# Beyond Climate: Addressing the Problem of Authoritarianism through ESG

*Javier El-Hage*†

First, I am grateful to the students of the North Carolina Journal of International Law for inviting me to participate in this symposium focused on the topic of Environmental, Governance and Social (ESG) investing, and the policy and legal issues around it. The paper that led to this invitation is one I first wrote in the Fall of 2019 for Prof. William Jannace's Global Capital Markets seminar at Fordham Law School. The paper was published in the Fordham Journal of Corporate and Financial Law in 2021 and was titled, "Fixing ESG: Are Mandatory ESG Disclosures the Solution to Misleading Ratings?"[1]

My paper focused on two things. First, it highlighted the fact that the existing ESG ratings and rankings were largely inconsistent and could mislead investors by making companies that engage in practices that harm the environment appear better than those that are actually leading a clean energy revolution.[2]

Second, my paper posed the question of whether the establishment of a U.S. Securities and Exchange Commission (SEC) mandatory disclosure rule on climate could be a driving force in more consistent and uniform ESG ratings and rankings.[3] For this, I relied heavily on a 2018 submission to the SEC by law professors Cynthia A. Williams and Jill E. Fisch, in response to a "Request For Rulemaking On Environmental, Social, and Governance (ESG) Disclosure,"[4] and a 2019 paper by Prof. Fisch, titled, "Making

---

† Adjunct Professor of Fundamental Lawyering Skills at Fordham University School of Law. Chief Legal & Policy Officer at the Human Rights Foundation (HRF).

1 Javier El-Hage, *Fixing ESG: Are Mandatory ESG Disclosures the Solution to Misleading Ratings?*, 26 FORDHAM J. CORP. & FIN. L. 359 (2021).

2 TIMOTHY M. DOYLE, AM. COUNCIL FOR CAP. FORMATION, RATINGS THAT DON'T RATE: THE SUBJECTIVE WORLD OF ESG RATINGS AGENCIES 10-11 (2018).

3 *See* Javier El-Hage, *supra* note 1 at 376-383.

4 *See* Cynthia Williams & Jill E. Fisch, "Request For Rulemaking On Environmental, Social And Governance (ESG) Disclosure, Commissioned Reports", *Commissioned Reports, Studies and Public Policy Documents Paper* 207 (2018).

Sustainability Disclosure Sustainable."[5]

As of 2019, and this remained largely the case as of the December 2020 submission deadline for the published article, these two seemed to be the most salient issues behind the growing practice and literature around the use of ESG factors by the investment community, particularly in the U.S. capital markets.

Since then, two main developments that I am confident will be debated at length by the experts during this symposium have taken place, both of which are summarized below and can be seen as very brief updates to my paper.

First, while the most influential ESG ratings and rankings have remained inconsistent and their divergence—and the ensuing investor confusion—is now conclusively documented,[6] the issue of ESG investing as arguably a tool to influence both public and private investment policy, particularly on the topic of "climate change," has now garnered mainstream political attention in the U.S. This has incited contention among, broadly, "liberal" and "conservative" policymakers, at both state and federal levels. Liberal lawmakers are generally in favor of allowing pension funds in their states to base investment decisions on ESG factors, particularly "climate change," as something that respects free markets. Conservative policymakers, on the other hand, are generally against allowing for this possibility because they see it as a betrayal and violation of their fiduciary duties to pensioners.[7]

---

5 *See* Jill E. Fisch, *Making Sustainability Disclosure Sustainable*, 107 GEO. L.J. 923 (2019).

6 Florian Berg et al., *Aggregate Confusion: The Divergence of ESG Ratings*, 26 REV. OF FIN. 1315 (2022).

7 *See* David Morgan, *U.S. Congress Votes to Block ESG Investing, Biden Veto Expected*, REUTERS (Mar. 1, 2023), https://www.reuters.com/business/us-senate-poised-consider-blocking-biden-esg-investment-rule-2023-03-01/ [https://perma.cc/4THN-AWHS]; John Frank, *Larry Frank "Ashamed" to be Part of ESG Political Debate*, AXIOS (June 25, 2023) https://www.axios.com/2023/06/26/larry-fink-ashamed-esg-weaponized-desantis [https://perma.cc/AXV2-Y6UL]; David Gelles, *How Environmentally Conscious Investing Became a Target of Conservatives*, N.Y. TIMES (Mar. 1, 2023), https://www.nytimes.com/2023/02/28/climate/esg-climate-backlash.html [https://perma.cc/9U2X-BUXD]; Robert Eccles & Timothy M. Doyle, *It's Time to Take the Unnecessary Politics Out of ESG and Retirement Savings*, REAL CLEAR ENERGY (May 9, 2023), https://www.realclearenergy.org/articles/2023/05/09/its_time_to_take_the_unnecessary_politics_out_of_esg_and_retirement_savings_898242.html [https://perma.cc/X84R-B5RE]; Korey Clark, *Red-State, Blue-State Divide on ESG Legislation*, LEXISNEXIS (May

Perhaps the only point of agreement is that, facing the sizeable reality of pervasive ESG investment products, "greenwashing"—or the practice of exaggerating a company's or an investment product's benefits on the environment[8]—is something to not only be frowned upon but to be watched closely from regulators for their potential as a form of securities fraud.[9]

The second paper-related development that has taken place is that, in April 2022, the SEC issued a proposed new rule titled, "The Enhancement and Standardization of Climate-Related Disclosures for Investors," that would "require registrants to provide certain climate-related information in their registration statements and annual reports."[10] According to the SEC, "[t]he proposed rules would require information about a registrant's climate-related risks that are reasonably likely to have a material impact on its business, results of operations, or financial condition", including the "registrant's greenhouse gas emissions" as well as "certain climate-related financial metrics [ . . . ] in a registrant's audited financial statements."[11] The SEC received more than 5,000 comments on the

18, 2023), https://www.lexisnexis.com/community/insights/legal/capitol-journal/b/state-net/posts/red-state-blue-state-divide-on-esg-legislation [https://perma.cc/A2XG-C4LZ].

8 *See* Adam Hayes, *What is Greenwashing? How it Works, Examples, and Statistics*, INVESTOPEDIA (Jan. 22, 2024), https://www.investopedia.com/terms/g/greenwashing.asp [https://perma.cc/BL3L-9BFJ]; Timothy M. Doyle, *Understanding ESG Objectives and Goals in the Era of Greenwashing*, REAL CLEAR ENERGY (Dec. 19, 2022), https://www.realclearenergy.org/articles/2022/12/19/understanding_esg_objectives_and_goals_in_the_era_of_greenwashing_870755.html [https://perma.cc/43G9-A7BS].

9 Douglas Gillison & Michelle Price, *US SEC Cracks Down on Funds "Greenwashing" with New Investment Requirement*, REUTERS (Sept. 20, 2023), https://www.reuters.com/sustainability/us-sec-poised-ban-deceptive-esg-growth-fund-labels-2023-09-20/ [https://perma.cc/P8PF-CXSU]; David Cifrino, *The Rise of International ESG Disclosure Standards*, HARV. L. SCH. F. ON CORP. GOVERNANCE (June 29, 2023), https://corpgov.law.harvard.edu/2023/06/29/the-rise-of-international-esg-disclosure-standards/ [https://perma.cc/H7T3-FD2J].

10 The Enhancement and Standardization of Climate-Related Disclosures for Investors, 87 Fed. Reg. 21334 (proposed Apr. 11, 2022) (to be codified at 17 CFR pts. 210, 229, 232, 239, & 249).

11 *Id.*

proposed rule,[12] and delayed its adoption[13]—presumably because the comments received have caused it to continue pondering the final text, but likely also because a final adoption is likely to prompt litigation.[14] A modified version of the rule was ultimately adopted on March 28, 2024.[15]

Outside of the immediate focus on climate disclosure and how my paper may be updated four years down the road, however, two serious real-world issues have occurred that warrant a novel look at ESG and its potential to provide positive investment incentives for capital markets worldwide. First was the Covid-19 pandemic that emerged in Wuhan, China, and the unbearable human toll that ensued globally as a result, as well as the financial chaos, poverty and inflation, that continues to reverberate globally.[16] Second was Russia's full-scale invasion of Ukraine, and its continued effect on oil prices and the global economy, including its potential for causing a wider, more deadly, global war.

Regardless of where one's opinion lies on the potential of ESG investing or further climate-related regulation becoming a force for good in curbing climate change, what these two events make clear is that two of the most globally consequential events of the past few years have been either caused or aggravated by governments that do not rule their countries democratically.[17] Instead, these countries are ruled by openly authoritarian or dictatorial regimes with dismal

---

12 Cynthia A. Williams et al., *Review of Comments on SEC Climate Rulemaking*, HARV. L. SCH. F. CORP. GOVERNANCE (Nov. 23, 2022), https://corpgov.law.harvard.edu/2022/11/23/review-of-comments-on-sec-climate-rulemaking/ [https://perma.cc/6CRU-44VV].

13 Soyoung Ho, *SEC Delays Climate Change Disclosure Rulemaking*, THOMSON REUTERS (Jun. 15, 2023), https://tax.thomsonreuters.com/news/sec-delays-climate-change-disclosure-rulemaking/ [https://perma.cc/PC2L-FD46].

14 Jacqueline M. Vallette *et al.*, *US SEC's Climate Risk Disclosure Proposal Likely to Face Legal Challenges*, MAYER BROWN (Apr. 21, 2022), https://www.mayerbrown.com/en/insights/publications/2022/04/us-secs-climate-risk-disclosure-proposal-likely-to-face-legal-challenges [https://perma.cc/F8FZ-YXAL].

15 Note of author: On March 28, 2024, after I submitted the first draft of my symposium presentation, the SEC published "The Enhancement and Standardization of Climate-Related Disclosures for Investors."

16 *See* Nicholas P. Mack, *The COVID-19 Pandemic Highlighted the Need for Mandated ESG Disclosures: Now What?*, 30 U. MIAMI BUS. L. REV. 188, 210 (2021-2022).

17 *See* Alexandra V. Orlova, *Russia's Utilization of the COVID-19 Pandemic: Lockdowns, Re-Sovereignization, and Disengagement from the West*, 29 IND. J. GLOBAL LEG. STUD. 119, 122-123 (2022).

human rights records.[18] Xi Jinping's Chinese Communist Party exhibited an outrageous lack of transparency regarding the origins and its initial handling of the Covid-19 emergency, let alone acknowledge any responsibility for it; the Vladimir Putin regime's disregard for democratic norms domestically grew into an international war with global consequences.[19]

In other words, these two events have made us realize that dictatorial or authoritarian regimes matter. Not only because they abuse the basic rights of the people living in those countries, but because the effects of their actions reverberate across the world economy, including by negatively affecting the prospects of addressing important matters like climate change.[20]

And shouldn't ESG play a role in addressing the issue of authoritarianism? Aren't "human rights" one of the categories covered under the "social" prong of ESG? Shouldn't rating firms and investors worldwide be as interested in addressing the global democratic backsliding, because of their potential for downstream market instability, as they are in addressing the environment? A recent groundbreaking book by author Marcos Buscaglia, *Beyond the ESG Portfolio, How Wall Street Can Help Democracies Survive*, provides a systematic answer to this question, arguing that, to reach its full positive potential, "the 'D' of Democracy should be added to ESG," and so ESG should evolve towards "DESG or ESG+ indexes."[21] Buscaglia relies on the currently-available democracy indexes—by Freedom House, V-Dem and the Economist Intelligence Unit—to determine which countries are considered democratic and which non-democratic or authoritarian.[22]

Unfortunately, as Buscaglia aptly finds, current ESG ratings by the six main ESG rating firms all but ignore the issue of democratic backsliding and authoritarianism, despite the broad categories like "human rights," "labor force" or "supply chain" being among the total of sixty-four categories typically addressed in ESG ratings or

18 *Id.*

19 *Id.*

20 *See generally* Seongjun Park, *War, Cacophony & Beyond: Reexamining and Adding Security to Environmental, Social & Corporate Governance Investing*, 46 FORDHAM INT'L L. J. 251 (2023).

21 MARCOS BUSCAGLIA, BEYOND THE ESG PORTFOLIO, HOW WALL STREET CAN HELP DEMOCRACIES SURVIVE 160 (2024).

22 *Id.* at 160-167.

rankings, drawing from the paper by Berg et al. about the divergence of ESG ratings.[23] Buscaglia also underscores that "ESG scores pay little to no attention to democracy:

> I reviewed several popular books on the subject, including *Your Essential Guide to Sustainable Investing* and *The ESG Investing Handbook*, and they do not so much as mention the word democracy, though they do include some cousins of democracy, such as human rights in one case and corruption in the other. The same pattern emerges for the methodologies of the main ESG score providers. Miranda Cortizo and Connor Fernandez, from my research team, found that S&P Global mentions corruption, bribery, and human rights as part of the S of ESG. Rep Risk mentions human rights abuses and corporate complicity in S, and corruption, bribery, extortion, and money laundering in the G. MSCI mentions corruption and human rights, but does not include them in their ESG key issues. Sustainalytics does not mention any of these.[24]

After finding that democratic countries generally grow faster and are subject to fewer downside risks,[25] Buscaglia argues,

> In my view, index providers should let investors decide whether they want to add a D to the ESG portfolio. **In the sovereign debt market**, index providers should add DESG or ESG+ indices to their product suites. These indices could replicate their ESG indices except for the exclusion of autocratic, or at least of highly autocratic, countries. **In the equity market**, they could exclude companies of highly autocratic countries and quasi-sovereign companies of autocratic and highly autocratic countries. Quasi-sovereigns, as we saw in Venezuela and Russia, are pawns used by their governments to achieve certain domestic or international political goals often not in the best interests of a healthy democracy.[26]

In the last chapter of his book, Buscaglia addresses how the well-known and widely practiced investment strategies of exclusion,[27] positive DESG screening (best in class[28], DESG

---

23 Florian Berg et al., *Aggregate Confusion: The Divergence of ESG Ratings*, 26 OXFORD REV. FIN 1315, 1326-1327 (2022).

24 BUSCAGLIA, *supra* note 22, at 133.

25 *See id.*

26 *Id.* at 171.

27 *Id.* at 180.

28 *Id.* at 183 (" . . . the weights would be rebalanced at the end of the year, or

momentum[29]), DESG integration,[30] DESG impact investment,[31] and DESG engagement,[32] could also be carried out in the context of DESG.

I wholeheartedly endorse Buscaglia's innovative approach. In my experience over a decade and a half as head of policy at the New York-based Human Rights Foundation (HRF), many of the topics

---

whenever the selected democracy index provider releases a new democracy index.").

29 *Id.* at 183-84 (" . . . overweighting, relative to indices such as the MSCI Emerging Markets stock index, companies located in countries that have improved their democracy ratings during the past year, and underweighting the stocks of companies located in countries whose democracy ratings have deteriorated . . . . [D]emocracy indices keep good track of these steps, and a strategy that punishes countries whose democracy standards are deteriorating would deprive the aspiring autocrats of fresh funds to bankroll their ventures before they become full-fledged autocrats. In the same vein, this strategy would help countries that are improving their democratic standards by providing them with more and cheaper funding.").

30 *Id.* at 184, 186 ("To implement a DESG integration strategy, investors, financial advisors, and portfolio managers would have to add an extra layer to ESG to their security selection process, based on democracy indices. There is a relatively simple way to do this in the sovereign bond market . . . . Individual investors, financial advisors and portfolio managers can also check the exposure of different ETFs to autocratic countries on their own thanks to a tool created by the Human Rights Foundation in a joint endeavor with Life + Liberty Indexes. On the Defund Dictators website . . . [t]he tool assigns each ETF a score: the higher the number, the freer the country allocations.").

31 *Id.* at 186 ("There are several alternatives to implement a DESG Impact Investment strategy. One is to invest in Green Bonds from companies and countries that excel in their democracy standards. The greater impact would be when the countries issuing them are Emerging Markets or low-income countries, or are from companies domiciled in these type of countries."). *See also id.* at 187 ("Another democracy strategy that could have an important impact is to invest in sovereign bonds from countries that have just had a significant democracy improvement. One example is if/when the current opposition is able to win the presidency in countries such as Hungary, Türkiye, or Venezuela.").

32 *Id.* at 187 ("DESG Engagement strategies would involve shareholder and bondholder activism to prompt companies to include democracy considerations in their strategies and governments to avoid introducing reforms that undermine democracy. In the case of companies' bonds and stocks, investors would engage companies to try to avoid sourcing too much of their products from undemocratic countries, in which elemental human rights are violated."). *See also id.* at 187 ("In the case of sovereign issuers, big investment houses could engage with the issuers to warn them that if they cross certain democratic thresholds, such as the packing or the Supreme Court or of the body that appoints judges, they will not participate in future debt auctions."). *See also id. (*"This special access [enjoyed by big investment houses and companies that are about to make an important investment decisions] could be used to prompt leaders at least to take small steps to improve human rights conditions in their countries, such as the release of political prisoners.").

considered among the sixty-four ESG categories (for example access to basic services, access to healthcare, health and safety, indigenous rights, labor practices, or water) are in fact risks that tend to be exacerbated by authoritarian regimes when the companies owned by these regimes or subservient to them have big exposure to those countries.[33] This typically occurs because these companies (a) are headquartered or based in an authoritarian regime; (b) source their materials from authoritarian regimes; or (c) their revenue is generated from consumers in authoritarian regimes.[34]

While we await to see the practical consequences of the recently-adopted rule on climate disclosure, I invite you to start thinking of how adding the D of Democracy to ESG may be another step in the right direction.

---

33 Thor Halvorssen, *Starving for Food, Thirsting for Freedom*, HUFFPOST (Dec. 6, 2017), https://www.huffpost.com/entry/starving-for-food-thirsti_b_784196 [https://perma.cc/PQL3-EAY3].

34 *Id.*