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NAVIGATING ESG ISSUES FOR PUBLIC COMPANIES

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Overview

I. Current Landscape & What's on the Horizon

II. Trends in ESG Disclosures

III. Advising Boards, Best Practices & Legal Risks in Drafting ESG Disclosures

ESG – THE CURRENT STATE OF PLAY

What is ESG?

E is for "Environment"	S is for "Social"	G is for "Governance"
• Greenhouse gas emissions • Climate change • Energy use • Water use • Pollution • Hazardous waste • Recycling • Sustainability	• Corporate giving and philanthropy • Working conditions • Workplace health and safety • Compensation and benefits • Internal pay equity • Employee opportunity • Labor and human rights • Child and forced labor • Diversity and inclusion • Supplier practices	• Board structure and composition (including tenure and diversity) • Executive compensation • Shareholder rights • Enterprise risk management • Audit oversight • Disclosure and reporting • Ethics and compliance • Privacy and cybersecurity

Evolution of ESG

2006
UN Principles for Responsible Investing Established

2007
NY AG subpoenas five large energy companies re: disclosure of financial risk of GHG emissions

2018
SASB Publishes Industry Stndards

2020
SEC Adopts Human Capital Disclosure Requirements in 10-Ks

2021
Biden Administration ESG Policies

Difference between ESG and CSR

- Corporate Social Responsibility (CSR) is an older concept that corporations should be accountable to society and not invest in harmful or unethical businesses
- We can think of CSR as a precursor to ESG
  - CSR lacked the focus on measurability of results using key performance indicators (KPIs) or reference to third-party standards/metrics, which came out of impact investing
  - Criticized for being a footnote in an annual report or marketing tool

Where Do Companies Address ESG Disclosures?

Human Capital Disclosure

COVID-19

SEC Filings

CSR Reports

Climate Change

Comp and Pay Equity

Community Impact

Diversity & Inclusion

Company Website

How Do Companies Think About ESG Disclosure?

Consider:

- Industry
- ⇨ What specific ESG disclosures are germane to our industry?

Peer group

⇨ What are our peers doing?

Level of stakeholder engagement

⇨ Have we received feedback from shareholders, employees, board members, activists, proxy advisors, or other institutions?

Varying ESG Standards

- ESG frameworks and standards continue to evolve rapidly; lack of harmonization
  - There are over 650 rating agencies
- Growing confusion regarding appropriate disclosure framework
  - The market relies on ESG rating agencies to review and assess ESG data; hundreds of agencies
  - Each agency has a different methodology for how they rate all the underlying ESG metrics
  - Vanguard has stated that voluntary disclosure regime and the “subjective nature” of ESG ratings can lead to “inconsistencies” and “material differences” in how companies are assessed on ESG

ESG Frameworks At-a-Glance

	GRI *Global Reporting Initiative*	**TCFD** *Task Force on Climate-Related Financial Disclosures*	**SASB** *Sustainability Accounting Standards Board*	**CDP** *Formerly known as Carbon Disclosure Project*	**UN SDG** *UN Sustainable Development Goals (SDGs)*
Founded	1997	2015	2011	2000	2015
Format	Modular standards that contain requirements, recommendations, and guidance	Climate-related financial disclosures to be made in mainstream annual filings (Form 10-K) within existing disclosure framework	Quantitative; includes standards by sector; focuses on materiality from a financial reporting perspective SASB and the International Integrated Reporting Council (IIRC) are to merge into one organization by mid-2021	Questionnaires within areas of focus – climate change, water, forests	Aspirational goals, targeting 2030 for achievement

Unified Disclosure Standard?

- In July 2020, the GAO issued a report acknowledging the lack of comparable ESG disclosures
  - Sen. Warner: “It is time for the SEC to establish a task force to establish a robust set of quantifiable and comparable ESG metrics that all public companies can adhere to”
  - In August 2020, SEC Commissioner Allison Herren Lee said that the SEC should “get investors the standardized, consistent, reliable, and comparable ESG disclosures they need to protect their investments and allocate capital toward a sustainable economy”
- In his 2020 letter to CEO, Larry Fink asked companies to report based on TCFD and SASB recommendations; his 2021 letter, Mr. Fink stated the following:
  - **We strongly support moving to a single global standard**, which will enable investors to make more informed decisions about how to achieve durable long-term returns

Corp Fin Leadership Changes

- Last week, John Coates was appointed Acting Director of Corp Fin
  - "During my four years on the Investor Advisory Committee, I observed firsthand the staff's enthusiastic commitment to **helping build the world's most socially productive capital markets.** I look forward to working closely with the staff both in daily mission-critical work and as we consider ways to address new challenges facing companies and investors as they seek to raise and **allocate capital sustainably** and efficiently."

    - John Coates, February 1, 2021

Corp Fin Leadership Changes (cont.)

- SEC also appointed Satyam Khanna to serve as Senior Policy Advisor for Climate and ESG
  - New role in which he will advise the agency on ESG matters and advance related new initiatives across its offices and divisions
  - Khanna served previously on the SEC's Investor Advisory Committee Investor-as-Owner Subcommittee of the
  - In May 2020, the Committee recommended that the SEC enhance disclosure requirements to include "material, decision-useful, comparable and consistent information" relating to ESG factors
  - The Committee also asked the SEC to "take control of ESG disclosure…before other jurisdictions impose disclosure regimes on US [i]ssuers and investors alike"

Human Capital Disclosure

- In August 2020, the SEC adopted rules that require a description of the registrant's **human capital resources**
- Required only to the extent such information would be material to an understanding of the registrant's business
- This disclosure requirement is largely principles-based
  - Meaning… not a lot of guidance from the SEC
  - The adopting release did not define the term "human capital"
  - SEC says that companies should consider disclosing "measures or objectives that address the development, attraction and retention of personnel"

What is “Human Capital Management”?

“Human capital management” includes:

- Diversity and inclusion
- Corporate culture and values
- Employee development, wellbeing, and engagement
- Compensation and non-monetary benefits

What is "Human Capital Management"? (cont.)

Commentators on the proposal suggested that human capital disclosure could cover :

- Worker recruitment
- Employment and hiring practices
- Employee benefits and grievance mechanisms
- Workplace health and safety
- Strategies and goals related to human capital management
- Legal and regulatory proceedings related to employee management
- Existence of collective bargaining agreements
- Employee compensation and incentive structures

Human Capital Disclosure – “Fluff” or Hard Numbers?

“…I do expect to see meaningful **qualitative and quantitative disclosure**, including, as appropriate, **disclosure of metrics** that companies actually use in managing their affairs”

Former SEC Chairman Jay Clayton, August 2020

What Kind of Numbers?

- Number of employees at fiscal year end
  - U.S. versus non-U.S.
  - Employees represented by a union
- Diversity metrics
  - Percentage of diverse leaders (board and executive team)
  - Percentage of diverse hires
  - Percentage of diverse workforce
- Health and safety metrics
  - Favorable changes in recordable injury rate
- Attrition rates
- Internal survey metrics

Outline of Human Capital Disclosure

I. Overview
   - Information on number of employees
   - “Mission statement” on how company thinks about human capital

II. Diversity & Inclusion

III. Employee Health and Wellness

IV. Compensation and Benefits

V. Employee Hiring, Development and Retention

VI. COVID-19

Human Capital and COVID

- Recent trend of "economic fairness" is likely to see greater traction in light of the pandemic and concerns regarding income inequity
- Business Roundtable statement:
  - "Americans deserve an economy that allows each person to succeed through hard work and creativity and to lead a life of meaning and dignity"
  - Asked for a commitment for corporations to invest in employees
  - "This starts with compensating them fairly and providing important benefits. It also includes supporting them through training and education that help develop new skills for a rapidly changing world. We foster diversity and inclusion, dignity and respect"

See Appendix

Racial and Ethnic Diversity – ISS

- For 2021, ISS will "highlight" boards of companies in the Russell 3000 or S&P 1500 that lack racial and ethnic diversity; that is, by indicating in research reports which boards lack such diversity
- In 2022, ISS will recommend voting against or withhold from the chair of the nominating committee (or other directors, on a case-by-case basis), if a board has no apparent racially or ethnically diverse members
- On February 8, ISS ESG announced enhancements to its Diversity and Inclusion subcategory
  - Factor will evaluate ethnic and racial diversity on a company's board
  - Compensation category will include a new factor that evaluates the level of disclosure of diversity and inclusion performance metrics

Racial and Ethnic Diversity – Proposed Nasdaq Rule

- Nasdaq has submitted a proposal to the SEC seeking approval of new listing rules to advance board diversity and increase transparency to investors regarding the diversity characteristics of Nasdaq-listed company boards
  - Proposed Rule 5605(f) would require each Nasdaq-listed company to have, or explain why it does not have, at least two "Diverse" directors, including (a) at least one director who self-identifies as female; and (b) at least one director who self-identifies as an Underrepresented Minority, or as LGBTQ+
  - For purposes of proposed Rule 5605(f), "Diverse" means an individual who self identifies in one or more of the following categories: female, Underrepresented Minority or LGBTQ+
  - Underrepresented Minority" means any person who self-identifies as Black or African American, Hispanic or Latinx, Asian, Native American or Alaska Native, Native Hawaiian or Pacific Islander, or two or more races or ethnicities
  - "Female" means an individual who self identifies her gender as a woman, without regard to the individual's designated sex at birth

ESG – Material Failures in Risk Oversight

- ISS’ voting policy currently provides that ISS will issue negative vote recommendations, under extraordinary circumstances, against board members in the event of, among other things, material failures of governance, stewardship, risk oversight, or fiduciary responsibilities at the company
- For 2021, ISS will include “demonstrably poor risk oversight of environmental and social issues, including climate change” as another example of a risk oversight failure
- This change follows a roundtable discussion held during 2020 between ISS and eight institutional investors regarding ISS's approach on a variety of ESG-related topics, including climate change risk, human capital management, and ESG-related shareholder proposals

What's On the Horizon

- President Biden's campaign promise to require companies to disclose climate risks and GHG emissions ⇨ coupled with leadership changes, this translates to additional SEC action on this front
- Increased transparency on D&I initiatives
- Additional push to disclosure framework harmonization
- Heightened risk of litigation centering on ESG disclosures
- Continuing impact of COVID-19
- Compensation tied to ESG metrics
- ESG activism

TRENDS IN ESG DISCLOSURES

Actions Companies Are Addressing in the New Normal

Keep COVID-19 front and center – disclosing how they treated their employees (under Social/Human Capital) during the pandemic.

- During COVID-19, some companies conducted employee engagement surveys to gather feedback from employees as to how the company was doing in meeting the needs of its employees during COVID-19. Employee engagement also is a SASB performance indicator for human capital. This is a great way for companies to be held accountable for their performance from employees. Some companies might include the special COVID related employee engagement results in their proxy or ESG disclosure report.
- Other actions company took to show they were addressing employees were:
    - Create a special employee led task force that reports out to the executives for status updates
    - Establish a COVID-19 PTO policy
    - Implement the use of facial coverings in the office policy (provide facial coverings, hand sanitizer to all team members who request it)
    - Create a pandemic symptom screening policy
    - Ensure team members are socially distancing and following CDC safety guidelines

Actions Companies Are Addressing in the New Normal (cont.)

- **Tell a story:** (sharing short employee stories) of how the company has positively impacted their lives.
- Include fact sheet in the proxy summary section with a link to their ESG report if they already have one. If they haven't done one before, we're suggesting some additional "viable" information in the main body of the proxy – focusing on goals and targets.
- This of course opens the door for requests for more disclosure in the very near future from stakeholders. We're strongly suggesting to firms to already have or at least be in the process of building out an ESG roadmap with other partners (outside counsel, advisory firms) before disclosing in the proxy.
- Disclosing how the firm is making ESG an integral part of the seasonal/yearly shareholder engagement plan.

ADVISING BOARDS AND BEST PRACTICES AND LEGAL RISKS IN DRAFTING ESG DISCLOSURES

Advising Boards on ESG

- Boards and ESG – Survey Results
- In the PwC 2020 Annual Corporate Directors Survey on ESG, although 55% of directors surveyed considered ESG issues to be a part of the board's enterprise risk management discussions, 49% saw a link between ESG issues and the company's strategy and 51% recognized that ESG issues were important to shareholders, directors were "not convinced that they're connected to the company's bottom line. Only 38% of directors say ESG issues have a financial impact on the company's performance—down from 49% in 2019." And only 32% thought that the board needed more reporting on ESG-related measures. Notably, 51% thought that their boards had "a strong understanding of ESG issues impacting the company."
- By contrast, the NYU Stern Center for Sustainable Business, *U.S. Corporate Boards Suffer From Inadequate Expertise in Financially Material ESG Matters*, analyzed the credentials of the 1188 Fortune 100 board directors, based on company bios and Bloomberg bios. The study "found that very few sectors and very few companies were adequately prepared at the board level for issues that were already affecting their performance."
- PWC found that more female than male board members are likely to say that climate change and human rights should be part of business strategy, for example (PWC 2020). Most boards have a preponderance of former CEOs sitting on their boards. Those CEOs were in charge 10-20 years ago when ESG issues were not regularly considered as material and they bring that mentality to the boardroom.

Advising Boards on ESG

Why should Boards care about ESG issues:

- Stockholders, stockholder advisory firms and other stakeholders (e.g. customers and employees) are increasingly holding boards and corporations more accountable for addressing ESG issues- COVID-19 catalytic effect
- Increase in ESG stockholder proposals for inclusion in proxies and ESG activist campaigns
- Buyers/Investors increasingly conducting ESG due diligence
- Increase in SEC regulation of ESG issues and potential for further increase in Biden administration
- Increase in federal and state legislation on ESG issues and potential for further increase in Biden administration
- Keeping up with peers and competitors - according to the Governance & Accountability Institute, 90% of the companies in the S&P 500 Index published sustainability reports in 2019. Further, 65% of the Russell 1000 Index companies published sustainability reports in 2019, up from 60% in 2018

Advising Boards on ESG

ESG risk areas:

- Lack of measurability and reporting standards – no equivalent of GAAP for ESG measurement and reporting
- Litigation/activist campaigns from shareholders over alleged breach or fiduciary duties for failing to maximize profits or litigation/activist campaigns from other stakeholders (e.g. consumers/advocacy groups) over allegedly false or misleading statements concerning ESG commitments
- Increased SEC regulation (e.g. human capital) and enforcement limiting board discretion
- Increased federal and state legislation (e.g. Senator Warren's proposed Accountable Capitalism Act, California legislation mandating board diversity) limiting board discretion or creating private rights of action

Advising Boards on ESG

- Current Delaware law mandates that "stockholders' best interest must always, within legal limits, be the end" of business decisions made by directors of a Delaware corporation. (*In re Trados Inc. S'holder Litig.*, 73 A.3d 17, 37 (Del. Ch. 2013))
- Shareholder primacy does not prohibit directors from considering the interests of constituencies other than shareholders, but those "[o]ther constituencies may be considered only instrumentally to advance [shareholders' best interests]" (*In re Trados, 73 A.3d at 37*)
- Therefore, it is crucial for the Board to begin any discussion of corporate purpose by asking not only why the interests of the Company's various stakeholders should be considered, but also how benefitting a non-shareholder constituency ultimately impacts shareholder value

Advising Boards on ESG

- Delaware courts have held that the deferential standard of review under the business judgment rule applies to directors' "rational judgments about how promoting non-stockholder interests — be it through making a charitable contribution, paying employees higher salaries and benefits, or more general norms like promoting a particular corporate culture — ultimately promote stockholder value" (*eBay Domestic Holdings, Inc. v. Newmark*, 16 A.3d 1, 33 (Del. Ch. 2010)).
- Accordingly, when approving an action that furthers the interests of a non-shareholder constituency, the Board should:
  - ***Consult*** with management and external advisors as needed, so that each director is prepared to reach an informed decision
  - ***Document*** its decision-making process in a way that protects the Board against claims that directors improperly allocated corporate resources to advance individual altruistic goals at the expense of shareholder value

Advising Boards on ESG

"Corporations that adopt stakeholder and ESG principles, with the implicit agreement of their shareholders achieved through active communication and engagement, will be best positioned to achieve sustainable growth over the long term. The objective is not to maximize the near-term stock price of the corporation; instead, as we have elsewhere noted, the purpose of the corporation is to achieve and conduct a lawful, ethical, profitable and sustainable business in order to create value over the long term. This does not just permit but rather *requires* consideration of all the stakeholders that are critical to the corporation's success (shareholders, employees, customers, suppliers, creditors and communities). The task of identifying stakeholders, and mediating amongst them, properly rests with boards of directors acting on their informed business judgment. Shareholders are essential partners in the corporation's pursuit of this mission, and regular engagement between investors and directors is another necessary element of effective stakeholder-oriented governance. Corporate action and decision-making, taken against the backdrop of this view of corporate purpose, will be fully protected by the business judgment rule, so long as it reflects the decisions of unconflicted directors acting upon careful deliberation."

Martin Lipton, Harvard Law School Forum on Corporate Governance – June 5, 2020

Advising Boards on ESG

Examples of actions that benefit other stakeholders but promote long-term shareholder value:

- Increasing employee wages
- Allocating resources to diversity and inclusion initiatives
- Offering fair terms to small, local suppliers
- Giving back to, and conscientiously engaging with, local communities
- Adopting environmentally sustainable measures

Advising Boards on ESG issues

- In the context of a sale of the business, the so-called *Revlon* duties do require profit maximization
- Unlike 44 other states, Delaware does not have a constituency statute
- Delaware has adopted a Public Benefit Corporation Statute that allows for stakeholder capitalism to be baked in the charter and override traditional fiduciary duties requiring profit maximization, including *Revlon* duties
- There are very few publicly-traded Benefit Corporations and Etsy, after it went public, abandoned plans to convert from a Certified B Corp to a Benefit Corp under stockholder pressure.

Best Practices for Implementing an ESG Program

- Define ESG goals, KPIs and rating systems/metrics, looking at peers/competitors
- Engage with C-Suite/Board on ESG goals
- Prioritize the time and resources needed to support ESG goals
- Engage with other internal stakeholders, along with third-parties, advisors, shareholders and other stakeholders, on achieving ESG goals
- Communicate strategic importance of ESG goals with disclosure team
- Develop disclosure and reporting policies and procedures
- Consider forming ESG reporting and disclosure committee

Best Practices for ESG Reporting – US Chamber of Commerce

- When possible, ESG disclosure should focus on a company's risks and opportunities with sufficient potential to impact the company's long-term operational and financial performance in light of its business and should discuss the company's approach to risk management, making the connection, to the best of their ability, between the ESG topics on which they report and the company's long-term value creation strategy
- Before preparing its ESG disclosures, a company should consider which audience (or audiences) is the intended recipient of its reports and should tailor the tone and content of its reports accordingly, particularly regarding information that would be most useful for investors or whether for other ESG-oriented stakeholders

Best Practices for ESG Reporting – US Chamber of Commerce (cont.)

- Preparers of ESG reports should consider how best to liaise with relevant departments and functions within the company to ensure that all relevant information is collected and addressed and that diverse perspectives and inputs are accounted for
- However, when it comes to determining whether information is material or not as a matter of law, that assessment should reside with a company's legal department
- In their ESG reports, companies should clearly define in plain English technical terms and terms that do not have a universally accepted definition
- It is important to allow companies discretion in how they report and discuss ESG information
- Each company should maintain the flexibility to determine which ESG factors and related metrics are relevant to it and what disclosure is meaningful for its stakeholders and not necessarily what is identified in various third-party frameworks and standards

Best Practices for ESG Reporting – US Chamber of Commerce (cont.)

- ESG information should be easy for users to find, such as through dedicated ESG disclosure web pages and links
- ESG reports need not be incorporated into SEC filings to accomplish this objective, nor should ESG information be required as part of an SEC filing if it is not material under the Supreme Court's well-established definition of materiality for federal securities law purposes
- Finally, a company should consider including in its voluntary ESG reports a description of the company's internal review and audit process or any external verification of the information that the company received

How Do Companies Report ESG?

- **<u>Press Releases and Other Website Posts</u>** –
  - Press releases and website posts are the typical channels for companies to highlight their ESG achievements and commitment to their stakeholders, as well as to host ESG-related content, such as sustainability reports
- **<u>Annual and Periodic Reports</u>** –
  - Due to the legal liability associated with information disclosed in an SEC filing, most US public companies tend not to include extensive ESG discussions in their reports on Form 10-K or 10-Q
  - Depending on the industry and the circumstances, some companies include more fulsome risk factors outlining the interconnections between the well-being of key non-shareholder stakeholders and the company's financial performance or the success of post-M&A business integration

How Do Companies Report ESG? (cont.)

- **<u>Proxy Statements</u> –**
  - US public companies must distribute proxy materials that provide sufficient disclosure on matters to be addressed at a shareholder meeting (for example, director elections, shareholder proposals, or a proposed sale of all or substantially all of a company) so shareholders are able to vote in an informed manner
  - While disclosure on corporate purpose is not necessarily required, many US public companies currently highlight their ESG oversight frameworks or recent ESG achievements in their proxy statements, including ESG expertise represented on the board or executive team
- **<u>Social Media and Advertising</u> –**
  - While both social media and advertising can be powerful tools to send an ESG message, care needs to be exercised to avoid misunderstandings and potential backlash

Takeaways

- Benchmark ESG efforts against peers and broader industry
- Ensure that all ESG disclosures are thoroughly vetted
  - Avoid the temptation to “lift” HCM disclosures from the career portion of the website
- Consider integrating TCFD and SASB frameworks, and identify material metrics
  - Indicate in the body of the disclosure document how factor correlates to each reporting framework being used
  - Indicate the extent to which a framework element is not being reported upon and why
- Highlight the intersection of programs with UN SDGs or other UN initiatives
- Highlight participation in industry ESG-related initiatives

QUESTIONS?

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APPENDIX

COVID-Related Proxy Disclosures: Examples

Employee Engagement

Employee-led and company-sanctioned groups of those who share similar interests that also promote ESG goals including exercise groups and, in this year of COVID-19 and uncertainty, a victory garden contest (Mesa Laboratories, Inc.)

Board Oversight

During the outbreak of COVID-19…our Board has closely monitored [our] business and response, receiving frequent updates and briefings from management who, under the leadership of our Chief Executive Officer and executive leadership team, were able to maintain business continuity, proactively act in the best interests of our business and stockholders over the short and long term, and maintain the health and safety of our most valuable asset - our employees (Change Healthcare Inc.).

Board Oversight

Regarding the COVID-19 pandemic, our management is meeting frequently to address concerns of our employees and business, as well as updating and communicating with the Board regularly. In addition to the committees' review of COVID-19's impact in the scope of their respective authorities reflected above, the Board also has oversight and has been engaged concerning the monitoring and identification of risks to the Company, and actions we are taking to mitigate risks related to this pandemic (New Relic, Inc.)

COVID-Related Proxy Disclosures: Examples (cont.)

Community Support and Corporate Citizenship

We showed our support for the military community, front-line workers, and vulnerable populations through philanthropic donations to the COVID-19 Military Support Initiative, the CDC Foundation, and Feeding America, as part of an ongoing pandemic resilience program. (Booz Allen Hamilton)

Community Support and Corporate Citizenship

As part of the Data for Good program, we partner, on a pro-bono basis, with companies who leverage data for social good. For example, we've partnered with the Truth Initiative to help fight the opioid epidemic, and more recently, with a variety of telehealth platforms to help better serve individuals during the COVID-19 crisis. (LiveRamp Holdings, Inc.)

Community Support and Corporate Citizenship

In addition to helping our customers to deliver critical medical equipment to combat the COVID-19 virus, the Company and the Flex Foundation have donated over $1 million to date. For example, as members of the U.N. Global Compact ("UNGC"), we supported their COVID-19 crisis fund with the World Health Organization and have also made donations locally to the communities where we operate. The Company also donated over 250,000 masks to hospitals and first responders (Flex Ltd.)

Shareholder Outreach

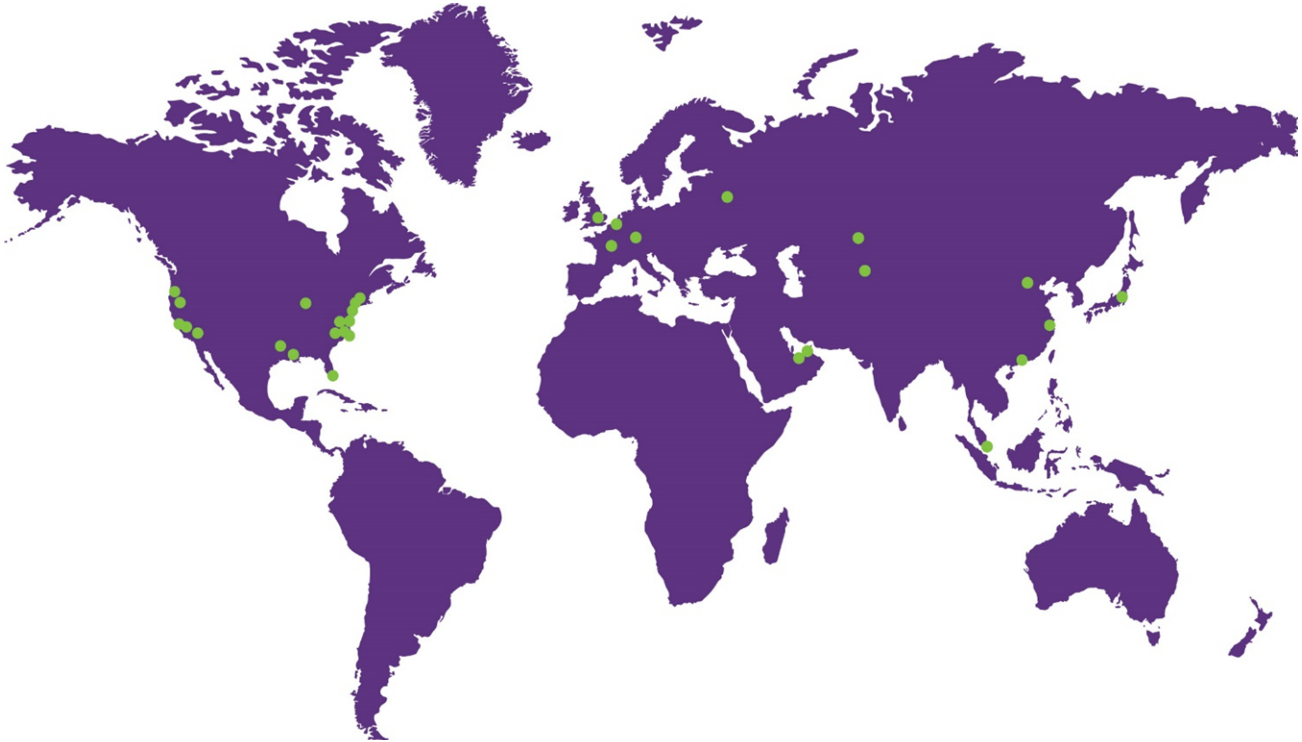
Given our commitment to the health and safety of our employees and shareholders, we elected to cancel our in-person Investor and Analyst Day in March 2020. Instead, we hosted a webcast during which Flex's executive leadership team presented an in-depth discussion regarding the Company's response to the COVID-19 pandemic, our corporate strategy update, evolution around the Company's segments, and our financial framework (Flex Ltd.)

Our Global Reach

Africa
Asia Pacific
Europe
Latin America
Middle East
North America

Our Locations

Abu Dhabi
Almaty
Beijing*
Boston
Brussels
Century City
Chicago
Dallas
Dubai
Frankfurt
Hartford
Hong Kong*
Houston
London
Los Angeles
Miami
Moscow
New York
Nur-Sultan
Orange County
Paris
Philadelphia
Pittsburgh
Princeton
San Francisco
Shanghai*
Silicon Valley
Singapore*
Tokyo
Washington, DC
Wilmington



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