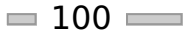


Risk 2023: Déjà Vu All Over Again

By Beth Siegert and Matthew Bey



Listen to article



Boards continue to be challenged by the war in Ukraine, China relations and ESG expectations.

This year, geopolitical, climate change and environmental risk will again dominate global headlines. We are at the world not only faces a crucial inflection point, not only in relations between the West and the rest of the world, but also over ESG investment strategies and corporate policies in the private sector. Four interrelated themes will play out, and board members of multinational corporations should track them closely. These include the ongoing Ukraine war, the global economic slowdown and cost-of-living crisis, growing U.S.-China

scrutiny over ESG corporate policies.



The war in Ukraine is unlikely to end

in 2023, so risks associated with it will persist for the foreseeable future. Not only will sanctions multiply in 2023, but also the risk of escalation will increase as the West ships more advanced weaponry, such as battle tanks, to the Ukrainian military. Moreover, Russia's strategic interest in targeting Western companies with a litany of cyberattacks remains high even though the number of ransomware attacks declined in 2022. The fallout from the war will likely lead to sustained high oil prices and strain between the West and non-Western countries, such as Saudi Arabia, that are unwilling to take a tougher position on Russia's invasion of Ukraine, limiting the West's ability to influence OPEC+ decision-making. The continued failure to get other countries on board with restrictions will

lead to growing compliance risks for businesses in countries including the United States, the United Kingdom and the European Union, which will likely need to step up their sanctions-enforcement efforts, increasing scrutiny in places where Russian businesses have sought to skirt sanctions, such as the Middle East, China, India and Turkey.

Although inflation may have peaked in places like the United States, the global cost-of-living crisis will continue this year, as energy and food prices are likely to remain high, with many of the drivers of high energy and food prices remaining in place. In the developed world, the European Union will continue diversifying away from Russian natural gas, but Europe's purchase of high-priced, liquefied natural gas will undermine the continent's industrial competitiveness, as it is no longer buying cheap Russian gas, and the gap between U.S. and European natural gas prices will grow accordingly. High European liquefied natural gas demand, coupled with growing Chinese demand following the end of its "zero-COVID" strategy, is likely to wreak havoc on developing countries struggling to afford more expensive natural gas. South Asian countries have borne the brunt of this from a political risk perspective thus far, but African and Latin American countries facing higher food and energy prices are likely to see even more political risk in 2023.

The United States and some of its allies will continue to impose more restrictions on China's technology sector in 2023 and, as recent Chinese spy balloon incidents demonstrate, any guardrails Washington and Beijing try to place on their competition will be fragile. Expanded U.S. export controls on the semiconductor industry announced in October 2022 marked a significant shift in the U.S. strategy against China, demonstrating that the United States would go beyond restrictions on individual Chinese companies to sector-wide restrictions, a trend likely to continue in 2023. Beyond the semiconductor industry, similar export controls are likely on other critical sectors, including quantum computing and artificial intelligence. Although less likely, restrictions on cloud computing, biotechnology and Chinese apps are also possible. The United States is also likely to place restrictions on outbound investment, either through an outright ban on investment into certain sectors or eventually through a screening mechanism that could block certain investments.

The big question, however, remains whether China will start to retaliate against Western companies with operations in China. Thus far, Beijing has refrained from doing so on a broad scale, likely over fears that it would only accelerate U.S. restrictions on China (and make it easier for the United States to convince other

countries to follow suit) and give foreign companies an incentive to leave China altogether. Still, the highly effective U.S. restrictions on China's semiconductor industry will likely lead at some point — and potentially as early as 2023 — to Beijing's being forced to target Western companies. China is more likely to do so in industries such as retail and food services, which it deems less crucial to its economic ambitions.

This year, we expect to see companies grappling with meeting ESG expectations from investors, employees and other stakeholders while maintaining profits and exercising fiduciary duty. With pending or indicated proposals from the SEC focusing on climate, human capital management and board diversity disclosures, and with investors and proxy advisory firms pressing for companies to voluntarily disclose ESG topics in the interim, opportunities for scrutiny will increase. In the United States, ESG matters are highly politicized. This means that disclosures, whether voluntary or required, could subject companies to potential liability as well as reputational and political risks. Any disclosures companies make should be thoroughly reviewed and vetted, and any ESG-related commitments must be made with a thoughtful rationale about how they promote the success of the company. Directors and boards should remain apprised of shareholder ESG litigation and derivative claim strategies, as recent settlements in the United States and the United Kingdom reveal a playbook that activist shareholders will likely seize upon and execute widely in 2023. Although the current uncertain economic outlook may cause companies and investors to prioritize near-term returns over ESG progress, interest in ESG matters over the long term is not expected to wane. Boards and directors should continue to engage critically in a manner consistent with their fiduciary responsibilities.

Beth Siegert is senior legal, regulatory and compliance analyst, and Matthew Bey is senior global analyst at RANE Network Inc.