BankDirector.com CHARTING A COURSE FOR AMERICA'S BANKING LEADERS

Creating a Comprehensive ESG Approach, From Compliance to Competitiveness

By: *David Portilla, Minh Van Ngo* | November 17th, 2021

Not only are investors increasingly incorporating environmental, social and governance, or ESG, factors in decisions about how to allocate their capital, but customers, employees and other stakeholders are also placing greater emphasis on ESG matters.

ESG will also continue to be a focus for regulators, with a particular emphasis on climate-related risks. It has rapidly evolved from a compliance matter to a strategic and competitive consideration; boards of directors and management teams should respond with both short-term action and preparation for the longer term. We review key developments and offer six steps that boards and management can take now to position a bank for the current ESG environment.

SEC's Approach to Climate Change

The Securities and Exchange Commission has made considerations relating to ESG topics a top priority going forward, especially with respect to climate change-related issues. Chair Gary Gensler has *charged* SEC staff with developing a rule proposal on mandatory climate risk disclosure by the end of this year. Based on Gensler's statements, the rulemaking is likely to be distinct from approaches developed by private framework providers and may not necessarily be tailored according to company size, maturity or other similar metrics.

Gensler has emphasized the importance of climate change disclosures generating "consistent and comparable" and "decision-useful" information. These disclosures may be contained in Form 10-K; given the tight timeframes associated with preparation of Form 10-K filings, this approach may require certain registrants to adjust their data collection and verification practices.

Bank Regulators' Approach to Climate Change

Federal Reserve Chair Jerome Powell has indicated that he supports the Fed playing a role in educating the public about the risks of climate change to help inform elected officials' policy decisions. The Fed established a Financial Stability Climate Committee to identify, assess and address climate-related risks to financial stability across the financial system, as well as the Supervision Climate Committee to help understand implications of climate change for financial institutions, infrastructure and markets.

The Office of the Comptroller of the Currency and Federal Deposit Insurance Corp. are also taking climate risk seriously. In July, the OCC joined the Network of Central Banks and Supervisors for Greening the Financial System and announced the appointment of Darrin Benhart as its first climate change risk officer. Most recently, Acting Comptroller of the Currency Michael Hsu *said* the OCC is working with interagency peers to develop effective climate risk management guidance. The FDIC expects financial institutions to consider and address climate risks in their operating environment.

ESG as Competitive Advantage

Many companies have begun integrating ESG considerations into their products and strategies. Some *research* has shown that ESG can drive consumer preferences, with certain consumer demographics using ESG factors to differentiate among products. Younger demographics, for example, are choosing banks according to ESG credentials. Moreover, ESG considerations are becoming increasingly important to certain employee bases.

ESG issues are also top-of-mind for *many investors*, driven by prominent institutional investors that are linking a company's ESG profile with its *long-term financial performance* and other stakeholders who want to align investments with social values and goals.

Directors and management teams should engage in an honest self-assessment of their bank's ESG status, including determining which ESG matters are most material to their business. They should establish processes for board-level ESG strategy and oversight, along with clear management authority and reporting lines. They should also strengthen controls around ESG quantitative reporting. Ultimately, **management should now consider whether and how to begin integrating ESG into commercial activities and overall strategy**. With that in mind, here are six steps that boards and management can take now:

1. Conduct a self-assessment on ESG matters, including on materiality, performance and controls.
2. Begin preparations for an imminent SEC rulemaking on mandatory climate change disclosure that could potentially apply to Form 10-Ks in time for the 2022 fiscal year.
3. Strengthen ESG processes and controls, while allowing flexibility for frequent reevaluation.
4. Understand the key players in the ESG space and their varied perspectives.
5. Establish responsibility for maintenance of a core ESG knowledge base and awareness of key developments.
6. Monitor ESG developments as part of operational and strategic planning.

David Portilla is a partner at Cravath, Swaine & Moore LLP in the corporate department whose practice focuses on advising international and domestic banking organizations and other financial institutions on transactional, regulatory, supervisory, enforcement and governance matters. From 2011 to 2013, Mr. Portilla served as a senior policy advisor to the U.S. Department of the Treasury's financial stability oversight council office.

Minh Van Ngo is partner at Cravath, Swaine & Moore LLP in the corporate department whose practice focuses on mergers and acquisitions and corporate governance matters, including those related to ESG. He advises clients in connection with M&A, corporate governance and crisis management, including consensual and hostile transactions, leveraged buyouts, strategic investments, takeover defense, proxy contests and hedge fund activism.