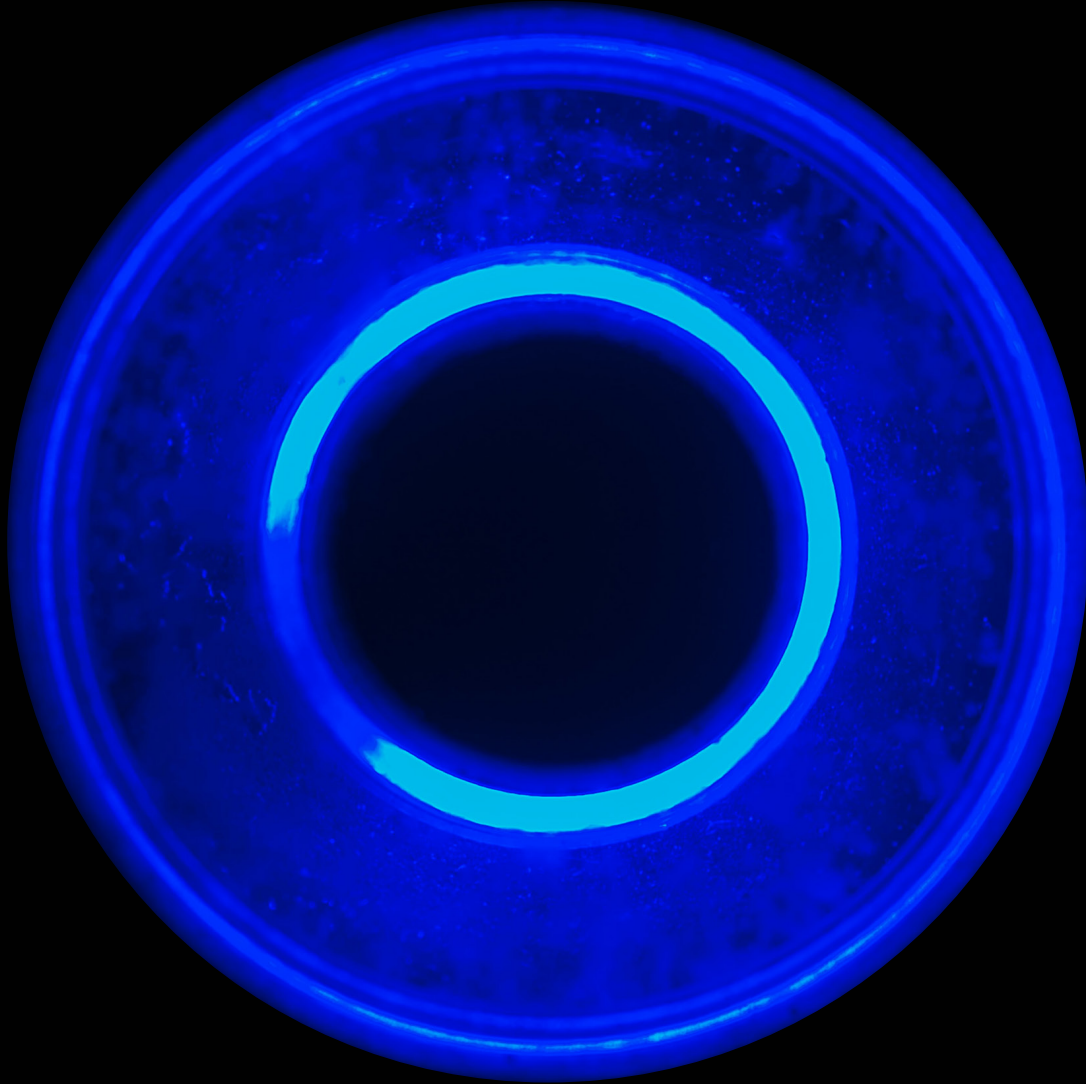




The role of the
chief legal officer in
driving ESG strategy

A recent Deloitte survey found that after quality, the second highest reason for brand loyalty is ethical or sustainable business practices.¹ As further evidence of the rise of importance of environmental, social, and governance (ESG) practices, it may be helpful to note that in 2020, 90%² of the S&P 500 published some form of ESG disclosure, a significant increase from a mere 20% in 2011.³ Recent research also shows a correlation between ESG ranked stocks and financial performance.⁴ When done well, ESG strategies may do much more than positively influence a corporation's financial performance. Strong execution on ESG priorities may also positively impact recruiting and retention and allow for greater innovation and brand differentiation.⁵

As the push for organizations to develop and execute on their ESG strategy grows, leaders are increasingly making choices in alignment with ESG considerations. Organizations are also becoming increasingly accountable to a broader set of stakeholders: consumers, employees, suppliers, and even communities. In some discussions of ESG, this has been called a shift from shareholder capitalism to stakeholder capitalism⁶—meaning that the shareholder may no longer hold the most important influence for the enterprise. Instead, corporate decision-making seems to be shifting from the framework of “what’s best for the shareholder” to “what’s best for a wide range of stakeholders,” and nearly three-quarters of surveyed consumers believe that companies should prioritize the needs of all stakeholders, not just financial reward.⁷

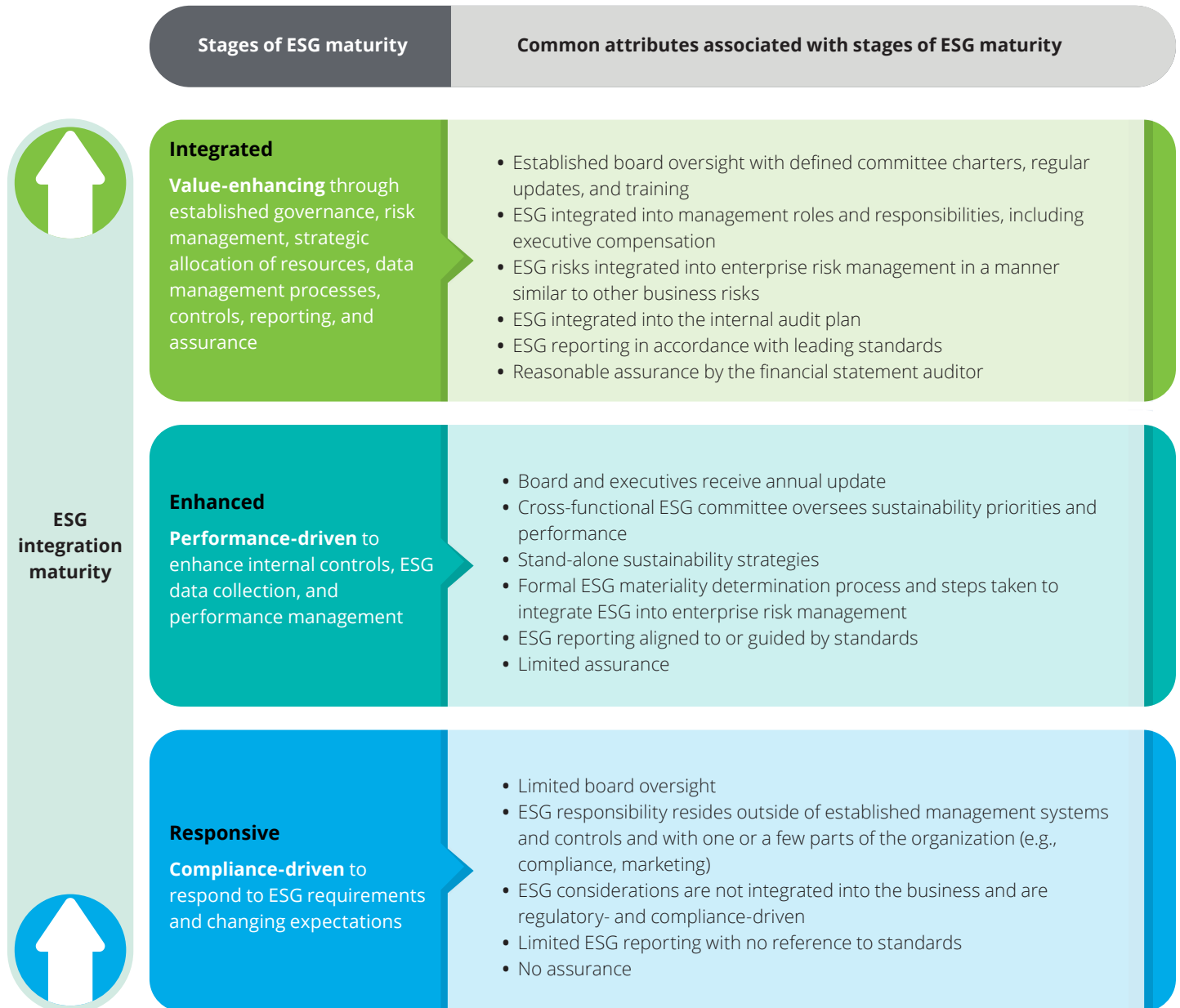
For these reasons, in a relatively short period of time, ESG concerns have risen to a position of prominence within the enterprise.

What role does the chief legal officer (CLO) play in ESG efforts? In the 2021 Association of Corporate Counsel survey,⁸ 15% of CLOs indicated that ESG reports to them, and another 8% felt it should. Whether ESG reports to the CLO or not, CLOs have an opportunity to take on a leadership role in this area. As the established conscience of the company, with a deep understanding of risk and exceptional communication skills, the CLO is well-positioned to guide the enterprise as ESG efforts evolve. The CLO role under ESG may be broken into three key components: effectively communicating the risks and opportunities of the ESG strategy, developing ESG reporting and disclosure mechanisms, and influencing the regulatory environment.



ESG integration maturity model

The ESG integration maturity model shows the stages of ESG maturity and describes common attributes associated with those stages.



Source: Deloitte, [#DeloitteESGnow – Enhancing Trust in ESG Disclosures](#), September 22, 2020.



Effectively communicate the risk and opportunities of the ESG strategy

ESG as a stand-alone or ancillary feature of strategy per se is not often as impactful as when those efforts are fully integrated into the greater business strategy⁹ and are embraced by each company executive. The development of the company's ESG purpose and mission should be an effort shared among executive stakeholders and include clear objectives and governance mechanisms that support those objectives. A materiality assessment can serve as a starting point. Leaders across all functions should be encouraged to integrate ESG considerations into their functional strategies, work to align ESG priorities with business strategies, and include ESG objectives in strategic planning and resource allocation.

In this process, the CLO can play a role in helping leaders understand the risks and opportunities inherent in the ESG strategy by clearly communicating how ESG risks are identified and prioritized. Much like the CLO's work in compliance generally, the leadership opportunity here lies in the effective communication of the ESG framework to all stakeholders (including not only shareholders, but also others such as leadership, employees, customers, regulators, and the board) and the development of a strong and enforceable ESG compliance program across the enterprise.

A CLO should identify the stakeholders that will play a role in telling the ESG story and communicating ESG disclosures. For these stakeholders, understanding how ESG risks are identified and prioritized is especially critical. Additionally, this group of stakeholders should understand how materiality is defined in the context of ESG metrics, the internal controls in place around such metrics, and how and where those metrics are disclosed (for example, in sustainability reports or public filings).¹⁰

CLOs should consider the following questions:^{11,12}

- **Does the board and executive leadership understand the risks and opportunities for the business with respect to sustainability?** This includes determining how sustainability-related risks and opportunities affect the company's strategy and whether or not ESG is integrated into the company's enterprise risk management activities.
- **In developing the ESG strategy, does the company understand what types of ESG disclosures its largest investors and other stakeholders seek, and if so, how is the board and the company responding to these expectations?**

Advocate for a consistent, compelling narrative to tell the sustainability story, even though the extent, form, location, and content of specific ESG disclosures may vary.

- **Has the enterprise undergone a materiality assessment?** Research indicates that companies that perform well on material sustainability issues and concurrently perform poorly on immaterial sustainability issues enjoy the strongest financial returns. The research also found that 80% of disclosures are immaterial, having no correlation to positive performance.¹³





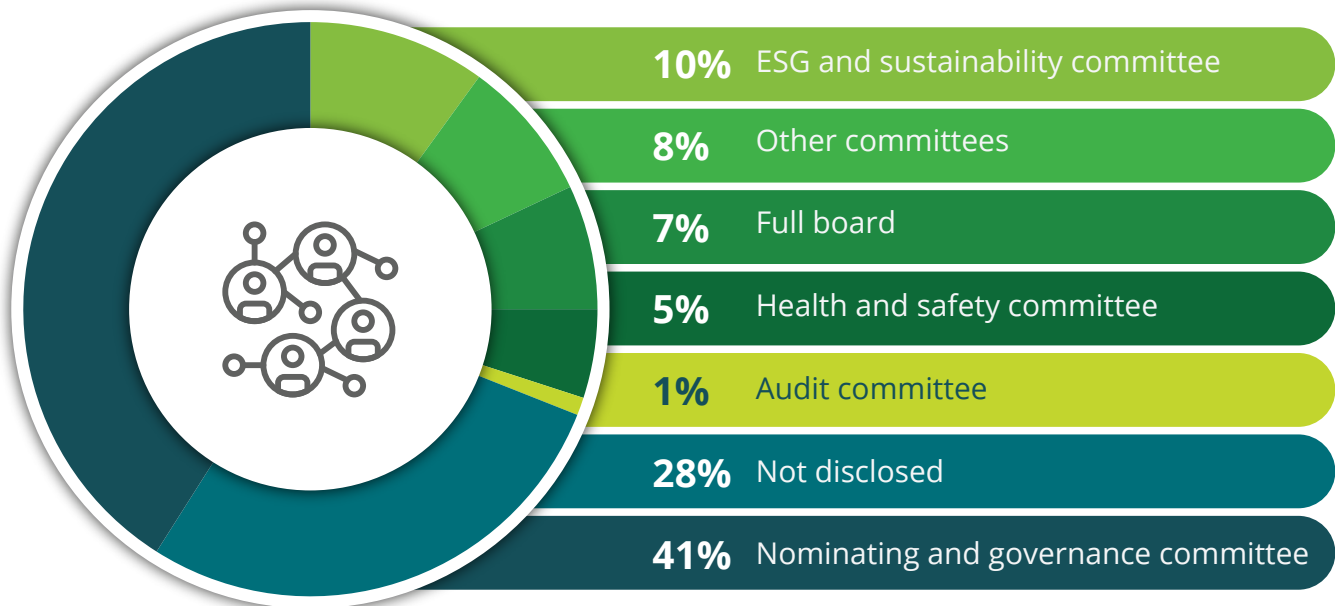
Develop ESG reporting and disclosure mechanisms

As already noted, a rising number of corporations are publicly reporting on ESG initiatives, and investors and capital markets increasingly expect effective disclosures to effectively price in risk.¹⁴ An increasing number of companies are also recognizing that simply providing data may not go far enough for investors; accordingly, 36% of S&P 500 companies now obtain assurance on select ESG information in their sustainability reports, and 3% obtain assurance on sustainability reports as a whole.¹⁵

Because of the evolving importance of ESG disclosures to investors, it is likely that the audit committee of the board will be a key player in the development of reporting and disclosure protocols, and the CLO should stay in good communication with the audit committee. Research indicates, however, that there is currently wide variability in how ESG is supervised from a board perspective.¹⁶ In many cases, the nominating and governance committees have primary oversight, but in some cases, an entirely new committee has been formed for the purposes of ESG oversight,¹⁷ and as ESG reporting requirements continue to evolve, different aspects of the ESG mission could fall into the purview of various board committees, depending on their respective charters.¹⁸ Thus, it is important that the CLO engage and communicate with all relevant stakeholders in a clear and consistent manner.¹⁹

S&P 500 board committee oversight of ESG

Responsibility for ESG within the board varies

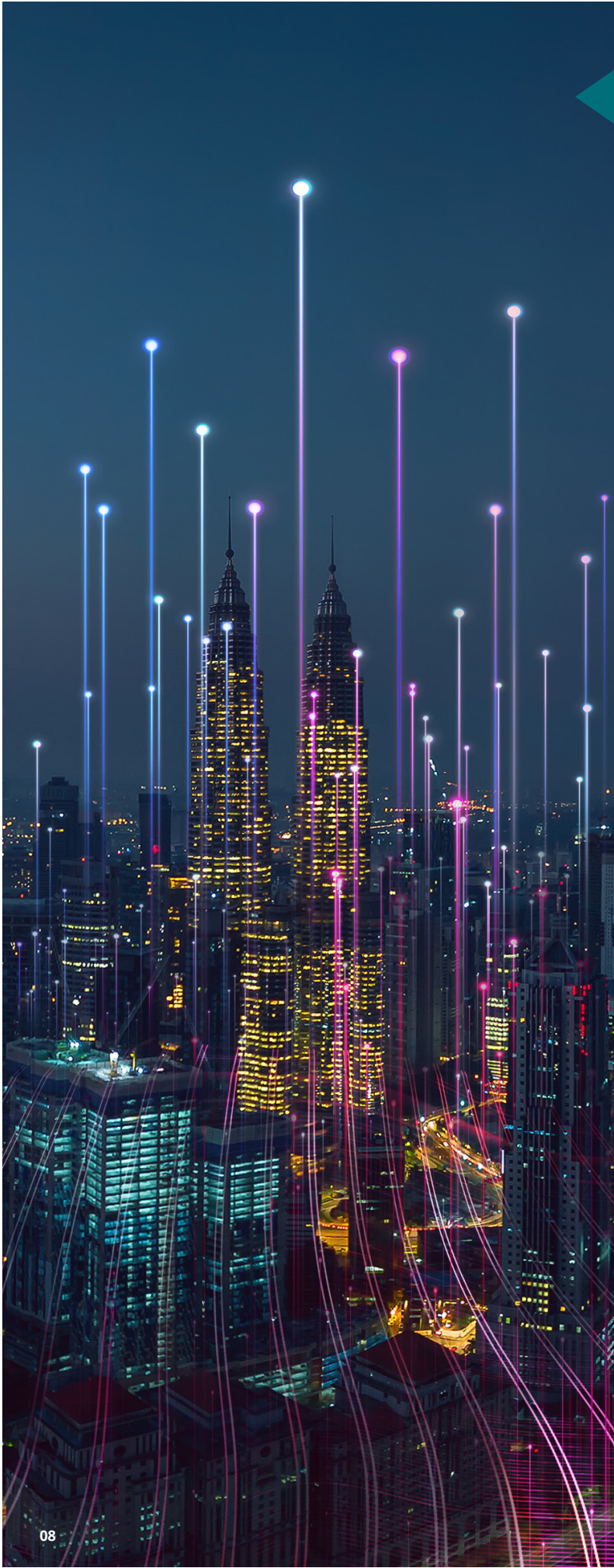


Source: Deloitte 2019–2020 proxy research

In order to develop a strong reporting and disclosure mechanism, a leading-edge ESG program should be data-based, metrics-driven, and aligned to the mission of the organization. But reporting on ESG goes beyond data and metrics, and the CLO can lead in the development of a compelling and consistent narrative that tells the company's ESG story.

CLOs should consider the following questions:²⁰

- Who within the company is responsible for ESG management and performance disclosure, and what is the internal governance structure?** A true understanding of ESG governance requires consideration of how the company identifies ESG issues that are material and collects data that supports high-quality disclosure.
- Is sustainability the responsibility of the full board, or is it delegated to one or more committees?** Given their oversight of the financial reporting process, the audit committee could play an important role in reviewing and assessing the disclosure of material ESG matters. With increasing investor attention and reliance on ESG disclosure, the audit committee will likely also play a role in overseeing how ESG information is presented to investors.
- If the company currently reports on ESG matters, what ESG standards or frameworks are being used to prepare ESG disclosures?** How often is the form and content of that reporting revisited to assess changes and modifications to reflect current trends? Periodic review of ESG reporting is relevant because information reporting standards are still evolving.
- Has management considered obtaining assurance on its ESG disclosures? What level of engagement has management had with the independent auditor on ESG reporting?** Having an independent party assess and opine on the reliability of ESG disclosures can play an important role in signaling the quality and reliability of the information to potential investors.



Influence the regulatory environment

Although there is an increasing supply of ESG-related information available, the lack of a standard for investor-grade information has left some investors dissatisfied.²¹ As the CLO gains more experience in developing the enterprise ESG strategy and understanding the related risks and opportunities, they have an opportunity to be a voice in the development of regulatory frameworks relative to ESG. A Calvert report²² notes that “the most effective way to achieve the pecuniary benefits of improved risk/returns is to support ongoing improvements in the quality of information available to investors, not discouraging fiduciaries from considering them in the first place.”²³

Notwithstanding the growing call for more reliable disclosures, regulatory actors are not all aligned in their response. For example, the US Department of Labor’s Employee Benefits Security Administration issued a proposed rule²⁴ on June 30, 2020, suggesting a deemphasis of ESG considerations in investing decision-making. Although the current administration has since paused this initiative, it is important to note that the proposal was opposed by 95% of those who submitted comments.²⁵ At the same time, several regulatory bodies are considering moves in the opposite direction (see sidebar for a brief overview of some of those proposals). In this process, CLOs have an opportunity to share their experiences with regulators and work to positively influence the development of the ESG regulatory structure.



Market developments:

01

On August 26, 2020, the SEC issued a final rule that modernizes certain disclosure requirements in Regulation S-K.2. Two SEC commissioners, Caroline Crenshaw and Allison Herren Lee, dissented to the decision and expressed concern that the final rule does not go far enough to adequately address climate change risk, human capital, and diversity. Commissioner Lee stated, "It's time for the SEC to lead a discussion—to bring all interested parties to the table and begin to work through how to get investors the standardized, consistent, reliable, and comparable ESG disclosures they need to protect their investments and allocate capital toward a sustainable economy."

02

Other SEC activity: The SEC's Investor Advisory Committee published a report encouraging the SEC to develop a framework for ESG reporting in SEC filings.

03

The SEC's ESG Subcommittee provided a report in May 2020 and an updated report in September 2020 to the SEC Asset Management Advisory Committee, highlighting the need for certain ESG-related disclosures by asset managers, including disclosure and independent validation of the degree of ESG compliance. See Deloitte's September 3, 2020, *Heads Up* for more information about the final rule. The report also noted that the ESG subcommittee is studying possible enhancements to issuer disclosures.

04

The International Business Council (IBC) of the World Economic Forum (WEF) published a report that includes a set of core ESG metrics designed to enable companies to measure and report on sustainable value creation. The publication helps advance the momentum toward global ESG standards by establishing a coherent and comprehensive corporate reporting system. The WEF-IBC report includes references to the separate WEF Impact Management Project, which culminated in the issuance of a joint statement by the five major ESG standard-setting institutions of a shared vision of what is needed for progress toward comprehensive corporate reporting and their intent to work together to achieve it. At the same time, the International Federation of Accountants launched its consultation for the IFRS Foundation to create an authoritative nonfinancial standard-setter.

05

The Commodity Futures Trading Commission, an independent US federal agency, issued a report calling for regulators to actively promote, and in some cases require, better understanding, quantification, disclosure, and management of climate-related risks.

06

The Financial Accounting Foundation sent a survey asking the public about what the group's future priorities should be, including whether it should explore nonfinancial accounting standards such as those related to ESG issues.

07

Large investors, including CalPERS (the largest US public pension fund), are calling for mandatory reporting by companies and auditors on climate risk.

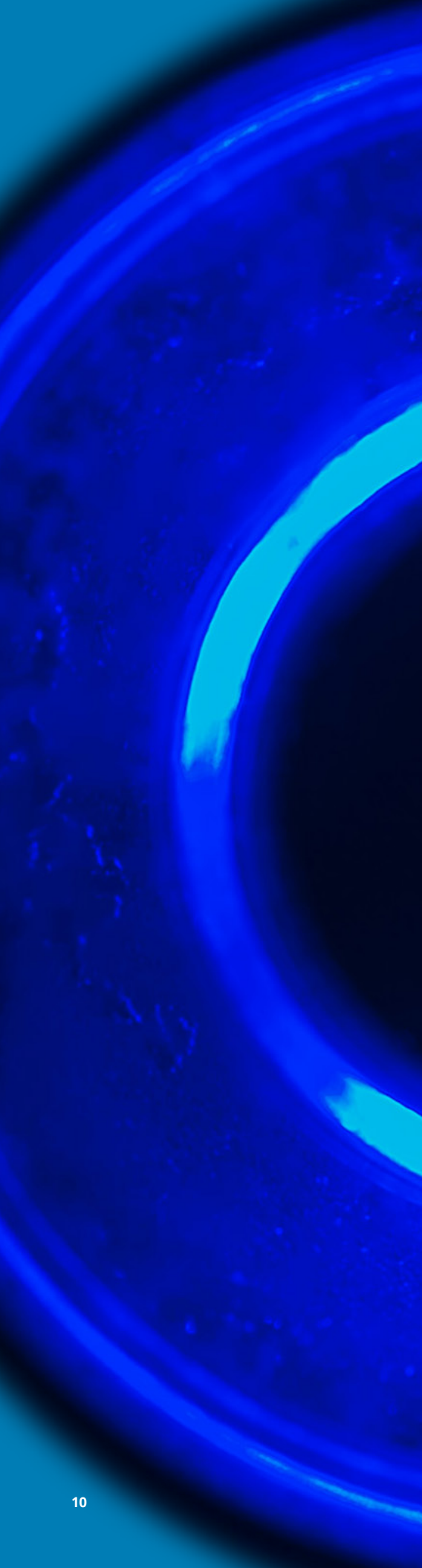
08

Asset managers continue to focus on ESG within investment decisions. BlackRock published a special report highlighting its increased engagement on ESG and actions taken against companies deemed to be making insufficient progress. State Street issued a letter to board chairs requesting that companies provide enhanced disclosure about diversity, specifically racial and ethnic diversity, including communication related to strategy, goals, metrics, the board, and board oversight.

09

The European Commission's upcoming revisions to the European Union Non-Financial Reporting Directive, on the basis of consultation responses received, could expand the scope of the directive to more companies and could require companies to provide additional disclosures of (and assurance over) ESG matters in annual reports.

Source: Deloitte, [#DeloitteESGnow – Enhancing Trust in ESG Disclosures](#), September 22, 2020.



If ESG is truly integrated into the overall enterprise strategy, then no one executive will have sole ownership over its effective execution, and the responsibility will be shared. But, notwithstanding the joint responsibility required for an impactful ESG program, the CLO is well-positioned to take a leading role in the development and implementation of ESG efforts by communicating risk and opportunities, developing ESG reporting and disclosure mechanisms, and influencing the regulatory environment, benefiting not just shareholders, but also a diverse and important array of stakeholders.

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