CEP Magazine - July 2021
ESG has always been in the compliance wheelhouse

By Lisa Beth Lentini Walker

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Environmental, social, and governance (ESG) concerns make up a broad area of investor and stakeholder interest. There are many different specific definitions, but generally:

- "E" covers a wide spectrum of **environmental** initiatives aimed at minimizing an entity's harm to the environment, including climate change, pollution, deforestation, and greenhouse gas emissions; doing business with ecofriendly practices in mind, such as having energy efficiencies and goals; and practicing pollution mitigation, waste management, and water usage reduction.
- "S" focuses on the many aspects of **social** interactions and human capital, including justice, equity, diversity, and inclusion; compliance and ethics matters, including reporting hotlines, labor standards, wages, and benefits; workplace and board diversity; racial, social, and organizational justice; and stakeholder and community relations.
- "G" is the **governance** and oversight of this area, like board composition and structure, oversight and compliance, executive compensation, political contributions and lobbying, and bribery and corruption.

Prior to 2019, the general thought was that a company's primary purpose was to make money for its shareholders, but interest in ESG matters on the part of investors and other corporate stakeholders has intensified, and the current economic, public health, and social justice crises have made this focus acute. ESG is now a critical way in which companies are being evaluated beyond the financial reports.

Why do investors (and your board) care about ESG?

For a long time, investors in the United States have had the option of submitting shareholder proposals. These proposals were typically designed to request a company take action or not take action. For decades the proposal topics ranged from operational requests to accountability and reporting on new items. More recently, there has been an uptick in ESG-related proposals, and the shareholder votes have increasingly favored action by companies. At the same time, initiatives have been growing in the investment philosophies world. "Green" investors initially focused around sustainability and later on socially responsible investing; however, unlike accounting, there is not a single well-defined and generally accepted standard for the measuring and reporting of ESG matters.

Due to the absence of an international consensus regarding ESG disclosures, a number of frameworks and indices have emerged to guide company disclosures and inform investors. Some of the leading international frameworks include the Global Reporting Initiative standards,[1] the Sustainability Accounting Standards Board (SASB) standards,[2] the United Nations Principles for Responsible Investment,[3] and the United Nations Sustainable Development Goals.[4] Ratings have also proliferated over the last decade. Morgan Stanley Capital International and specialist firms such as Sustainalytics have recently been joined by traditional credit rating agencies such as

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Moody's Investors Service and S&P Global Inc.

ESG metrics have continued to be an area of focus for investors to measure risk as well as opportunity. BlackRock, a major American multinational investment management firm with $8.67 trillion in assets under its management as of January 2021, has been very influential in continuing to foster the movement toward ESG accountability and transparency. In his "Dear CEO" letter in 2021,[5] BlackRock Chairman and CEO Larry Fink wrote:

> Assessing sustainability risks requires that investors have access to consistent, high-quality, and material public information. This is why last year, we asked all companies to report in alignment with the recommendations of the Task Force on Climate-related Financial Disclosures (TCFD) and the Sustainability Accounting Standards Board (SASB), which covers a broader set of material sustainability factors. We are greatly encouraged by the progress we have seen over the past year – a 363% increase in SASB disclosures and more than 1,700 organizations expressing support for the TCFD.

He goes on to say:

> In 2018, I wrote urging every company to articulate its purpose and how it benefits all stakeholders, including shareholders, employees, customers, and the communities in which they operate. Over the course of 2020, we have seen how purposeful companies, with better environmental, social, and governance (ESG) profiles, have outperformed their peers....
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> It is clear that being connected to stakeholders – establishing trust with them and acting with purpose – enables a company to understand and respond to the changes happening in the world. Companies ignore stakeholders at their peril – companies that do not earn this trust will find it harder and harder to attract customers and talent, especially as young people increasingly expect companies to reflect their values. **The more your company can show its purpose in delivering value to its customers, its employees, and its communities, the better able you will be to compete and deliver long-term, durable profits for shareholders.**

Other business leaders have also supported more expansive views regarding the purpose of a corporation. In August 2019, the Business Roundtable, a nonprofit organization made up of corporate CEOs, released a new statement on the purpose of a corporation.[6] The statement was signed by the CEOs of nearly 200 leading US companies and identified shareholders as one of five key stakeholders, along with customers, workers, suppliers, and communities.

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