

ESG: what Boards, Directors & GCs need to know

MAY 2021



Foreword

Clients frequently ask us to help them horizon scan – to look ahead to help them identify the risks, and also opportunities, that changes to legislation might represent for them and their business model. Rarely are there issues that have to be tackled globally, that impact every market, every business model. But ESG is one of those issues. One consequence of the pandemic has been a heightened sense of the awareness of the importance of social impacts across the globe. If your organization hasn't yet started to grapple with how it integrates ESG into your broader organizational strategy, it needs to do so, and quickly.

This document reflects our experience with clients to date: the questions they ask, the high-level insights they want and the answers to why ESG is a burning platform that their organization must address.

Read this document and you will gain a great understanding of what ESG means in practice, why your organization needs to address it, and how, in broad terms, to assess the sophistication and maturity of your current program.

ESG is a topic best discussed with others – getting the right experience and insights when you are navigating uncharted waters can make the difference between success and disaster. We have a global team, with experts from across disciplines, that can provide the integrated ideas and solutions you will need to develop your strategy and then ensure your ESG program can be implemented successfully across the world.

Whether you are at the beginning of your ESG journey, or heading toward maturity, we have the global solutions and expertise to help. Our global ESG steering group encompasses former General Counsel, leading academics and authorities on ESG as well as cross-practice experts to ensure you – and we – take a holistic view as we plot the roadmap ahead (see our global steering group members on p.16).



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Environmental, Social, Governance (ESG) explained

ESG generally stands for Environmental, Social, Governance - but not always. For some, the S represents Societal or even Sustainable. Figure 1, developed by MSCI, provides a good summary of all the elements that are typically covered by these titles. Not all items listed will apply or need to be addressed by all organizations, but if you want to take a quick 'stock take' with regard to what an ESG strategy might need to address, it is a good place to start. A shorter summary of ESG can be found in Figure 1.

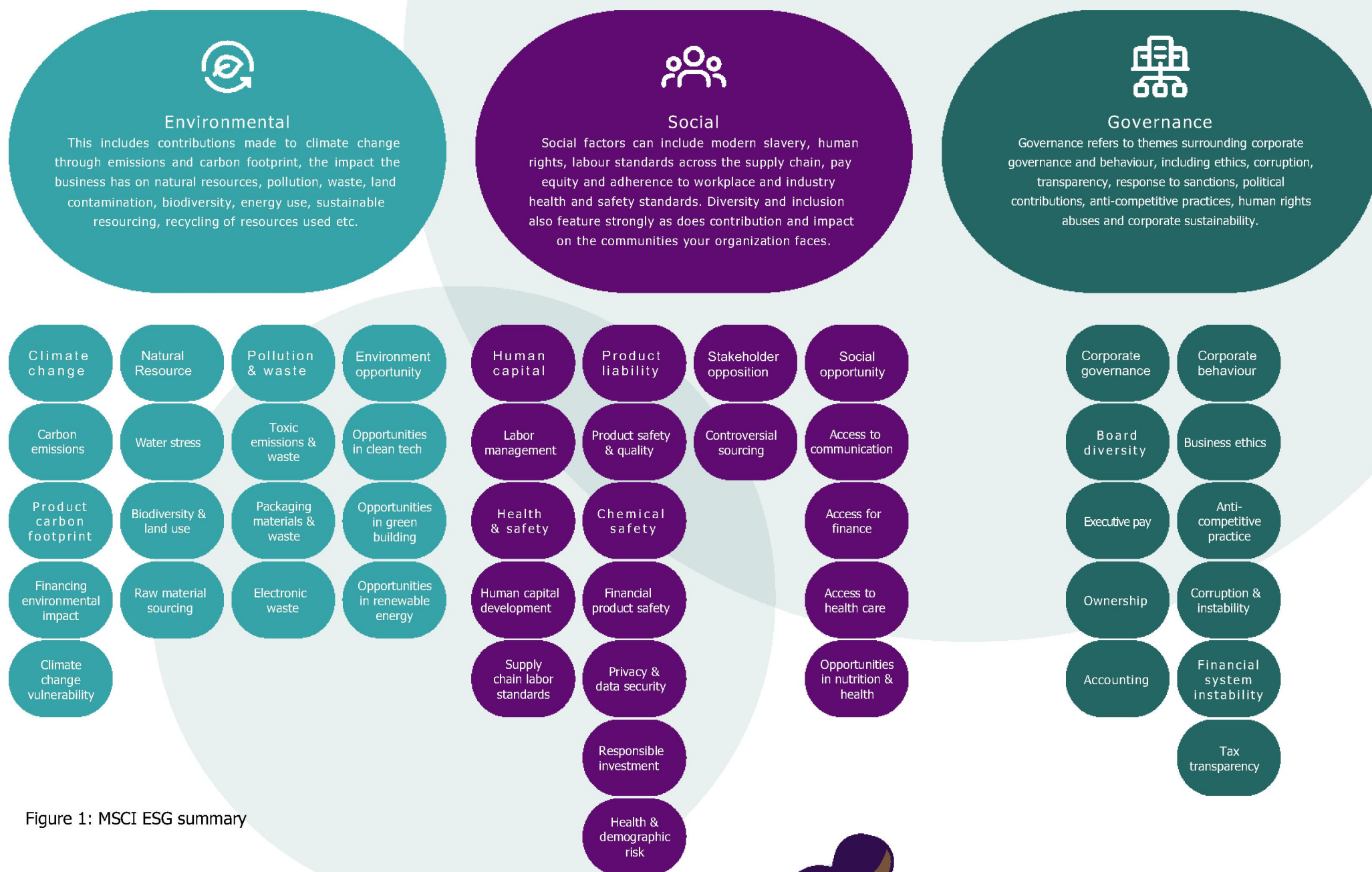


Figure 1: MSCI ESG summary

ESG can mean different things to different people, in different countries and in different cultures and is used interchangeably in a commercial context to express:

1. Societal concerns about the contribution organizations are making to environmental, social, governance challenges.
2. The reporting organizations do to satisfy their shareholders and stakeholders that their ESG impacts are being fully surfaced and addressed.
3. The measuring of organizations and their ESG performance by third parties (including stock exchanges, financial institutions and ratings agencies such as S&P Global, Fitch, Moody's, MSCI, Sustainalytics).
4. Laws & regulations on ESG compliance, reporting, liability and sanctions.



HELP AT HAND

Dentons can help your organization identify (1) key stakeholders; and (2) which elements of the ESG smorgasbord are relevant to those stakeholders and therefore what it should focus on

Is ESG not the same as CSR (Corporate Social Responsibility)?

We get asked this question all the time. Corporate Social Responsibility (CSR), Corporate Sustainability, and Environmental and Social Governance (ESG) all cover broadly the same subject matter, but society appears to be morphing from a narrative of 'CSR' to 'ESG'. So what's the difference? The real question, is not whether this process is 'ESG' or 'CSR', but whether there is a shift in the way a business evaluates and embeds the environmental and social impacts of its enterprise into every day performance and strategy.

ESG is widely being used to acknowledge the prevailing dynamic of balancing those impacts with profit objectives in day to day activity, and is characterised by avoiding detriment and a rapidly growing body of law to regulate this behaviour. Whilst CSR has been used in the past to encapsulate a voluntary approach by corporations to manage such impacts, which in many instances was separate from corporate strategy and a means of redress rather than prevention.

So in essence, the question for corporations is whether environmental and social performance is ancillary to or embedded as part of corporate strategy and operational decision making. The ESG narrative points corporations to the latter.



Why now? Why is everyone talking about ESG now?

ESG has been garnering more attention in the last couple of years for a number of reasons, including:

1. Successful negligence actions, successful NGO campaigns and the use of social media to increase the strength of consumer voices affecting consumer choices at a larger scale (for example, the global reach of the Black Lives Matter campaign following the death of George Floyd and the increasing focus on diversity and equality). As a result, Company stakeholders (internal and external) are demanding action.
2. ESG issues are emotive, many of which affect every person on the planet to some degree (such as climate change, deforestation and biodiversity loss). The universal reach of ESG has unified key stakeholders in their expectations, driving the pressure behind the requirement for your organization to address the ESG issues relevant to it.
3. Investor responses have been prolific. For example, the protocols that funds and financial institutions have been developing will see companies cut off from finance streams if they cannot report on their ESG credentials.
5. ESG is rising up the political agenda and therefore it is being reported on. Biden's Leaders Summit on Climate Change received huge publicity, the Biodiversity conference in China in October 2021 and the Climate conference COP26 taking place in Scotland in November 2021 are also both generating interest and momentum.
6. Regulation is here or coming fast – to put this into context - we are likely to see more legislation in the next two years than we have seen in the past twenty. Regulation is coming as a "smart mix" of laws, standards, reporting and compliance management, civil and criminal liability and administrative sanctions. For example, a diversity requirement on corporate boards is prevalent in Europe and gaining traction in the US with the new California law. New sanctions laws on human rights abuses and corruption are in force in a number of key jurisdictions and with regard to climate, significant amounts of new regulation is coming.

An example of the regulation now coming

On March 10, 2021, the European Parliament ("EP") adopted a resolution "Towards a WTO-compatible EU carbon border adjustment mechanism" ("CBAM").

This mechanism, which is a key component of the December 2019 European Green Deal, is planned by the European Commission to be the subject of a proposal for a regulation in June 2021. It would introduce a carbon price on certain goods, when imported from countries outside the EU that are considered to have less robust carbon pricing arrangements than the EU. The main purposes of the CBAM would be to discourage EU businesses from moving their production to countries with less ambitious climate change policies, (carbon leakage) and to encourage a global move towards net zero carbon emissions by 2050 in line with the Paris Agreement.



HELP AT HAND

Dentons can provide the data and market insights you need to help you accelerate the development or implementation of your ESG strategy.

Why is ESG increasingly an issue for the legal team?

Increasingly we are seeing legal teams own their organization's ESG agenda (or at least its implementation) because:

1. The ESG agenda is being driven by law – class actions, consumer claims, investor activism and, increasingly, regulation. Who better to anticipate forthcoming changes and provide your organization with a view of the legal baseline globally than your legal team?
2. Implementation of an ESG strategy requires legal input. For example, drafting contracts that ensure your supply chain upholds labour practices that meet your standards and M&A due diligence to establish what work needs to be done to on-board an acquired asset so that it meets your organization's ESG standards.
3. The risks associated with ESG claims and statements your organization may wish to make or are required to make by regulation and how to validate and evidence those claims, especially in the context of a significant dispute, is the domain of lawyers.
4. General Counsel are often the governance leader in their organization and the advisor to the Board on governance related issues.
5. Lawyers understand the value of, and need for, attorney client privilege/legal advice privilege.
6. Ultimately law will be used to hold organizations to account whether by criminal or civil liability and sanctions.



HELP AT HAND

Dentons can provide you with the legal baseline you are required to meet across all your markets.

ESG reporting increasingly not a 'choice' - for example:

SEC Announces Enforcement Task Force Focused on Climate and ESG Issues

Washington D.C., March 4, 2021 —

The Securities and Exchange Commission today announced the creation of a Climate and ESG Task Force in the Division of Enforcement...

...Consistent with increasing investor focus and reliance on climate and ESG-related disclosure and investment, the Climate and ESG Task Force will develop initiatives to proactively identify ESG-related misconduct. The task force will also coordinate the effective use of Division resources, including through the use of sophisticated data analysis to mine and assess information across registrants, to identify potential violations.

Measuring and reporting on ESG

As you become immersed in ESG, you will quickly grasp that a core aspect to ESG is measurement. To have a robust ESG approach requires you to be able to measure your performance, sometimes against metrics of your picking, at other times, against metrics or standards that have been set by others. ESG metrics are becoming commonplace and

will shortly be a major factor regarding your ability to be a supplier to, or even a customer of, other organizations.

One of the issues for teams to consider in relation to your ESG strategy is what KPI (key performance indicators) or metrics you wish to hold yourselves accountable against.

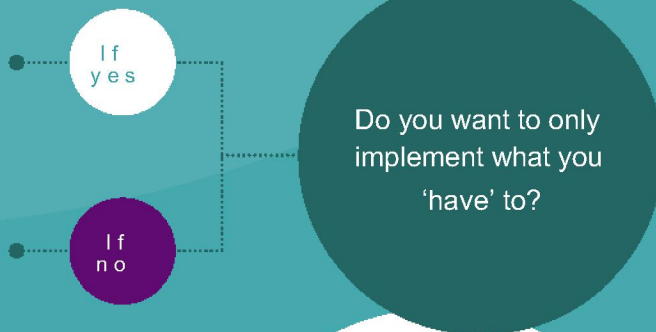


Which standard or framework do you wish to adopt (or do you want to adopt several to cover all bases?) What is the cost/implication of each route? What are the risks in taking this approach (being accredited by a third party does not protect your business from legal action or negative media)?

What are the risks in taking this approach? Will your own standards be strong enough to enable your business to progress/achieve its goals and address its needs in the next 3-5 years?

You need to understand your legal baseline, across all the markets you operate in.

You need to consider what your stakeholders (investors, employees, financiers, customers are going to demand) and make sure your strategy covers their expectations.



HELP AT HAND
Dentons can provide you with a comparative study of the main standards and frameworks



Which standard or framework you may wish to use (if any) will depend on your organization's ESG strategy, goals and roadmap.

Investors pile pressure on companies over ESG at annual meetings

Record number of social and environmental resolutions backed by at least half of share holders

Financial Times, October 31, 2020

Reporting

Organizations give different names to their reports on ESG – you will find purpose-led, social impact, corporate social responsibility and sustainability reporting are all commonplace and increasingly documents of interest to the market. Providing this information can help promote your brand, whilst not having reports of this nature could, by implication alone, damage your brand. Reports may include details of the standards/frameworks your organization complies with. Organizations typically share information about their ESG strategies and goals via AGMs, proxy statements, investor presentations, reports and other content on their website and annual reports.



The number of companies ___ that have chosen to publish annual sustainability or ESG reports has grown significantly in recent years, with 90% of companies in the S&P 500 publishing such reports. But often, these reports do not address what investors are looking for.

Governance & Accountability Institute, 2020 Flash Report S&P 500, July 2020



"If certain information that happens to fall in any of the ESG categories is material to that company, the company needs to disclose it. We expect management and the board to do that, and we will come after them when they don't."

SEC Commissioner
Elad L. Roisman, July 2020

Formal disclosure

Some regulators have already incorporated elements of ESG into mandatory reporting regimes. For example, Hong Kong was one of the first exchanges to require ESG reporting of listed companies. For public companies in the United States, the SEC does not mandate specific ESG disclosures. Instead, they focus on the broader requirement to disclose material risks – and as their recent taskforce announcement indicates, they will be coming after boards and management teams that do not disclose ESG related risks. Certain states in the United States, such as California, require disclosing efforts made to monitor human trafficking in the supply chain. Meanwhile in the EU, EU Regulation on sustainability related disclosure in the financial services sector (the SDRF) now applies and there is the draft Directive as regards Corporate Sustainability Reporting. For those wishing to horizon scan, getting to grips now with the regulation that is likely to come, is key.

Standards and frameworks

Generally speaking, standards, which follow a typical process (including receiving public comments), offer specific guidance for measurement and disclosure. Frameworks however provide general guidelines on disclosure. Frameworks and standards are progressing rapidly as industry bodies all seek to define what ESG should look like for their sector and therefore how organizations can compare/ contrast their performance against their peer set. Alongside this, there are a number of other standards competing to be the global benchmark. You will likely find reference to Global Reporting Initiative (GRI); Sustainability Accounting Standards Board (SASB); Carbon Disclosure Project (CDP); Task Force on Climate-related Financial Disclosures (TCFD); UN Sustainable Development Goals (SDGs); UN Global Compact; UN Guiding Principles on Business and Human Rights; OECD Guidelines for Multinational Enterprises; WEF (World Economic Forum) proposal by Big 4 and 200+ CEOs and ESG certification offered by B Lab.

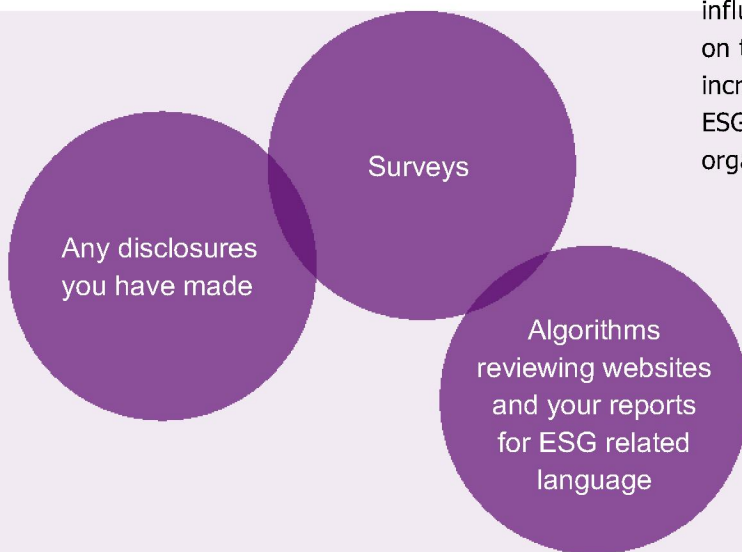


There is more than 'one' answer to which framework/badge/ accreditation your organization could or should seek. Which means you need to define your own goals and understand the options available to you.

You will be measured whether you like it or not!

Given the huge stakeholder interest in ESG, rating agencies have emerged. As with those promoting standards and frameworks, there is no single methodology adopted by the agencies. Ratings agencies gather data through:

These ratings are then 'sold' to asset managers and similar that wish to understand the ESG rating of a given company and its performance compared to others in their market or sector. Ratings agencies include MSCI, Institutional Shareholder Services (ISS), Sustainalytics and S&P Global. Clearly you can influence how you perform in these rankings based on the content you disclose. And, given the increasing focus by the financial services sector on ESG, strong performance in this area will ensure your organization is well positioned to access capital.



ESG investing now accounts for one-third of total U.S. asset under management –

Market Watch, 2020

JPMorgan shoots for green finance stratosphere as ESG target tops peer plans

REUTERS 15 April 2021

Moody's warns on ESG risks for some structured finance assets –

Arab News 15 April 2021

ESG funds forecast to outnumber conventional funds by 2025 with new EU rules and growing investor focus on sustainability fuelling growth –

PwC, 2020

Why do you need to consider a variety of stakeholders in your ESG strategy?

ESG is a means of measuring the environmental, social and ethical expectations of all stakeholders in a business. If a business does not understand its stakeholders and their expectations, it cannot begin to set measurable targets that will enhance performance. The same stakeholders are pushing governments to regulate and using consumer pressure to drive change.



62% of directors agree that companies should prioritize a broader group of stakeholders in making company decisions (rather than just shareholders)

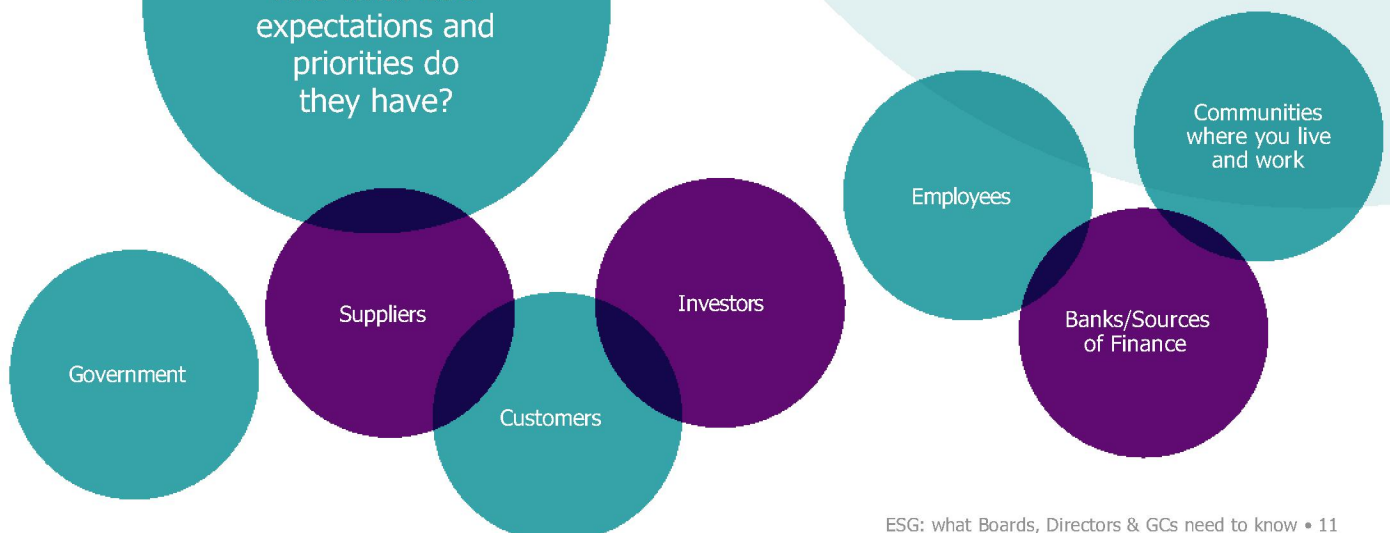
Source: PwC, 2020 Annual Corporate Directors Survey, September 2020.

62%

Broader stakeholders include employees. Gen Z and Millennials are particularly focused on selecting an employer brand that cares about ESG and as these constituents will make up a large proportion of your workforce within the next ten years, businesses need to plan their talent acquisition strategy now.



Who are your stakeholders?
And what ESG expectations and priorities do they have?





Quick test

As a Board – do you have ESG covered?



If yes

You will have answers to the following key questions:

- What is your organization's ESG strategy?
- Who has responsibility for making the ESG strategy a reality and how does the Board have oversight and monitor?
- What is the cost, risk and opportunity associated with the ESG agenda for your organization? Are you aware of the laws and liabilities for the company and the board associated with ESG?
- How are you measuring the impact of your ESG strategy?
- How are you reporting or communicating your ESG strategy to stakeholders?

If no

● Gather information, anticipate change ●

- Identify the elements of E,S and G that resonate most for you and your business
- Identify what strategic ESG concerns you have
- Review what your competitors/the sector you operate in is doing
- Name your stakeholder groups, are you confident about what they expect? Is access to finance a priority for you?
- If listed, know what existing and upcoming ESG related disclosure obligations your exchange requires
- Complete a supply chain risk assessment
- Prepare a legal baseline of current and near term regulatory requirements
- Agree what data/information you need e.g. are you sure you understand the situation across markets?
- Consider legal risk exposure in relation to current statements you are making or what you are disclosing
- Does your mission statement/values/goals incorporate impact on stakeholders other than shareholders? Should it?
- Horizon scan – have ESG issues been fully considered in your longer-term planning e.g. brand positioning, launch of new business models, entry into new markets, supply chain and customer modelling.
- Understand the cost, risk and opportunity associated with your current ESG state and your desired future state

“Getting executives and board members to look at ESG as an integrated business function is crucial. So much ESG data is traditionally based on past performance, and not forward looking. The more real-time you can get with your data, the better able you are to forecast where your company needs to go.”

Evan Harvey, Global Head of Sustainability, Nasdaq

● Set strategy ●

- Define your ESG strategic goals and integrate into the organization’s broader strategy
- Assign responsibility, and make sure cross-team and (if relevant, cross-market stakeholders) are engaged and accountable
- Be clear about what and how you will measure and report

Manage implementation – examples of what this might include ●

- Have plans by function e.g. approach to talent acquisition by HR; supply chain/supplier management by procurement; ESG due diligence protocols for M&A/corporate affairs; risk screening for corporate communications
- Agree reporting/disclosure time line
- Align executive compensation to goals/strategy/success
- Put ESG updates on the Board meeting agenda
- Integrate ESG related risks into your Enterprise Risk Management protocols

Conclusion

The ESG debate makes it clear that the way we do business is changing and it is going to continue to change significantly in the months and years ahead.

For some, ESG is a tactical step to attract new consumers. For others it is a defensive move to maintain the social licence to operate or compliance with evolving laws and regulations. Wherever your business sits on this spectrum, avoiding the pitfalls of over-promising requires a methodical approach to developing your position.



Whether you are at the start of your ESG journey, or your approaches have matured and you need help with anticipating, measuring or managing ESG - Dentons can help – anywhere in the world.

How Dentons supports its clients



Workshops

- Introducing the ESG agenda to Boards and teams
- Overview of the data/information you need to review
- Introduction to the legal risk exposure you need to manage
- Examining your stakeholder groups and their needs and expectations
- An overview of the key standards and frameworks and industry approaches for your sector
- Legal baseline – an overview of the key legal issues to examine from a regulatory perspective
- Linking executive compensation and employee codes of conduct and handbooks to ESG



Analysis

- Legal baseline review tailored to your organization and markets, including ESG Filter, Heat Map and ESG Framework
- Legal risk review of current ESG statements – verify or write disclosures, review prospectus for IPOs and other investor materials
- Future plans – risk screening, agility assessment and advice surrounding setting up and building governance structures
- The pros and cons of different accreditation and validation approaches for your organization
- Legal baseline – what regulatory exposures will you have across your business and markets?



Diligence Products

- Acquisition
- Financing
- Product development



Response Products

- Incidents
- Changes of law
- Sanction response
- Litigation support



Intelligence

We have developed a number of global intelligence solutions including global trackers reviewing regulation on a country by country basis relating to:



Contractual / implementation

- Implementation of ESG into all stages of a deal
- Audit rights
- Remedies
- Implementation and ongoing audits
- Transforming plans to execution
- Employee code of conduct/handbooks/contracts



Knowledge

Our legal teams across the world are producing legal alerts, articles and webinars. To access the latest news by country and theme, visit our Global ESG hub at www.dentons.com



Get in touch

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ABOUT DENTONS

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