

# ESG Disclosure and Compliance: Navigating the Confusion

Tailored risk assessment, accountability and engagement helps guide board strategy. By Ken C. Joseph and Nicole Y. Lamb-Hale

Shifts in the social, economic and geo-political landscape place boards under pressure to expand their obligations well beyond the direct needs of their corporation and its shareholders. In addition to grappling with issues that face the corporation, directors, it seems, must now place the greater social good on their dashboards and collectively develop probing expertise on issues as far ranging as: climate change, diversity, benefits, privacy, data security, etc. They are now expected to balance profitability and value-creation goals with the demands of a broader community of stakeholders, including possible misaligned perspectives of regulators, employees, counterparties, consumers, investors and noninvestors — all of whom claim a vested interest in the corporation's practices and community impact.

There are a number of steps a board should take to adequately address environmental, social and governance issues (ESG).

**The first step** is often overlooked in the rush to respond to the latest headline or perceived threat. To identify and measure the impact of ESG factors on an entity, boards are advised to commission a holistic risk assessment and leverage expertise available to them. This initial step involves a candid assessment — or reassessment — of the strengths, opportunities, weaknesses and threats across geographies facing the corporation, and defining what it takes for the entity to grow responsibly. This may require outside ex-

pertise to ensure that the board is well equipped with the tools it needs to navigate and mitigate the myriad of complexities and risks with respect to ESG. The fact that the ESG landscape and the competitive pressures are continuously evolving requires ESG to be a regular agenda item for the board.

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**Second**, ensure that management formulates a tailored, coherent, flexible and realistic strategic plan for board review that specifically includes the mapping of all applicable short- and long-term ESG factors that impact the entity in all markets where the company's products, intellectual property or services have a touchpoint. The strategic plan should include factors that measure progress towards goals and detail how the enterprise will wield its competitive advantage responsibly. The board's review and oversight of the resulting strategic plan should include priorities for execution, an assignment of responsibility for each priority and escalation and crisis management components.

**Third**, assign accountability and tap management's expertise. Given the punishing impact that governance and ethics missteps can have on enterprise value and sustainability, the board and management should perform a culture audit to assess whether the core values of personnel at all levels are aligned with the core values and priorities that the organization has identified as keys to its success. "Tone at the top" no longer suffices, and must be replaced by tone throughout the organization, including in remote locations where it operates. Training initiatives should be conducted to educate and gain buy-in from company personnel. Boards should advocate to appoint an ESG officer/champion charged with evaluating and reporting to the board on the company's standards, relationships and practices. Boards, whether via a special committee or standing committees, must ensure that they have the qualified expertise and skills to effectively evaluate whether the ESG risks have been properly identified, measured and prioritized. The board should ensure that management performance, accountability and compensation factors are defined clearly and calibrated properly to incentivize adherence to the enterprise's mission and ESG goals.

**Fourth**, review and update disclosures and statements by, or on behalf of, the company. In an era where private litigants, regulators, consumers and competitors stand ready to pounce on actual or perceived ESG missteps, often resulting in costly financial and reputational penalties, boards should commission a review of both public and internal statements that are related to the company's ESG practices. While competent counsel, management and boards are often focused on public risk disclosure statements, internal communications review is often overlooked. Internal communications provide insight into the culture and penetration of core values throughout the organization; communications, which are often intended for internal or private use, can provide fodder for whistleblowers, hackers and others purportedly seeking to hold the enterprise accountable

for its activities. The resulting reputational and financial damage could be immeasurable. Such review should be conducted in accordance with legal and privacy considerations.

**Fifth**, engage with and seek guidance from regulators and standard setters. Reporting standards for socially responsible and sustainable business practices, along with accurate measures for ESG compliance, suffer from a relative lack of definition and are often conflicting across jurisdictions and constituents. This can expose even the most well-meaning enterprise to litigation and reputational claims that are informed primarily by hindsight. As part of the board's and management's strategy to protect the best interests of the corporation and its shareholders and to reduce the costs of compliance, boards are advised to influence the development of clear standards that are harmonized, to the fullest extent possible, across industries and jurisdictions. While this strategy has a longer-term focus, directors and managers need to harness their clout to actively influence policies and standards under which they are expected to comply.

Companies that employ ESG factors and shift away from a myopic reliance on financial metrics to assess value can benefit in the long-term from generating alpha, lowering funding costs, avoiding litigation and reducing reputational risks, in addition to increasing the possibility that they outperform their non-ESG-focused peers. Regardless of one's view on whether the focus is better prioritized as GSE, SEG or SESG (shareholder first!), directors must employ a 360-degree multidimensional focus. What was true yesterday is still true today: good corporate citizenship, risk assessment, planning and execution correlates with long-term value creation and sustainability. ■

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