construction Materials, Biofuels, Forestry Management, Pulp and Paper Products, Chemicals, and Containers and Packaging.[25]

[21]Interest in ESG is also related to recognition that financial markets have been too focused on short-term maximization of profits. For further discussion, see: Schoenmaker, D. (2017). *From Risk to Opportunity: a Framework for Sustainable Finance.* RSM Positive Change Series. Retrieved from http://hdl.handle.net/1765/101671 Also see, discussion of B-Corps: https://www.dovetailinc.org/portfoliodetail.php?id=5e2b28077dc85

[22]This is not an exhaustive list. Further discussion and other examples are available from: (Atkins, 2020.) https://www.forbes.com/sites/betsyatkins/2020/06/08/demystifying-esgits-history--current-status/?sh=c5c40d92cdd3

[23]https://www.globalreporting.org/how-to-use-the-gri-standards/gri-standards-english-language/

[24]International Financial Reporting Standards Foundation, https://www.ifrs.org/

[25]SASB Standards can be accessed and downloaded here: https://www.sasb.org/standards/download/

The Taskforce on Climate-related Financial Disclosures (TCFD)[26]: Started in 2015, the Task Force provides disclosure guidance and status reporting for the financial sector as well as for four non-financial groups and their associated industries: Energy, Transportation, Materials and Buildings, and Agriculture, Food, and Forest Products.[27]

In their 2020 letter, BlackRock asked the companies that they invest in to: (1) publish a disclosure in line with industry-specific SASB guidelines; and (2) disclose climate-related risks in line with the TCFD's recommendations.[28]

To aid investors in evaluating ESG performance, there are also rating agencies. Examples of four major ESG rating organizations are listed in Table 1.[29]

Table 1. ESG Rating Organizations

Name	Date Established	Rating scale	Scope	Forest Sector Relevance
MSCI	2010	Ranges from leader (AAA, AA), average (A, BBB, BB) to laggard (B, CCC).	Over 6,000 companies and over 400,000 equity and fixed-income securities	Includes analysis of paper packaging, paper products, and forest products within the materials sector. Utilizes an industry-specific weight-setting methodology.[a]
Sustainalytics	2008	0-100 scale, incorporates sector and industry-based comparisons	Over 7,000 companies across 42 sectors	Provides ratings for companies in many industries, including Construction Materials, Containers and Packaging, Paper and Forestry, and Textiles and Apparel.[b]
RepRisk	1998	Ranges from AAA to D	More than 200,000 companies spanning 34 sectors	Evaluates 28 ESG Issues and 73 Topic Tags including impacts on landscapes, ecosystems, and biodiversity; misleading communications, and supply chain issues.[c]
Institutional Shareholder Services (ISS)	1985	Ranges from A+ to D-	Over 7,800 companies across 18 sectors.	Provides ratings for companies in a variety of industries, including Paper & Forest Products.[d]

a https://www.msci.com/our-solutions/esg-investing/esg-industry-materiality-map

b https://www.sustainalytics.com/esg-ratings

c https://www.reprisk.com/content/static/reprisk-esg-issues-definitions.pdf

d https://www.issgovernance.com/esg/iss-esg-gateway/

[26]Also see the Taskforce on Nature-related Financial Disclosures, https://tnfd.global/

[27]Recommendations of the Task Force on Climate-related Financial Disclosures https://assets.bbhub.io/company/sites/60/2021/10/FINAL-2017-TCFD-Report.pdf Task Force on Climate-related Financial Disclosures 2021 Status Report https://assets.bbhub.io/company/sites/60/2022/03/GPP_TCFD_Status_Report_2021_Book_v17.pdf

[28]https://www.blackrock.com/us/individual/larry-fink-ceo-letter

[29]This is not an exhaustive list. Further discussion is available from: Demystifying ESG: Its History and Current Status. 2020. Forbes. https://www.forbes.com/sites/betsyatkins/2020/06/08/demystifying-esgits-history--current-status/?sh=c5c40d92cdd3 Also see: 9 Best ESG Rating Agencies. Feb. 2023. The Impact Investor. https://theimpactinvestor.com/esg-rating-agencies/

According to a report by Stanford University, demand for ESG information often exceeds the ability of providers to supply it. The researchers concluded that contributing factors include the immense number of considerations that fall under the heading of ESG, the difficulty in measuring ESG factors, and the challenge of determining their impact.[30] According to estimates from Deloitte, there are more than 600 ESG rating agencies and individual companies may receive different ratings from different agencies.[31] Despite these inconsistencies, the benefit of aligning with ESG frameworks is likely to remain important in coming years for many reasons, including demographic trends. By 2029, the Millennial and Gen Z generations will make up 72% of the world's workforce, compared to 52% percent in 2019, and these generations place greater importance on environmental and social concerns.[32] ESG performance can be a contributing factor for attracting investment and for recruiting and retaining employees.

Market Performance for ESG

The market performance of ESG investments can be evaluated and compared to other investment strategies, and there are a number of ESG indices that have been developed.[33] The S&P 500 ESG Index was launched in April 2019 and incorporates ESG values while maintaining similar overall industry group weights as the S&P 500. The S&P 500 ESG Index includes over 300 of the original S&P 500 companies, reflects many of the attributes of the S&P 500, and provides historically similar risk-adjusted performance profiles.[34] A comparison of the S&P 500 and the S&P 500 ESG index found that by the fourth quarter of 2020, the S&P 500 ESG index began to steadily outperform the S&P 500 by four points on average.[35]

A review completed by NASDAQ found that over a five-year period, companies considered as sustainability leaders under the MSCI[36] ESG framework exhibited both higher returns and less risk. Companies considered as sustainability laggards by the MSCI rating system showed the opposite results. Compared to the market, the median daily price return for leaders was 6.3% and for laggards was -22.7%. Similarly, the MSCI leaders exhibited 6.4% less risk and laggards displayed 10.2% greater risk. The laggards also had a median daily price return almost 23% less than the S&P 500. The dividend yield for leaders was 10.3% and -39.6% for laggards.[37] An analysis of more than 2,000 academic studies concluded that 70% of the studies reported a positive correlation between ESG and financial returns.[38]

Based on research by McKinsey, ESG creates financial and investor value in five key ways: [39]

1. ***Top-line growth.*** Helping companies access new markets and expand existing ones. Sustainability-marketed products grow 5.6 times faster than others.
2. ***Cost reductions.*** Combat rising operating expenses. McKinsey found a strong correlation between resource efficiency and financial performance.
3. ***Regulatory relief.*** Greater strategic freedom, less regulatory pressure, more government support, and better community relations.
4. ***Productivity uplift.*** Boost morale and motivation and attract quality talent. In a recent McKinsey survey, 82% of participants (representing a sample of employees of US companies) listed "contributing to society" and "creating meaningful work" as their top priorities.
5. ***Investment and asset optimization.*** Strengthen investment returns by allocating capital to more promising and sustainable opportunities.

[30]("ESG ratings a Compass without direction") https://www.gsb.stanford.edu/sites/default/files/publication/pdfs/cgri-closer-look-97-esg-ratings_0.pdf

[31]("ESG Ratings: do they add value? How to get prepared?") https://www2.deloitte.com/ce/en/pages/about-deloitte/articles/esg-ratings-do-they-add-value.html

[32]("ESG as a Workforce Strategy") https://www.mercer.com/our-thinking/esg-as-a-workforce-strategy.html

[33]For example, S&P Dow Jones Indices ESG: https://www.spglobal.com/spdji/en/index-family/esg/ For performance comparisons, see: https://www.spglobal.com/spdji/en/documents/performance-reports/dashboard-climate-esg-index.pdf

[34]The S&P 500 ESG Index: Defining the Sustainable Core. Nov. 2022. https://www.spglobal.com/spdji/en/education/article/the-sp-500-esg-index-defining-the-sustainable-core/

[35]Comparison of the effect of the S&P 500 ESG and S&P 500 indices between March 2019 and November 2022. Published by Statista Research Department, Nov 24, 2022. https://www.statista.com/statistics/1269643/s-p-500-esg-normal-index-comparison

[36]See Table 1 and https://www.msci.com/

[37]Demystifying ESG: Its History and Current Status. 2020. Forbes. https://www.forbes.com/sites/betsyatkins/2020/06/08/demystifying-esgits-history--current-status/?sh=c5c40d92cdd3

[38]("What is ESG?") https://www.mckinsey.com/featured-insights/mckinsey-explainers/what-is-esg

[39]Ibid.

Recent reporting identified three common aspects for top ESG performers in the market: (1) high consolidated ESG ratings; (2) use of ESG-related standards and incorporating stakeholder concerns and preferences in their strategies and reports; and (3) their ESG reporting was comprehensive and committed to ambitious medium- and long-term quantitative goals.[40]

ESG in the Forest and Wood Products Sector

Many companies, including forest and wood products companies, are already actively engaged in ESG and responsible investment efforts.[41] A study by Governance & Accountability Institute, Inc. found that 96% of the S&P 500 and 81% of the Russell 1000 are producing sustainability and climate change related reports.[42] Companies not directly linked to financial markets have begun to use ESG frameworks to address and get recognition for responsible corporate actions. A number of companies in the forest and wood products sector have produced sustainability reports for many years and continue to adapt their reporting to align with investor expectations (Table 2).

Table 2. Examples of Forest and Wood Products Sector ESG Reporting and Disclosures

Company	Description	Report
Manulife Investment Management	As the world's largest timberland investment manager, and second largest manager of agricultural investments, Manulife has over 30 years of experience demonstrating a commitment to the stewardship of its land and the communities where it operates. In 2021, Hancock Natural Resource Group adopted the Manulife Investment Management brand.	Sustainable Investing Report – Timberland 2020
PotlatchDeltic	PotlatchDeltic is a Real Estate Investment Trust (REIT) that owns approximately 1.8 million acres of timberlands in Alabama, Arkansas, Idaho, Louisiana, Minnesota and Mississippi. Through its taxable REIT subsidiary, the company also operates six sawmills, an industrial-grade plywood mill, a residential and commercial real estate development business and a rural timberland sales program.	2021 Environmental, Social, and Governance (ESG) Report
Rayonier	Rayonier is a timberland real estate investment trust. As of June 30, 2022, Rayonier owned or leased approximately 2.7 million acres of timberlands located in the US South (1.79 million acres), US Pacific Northwest (486,000 acres) and New Zealand (418,000 acres).	Rayonier Sustainability Report - Real Estate
Weyerhaeuser Company	Weyerhaeuser Company owns or controls 10.6 million acres of timberlands in the US, manages an additional 14.1 million acres of timberlands under long-term licenses in Canada, and operates 35 wood products manufacturing facilities and 19 building materials distribution centers across North America.	Global Reporting Initiative (GRI) standards: Core Options disclosures

[40](Brown, 2023) https://www.triplepundit.com/story/2023/research-esg-profitability-reporting/766971 and ("How ESG influence profitability and transparency in FT 500 companies - Center for Sustainability & Excellence") https://cse-net.org/how-esg-influence-profitability-and-transparency-in-ft-500-companies/

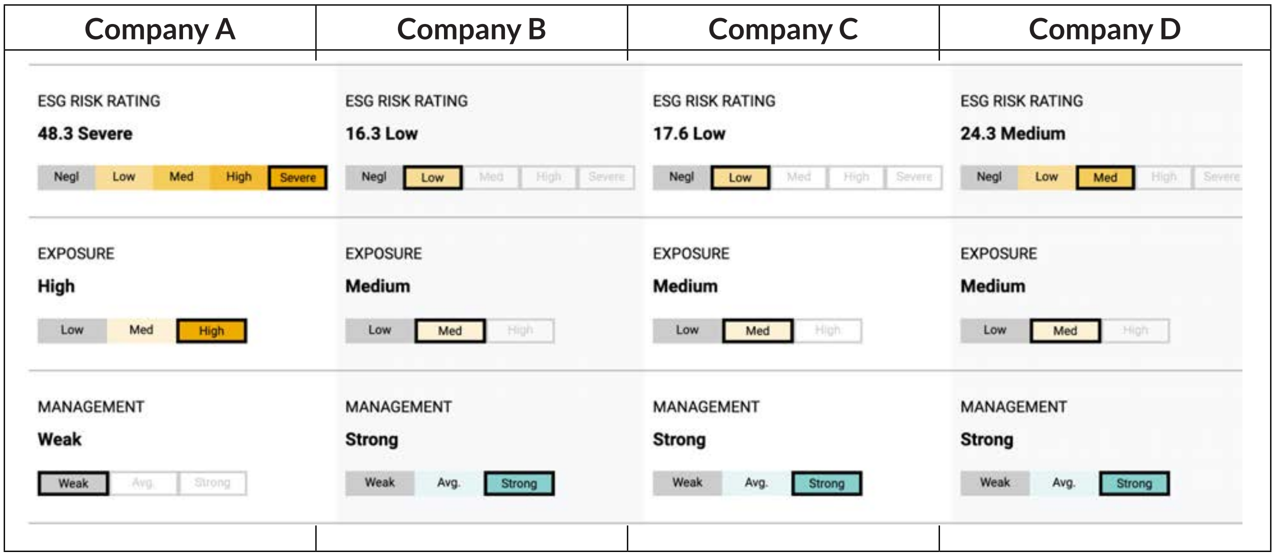
[41]An Introduction to Responsible Investment in Forestry. 2019. PRI. https://www.unpri.org/download?ac=6441

[42]("Rescuing ESG from the Culture Wars") https://hbr.org/2023/02/rescuing-esg-from-the-culture-wars

Forest products companies have been recognized as ESG leaders, one example in 2022 was Sappi North America, Inc., a producer of paper, packaging and pulp being recognized with a SEAL business sustainability award.[43] There has also been interest in the sector to learn more about ESG developments and investor interests.[44]

However, forest and wood products company rankings in ESG evaluations can vary considerably (Figure 3). The names of the companies are not included, but Figure 3 shows four forest product companies with North American operations and their ESG rating by Sustainalytics with results ranging from low to severe risk. Part of this variability can be expected because companies have different product types, geography, and scale of operations, but this variability creates confusion and potential misrepresentation of the sector when it is aggregated or reported out of context.

Figure 3. ESG Risk Ratings for Four Forest Product Companies with North American Operations



Information derived from: https://www.sustainalytics.com/esg-ratings (Accessed 17 Feb 2023)

An analysis of the global forest and paper products sector in 2019 concluded that environmental and social risks in forestry are lower than metals and mining[45], oil and gas, agribusiness and commodity foods, but higher than leisure[46], insurance and banks[47]

[43](“Sappi Recognized as ESG leader in 2022 SEAL Business Sustainability Awards”) https://www.sappi.com/sappi-recognized-as-esg-leader-in-2022-seal-business-sustainability-awards

[44]For further discussion, see the webinar “Investor trends for ESG and SEC reporting requirements” hosted in 2022 by the US Endowment for Forestry and Communities available at: https://youtu.be/GGFrMvYwe04

[45]Example and discussion of mining sector ESG efforts: Mining sector puts energy into ESG, but lacks focus on gender and diversity

https://www.kake.com/story/47845676/mining-sector-puts-energy-into-esg-but-lacks-focus-on-gender-and-diversity

[46]Example of Hotel Sector ESG: (“A Check-In on the Hotel Sector’s ESG Initiatives”)

https://www.csrwire.com/press_releases/765521-check-hotel-sectors-esg-initiatives

[47]ESG Industry Report Card: Forest and Paper Products. 2019. S&P Global.

https://www.spglobal.com/en/research-insights/articles/esg-industry-report-card-forest-and-paper-products

There are also efforts to evaluate ESG performance at the country level, including the Global Sustainability Index produced since 2012 with consideration of a country's natural environment, resource use, social conditions, education, business, and infrastructure.[48] European countries rank high in these evaluations. In the most recent report, the US was ranked 30th, noting good performance in intellectual capital, but scoring low in resource efficiency and social capital. The report ranked China 31st, Brazil 46th, and India 120th.[49]

The forest and wood products sector can play a key role in other sectors' ESG initiatives. For example, Dow Jones ranks ESG performance and in a recent evaluation Microsoft ranked first.[50,51] Microsoft's ESG initiatives include commitments to reduce its carbon footprint and one strategy is the use of mass timber in their building projects.[52] Meta[53] and Google[54] have also included the use of sustainable wood products within their strategies to improve ESG performance.

[48](The Global Sustainable Competitiveness Index) https://solability.com/the-global-sustainable-competitiveness-index/the-index

[49]("CSRWire - ESG Country Ratings: The Global Sustainable Competitiveness Index 2022") https://www.csrwire.com/press_releases/763181-esg-country-ratings-global-sustainable-competitiveness-index-2022

[50]https://www.investors.com/news/technology/microsoft-stock-attracts-esg-investing-interest/

[51]West Fraser Timber ranked #27 on the list. See: https://www.investors.com/news/esg-companies-list-2021-best-esg-stocks-environmental-social-governance-values-2/

[52]https://blogs.microsoft.com/bayarea/2021/04/23/nature-as-a-building-block-for-microsofts-new-silicon-valley-campus/

[53]https://sustainability.fb.com/ and https://sustainability.fb.com/data-centers/

[54]https://sustainability.google/ and https://realestate.withgoogle.com/bayview/#/solutions/circular-resources

Regulatory Developments

Given the various and competing approaches to ESG frameworks, ratings, and reporting it has been challenging for companies to engage in this space efficiently. Investors face similar challenges with the complexity of comparing and basing decisions on the information that is provided.The emergence of regulatory oversight has become essential for creating greater consistency. Regulatory bodies in Europe and the United States have advanced proposals for ESG reporting requirements and disclosures that would be broadly applied to create consistency across the marketplace. The International Organization for Standardization (ISO) has also developed the ISO26000 standard to provide guidance on ESG reporting. To date, 88 countries, including the US, have adopted ISO26000 as a national standard.[55]

The EU and European Commission

In April 2021, the European Commission adopted a legislative proposal for a Corporate Sustainability Reporting Directive (CSRD) and associated European Sustainability Reporting Standards.[56] The reporting requirements will be phased in over time for different kinds of companies. The first companies will have to apply the standards in 2024, for reports published in 2025. The draft standards are being considered in consultation with EU bodies and EU Member States and final standards are anticipated in June 2023. The standards are anticipated to affect companies in the EU as well as companies based outside of the EU but doing business in the EU.[57]

The US Securities and Exchange Commission

In the US, the attention of ESG regulation focuses on the role of the US Securities and Exchange Commission (SEC). The SEC has responsibility for determining which risk factors are material to investors while balancing the need for disclosure with the cost to companies for providing the information (see sidebar).

The Mission and Purpose of the SEC

The US Securities and Exchange Commission (SEC) has a three-part mission:

- *Protect investors*
- *Maintain fair, orderly, and efficient markets*
- *Facilitate capital formation*

When the stock market crashed in October 1929, so did public confidence in the US markets. Congress held hearings to identify the problems and search for solutions. Based on its findings, Congress — in the peak year of the Depression — passed the Securities Act of 1933. The following year, it passed the Securities Exchange Act of 1934, which created the SEC.

The main purposes of these laws can be reduced to two common-sense notions: (1) Companies offering securities for sale to the public must tell the truth about their business, the securities they are selling, and the risks involved in investing in those securities. (2) Those who sell and trade securities — brokers, dealers, and exchanges — must treat investors fairly and honestly.

Source:https://www.sec.gov/about/what-we-do https://www.sec.gov/sec-response-climate-and-esg-risks-and-opportunities

[55]https://iso26000.info/ Also see information about the ISO Strategic Advisory Group on ESG (https://iso26000.info/iso/iso-standards/iso-26000/iso-sag-on-esg/)

[56]https://efrag.org/lab6

[57](“CSRD Update: Impacted Businesses and How To Prepare for”) https://www.csrwire.com/press_releases/763281-csrd-update-impacted-businesses-and-how-prepare-mandatory-reporting

In 2022, the SEC proposed rules that would establish disclosure requirements for funds and advisers that market themselves as having an ESG focus and require ESG reporting.[58] The SEC also proposed expansion of reporting for climate-related risks.[59] The International Sustainability Standards Board (ISSB) is working to develop standards to align with the SEC requirements and proposed legislation.[60]

The direct effect of the potential and anticipated SEC rule making is reflected in the reclassification and reassessment of what is identified as ESG in the marketplace in the interest of staying in alignment with any future regulation.[61] In many ways, this can be viewed as exactly the type of improved consistency that one would expect to see from regulation.

The proposals made by the SEC have been widely criticized. There is also recognition that the financial-disclosure framework has been an effective mechanism. As one author recently concluded, *"The financial-disclosure framework established by Congress nearly nine decades ago has resulted in the greatest capital markets the world has ever seen… preserving and strengthening that framework should be a priority for policymakers on both sides of the aisle."*[62]

Proposed SEC Climate Disclosure Rule

Bloomberg Law February 16, 2023

With new climate-related disclosure rules in the making, the Securities and Exchange Commission has signaled greater enforcement ahead of environmental, social, and governance disclosures. For public companies, these developments signal the most significant overhaul of ESG reporting requirements in two decades. Even though the proposed rules have yet to be adopted, and face all but certain legal challenges thereafter, the SEC climate-related disclosure rules represent a growing global business push for more consistent, transparent ESG reporting standards by companies.

Source: ("Proposed SEC Climate Disclosure Rule") https://pro.bloomberglaw.com/brief/proposed-sec-climate-disclosure-rule/

Controversies and Concerns

The growth and development of ESG investment interest has met with strong legislative opposition in some US states, especially those with significant economic activity in industries that often rank poorly in ESG evaluations or are even excluded from ESG investment portfolios (i.e., fossil fuel industries, weapons manufacturing, and tobacco).[63] Anti-ESG or "boycott bills" have been proposed in 16 US states and five have enacted investment restrictions as of August 2022.[64] Some of these bills have included seeking protections for timber and the forest products sector.

[58] News release: https://www.sec.gov/news/press-release/2022-92 Full text of proposed rule Enhanced Disclosures by Certain Investment Advisers and Investment Companies about Environmental, Social, and Governance Investment Practices: https://www.sec.gov/rules/proposed/2022/33-11068.pdf

[59] News release: https://www.sec.gov/news/press-release/2022-46 Full text of proposed rule The Enhancement and Standardization of Climate-Related Disclosures for Investors: https://www.sec.gov/rules/proposed/2022/33-11042.pdf

[60] For discussion, see: https://hbr.org/2023/02/rescuing-esg-from-the-culture-wars

[61] Hallex, E. 2022. ESG Clarity. Managers stop calling some assets ESG ahead of SEC rules

https://esgclarity.com/managers-stop-calling-some-assets-esg-ahead-of-sec-rules/

[62] https://hbr.org/2023/02/rescuing-esg-from-the-culture-wars

[63] For discussion of ESG exclusions, see: S&P/BMV ESG Indices Consultation on Eligibility Requirements. April 2022. EXCLUSIONS BASED ON BUSINESS ACTIVITIES. https://www.spglobal.com/spdji/en/documents/indexnews/announcements/20220401-1451170/1451170_spbmvesgindicesconsultationoneligibilityrequirementsresults4-1-2022.pdf

[64] (Dial et al. 2022) https://www.reuters.com/legal/legalindustry/challenge-investing-face-state-anti-esg-legislation-2022-08-24/

The conflicting views of ESG are derived in part from its association with investor activism, broader social movements, and political beliefs.[65] BlackRock reports having voted against or withheld votes from 4,800 directors at 2,700 different companies where they feel that "companies and boards are not producing effective sustainability disclosures or implementing frameworks for managing these issues."[66] There is concern that the financial sector and investors are abusing their power, usurping the authority of governments, and signaling a loss of faith in government to solve broad problems.[67] There is also concern that all of this market-place disruption via ESG isn't actually advancing the world toward sustainability.[68]

Recommendations for the Forest and Wood Products Sector

The forest and wood products sector is already actively engaged in ESG developments and some companies are being recognized for their leadership. As ESG moves into more consistent regulatory frameworks it will be necessary to consider sector-wide strategies. Recommendations for the sector include:

Anticipate ESG (or something similar) becoming mainstream. The motivation for ESG reporting and disclosures is rooted in the investment sector and commitments to managing investment risk — this motivation is not going away anytime soon. At the same time, there is demand for sustainable options that is expected to grow. ESG is a business framework.

Connect with government agencies and regulators. The next chapter of ESG is largely within the arena of regulation and oversight agencies. The development of ESG policy is now engaging federal interests and will have direct impacts on domestic and international trade.

Look for the solutions that work and raise them up. Some ESG methodologies are better than others. Build on what is already a pretty good foundation and use sector-specific expertise to make it better and more widely accepted in the marketplace.

Align your efforts with your audience. One of the best practices of ESG is to gather information and feedback from your community (e.g., workforce, stakeholders, investors, interested and affected parties, etc.). This information is used to be targeted and efficient in ESG reporting and goal setting.

We got this. The forest and wood products sector has a great story to tell about people, prosperity, and planet and should be able to effectively align with investor interests to do good work with their financial choices.

The Bottom Line

Forest product companies are well-positioned to compete in a world focused on ESG. Forests and forest products provide many environmental and social co-benefits. Companies in the sector are already taking a thoughtful approach based on anticipating that ESG (or something similar) will be a primary driver of decisions by investors, consumers, and the workforce. Forest owners and forest product manufacturers can benefit from ESG efforts that lead to increased investment interest in the sector.

[65] For additional discussion, see: Interfaith Center on Corporate Responsibility (ICCR) Proxy Resolutions and Voting Guide (2023) https://www.iccr.org/sites/default/files/iccrs2023proxyresolutionsandvotingguide02.17.23.pdf

[66] https://www.blackrock.com/americas-offshore/en/larry-fink-ceo-letter

[67] https://news.bloomberglaw.com/esg/why-is-the-esg-focus-on-private-companies-not-the-government

[68] For further discussion see: https://hbr.org/2021/03/an-esg-reckoning-is-coming , https://www.weforum.org/agenda/2021/12/esg-sustainable-investment-backlash/ , https://hbr.org/2022/08/esg-investing-isnt-designed-to-save-the-planet

Appendix A. The US Position, Freshfields Report, 2005.

Excerpt from:

A legal framework for the integration of environmental, social and governance issues into institutional investing. 2005. Produced for the Asset Management Working Group of the United Nations Environment Programme Finance Initiative (UNEP FI). October 2005. Prepared by Freshfields Bruckhaus Deringer. https://www.unepfi.org/fileadmin/documents/freshfields_legal_resp_20051123.pdf (page 8)

The US position – the modern prudent investor rule
Institutional investors in the US are regulated through several strands of federal and state law. A common factor to almost all of this law is the application of the *modern prudent investor rule*, which has become the primary benchmark for investment decision-making – whether applied through federal statutes (notably ERISA, which governs private pension funds), state statutes implementing uniform laws or the development of state common law often with reference to the American Law Institute's *Third Restatement of Trusts (Prudent Investor Rule).* The modern prudent investor rule, which incorporates both a duty of care and a duty of loyalty, emphasises modern portfolio theory and provides that: • investments are assessed not in isolation but in the context of their contribution to a total investment portfolio; • there is no duty to 'maximise' the return of individual investments, but instead a duty to implement an overall investment strategy that is rational and appropriate to the fund; • the investment portfolio must be diversified, unless it is prudent not to do so; and • the prudence of an investment should be assessed at the time the investment was made and not in hindsight. The effect of the modern prudent investor rule is that institutional decision-makers are given latitude to follow a wide range of diversified investment strategies, provided their choice of investments is rational and economically defensible. The rule recognises that different investments play different roles within a balanced portfolio. Because there is no duty to maximise the return of individual investments, the prudence of any specific investment will only be assessed within the context of the overall investment strategy. There is accordingly no reason why investment strategies should not include investments with positive ESG characteristics. The important limiting requirement is that imposed by the duty of loyalty: all investment decisions must be motivated by the interests of the fund's beneficiaries and/or the purposes of the fund. No investment should be made purely to give effect to the personal views of the decision-maker. Instead, all considerations must be weighed and assessed in the context of their expected impact on the investment portfolio. Moreover, as with all considerations, ESG considerations must be taken into account wherever they are relevant to any aspect of the investment strategy (including general economic or political context, expected tax consequences, the role that each investment plays within the overall portfolio, expected risk and return, and the need for liquidity and/or capital appreciation). In addition, where the beneficiaries have expressed investment preferences in the fund instrument or otherwise, these preferences should also be taken into account. In short, there appears to be no bar to integrating ESG considerations into the day-to-day process of fund management, provided the focus is always on the beneficiaries/purposes of the fund and not on unrelated objectives.

The Freshfields Report has been recently updated to examine 11 jurisdictions (including the US). The report, *A Legal Framework for Impact: sustainability impact in investor decision-making* (2021) has a detailed examination of the US legal context available here: https://www.unepfi.org/publications/a-legal-framework-for-impact-sustainability-impact-in-investor-decision-making/ (pp 510-547)

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