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ESG and Sustainability: The Board's Role

In light of evolving—and sometimes actively debated—perspectives on the role of public companies with respect to sustainability, corporate social responsibility and other ESG matters (*e.g.*, Barron's recent report on Sustainable Investing), we are providing a high-level overview of how boards of directors and senior management teams may wish to approach these issues:

- Be aware that sustainability has become a major, mainstream governance topic that encompasses a wide range of issues, including a company's long-term durability as a successful enterprise, climate change and other environmental risks and impacts, systemic financial stability, management of human capital, labor standards, resource management, and consumer and product safety, and consider how your company presents itself with respect to these matters.

- Recognize that the role of the board in these areas is generally one of partnership with management and appropriate oversight, rather than unilateral board-level mandates. This includes achieving internal clarity on which stakeholder interests are critical to the long-term success of the company, investors, employees, customers, communities, and the economy and society as a whole. These issues should be considered as part of a company's annual strategy review.

- ESG matters often have important reputational impacts and significant public, investor and stakeholder relations dimensions. The board should work with management to identify which ESG issues are most pertinent to the company's business and key stakeholders and to oversee implementation of appropriate policies and processes for assessing, monitoring and managing material ESG risks and opportunities. In addition, companies should determine how best to integrate important risks and opportunities related to these areas into strategic and operational planning, crisis preparedness and risk management, corporate governance, investor and stakeholder communications, budgets, resource allocation and incentive structures.

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- The board may want to receive regular briefings on relevant ESG matters and the company's approach to handling them. Some companies have formalized board or committee-level review of these matters, especially as to those posing material risks to the business, and reference such reviews in committee charters and board-level governance guidelines. Doing so is a company-specific decision; review of these topics does not need to be delegated to a committee and may be considered by the board as a whole. To the extent that ESG matters are covered in committee charters, it is important that they be considered by the committee on a timely basis and reported to the full board.

- Appreciate that in some industries and sectors, sustainability and other ESG initiatives may have clear (and positive) impacts on a company's bottom line and may provide business benefits and competitive advantages over peers; in other businesses and contexts, the impact may not be immediately clear, certain or measurable. Companies should consider the value proposition of these kinds of initiatives relative to other business priorities and opportunities. The calculus for this, however, will continue to develop, especially as more institutional investors consider sustainability as an investment priority and more companies take a proactive but targeted approach to these issues.

- As the public conversation on the role of companies in addressing ESG issues continues to evolve, boards should consider how their risk oversight role specifically applies to various ESG-related risks. In large part, the board's function in overseeing management's identification and assessment of material ESG-related risks, such as supply chain disruptions, energy sources and alternatives, labor practices, and environmental impacts, involves both issue-specific and company-specific application of general risk oversight practices. However, as the public and investors scrutinize how companies address ESG issues, the board, working with management, should make a particular effort to ensure that its risk oversight role is satisfied with regards to various ESG risks. As part of this process, management should identify whether there are any emerging ESG issues or trends that could materially impact the company's ability to create long-term sustainable value and decide how best to allocate corporate resources towards managing the most critical ESG risks.

- The board should also be informed about the company's approach to dealing with investor requests for ESG-related engagement, external disclosure and reporting of the company's approach, response and progress on these matters. In determining what kind of external communication and, as determined appropriate by the company, reporting will be pursued, companies should develop a view on whether sustainability information, corporate responsibility initiatives and progress will be publicly shared on the company's website or in other forums and periodically monitor actions taken by industry peers. In some cases, companies will embrace appropriate public reporting on specific ESG issues over acceptable timeframes. Companies will also have to deal with pressure to set – and disclose – specific goals and targets. When constructively avoiding premature, immaterial or duplicative disclosures, or those that involve unwarranted time, effort or cost, it is prudent to also recognize that a complete lack of transparency is unlikely to be a sustainable approach over the long term. In the current environment, disclosure of the right kind may be viewed as an opportunity instead of just as a cost.

- If faced with an activist investor sounding ESG-linked themes, leverage prior preparedness and apply best practices to respond. If faced with a shareholder proposal addressing these matters, have an appropriate governance process for considering the proposal, its business implications and the company's options, including as to negotiating a withdrawal of the proposal on acceptable terms, pursuing legitimate exclusion under SEC rules or taking the proposal to a shareholder vote (while recommending for, against or taking no position on it) and securing investor support. In some situations, companies may want to present shareholders with a more preferable management-backed approach or proposal. Tailored, company-specific approaches to these issues are significantly better than simply taking a one-size-fits-all, overly rigid approach.

- Management should periodically monitor the level of disclosure by competitors and market cap peers pursuant to disclosure standards organizations with significant industry backing (such as SASB, GRI and IIRC) and determine, in consultation with the board, the company's disclosure posture with respect to these or other emerging approaches.

- Companies should also be prepared for more third-party information requests from emerging ESG-ratings services and existing providers (e.g., the proxy advisory firm ISS' new "Environmental & Social QualityScore" and accompanying list of 300-plus questions for companies to complete). Some of these entities seek to impose, on public companies, the burden of providing data for third-party subscription-based services. The products and any asserted benefits of ESG-ratings services should be assessed carefully, especially those that fail to demonstrate consistent quality and accuracy. Management should be selective when allocating resources towards such services, including as to error-checking, and should consider whether increased investment in the company, improved positioning or other benefits will in fact result.

- Not every director or member of senior management can be an "ESG expert," but directors and appropriate company personnel should educate themselves on the key ESG issues facing the company and be able to converse comfortably on those issues that matter or present significant risks. Well-resourced companies are also increasingly developing specialized in-house expertise and updating internal reporting and business unit structures to have greater capacity in these areas.

We anticipate that company approaches to these topics will continue to evolve, especially as investor and third-party scrutiny of these matters intensify. In any event, companies will need to dedicate appropriate resources to managing these matters effectively.

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