ESG Treatise Part 2 – United Nations Global Compact – Whether to Join or Not?

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Davis Polk's series on environmental, social and governance ("ESG") standards continues with a discussion of the United Nations Global Compact ("UN Global Compact"), an internationally recognized principles-based ESG corporate disclosure and values framework. The series began with a discussion of the UN's Principles for Responsible Investment ("PRI"), available **here**. A future article will discuss the UN's Sustainable Development Goals ("SDG"), seventeen cutting-edge principles that the investment community is beginning to incorporate and which will impact all PRI and UN Global Compact signatories.

The UN Global Compact, launched in 2000, remains one of the most relevant ESG frameworks as the largest corporate sustainability initiative in the world and, unlike PRI, is targeted at corporations more generally. Several financial institutions are signatories to both UN initiatives.

Many corporations, particularly in the financial services industry, are often urged to join the UN Global Compact. This article provides an overview of the UN Global Compact and discusses potential implications for businesses that agree to sign onto it. Below is a snapshot summary of the key impacts:

Considerations/Costs	Benefits/Opportunities
Annual reporting/disclosure requirements that may become more onerous over time	Improving third-party ESG ratings (e.g., Sustainalytics) and other "halo effects" (i.e., participation as an imprimatur of good governance and long-term value)
CEO-level commitment renewed annually	Keeping up with peer companies that are members
Integrating/coordinating Global Compact reporting/disclosure with other ESG disclosure (e.g., SEC disclosure, PRI, GRI and corporate sustainability reports or website)	Satisfying or proactively heading off demand to measure, report and/or improve ESG impact by stakeholders (e.g., shareholders or other investors, lenders, suppliers and customers)
Annual financial contribution	A relatively easy way to "get credit" for what companies (particularly, large internationals) may already be doing in the ESG space
Delisting can adversely affect reputation	Can improve operational and financial performance (particularly companies with operations in less developed countries)

Overview

On July 26, 2000, the UN launched its Global Compact to encourage businesses around the world to adopt and report on their sustainable and socially responsible policies. It has since become a major ESG initiative with over 9,500 company members in over 160 developed and developing countries.[1] The UN Global Compact's voluntary, principle-based policy initiative encourages companies to pledge to

[1] https:/www.unglobalcompact.org/what-is-gc?lnkid=About-the-UN-Global-Compact-DA.

"implement universal sustainability principles and to take steps to support UN goals" in the four areas of human rights, labor, environment and anti-corruption.[2] Members signal support for the following Ten Principles and pledge to integrate them into their business operations:

Category	Principles
Human Rights	1. Businesses should support and respect the protection of internationally proclaimed human rights; and 2. make sure that they are not complicit in human rights abuses.
Labor	3. Businesses should uphold the freedom of association and the effective recognition of the right to collective bargaining; 4. the elimination of all forms of forced and compulsory labor; 5. the effective abolition of child labor; and 6. the elimination of discrimination in respect of employment and occupation.
Environment	7. Businesses should support a precautionary approach to environmental challenges; 8. undertake initiatives to promote greater environmental responsibility; and 9. encourage the development and diffusion of environmentally-friendly technologies.
Anti-Corruption	10. Businesses should work against corruption in all its forms, including extortion and bribery.

Currently, 32 US companies and 724 international companies that classify themselves as banks or financial services firms are UN Global Compact signatories, including a few large US-based financial institutions and asset managers.[3]

Membership – Pros and Cons

Joining – CEO/Financial Commitment

Companies can participate in the UN Global Compact as either participants, a more rigorous commitment, or signatories. Participants engage with the UN Global Compact principles at a global level while signatories only need to on a national or regional level. Signatories and participants make the following annual contributions based on annual gross sales or revenue:[4]

Category	Required Annual Contribution	
Company Revenue Tiers by Annual Gross Sales/Revenue	**Participant**	**Signatory**
> USD 5 billion	USD 20,000	USD 10,000

[2] https://www.unglobalcompact.org/about.

[3] A full list of US-based signatories that define themselves as banks or financial services companies (including equity and non-equity investment companies), is available at https://www.unglobalcompact.org/what-is-gc/participants/search?utf8=%E2%9C%93&search[keywords]=&search[countries][]=209&search[sectors][]=16&search[sectors][]=19&search[per_page]=50&search[sort_field]=&search[sort_direction]=asc.

[4] https://www.unglobalcompact.org/docs/publications/UNGC-Value-Proposition.pdf at page 4.

USD 1 – 5 billion	USD 15,000	USD 7,500
USD 250 million – 1 billion	USD 10,000	USD 5,000
USD 50 – 250 million	USD 5,000	USD 2,500
USD 25 – 50 million	USD 2,500	Local Network fee may apply
< USD 25 million	USD 1,250	Local Network fee may apply

Participants enjoy access to more comprehensive resources than signatories, including the UN Global Compact help desk and support services to assist with engagement and sustainability efforts, tailored road maps for advancing the UN Global Compact goals and invitations to UN Global Compact events. Additional information on the resources available to signatories and participants is available **here**.

To become either a participant or signatory, a company must prepare a Letter of Commitment signed by the highest executive officer expressing the organization's commitment to (i) the UN Global Compact and its Ten Principles, (ii) take action to support UN goals and (iii) annually submit a Communication on Progress ("COP") report (discussed below).[5] Applicants must include information on their size, location and sector. The Letter of Commitment is posted and made publicly available on the participant or signatory's profile page on the UN Global Compact website.

Reporting Requirements

The main requirement of membership, and the one most measured, is the production and publication of an annual Communications on Progress ("COP") report. COP reports vary considerably in form: new and/or smaller company signatories use an Express COP[6] (three yes-or-no questions) or a basic web-based template.[7] More established participants submit reports that tend to be in the eight-ten page range, often incorporated into larger corporate responsibility or sustainability reports for stakeholders.[8] Regardless of format or length, the COP report, including an Express COP report, must include: (i) a statement by the CEO expressing continued support for the UN Global Compact and its goals; (ii) a description of practical actions the company has taken or plans to take to implement the Ten Principles; and (iii) a measurement of outcomes.[9] Finally, members must integrate their COP reports into their main stakeholder communications, usually annual or sustainability reports, and submit their COP reports for publication on the UN Global Compact website, along with a so-called self-assessment that briefly summarizes its content.[10]

Effect on ESG Ratings and Reputation

A company might consider joining the UN Global Compact to signal to stakeholders that it values corporate governance and/or to attract business. COPs from all years of participation are available on the UN Global Compact website, allowing interested parties to track the level of involvement of and implementation by the company. Although the UN Global Compact focuses on disclosure rather than performance, it still provides a way for companies to differentiate themselves, including by conforming

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[5] The CEO letter is submitted with an online application form available **here**. Additional information on the CEO letter and application process is available **here**.

[6] **https://www.unglobalcompact.org/docs/communication_on_progress/express-cop-faq.pdf.**

[7] **https://www.unglobalcompact.org/docs/communication_on_progress/Basic_COP_Step_by_Step_Guide.pdf.**

[8] **https://www.unglobalcompact.org/docs/communication_on_progress/COP_Submission_Step_by_Step_Guide.pdf.**

[9] **https://www.unglobalcompact.org/docs/communication_on_progress/COP_Policy.pdf.**

[10] **https://www.unglobalcompact.org/participation/report/cop/create-and-submit/active.**

their COPs to the "Advanced" classification. These Advanced COPs provide information on the following additional criteria:

1. implementing the Ten Principles into strategies and operations,
2. taking action in support of broader UN goals and issues, and
3. corporate sustainability governance and leadership.

Companies can also distinguish themselves by being a part of the UN Global Compact 100, a stock index made available for license to third-party investment companies, composed of a representative group of signatories that have both demonstrated strong implementation of the principles and base-line profitability.[11] Sustainalytics, an ESG ratings firm used by many investors, in partnership with the UN Global Compact, assesses participation in this **list** on a yearly basis. Although external agencies' methodologies for their **ESG performance ratings** are proprietary, participation in the UN Global Compact may impact ratings of performance. While not explicitly considering membership in the UN Global compact as a factor for assigning ratings, several ESG rating agencies and tools, including RepRisk and Arabesque's S-Ray, assess companies on factors which map onto the Ten Principles of the UN Global Compact. Additionally, information from UN Global Compact COPs has been incorporated on the Bloomberg Professional service since 2009, increasing the ease with which both the fact of membership and the information contained in COPs can be incorporated into ESG rankings and investment decisions more generally.[12] As with any public disclosure, signatories should expect that shareholders and others will review any disclosures made in the COP report and may use the information to benchmark performance and measure progress with respect to sustainability metrics. Some companies, including Sustainalytics, even provide UN Global Compact compliance services to help investors identify companies that breach or are at risk of breaching the principles.[13]

Overlap with Other ESG Disclosure Requirements or Standards

In thinking about signing on to the UN Global Compact, would-be members should consider not only the requirements of the COP report, but also how such requirements overlap with or contradict other disclosures or reports, including those for other standards and resulting management time required. This assessment will help streamline administrative requirements, avoid inconsistencies in public reports and ensure complete public disclosures in all reporting regimes, including in SEC public filings or publicly available sustainability reports. For example, although the UN Global Compact aligns with the Global Reporting Initiative ("GRI") reporting criteria, facilitating integration of the information gathered in the GRI reporting process, it would still require attention. To address this need, the UN Global Compact's website provides guidelines for using GRI criteria to prepare the COP report.[14] With regard to PRI which disclosure framework is summarized in our prior **memo**, there is considerable overlap between PRI and the UN Global Compact. That said, PRI provides considerably more flexibility regarding which issues signatories choose to address; often they are market-specific and identified by the organization in conjunction with the signatories. In contrast, the UN Global Compact requires, in its COPs, a description of the practical actions taken by the company regarding all four of the issue areas (or an explanation as to why it failed to do so), suggesting that would-be signatories ought to consider all areas of its Ten Principles. Moreover, the UN Global Compact has begun to implement integrity measures, including requiring that members engage in dialogue within two months of a credible allegation of abuses. If not addressed, these

[11] **https://www.sustainalytics.com/global-compact-100/#1484940111013-e737689d-f242.**

[12] **http://www.csrwire.com/press_releases/27659-Global-Compact-Participant-Reports-Now-on-Bloomberg.**

[13] **https://www.sustainalytics.com/global-compact-compliance-service/.**

[14] **www.unglobalcompact.org/library/306.**

members would be downgraded to "non-communicating" or possibly expelled. Taken together, if a company is able to meet the more strict requirements of the UN Global Compact, then also signing onto PRI could be a reasonable next step to demonstrate to stakeholders and potential clients its commitment to ESG issues, as PRI adds primarily procedural obligations only to the UN Global Compact's substantive requirements.

Delisting

Members that do not produce the required COP reports (or that otherwise fail to make efforts with respect to the Ten Principles) run the risk of being delisted from the UN Global Compact. Since 2000, thousands of companies have been delisted, though the delisting rate is significantly higher among smaller companies with limited sustainability reporting in place than it is among large international companies.[15] The UN Global Compact website classifies over 390 banks and financial services companies as delisted (with an additional 72 classified as non-communicating, a status that if not remedied within a year of notice leads to delisting).[16] [17] Companies could face significant negative public attention if delisted.

Risk of Changing Requirements

It is possible that the UN Global Compact's requirements will become more rigorous in the future. Over the years, the UN Global Compact has introduced measures that place higher burdens on signatories: it introduced the concept of delisting in 2008; reduced the number of months allowed for a signatory to fail to respond to an abuse allegation from three months to two in 2009; began differentiating between Advanced and Active members in 2010 in order to incentivize increased participation through a maturation process; and began including SDG reporting in 2016 to enable a "truly global business contribution to the UN's 2030 agenda for sustainable development."[18]

If you have any questions regarding the matters covered in this publication, please contact any of the lawyers listed below or your regular Davis Polk contact.[19]

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[19] The authors gratefully acknowledge the assistance of law clerk Aru Gonzalez in preparing this memorandum.

[15]**https://www.researchgate.net/publication/225555387_Company_Delistings_from_the_UN_Global_Compact_Limited_Business_Demand_or_Domestic_Governance_Failure.**

[16] **https://www.unglobalcompact.org/participation/report/cop/create-and-submit/expelled.**

[17] **https://www.unglobalcompact.org/participation/report/cop/create-and-submit/non-communicating.**

[18] **https://www.unglobalcompact.org/sdgs/action-platforms.**