6 Steps for Effective ESG Oversight

Compliance and Ethics

Environmental

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Environmental, social and governance (ESG) matters have been a subject of increasing focus for companies, regulators, investors, and other stakeholders. Effective oversight by boards and management over ESG-related matters have simultaneously become the subject of increasing scrutiny.

For example, several greenwashing lawsuits have been filed against companies alleging fraud and related theories of liability for the environmental claims made in their advertising. In addition, the Nasdaq Stock Market recently updated its listing standards to specify minimum board diversity standards and disclosure tables for public companies, and institutional investors and advisory firms have developed policies to vote against company directors and/or proposals for companies that do not fulfill certain diversity ratios and disclosures regarding their boards and management. As for federal regulators, the US Securities and Exchange Commission's (SEC) Climate and ESG Task Force recently settled its first case over a company's ESG-related disclosures and alleged misrepresentations, resulting in a settlement of almost US$56 million. Certain states have also attempted or considered regulation in this area.

Companies need to know about the SEC's evolving stance on ESG to stay compliant. Artwork by AevanStock / *Shutterstock.com*

These types of actions demonstrate that inquiries regarding ESG disclosure will continue, which means companies must keep ESG matters at the forefront of risk management.

Effective board and management oversight of ESG matters is crucial. Below are some practical tips to consider incorporating into your ESG oversight model.

Board oversight of ESG-related matters

Boards must consider three key areas with respect to its oversight of ESG-related matters:

1. Training of board members in relevant areas

As boards continue to focus on ESG, there are steps they can take to gain relevant ESG knowhow. First, a company's nominating and corporate governance committees (or equivalent) should consider whether nominating individuals with ESG expertise relevant to the company's business or industry would be warranted. Companies should also consider offering training to current board members on trending and relevant ESG topics, which is particularly important for boards without any current ESG expertise. Board members could also be paired with executives, other employees, or third-party ESG experts for training and input.

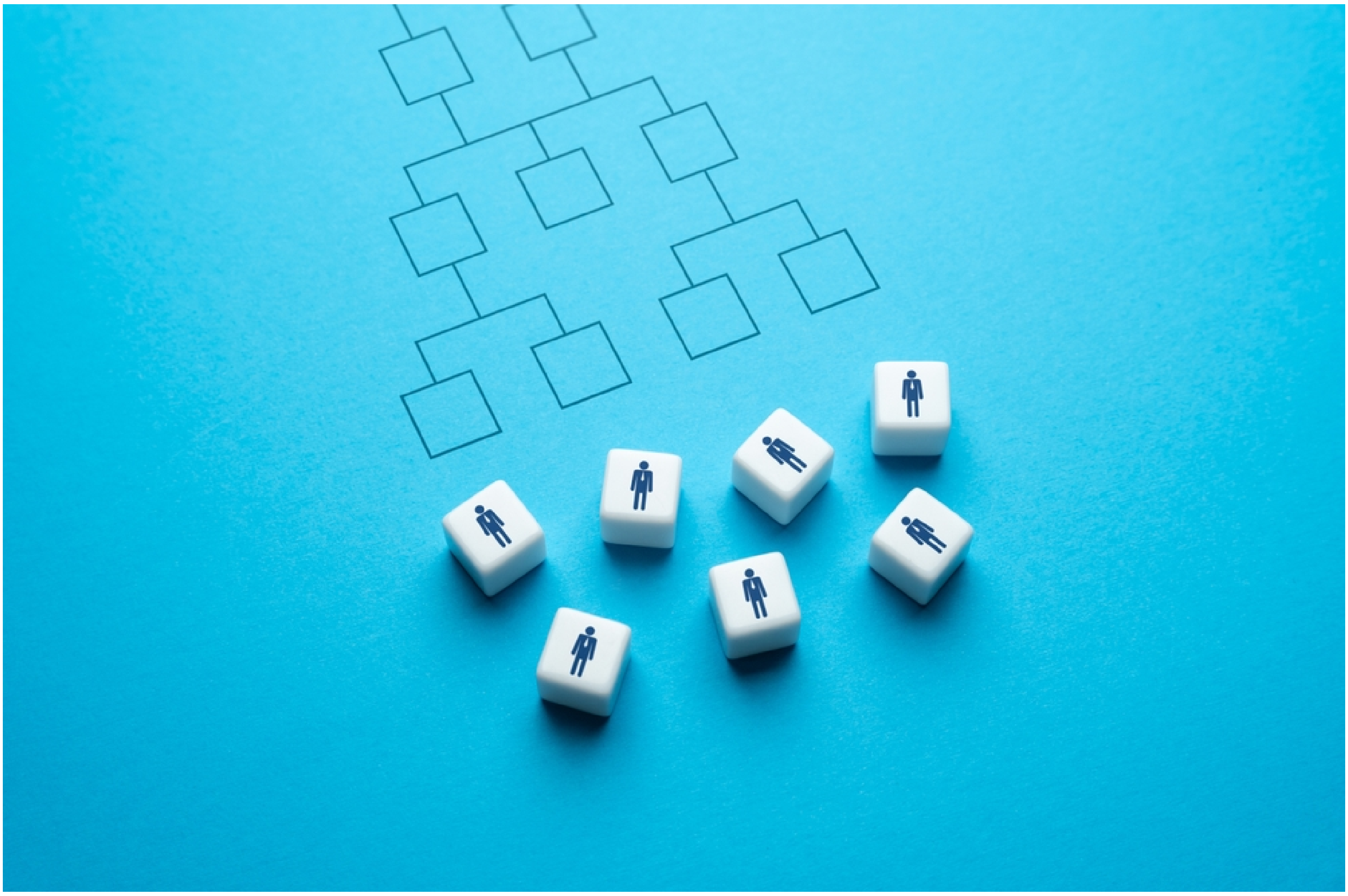
With the pending climate change and cybersecurity disclosure rules the SEC proposed last year, boards should also consider how disclosure regarding any climate-related and cybersecurity expertise would appear if related disclosure requirements were ultimately passed.

2. Clear delineation of ESG oversight responsibilities

While oversight of ESG-related matters falls on the entire board, many companies delegate ESG oversight to single or multiple committees of the board, such as the audit committee or nominating and governance committee.

Given the breadth of issues that fall under ESG, specific subsets may be delegated to different committees as these matters fall within their various purviews.

For example: diversity matters to the compensation committee, cybersecurity to the audit committee, program governance to the nominating and corporate governance committee



Companies should ensure that the roles of each committee and overall board are clearly delineated. Artwork by Andrii Yalanskyi / *Shutterstock.com*

Further, some companies should consider whether forming a specific ESG or sustainability committee would better serve ESG oversight, given their industry and business. Companies should ensure that the roles of each committee and overall board are clearly delineated in the respective committee charters and corporate governance guidelines, including the frequency with which ESG matters are discussed with the entire board. If delegated to a committee already in existence, companies should amend that committee's charter to expressly include ESG oversight. If delegated to a new committee, companies should ensure clarity of ESG responsibility in that committee's charter. Even if delegated to a committee, the board should still regularly discuss ESG as it relates to risk management.

3. Reliable communication with management

The board's ESG oversight includes appropriate and frequent communication with management, so mechanisms should be implemented to ensure an appropriate reporting structure. This might include set frequencies with which the board and management meet to discuss certain ESG matters and easy access by board members to management overseeing ESG matters.

> Board and management discussions should encompass ESG-related policy approvals and updates, progress on ESG metrics and goals, alignment between actual ESG practices and company objectives, as well as public communication consistency.

Board and management discussions should encompass ESG-related policy approvals and updates, progress on ESG metrics and goals, alignment between actual ESG practices and company objectives, as well as public communication consistency. For publicly traded companies, SEC disclosure also forms a vital part of these discussions. Additionally, shortfalls to previously set goals should be a regular part of leadership review, with a plan to rectify and update stakeholders of relevant changes.

Management oversight of ESG-related matters

Management must prioritize ESG-related goals, progress, and disclosures by ensuring the following areas are present:

1. Appropriate ESG expertise

Just as board expertise can be expanded to cover ESG matters, management should be trained and attuned to the ESG matters that are relevant to the company. Management should identify areas in which the company needs additional expertise and either provide training for current members of management or consider whether to hire individuals and/or retain third-party experts.

2. Qualified personnel to manage ESG-related matters in sufficient numbers

As ESG matters remain a priority, companies should ensure that employees with ESG expertise are not stretched thin with additional responsibilities that would take away from effectively fulfilling their respective ESG oversight roles. Additionally, personnel should have the budget and resources needed to make ESG a priority. This will become a higher priority for companies as the SEC and other regulators continue to propose comprehensive ESG-related laws and regulations. Note also that the anticipated expenses included in the SEC's proposed climate change rules last year are considered to fall short of the actual expenses that some companies may incur to effectively implement the rules. This is particularly the case when hiring and/or training personnel and third-party services to help implement the rules.

3. Cross-departmental coordination for ESG-related goals and disclosure

Various departments must communicate, collaborate, and coordinate with each other on ESG-related goals and disclosures. Several management models exist for ESG implementation and collaboration. One such model is for a company to have a Chief Sustainability Officer (or equivalent dedicated senior position) leading coordination and working with heads of various departments involved with ESG affairs. At a minimum, the departments involved should include legal, investor relations, finance, and human resources. A cross-departmental committee is often formed with representatives of these various departments and chaired by the Chief Sustainability Officer.

ESG collaboration isn't just good ethics; it's good business. Artwork by eamesBot / *Shutterstock.com*

4. Legal and investor relations departments closely connected to ESG-related matters

The importance of involving and integrating legal and investor relations departments cannot be overstated. Historically, these departments often operate separately from others involved in ESG and are brought in at the final stages of disclosure review and preparation. This frequently results in the unspoken expectation of effectively “rubber stamping” the proposed disclosure without having an appropriate opportunity to vet it for accuracy and compliance. As regulators and investors are increasingly scrutinizing ESG reporting, it becomes essential to involve both departments early and regularly. To do so, some companies have created an ESG subcommittee within the existing investor relations department to closely monitor and coordinate related disclosure in which legal personnel also are involved.

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5. Keep in touch with industry peers

As regulations, expectations, and codifications of ESG-related practices and disclosures continue to evolve, an important aspect of keeping abreast of current ESG practices and disclosures is looking to what peer companies are doing. It is helpful for companies to utilize relationships, industry associations, and publicly available information to monitor evolving practices in the ESG space with respect to companies it considers peers — by industry, size, and/or other measures.

6. Data quality control

While companies face pressure from various stakeholders to ramp up ESG-related goals and disclosure, it is imperative to ensure the quality of data that is used to produce such disclosures and goals is reliable, consistent, and thoroughly vetted. Companies cannot expect to produce quality disclosure and meaningful goals without undertaking the thorough process that precedes their publication. Preparatory steps include careful internal monitoring, collection, oversight, vetting, and cross-departmental collaboration to produce the data points that will ultimately make quality public disclosure and informed goals.

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Steering the course

Effective board and management oversight of ESG-related matters has become increasingly important for public and private companies. What exactly is considered effective is an equally evolving perspective amongst investors, regulators, and other stakeholders, and companies should be prepared to reassess and adapt oversight models amidst these changes.

The steps described above will help companies prepare for effective ESG oversight as many unknowns await, particularly with respect to pending rule proposals and developing viewpoints by various stakeholders.

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