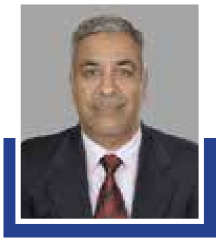
ESG: A KEY BOARD ROOM AGENDA



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THE PERSPECTIVE

Our world faces a number of global challenges: climate change, transitioning from a linear economy to a circular one, increasing inequality, balancing economic needs with societal needs. Investors, regulators, as well as consumers and employees are now increasingly demanding that companies should not only be good stewards of capital but also of natural and social capital and have the necessary governance framework in place to support this. More and more investors are incorporating ESG elements into their investment decision making process, making ESG increasingly important from the perspective of securing capital, both debt and equity. The era of growing geo-political uncertainties, nationalism and populism are giving rise to economic and commercial uncertainties. In this scenario, ESG is emerging as one of the best lens to see the organization's resilience, adaptability and sustainability. It is emerging as a priority for investors who are now building an ESG framework to study companies and decide their course of action. ESG initiatives go beyond just doing the right thing. They may improve society's perceptions of the company, build competitive positioning, and increase market value.

Interest on the part of investors and other corporate stakeholders in environmental, social and governance ("ESG") matters has surged in recent years, and the current economic, public health and social justice crises have only intensified this focus. ESG, at its core, is a means by which companies can be evaluated with respect to a broad range of socially desirable ends. ESG describes a set of factors used to measure the non-financial impacts of particular investments and companies. At the same time, ESG also provides a range of business and investment opportunities.

UNDERSTANDING ESG

The term ESG, or environmental, social and governance factors, was coined by the Global Compact in 2004. However, the notion of incorporating all non-financial factors in business has been around for much longer; some might point to 2001 as the beginning of mainstream ESG with the launch of FTSE4Good indices. The term "ESG" was popularized in the 21st century and often comes up in the same conversation as sustainability and corporate social responsibility (CSR). However, while sustainability and CSR function more as philosophies or end-goals, ESG is more tangible;

it encompasses the data and metrics needed to inform decision-making for companies and investors alike.

Environmental, social and governance (ESG) is a broad concept with no standard definition, but most can agree on the scope of the issues it covers; how a company performs as a steward of nature, how a company manages relationships where it operates and ultimately, how ethically it acts. Unsurprisingly, ESG is also quickly rising to the top of board agendas. ESG — environmental, social, and governance — is a rapidly growing and complex landscape. From diversity to supply-chain due diligence to reducing carbon emissions, ESG cuts across vastly different corporate functions. ESG came from the recognition that a company's financial statements don't tell a prudent investor everything they need to know about the risks that a company should be managing. Although CSR, ESG and sustainability may overlap in their outcomes (for example, they all emphasize social benefit and environmental protection), they differ in their primary purpose and impact areas, but actually "CSR nudges me to contribute to my community; ESG satisfies investors that environmental, social or governance issues won't blindside them; and sustainability is what I embed into my core business strategy and decision-making processes."

- The E in ESG, environmental criteria, includes the energy your company takes in and the waste it discharges, the resources it needs, and the consequences for living beings as a result. Not least, E encompasses carbon emissions and climate change. Every company uses energy and resources; every company affects, and is affected by, the environment.

- S, social criteria, addresses the relationships your company has and the reputation it fosters with people and institutions in the communities where you do business. S includes labor relations and diversity and inclusion. Every company operates within a broader, diverse society.

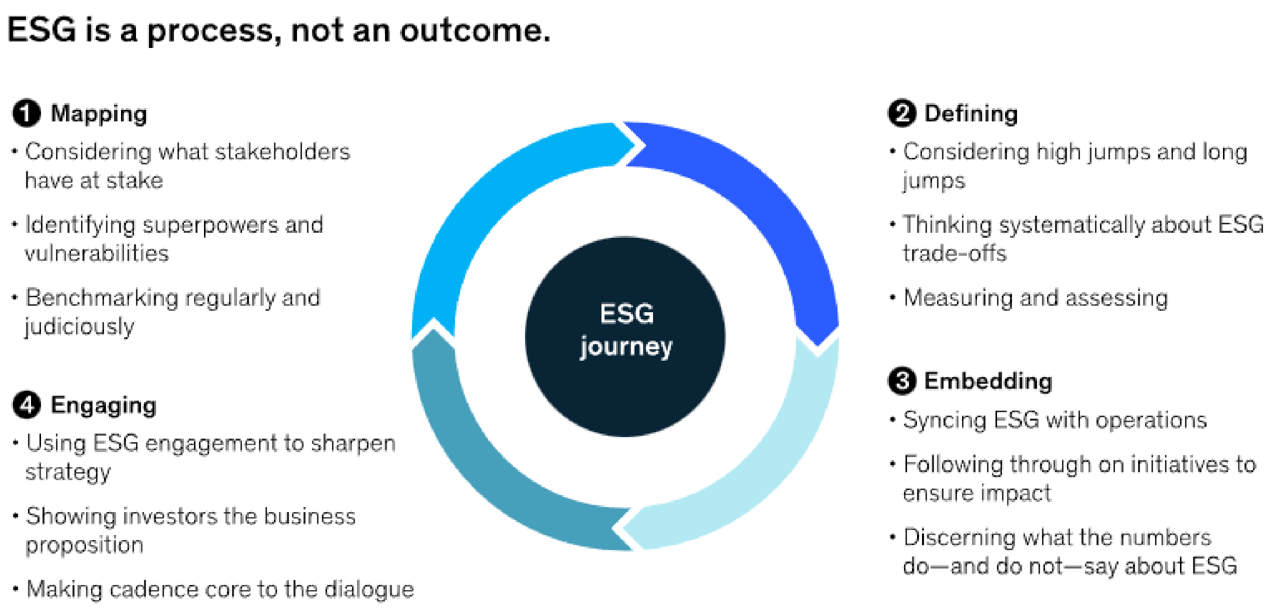
- G, governance, is the internal system of practices, controls, and procedures your company adopts in order to govern itself, make effective decisions, comply with the law, and meet the needs of external stakeholders. Every company, which is itself a legal creation, requires governance.

Just as ESG is an inextricable part of how you do business, its individual elements are themselves intertwined. For example, social criteria overlaps with environmental criteria and governance when companies seek to comply with environmental laws and broader concerns about sustainability. Our focus is mostly on environmental and social criteria, but, as every leader knows, governance can never be hermetically separate. Indeed, excelling in governance calls for mastering not just the letter of laws but also their spirit—such as getting in front of violations before they occur, or ensuring transparency and dialogue with regulators instead of formalistically submitting a report and letting the results speak for themselves.

ESG is not a discrete set of issues, but a powerful process for managing risk and leveraging business advantage. Investors and other key stakeholders recognize that ESG is a proxy for effective risk oversight, and there is increasing pressure on board members to focus on ESG issues. ESG grew out of investment philosophies clustered around sustainability and, thereafter, socially responsible investing. Early efforts focused on "screening out" (that is, excluding) companies from portfolios largely due to environmental, social or governance concerns, while more recently ESG has favorably distinguished companies that are making positive contributions to the elements of ESG, premised on treating environmental and social issues as core elements of strategic positioning.

ESG AGENDA IN THE BOARD ROOM

Environmental, social and governance (ESG) continues to evolve as a strategic business imperative. ESG investing trends and developments are creating opportunities for companies to better integrate ESG initiatives into core strategies and governance processes to enhance performance as well as attractiveness to investors, customers, current and potential employees. Many boards of directors are considering their approaches to environmental, societal and governance (ESG) topics and, more particularly, how ESG can contribute to the long-term success of their businesses. Such introspection is partly in reaction to demands from shareholders and other stakeholders.



The board's role is to develop a strategy for the enterprise's long-term success; ESG is the critical element to long-term success. ESG (environmental, social, and governance) performance as criteria for investment has a growing impact on value preservation, value creation, and, ultimately, the future of the corporation itself. Directors are bound by fiduciary duties, which many argue now extend to considering ESG factors when providing oversight of strategy and risk. The impact a company can have on its surrounding ecosystem has become vividly clear, whether it's on a global scale or within its local community. At the same time, people have become increasingly concerned about ESG issues such

as climate change, human rights and executive compensation. And so, embedding sustainability in business is top-of-mind for executives and investors alike in today's eco-conscious business landscape.

The broad scope and dual nature of ESG—which facilitates the creation of opportunities for business or reputational value, while also managing risks associated with ESG impacts—present a significant governance challenge for boards. The Rise of Boardroom ESG explores the following questions:

- What is ESG (Environmental, Social, Governance) and Climate Governance and how does this relate to the board's role?
- What practices should competent boards have in place to build ESG and Climate Governance in their organizations from the perspective of directors and corporate secretaries?
- How is the rest of the world responding? What are international developments and perspectives on ESG Governance and the implications for Canadian governance?
- How are capital markets making use of ESG information and how does it affect investor decision-making?
- What processes do we have for the identification of ESG opportunities and impending risks?
- Do we comprehensively understand the material ESG risks and parameters?
- Do we have the ability to integrate the identified ESG parameters to our vision, goals and metrics?
- Does the Board have the skills and the necessary information to guide the management on the way forward?
- Does our ESG criteria also cover governance matters like board diversity, board performance and ethics apart from topics like climate change, data security, labor practices, etc.?
- How can we increase our engagement on ESG matters, both internally and externally?
- How can we effectively communicate the company's "ESG story" to all stakeholders?

WHAT RESPONSE ACTIONS CAN THE BOARD CONSIDER ?

- **Level setting:** Agree on the definition of ESG and its importance to the company
- **Assessment:** Determine which ESG risks and opportunities are of significance to the company Integration: Encourage integration of material ESG issues to business strategy
- **Stakeholder communication:** Shape the ESG communication keeping in mind investors and other stakeholders in the context of long term value creation

- **Board oversight:** Ensure that the board has the right composition, structure and processes to oversee ESG in the context of long term value creation

- **Strategy:** Are ESG risks and opportunities integrated into the company's long-term strategy? How is the company measuring and monitoring its progress against milestones and goals set as part of the strategy?

TOP ESG ISSUES WHICH BOARDS SHOULD ADDRESS INCLUDE:

- **Climate change** is a systemic risk for all organizations and all boards must address climate change as a macro disruptor of the economy and their organizations;

- **Income inequality,** covering both CEO and workforce compensation. This links to how organizations manage their human capital and whether workers are valued and recognized as an asset, not just a cost;

- **Ethical practices** such as the ethical implications of emerging digital technologies, and organizational diversity and inclusion;

- **Stakeholder governance** is an essential board practice; boards need to be much closer to the organization's stakeholders to understand their issues and expectations – having diverse stakeholders on the board can address this;

ESG CONSIDERATIONS NO LONGER A 'NICE TO HAVE' BUT A MUST

Sustainability and ESG are no longer the sole responsibility of a company's sustainability officer or other corporate executives. Today, investors expect that the board will be fully engaged on ESG, as it has been shown that companies with robust board oversight tend to do a better job managing ESG risks. As identified by the World Economic Forum in 2018, eight of the top ten global risks are ESG related. Therefore, as agents of long-term enterprise value and risk oversight and with a legal duty to act in good faith and in the best interests of the company, boards must understand how their risk oversight role specifically applies to ESG related risks. ESG is no longer a 'nice to have', but a must.

BOARDS THAT ADAPT ESG WILL PROSPER

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As social and environmental issues continue to affect consumer and investor behavior and capital is re-allocated towards those enterprises with clear ESG strategies, boards must adapt to a more 'conscious capitalism' where ESG - when adopted effectively - can limit risk and contribute to improved returns. When it comes to ESG, the stakes are rising—as are the growth opportunities. The conversation isn't new, it's expanding. ESG oversight is about more than checking a box. It's about creating sustainable advantage and value. To do that, your board needs to see the full picture.

Environmental, social and governance (ESG) issues are increasingly seen by shareholders as a window into the future. And a clear hierarchy is emerging. Leading companies view ESG issues as a business imperative. They manage risks while capitalizing on opportunities, including sharing their story and vision for the future, setting themselves up for long-term success and value creation in the process. Laggards still think of ESG as a check-the-box exercise grounded in philanthropic activities. An important thing to remember is that ESG isn't a separate, independent, niche problem; it has fundamental effects on your approach to doing business (i.e., building products to be recycled, designing processes so they can be monitored for compliance with internal and external goals, etc.). Together, these are helping create frameworks for effectively approaching these issues using a system composed of people, processes, and tech working together to help companies effectively incorporate ESG as an essential component of their overall strategy, risk, and governance programs.

ESG STANDARDS AND FRAMEWORKS

In recent years, a number of groups, such as the Sustainability Accounting Standards Board, the TCFD, the Global Reporting Initiative, and the World Economic Forum International Business Council, have issued ESG-related reporting disclosures. Others, including the IFRS Foundation, are considering how to incorporate

sustainability information in corporate reporting.

Just as financial reporting is prepared in accordance with US GAAP, IFRS, or another accounting framework, ESG standards and frameworks allow companies to disclose standardized information. They provide consistency and comparability, and they benefit from due process, enabling investors to make more informed decisions.

DETERMINING THE RIGHT OVERSIGHT STRUCTURE FOR ESG OVERSIGHT

Directors should consider implementing an ESG oversight structure that ensures their decision-making process is adequate and will withstand the parameters of the business judgment rule. Hence, some boards may consider creating a specific committee to which they delegate specific responsibilities in order to benefit from centralized and integrated recommendations respecting ESG. Other boards may choose to deal with such matters at the board level and ask that new matrices be included in the risk management dashboards presented to them. An honest appraisal of ESG includes a frank acknowledgment that getting it wrong can result in massive value destruction. Being perceived as "overdoing it" can sap a leader's time and focus. Underdoing it is even worse. Companies that perform poorly in environmental, social, and governance criteria are more likely to endure materially adverse events. Businesses need to play the long game. That means they need to satisfy the needs of their customers, employees, and communities—these days,

often a global community—in order to maximize value creation. Thriving businesses concerned with long-term horizons fuel a virtuous cycle. They create jobs, increase tax revenue, and raise standards of living. ESG helps generate wealth,

USING A PROTOCOL IN ESG OVERSIGHT

When satisfied they have the right oversight structure and composition, boards should consider setting up a protocol to assist directors in properly discharging their duties of loyalty and care, taking into account ESG factors. As mentioned above, having such a protocol in place may prove useful as directors will be judged by the process they follow. Such a protocol could include the following steps.

- **Mapping :** Identifying and categorizing ESG factors is a key first step in helping directors discharge their duties. This enables directors to map out areas that need particular attention and decisions that might require further reflection. Many of these factors will have been flagged through issuers' legal compliance or risk management systems.
- **Weighing :** Once various factors have been mapped, directors should do their best to weigh them carefully and determine their impact on the corporation in a given situation, taking into account various stakeholders.[15] In some instances, the motivation to prioritize certain factors will be influenced by legal requirements or the management of specific risks. Conflicts are to be expected when weighing such factors.
- **Deciding :** After weighing various ESG factors and their expected impact on the corporation, directors should determine which course of action is in the corporation's best interest.
- **Documenting:** As directors remain accountable for their decisions, and different stakeholders might have conflicting views on what's in the corporation's best interests in a given situation, directors should maintain accurate and adequate records of their decision-making process.

ESG SCORE AND RATING

ESG scores are determined by third-party firms that have their own methodologies to identify a company's ESG rating. Currently, this isn't a process that is streamlined across the board, and different companies have their own way of determining a company's ESG rating. ESG scores and ratings are important because they give an overall picture of the company's performance in these three areas. These scores help inform potential or current investors and can even help inform governments as to whether they want a company operating within its borders. A higher ESG score also aligns with a company being more sustainable, having happier employees, and being more productive and profitable. There are some criticisms of ESG ratings — most notably that the scores and analysis aren't streamlined and there can be variations between how companies give out ratings. ESG ratings also encompass a lot of broad topics in the workplace, making it difficult to standardize the scores across every company and industry. It can also be difficult for older companies to make the changes necessary for a high ESG score — especially around automation and building changes.

BARRIERS TO PURSUING ESG GOVERNANCE AND SUGGESTED STRATEGIES TO ADDRESS THEM.

- **Barriers:** Information overload for boards , Lack of board turnover (inhibits diversity) , Lack of business case , Lack of internal resources and expertise, Difficulty in making structured governance

changes, Lack of ESG Governance benchmarking for industry peers

- **How to address the barriers:** Boards and management should prioritize and focus on material ESG issues, Boards and Governance Committees should formalize the structures needed that will endure even with management turnover

CONCLUSION

The era of stakeholder capitalism and ESG will have consequences that reach much farther than we can anticipate today. ESG is here to stay and will continue to disrupt business models; and the boards that lead and direct companies with the right approach by overcoming such biases will ensure the success of companies into the future. ESG is not just about "doing good"; it's a top business imperative. Ultimately one of the board's most critical tasks is safeguarding the company's reputation, and ESG goals and outcomes directly impact the company's reputation with the public and employees. In short, boards should consider taking responsibility for ESG and ensure they have the right people to do so. They should consider developing protocols to identify which factors are important and integrate them into their decision process and compensation plans. They should also make sure reporting is adequate and be mindful of potential liability. ESG is more than just metrics, regulations and frameworks. At its core, ESG is an actionable way to measure progress and take steps towards a more sustainable future. The ESG debate makes it clear that the way supports its clients we do business is changing and it is going to continue to change significantly in the months and years ahead. No company can prosper nowadays if it is not involved in the community and the people around it. Companies need to take an active role in the community, beyond just making a profit.

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