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What directors are asking about sustainability

Mar 06, 2018

Governance teams and advisers fielding growing number of inquiries about ESG issues

Sustainability is increasingly being considered as a material risk – and opportunity – issue by investors, elevating it to a subject that must be discussed in the boardroom. To help you prepare your board, we've listed the top six questions directors have asked us recently about sustainability-related matters.

1. Our board is comfortable with its governance (G) efforts. Do we need to expand our attention to environmental (E) and social responsibility (S) matters?

For most of the 20th century, companies operated under one guideline: increase shareholder value. Worrying about anything other than financial metrics was unnecessary; board governance was not given much attention. Then an array of events – including the Enron and WorldCom scandals, the 2008 financial crisis and the passage of the Sarbanes-Oxley Act and Dodd-Frank Act – rattled the governance world, causing directors to reassess how they did their work.

Adopting best practices became the norm. But today, thinking only about G is no longer enough. Boards must focus on E and S. Employees, customers and investors are increasingly using their capital market powers to encourage responsible practices and oversight of environment, energy, sustainability, human rights and workplace issues – elements these stakeholders believe contribute to long-term value.

Directors must leave their comfort zone and respond in order to keep pace with competitors. BlackRock CEO Larry Fink in his 2018 letter to CEOs highlights BlackRock's increasingly active approach to engagement, its view that boards are central in the oversight of companies' long-term strategic direction and what he believes is a connection between companies' management of ESG risk factors and long-term value creation.

2. How do we know where our company's sustainability efforts stand?

Rigorous competitive benchmarking is crucial to understanding how your company's sustainability efforts compare with sector and proxy peers. It is challenging to get a complete sense of how your efforts are viewed by others. Perception studies are helpful, but may only include one or two constituency participant groups before becoming unwieldy.

Until recently, general rules of thumb included assumption that E was only important to environmental activists, S to customers and employees and G to shareholders – but that's no longer the case. In addition, the historically compartmentalized focus on proxy voting services and ESG raters and rankers are also blurring.

3. How can we gauge the amount of attention our sector is getting on sustainability matters and what competitors do?

Trade associations are a good place to start; many have added sustainability commentary. Look also to accounting firms and proxy voting services. KPMG has been surveying sustainability reporting for years and just published its 2017 survey results in a report titled, *Corporate responsibility reporting: Where are we, what is the road ahead*.

ISS this year unveiled its new E and S quality scores for an initial 1,500 companies, expanding beyond core G scores, which are expected to be given to roughly 5,000 companies in 2018. In addition, the Governance and Accountability Institute recently launched a management briefing series to provide continuing educational sharing geared to corporate executives.

4. How should we prepare for an investor inquiry?

Institute regular investor relations-sustainability briefings to the board. Build internal sustainability finance and accounting bench strength to support data analysis and sustainability performance-related information integrity.

A recent article in *The CPA Journal* says sustainability is becoming 'a unique opportunity for the accounting profession'. CFA Institute now tests sustainability-related proficiency in all three levels of its certification exam. Ensure your company has the appropriate talent and resources.

5. Can collaboration between IR and sustainability teams be a competitive advantage for us?

Companies that integrate an ESG plan with operations, and co-ordinate these efforts with IR, are better prepared to talk with institutional investors that are increasingly focused on ESG performance. Getting the right message out and ahead of others in your industry gives your company a competitive advantage. This is one of the key findings of the Conference Board's recent report on sustainability practices.

‘Corporate sustainability reporting – the disclosure of [ESG] practices – continues to transition from an exercise in transparency to a more targeted and strategic mechanism for companies to engage with stakeholders,’ the report’s authors write.

As a note of caution, only about 20 percent of ESG disclosure translates to effective IR material ESG messages, based on 2017 research published by Deloitte. It is very important for the CFO to be involved in this collaboration.

6. How do we know if we have an effective board oversight approach?

Ensure directors are talking with management about ESG issues, confirm there is a process for elevating ESG competitive information to the board and put ESG on the board agenda. Ask management how it assesses the risks arising from conducting, or not conducting, ESG initiatives. Discuss the following:

· What does ESG mean to us?

· Do our leaders incorporate ESG factors into operations and board reporting?

· What are our competitors doing, and what is our industry’s standard?

· How do we turn ESG into a competitive advantage?

· What high-impact ESG events could impact our operations?

Denise Kuprionis is founder and president of the Governance Solutions Group and Pamela Styles is founder and principal of Next Level Investor Relations

How to improve your board’s sustainability game plan

Mar 12, 2018

Ten tips, ranging from leadership to positive thinking

In the second part of a series on boards addressing ESG matters, Denise Kuprionis and Pamela Styles suggest ways governance teams can work to make sure their board is on track

1. Be the leader. Explain to your colleagues that sustainability must be on the agenda. A good way to get out in front as a leader is to publish formal board ESG policies and describe your committee oversight structure.

2. Focus on what sustainability means at your company. Narrow your ESG definition down to something substantive and workable. Encourage management to facilitate in-depth discussion about how ESG is incorporated into your strategic planning.

3. Ask for briefs on ESG-related industry developments. Learn what your peers are doing about ESG. Monitor hot topics. Track ESG-related shareholder proposals leaping from one sector to the next.

4. Insist sustainability strategy and execution is co-ordinated to avoid ineffective leadership silos. Raise the general level of ESG familiarity across the organization to empower your employees' collective understanding and collaboration.

5. Consider how positive ESG attention could generate revenue growth. Prioritize ESG efforts that can have a material impact on top and bottom lines. Focus on addressing your customer's ESG interests first (retail and B2B supply chain).

6. Understand the source of negative activism. But don't prostrate your sustainability program or public positioning just to appease activists.

7. Know your stakeholders and ensure a balanced perspective. Understand who in the company's circle of friends, alliances and competitors cares about ESG, why they care and what they think is most important. Ask who doesn't care and why.

8. Create a chief sustainability officer position. More companies are creating an executive officer position to ensure all the ESG/sustainability-related efforts are co-ordinated to an overarching strategic plan.

9. Define sustainability as a strategic pillar of your company. Elevate sustainability to full status in your annual strategic planning reviews.

10. Review your sustainability disclosures. Ask if the company is effectively communicating the rationale for its sustainability choices to stakeholders. Review and update the disclosures regularly.

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