OPINION ARTICLE

Board Accountability on ESG issues is here to stay

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> "Board directors face increasing scrutiny on how they oversee environmental, social and governance matters. Strengthening ESG oversight and accountability should be a priority for all boardrooms in 2022 and beyond."

The sharpening climate crisis and the Covid-19 pandemic, with all its unforeseen and unparalleled consequences, are helping to make ESG a top concern for today's investors. Large institutional investors are not only backing environmental and social shareholder proposals like never before; they are also voting against the re-election of directors where ESG management is perceived as ineffective. Boards need to understand these concerns and act – fast.

Shareholder pressure is hitting home. For example, BlackRock voted against 255 directors for climate-related concerns during the 2020-21 proxy season, according to their voting spotlight report. Activist hedge fund Engine No. 1 elected three directors to the board of Exxon Mobil, against the board's recommendation, with the goal of forcing the energy giant to reduce its carbon footprint. Other investors are taking a similar approach, holding directors accountable for resource management, human rights, and racial, ethnic and gender diversity issues in addition to climate concerns. As a result, companies are under pressure to develop sound ESG programs that meet shareholders' rising expectations.

Adding to the pressure is a growing number of studies that show that high ESG standards are positively correlated to stronger financial performance.

Starting at the top

To build credibility with investors and the broader stakeholder community, boardrooms first need to train the spotlight on themselves: do they have the right mix of skills and gender, age and ethnic diversity to effectively guide their company and its

ESG strategies? Are they walking the talk by aligning executive pay to ESG targets? In a recent survey undertaken by Russell Reynolds Associates and the UN Global Compact, it was found that sustainability experience or mindset is a requirement in only 4 percent of non-executive and senior executive appointments today.

ESG oversight should ideally be performed by directors from diverse backgrounds, with the right skills and relevant environmental or social experience. Thus far, most institutional investors are not prescriptive in this regard; they recognize that appropriate skills may change with industry and size. However, some expect boards to at least provide clear disclosure on the ESG knowledge and awareness among their ranks.

Secondly, boardrooms need to determine the right oversight structure. Some boards may consider creating a specific ESG committee responsible for centralizing and integrating recommendations. Others may prefer to deal with such matters at board level. Either way, board directors must be able to demonstrate that ESG oversight is strong and capable of delivering the sustainable value creation and total shareholder return that investors now demand.

Adopting sound principles

Ultimately, however, companies are judged by their actions. Those that can demonstrate their commitment to the Ten Principles of the UN Global Compact (UNGC) and the UN's Sustainable Development Goals (SDGs) are likely to be more credible and more valued by stakeholders.

Embracing the Ten Principles means that companies agree to operate in ways that respect human rights, labor rights, the environment and the fight against corruption. These principles are critical to corporate integrity, helping companies set the stage for long-term success.

The UN Global Compact is the world's largest corporate sustainability initiative and in 2022 we will enhance our requirement for communicating progress. All participants in the UN Global Compact are required to report annually using a framework called the Communication on Progress (CoP). The enhanced CoP will include more granular questions on the SDGs and Ten Principles.

The enhanced CoP has been designed to give solidity to corporate ESG credentials at a time when regulators are clamping down on greenwashing and stakeholders are more skeptical about ESG claims. Among other benefits, the new CoP will allow companies to measure and demonstrate progress on the Ten Principles in a consistent and harmonized way which will help build credibility and brand value. They will also be able to compare their progress against peers by accessing a UN Global Compact database that will be one of the largest sources of free, public and comparable corporate sustainability data in the world. This database will provide technical help, resources and guidance while also helping to identify gaps and set goals to improve sustainability performance year on year. As such it is set to become a valuable asset for corporate transparency.

Ensuring performance

Sound sustainability governance and management are more important than ever. Joining in the CoP process will not only allow companies to gauge how well they are doing, but will also help prepare them for a raft of mandatory new ESG regulatory and reporting requirements that will begin to take effect in the new year.

After years of work, regulators are getting closer to issuing a single set of globally accepted accounting and sustainability disclosure standards. The International Sustainability Standards Board, set up by the International Financial Reporting Standards Foundation (IFRS), will report on its recommendations in 2022. The EU and UK will also issue new ESG-focused reporting requirements next year.

But rather than see these as an additional reporting burden, companies should seize the new disclosure regulations as an opportunity to prove, transparently and conclusively, that they can do well by doing good. Companies that hold themselves to high environmental, social and governance standards outperform their peers. This fact should be front of mind in every boardroom as 2022 begins. ▪