Anti-Corruption Report
An Acuris company
anti-corruption.com

October 28, 2020

CORPORATE SOCIAL RESPONSIBILITY

Five Steps to Establishing a Corporate ESG Policy for the Present Moment

By Bryan J. Sillaman and Alexandra Poe, *Hughes Hubbard*

Pick up the annual report of many major corporations, growth companies and pooled investment funds, and chances are you will somewhere see reference to three initials that have become a critical part of their messaging: E, S and G. The fact that environmental, social and governance concerns have earned a globally recognized moniker reflects investors' expanding focus on the impact that companies have on people and the planet.

The trend is not new, but it has migrated from adoption by values-based investors, once considered eccentric, to a mainstream concern.

See "The Global Modern Slavery Landscape: Standard Practice for Maintaining Compliance" (May 29, 2019).

New Reporting Standards

Recent years have seen a proliferation of reporting standards proposed to address ESG factors[1], and now regulations and corporate governance theories are following suit. Among the most significant of these are the European Union's new Taxonomy Regulation on Sustainable Finance (Taxonomy Regulation) and, globally, the novel governance theory advanced by corporate leaders at The Business Roundtable and the World Economic Forum, *i.e.*, governance for stakeholders, or stakeholder capitalism.[2]

The Taxonomy Regulation is one of the first disclosure laws requiring large corporations and financial market participants in Europe engaged in climate mitigation or climate adaptation activities to meet certain criteria[3] in order to claim their activities as "Taxonomy Aligned." The Taxonomy Regulation, with its prescriptive requirements, contrasts with existing U.S. norms, where the SEC continues to stand behind its content-neutral, principles-based approach, that disclosures must be material and not misleading.[4] Financial market participants must make their first disclosures against the Taxonomy Regulation by December 31, 2021; corporates are required to make their first disclosures during 2022.

See "How the EBRD Promotes Compliance Internally and For Its Clients" (Jun. 12, 2019).

Beyond Share Prices

Governance for stakeholders upends the idea that shareholders and share prices are the only factors corporate leaders need to prioritize. It embraces the idea that corporations are responsible for having policies and programs to address ESG – the impact that management practices, employment practices, procurement,

©2020 Anti-Corruption Report. All rights reserved.

waste management and operations have on the many communities the corporation touches.

In addition, investor interest in corporate ESG policies continues to grow, fueled by concern for the corporate response to the current global health crisis. Growing data support investors' view that addressing environmental, social and governance issues promotes corporate social responsibility and better long-term financial performance than strategies which do not take such factors into account.

For all these reasons, it is essential for international companies to consider how best they can implement ESG policies and programs. Multinationals that have gone through the experience of implementing robust corporate compliance programs to address other enterprise risks may find parallels and draw from that experience to construct their approach to ESG policy and program development. The following are five steps to consider when establishing a program.

See "How the World's Most Ethical Companies Are Aligning Corporate Culture and Strategy" (Jul. 24, 2019).

1) What's Right for Your Company?

One of the challenges associated with ESG assessments is that ESG objectives can mean different things to different people. The first step in any assessment should be to develop the language and objectives appropriate to your policy-setting project by consulting published standards like the Taxonomy Regulation, the U.N. Sustainable Development Goals (UN SDG), the U.N. Principles for Responsible Investment (UN PRI), the recommendations of the Task Force on Climate-Related Financial Disclosures (TCFD), the CDP Global Framework, the Global Reporting Initiative, the Sustainability Accounting Standards Board (SASB) and the International Integrated Reporting Council (IIRC).

Depending on your company's activities, there are also more and more industry-specific guidelines, standards and initiatives that may serve as useful starting points for assessing areas of greatest risk and attention.[5]

2) Customizing the ESG Policy Program

The second step in an assessment should be to focus on which ESG considerations are applicable generally with respect to your industry and then with greater specificity to the conditions, operations and geographic footprint of your particular company. For example:

Environment

Consider the company's contribution to climate change, including energy use (such as its carbon footprint and use of clean energy), waste management, pollution, resource conservation, impact to habitats and environmental remediation. Consider whether the company has opportunities to promote positive change, such as by reducing energy loads, expanding organic food production, or adopting technologies that repair environmental damage. Increasingly, investors want to see companies consider their own operations and impacts arising from your supply chain.

©2020 Anti-Corruption Report. All rights reserved.

Social

Consider the company's conduct that affects its relationship with human communities, from employees to customers and local communities where the company operates. These concerns start with health and safety, including pandemic-response, and also embrace issues of human capital policies (in your company and your supply chain), childcare, education, equal opportunity, pay equity, financial inclusion, job creation and social justice. Companies that make products that have the potential to harm people, like guns, toxic materials, alcohol and other addictive substances, have special considerations in this regard.

Governance

Consider the company's practices relating to regulatory compliance and the conduct of officers and directors and the expectations of integrity set at the top of the organization. Concerns range from accurate and transparent financial reporting, to executive compensation practices, diversity and inclusion, and avoidance of conflicts of interest, sexual harassment and corrupt practices. Governance considerations may also look at the composition of a board of directors or executive teams, to assess whether representatives to those bodies are well suited to address concerns of all stakeholders and potential ESG risks.[6]

See "Beyond Technical Capacity: The Importance of Building Relationships As a CCO" (Jul. 11, 2018).

Industry Commonalities

Within these three areas lies a world of complexity. Assess generic topics for applicability, then calibrate policies and practices based on your company's unique characteristics. Certain industries may find some commonality in terms of heightened risk or areas of particular focus, such as the following examples.

- *Technology*: Depending on the technology and the company's place in this diverse sector, a tech company may face social risk, through practices related to data privacy, free speech and the sharing of sensitive information with state actors. Metal sourcing and waste disposal or recycling may also be relevant from an environmental risk perspective.
- *Extractives*: Companies that extract natural resources will need to assess environmental risks presented by their activities, but they should not overlook the potential for significant social risks related to human rights and labor practices, and governance risk that may arise by exposure to corruption in jurisdictions where extractive activities are conducted.[7]
- *Construction*: The construction industry has presented social risk for years, particularly as it relates to the use of labor in certain jurisdictions. The use of third-party recruitment and staffing companies to provide project labor can heighten a company's risk in this area, particularly if they do not have robust due diligence processes in place.[8]
- *Agriculture*: The agriculture industry faces increased scrutiny, particularly vis a vis the environmental impact of commercial farming versus organic and sustainable agriculture. Not to be overlooked in this respect are also the potential social risks arising from labor practices and the availability of quality food for all. Agriculture companies may

©2020 Anti-Corruption Report. All rights reserved.

also assess their government relations (lobbying) stances as part of a focus on governance risk.

See "The New Landscape of Corporate Social Responsibility Regulation and Its Overlap With FCPA Compliance" (Nov. 7, 2012).

3) Setting a Standard for an ESG Assessment

The third step in your ESG assessment is to determine what standard the company seeks to meet, distinguishing what is *required* from a regulatory perspective, versus what may be *desired* from a values, investor, or market perspective. Here, differences in approach between the E.U. and the U.S. warrant attention, as the E.U. (and, more specifically, certain E.U. member countries) has advanced more quickly on mandating ESG-related disclosures to date.

France, for example, first mandated disclosure on the social and environmental consequences of activities of publicly traded companies in 2001. The European Union has since adopted directives that also impose non-financial reporting obligations, such as E.U. Directive 2014/95/EU (the non-financial reporting directive, or NFRD) and the Taxonomy Regulation. For companies headquartered in the E.U., including financial market participants, it is likely that regulations mandating disclosure of activities that have ESG impacts are going to continue to increase over the coming years.

Meanwhile, in the U.S., the SEC continues to believe that the existing legal standard for financial reporting – that disclosures and claims are not misleading – is a sufficient yardstick for ESG-related disclosures. Management must consider which ESG related risks are material to company disclosures under these standards. Investor initiatives like the TCFD were launched to push issuers to think about materiality more expansively than they had historically.

Finally, the U.S. Department of Labor recently proposed new rules setting guardrails for pension plan fiduciaries considering ESG factors as part of their investment decisions, while also making it more difficult to do just that.

4) Coordination With the Corporate Compliance Program

The fourth step is to consider the value in coordinating your ESG policy program with your corporate compliance program. The requirements of certain existing laws overlap with some ESG priorities. Some companies may decide to establish a dedicated team to advise management and monitor implementation of an ESG policy program, while others may decide this is a natural extension of the role of the compliance team. Considering these programs together may allow companies to leverage investment in compliance technology (relating, for example, to due diligence, gifts and hospitality, mechanisms for individuals to report wrongdoing) for the benefit of ESG policy program implementation. Common overlapping or adjacent considerations may stem from:

©2020 Anti-Corruption Report. All rights reserved.

Anti-Corruption Laws

The FCPA, the U.K. Bribery Act, the Brazilian Clean Companies Act, the French loi Sapin II, global anti-money laundering and economic sanctions regimes, and other similar laws set baseline standards of lawful conduct. Companies should consider whether the ESG program should extend the same principles to standards of ethical conduct.

See "The French Duty of Care Law: A First Assessment" (Jun. 12, 2019).

Human Rights Laws

Many companies have expanded compliance programs to cover laws addressing human rights abuses and other ethical violations, such as the U.K. Modern Slavery Act, the California Law on Transparency in the Supply Chain, the Dodd-Frank Provisions on Conflict Minerals and the French Duty of Care Law (*loi de devoir de vigilance*).

Labor, Public Health, Environmental and Disclosure Laws

These laws, which companies already are required to follow, also implicate ESG-related concerns. As a result, policies, procedures and/or controls that companies have in place to help ensure compliance with these laws may serve as useful sources when developing a broader ESG program.

Considering compliance and ESG programs together can minimize redundancy and avoidable missteps arising from uncoordinated policies, while optimizing investments in existing technology and personnel.

See "No Good Deed Goes Unpunished: Possible Unintended Consequences of Enforcing Supply-Chain Transparency (Part One of Two)" (Apr. 26, 2017); Part Two (May 10, 2017).

5) Implementation

Finally, companies must conform their conduct to their ESG policies and procedures. It starts with the "tone at the top" – that is, the words and actions of corporate management should promote the sincerity of the company's commitment. Senior management and boards of directors can have a significant impact on the success of a company's ESG efforts through (i) clear communication; (ii) the devotion of resources and time; (iii) the establishment of key performance indicators and other metrics to ensure accountability; and (iv) leading by example in their own activities.

As with any corporate policy, developing a program is only the first step in a continuous process of implementation, testing and improvement. Companies should revisit the ESG policy program on a regular basis, improving it based on operational changes, collected data, evolving regulations, evolving industry norms and other factors. Companies should be prepared to test their assumptions and to adapt as needed to new ESG risks as they emerge.

Having come this far, companies should not miss the opportunity to differentiate themselves from their competitors. Just as a well-developed compliance program can serve as a competitive advantage, attention to ESG offers opportunities for companies to lead in this arena. International companies are already standing out through creative finance (*i.e.*, "green" bonds, sustainability linked loans),

©2020 Anti-Corruption Report. All rights reserved.

procurement and supply chain enhancements (*i.e.*, sustainable purchasing programs), employing cleaner systems and technology, and adding diverse perspectives on the board and in other leadership roles.

All these developments point to the beginning of new era in corporate citizenship and investor expectations, which is beyond reversal, and signal optimism about ESG outcomes in the years ahead.

Bryan Sillaman is managing partner of Hughes Hubbard's Paris office, and a member of the firm's anti-corruption and internal investigations practice group. He regularly advises multinationals on a range of compliance-related matters, including conducting internal investigations and assisting on the development, implementation and improvement of compliance programs around the world.

Alexandra Poe is chair of Hughes Hubbard's private funds practice and a thought leader in ESG and impact investing since founding the HWW Symposium: Investing for Impact in 2012. She regularly advises alternative asset managers and institutional investors and has long advised boards on fiduciary governance matters.

The authors wish to thank Hughes Hubbard Associate Grace Ha for her excellent assistance in preparing this article.

---

[1] *See, e.g.*, GRI, GRI Standards; Climate Disclosure Standards Board, CDSB Framework for Reporting Environmental & Climate Change Information (Dec. 2019); Nasdaq, *ESG Reporting Guide 2.0*: *A Support Resource for Companies* (May 2019).

[2] *See* Business Roundtable, *Statement on the Purpose of a Corporation* (Aug. 19, 2019); Richard Samans & Jane Nelson, World Econ. F., Integrated Corporate Governance: a Practical Guide to Stakeholder Capitalism for Boards of Directors (June 2020). Although the international business community *seems* to be largely embracing a move towards stakeholder capitalism, there are skeptics within various organizations, including Commissioner Peirce from the U.S. Securities and Exchange Commission, who has questioned whether ESG issues should be part of corporate decision making process absent concrete data that they generate greater shareholder returns, and the U.S. Department of Labor, which has proposed a rule on fiduciaries of pension funds that would prohibit them from taking ESG considerations into account. *See* Hester M. Peirce, *Scarlet Letters: Remarks Before the American Enterprise Institute* (June 18, 2019); U.S. Dep't of Labor, *Department of Labor Proposes New Investment Duties Rule* (June 23, 2020).

[3] The Taxonomy Regulation requires issuers to meet technical screening criteria and to refrain from activities that do significant harm to other defined environmental objectives.

[4] *See, e.g.*, SEC, *Commission Guidance on Management's Discussion and Analysis of Financial Condition and Results of Operations*, Rel. No. 33-10751 (Jan. 30, 2020). *See* also, SEC Investor Advisory Committee,

Recommendation of the SEC Investor Advisory Committee Relating to ESG Disclosure (May 21, 2020), wherein the Investor Advisory Committee urges the SEC to require ESG

©2020 Anti-Corruption Report. All rights reserved.

related disclosures and provide a framework for issuers in reporting these items.

[5] The SASB Standards, in particular, separately address 77 industries. Sustainability Accounting Standards Board, *Industry Standards*.

[6] See, *e.g.*, Cal. Corp. Code § 301.3 (establishing minimum gender diversity requirements for boards of directors of publicly held companies with principal offices in California).

[7] *See* Samantha Pearson et al., *Brazil's Vale Vowed 'Never Again.' Then Another Dam Collapsed*, Wall St. J. (Dec. 31, 2019).

[8] *World Cup* 2022: *Qatar still failing to protect workers' rights, says Amnesty International*, BBC News (Sept. 19, 2019).

©2020 Anti-Corruption Report. All rights reserved.