Practical Steps for Board and Management Supervision of ESG Data Gathering and Disclosure


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1 Introduction

Environmental, social and governance ("ESG") topics are now ubiquitous on the agendas of boards of directors and company management. As ESG considerations have achieved significant influence among constituencies such as investors, customers, suppliers, employees and regulators, companies have been pressured into making an increasing number of ESG-related commitments and disclosures, in light of the imminent prospect of additional required disclosures for U.S. listed companies by the U.S. Securities and Exchange Commission (the "SEC"). The explosion of stakeholder interest in ESG matters in recent years has also prompted a nascent backlash with countervailing pressures to *avoid* making significant ESG commitments, particularly if they are perceived as detrimental to pecuniary returns to investors. Directors and management have been thrust – willingly or unwillingly – into engaging with ESG topics despite being potentially caught in the crossfire between the pro- and anti-ESG camps on the substantive merits and goals of ESG.

Regardless of the ultimate merits or success of the ESG movement, it remains a reality that boards and management are and will be subject to significant and growing requirements and expectations to gather and report ESG-related data. Responding to these requirements and expectations and having effective processes and procedures for ESG data gathering and management are fundamental challenges requiring significant attention from directors, managers and their outside advisors.

This chapter begins by providing an overview of the current landscape of ESG data and disclosure, which includes a discussion of relevant drivers and challenges. Next, we provide recommendations for practical steps that boards of directors and management of all companies should consider in gathering ESG data and making ESG disclosures. We consider, in turn, the steps management should take to produce disclosure-ready data and the role of boards of directors in supervising the ESG data gathering and disclosure processes.

Each company's organisation and structure may be different; it may be subject to different ESG requirements or expectations as a result of its industry or jurisdiction, and each company may find itself in a different place in the fractious debate over ESG. Nonetheless, we believe robust systems for the collection and review of ESG data and rigorous controls for the review of ESG disclosures are table stakes for all companies.

2 Overview of the Current Landscape of ESG Data Gathering and Disclosure

A Drivers of Increasing ESG Data Collection and Disclosure

Companies have been subject to increasing pressure in recent years to collect ESG data and disclose it in comparable forms. This data-driven focus has come from a variety of sources, including investors, laws and regulations, employees, consumers and financing requirements.

In parallel with the socioeconomic upheaval from the COVID-19 pandemic and a continuing academic debate around corporate purpose and the efficacy and forms of stakeholder-centric (*versus* shareholder-centric) governance, investors are increasingly reporting that they are using ESG data in decisions about how to either vote their shares or allocate their capital. This trend can be seen in investors of all varieties, from large institutions (such as the "Big Three" of BlackRock, Vanguard and State Street, each of which has published voting guidelines that include ESG-related voting standards[1]), to a growing number of ESG-themed funds seeing increasing capital inflows (particularly in 2020 and 2021), to ESG-focused activist investors, to private capital sources such as private equity funds or venture capital firms.

Companies are feeling heightened pressure to make ESG disclosures as these investors are themselves subject to increasing pressure to validate their ESG *bona fides* from their own regulators and investors, each of which is likely to be mindful of increased attention to so-called "greenwashing" concerns in the ESG space.[2] Rigorous collection and processing of ESG data gives money managers evidence to rebut a charge of greenwashing, meaning that, as pressure to stamp out greenwashing grows, companies should expect even more intense demands for ESG data from their investors.

Laws and regulations are also increasingly requiring the collection and disclosure of ESG data. This trend has been led particularly by regulation in Europe (the "European ESG Regulation"), such as through the Non-Financial Reporting Directive (the "NFRD"), the Sustainable Financial Disclosure Regulation ("SFDR"), the European Union NFRD (the "EU NFRD") and potentially a Corporate Sustainability Reporting Directive ("CSRD").[3] While some of these rules will likely affect U.S.

multinational companies to some extent, even companies with solely U.S. domestic operations will be subject to pressure in the current U.S. regulatory landscape as well.

For example, the SEC has been signalling its intent to oversee and regulate public companies in terms of certain ESG-related data gathering and disclosures. On June 22, 2022, the SEC released its regulatory agenda (the "Spring 2022 Reg. Flex Agenda"), which lists the agency's anticipated short- and long-term regulatory actions.[4] In particular, three SEC proposed or planned rulemakings included in the Spring 2022 Reg. Flex Agenda will almost certainly affect companies' ESG data gathering and disclosures; these will be discussed later in this chapter.[5] The SEC also seems focused on delivering new regulation and enforcement in the space of ESG investing which, as described above, will ultimately heighten pressure on companies to provide reliable ESG data and disclosures.

Besides the SEC, U.S. domestic companies are subject to ESG-related regulations by a variety of other U.S. agencies, such as the U.S. Equal Employment Opportunity Commission (the "EEOC") and the U.S. Environmental Protection Agency (the "EPA"). The EEOC annually requires private companies with 100 or more employees and federal contractors with 50 or more employees to gather and submit demographic workforce data, including data by race/ethnicity, sex and job categories on an EEO-1 Component 1 report, or "EEO-1 report". Although the EEOC is prohibited from making public an employer's EEO-1 data, there has recently been a strong push by investors through various means, such as shareholder proposals, to have this data made public by companies. Additionally, the EPA requires annual reporting of, and annually publishes, greenhouse gas ("GHG") and related data from large GHG emissions sources and fuel and industrial gas suppliers in the United States pursuant to the Greenhouse Gas Reporting Program. These mounting U.S. regulatory pressures for ESG disclosures underscore the importance of ESG data collection processes for U.S. companies.

Current and potential employees also drive companies to gather and disclose ESG data. A company's ESG data and performance may affect employee satisfaction – and, therefore productivity – as well as the talent pool interested in applying and working for a particular company. Amidst the Great Resignation[6] and phenomena such as "quiet quitting", employers are increasingly focusing on talent acquisition and retention, and ESG performance can be a source of competitive advantage for companies in these fields, particularly in industries such as technology. According to certain studies, top employers (measured by employee satisfaction and attractiveness to young talent) score higher on ESG performance.[7]

ESG performance is also expected to continue increasing in importance in hiring and retaining talent as millennial and Generation Z workers begin to make up more of the global workforce. These generations generally place greater weight on environmental and social concerns when deciding where to work and, as such, expect more from their employers on ESG matters than past generations. To demonstrate their ESG credentials to current and prospective employees, companies may feel pressured to commit to potentially significant ESG initiatives or goals, which typically require greater gathering and disclosure of ESG data. Indeed, the collection of ESG data itself (such as surveys of worker satisfaction) can be a visible signal to current and potential employees concerned with ESG that the company cares and is engaged.

Finally, financing pressures can also significantly influence what ESG data companies collect and disclose. Recently, many large banks have made significant public commitments to sustainability goals and sustainable financing. To demonstrate compliance with these commitments, financing sources are demanding more data and disclosure.

B Challenges in the Collection of ESG Data and Disclosure

While a number of factors are pressuring companies to collect and disclose ESG data, identifying, tracking and disclosing it is often not a simple undertaking.

As an initial matter, due to the rapid rise of ESG, many companies lack experience collecting the types of ESG data they are now called upon to disclose. Unlike disclosures that U.S. domestic public companies have had many years of experience disclosing (such as traditional financial results), or disclosures for which data can be mined from pre-existing systems (such as new requirements for "pay *versus* performance" executive compensation disclosures, which should generally be derivable from normal financial and accounting records or other SEC disclosures), the ESG data being demanded by stakeholders (as well as related calculation protocols) may be novel to many companies. While some ESG data gathering and reporting is not newly invented (*e.g.*, the previously discussed EEO-1 report and the EPA's Greenhouse Gas Reporting Program), not all companies have been subject to ESG data gathering and disclosure requirements, meaning they may not all have sufficient experience collecting and/or calculating or establishing and implementing reliable protocols for verifying and reporting such data, particularly where it must be sufficiently rigorous for public consumption and scrutiny. However, as ESG data and disclosure regulations and requirements have evolved, more companies will be required to gather and disclose a growing number of ESG metrics.

Next, the ESG data that stakeholders are requesting be disclosed is not always consistent and stakeholders may not evaluate ESG data in consistent ways. Given the many different stakeholders and their ever-evolving agendas, there may be differences in the ESG data disclosure methodologies that different stakeholders apply, and it is seemingly impossible to please every investor or ESG rating agency with their numerous and differing disclosure expectations. Considering the evolving and complex nature of these disclosures and stakeholders' complicated scorecards (and, often, a lack of transparency in scoring methodologies), even when companies attempt to disclose one or more of their stakeholders' favoured metrics, there may be a low correlation in their ultimate ESG ratings and scores. While there are signs that repeated calls to standardise the ESG reporting environment may lead to some consolidation, it remains to be seen whether these efforts will bring meaningful clarity and consistency to this space. For now, developments in the "private ordering" of ESG will continue to remain fluid and will require companies to be poised to act pre-emptively and quickly, with companies needing to collect and disclose ESG without clarity on what types of data will satisfy the relevant constituencies.

Further, ESG data gathering and disclosure is itself caught up in the conflict over the merits of ESG. Critics of the Proposed Climate Rules have focused on the costs surrounding requirements for climate disclosures, and opponents have argued that the increased financial burdens carried by covered companies will prevent companies from wanting to go public in the United States, force small private companies, such as local farmers and ranchers, to gather and provide disclosure to large multinational companies that disclose their Scope 3 GHG emissions, and misallocate resources towards disclosure and away from proactive climate solutions. Companies concerned about anti-ESG backlash may be hesitant to implement ESG data collection policies if they risk inviting negative scrutiny or if they believe the backlash will reduce or eliminate the pressure they feel to make ESG disclosures.

Despite these challenges, the pressure to compile and disclose ESG data seems unlikely to go away any time soon. Accordingly, boards of directors and management should take concrete steps to respond to ESG data and disclosure demands in the short term as well as to prepare for the long term. Despite the uncertainties continuing to surround both the regulatory process and private ordering in the ESG space, as well as the fragmentation in reporting demands and expectations, the potential risks posed by inaction or delay are serious. These risks include, among others, falling out of favour with key investors or ratings providers, reputational damage with customers and suppliers, lost business opportunities and being significantly behind other companies in implementing ESG-related practices if – or more likely when – they do become mandatory.

3 Practical Management Steps to Produce Disclosure-Ready Data

While the board of directors is responsible for overseeing the company's ESG direction as a whole (considered in the next section), it is management's duty to obtain and produce disclosure-ready ESG data. While there are a number of components to an effective ESG disclosure regime, management should prioritise developing and maintaining robust procedures and controls around ESG data gathering, establishing and coordinating cross-functional teams to review ESG disclosure and undertaking a thoughtful process to determine which ESG data should be collected in the first place.

A Procedures and Controls

Management should develop and maintain robust controls to gather and validate its ESG data to ensure it is complete, reliable, consistent across the company and secure, and to ensure all ESG disclosures are timely and accurate.

First, these sorts of controls and procedures may be required by existing laws and regulations. Pursuant to the Sarbanes-Oxley Act of 2002, as amended (the "Sarbanes-Oxley Act"), public companies must establish and maintain, and management must periodically evaluate, the effectiveness of their disclosure controls and procedures designed to ensure that information required to be filed or submitted by the issuer in its Securities Exchange Act of 1934, as amended (the "Exchange Act") reports is recorded, processed, summarised and reported to meet the relevant requirements.[8] Relevant information must also be accumulated and communicated to management as appropriate to allow for timely decisions regarding required disclosure. To the extent that any ESG-related information must be disclosed in a company's Exchange Act reports, it would be subject to the disclosure controls and procedure requirements of the Sarbanes-Oxley Act. It is particularly important to prioritise the development of controls and procedures surrounding ESG in light of the Proposed Climate Rules and any forthcoming human capital reporting requirements.

Additionally, beyond disclosure controls and procedures, the Proposed Climate Rules would require companies to include climate-related financial statement metrics and related disclosures in a note to their audited financial statements in a new Article 14 of Regulation S-X ("Article 14"), which would be subject to the company's internal control over financial reporting. This, in turn, will require coordination between a company's accounting and data teams to ensure all relevant inputs to Article 14 (*e.g.*, the occurrence and consequences of climate events) are considered and their controls are designed and implemented to provide reasonable assurance regarding the reliability of the Article 14 footnote. The Article 14 component of the Proposed Climate Rules has received significant criticism in the comment process and is considered by some to be extremely difficult for companies to operationalise. Companies may need to expend significant effort to implement appropriate internal control over financial reporting if the Proposed Climate Rules are adopted as proposed.

Secondly, companies should adopt robust ESG-related controls and procedures because there are increasing risks for getting ESG disclosures wrong. A number of recent lawsuits have been filed by private plaintiffs against companies for allegedly misleading or incorrect disclosure related to ESG.[9] Although these lawsuits have not yet been particularly successful, public scrutiny of such data is likely to continue and successful claims in the future may result in such lawsuits becoming more attractive to plaintiffs' lawyers.

Regulators also have increasingly been penalising companies for incorrect and misleading data. For example, in April 2022, the SEC charged Vale S.A. ("Vale"), a publicly traded Brazilian mining company and one of the world's largest iron ore producers, with making false and misleading claims through ESG disclosures in its public sustainability reports and other public filings regarding the safety of one of its dams prior to a collapse that killed 270 people, caused substantial environmental and social damage and led to the loss of more than $4 billion in Vale's market capitalisation. The SEC's charges include, among others, using unreliable laboratory data for dam stability declarations, concealing material information from dam safety auditors, disregarding accepted best practices and minimum safety standards and making false and misleading statements to investors. The SEC seeks injunctive relief, disgorgement plus prejudgment interest and civil penalties against Vale.

In 2019, the New York Attorney General ("AG") sued ExxonMobil in New York state court under the state's Martin Act, alleging it misled investors with respect to its disclosure of climate-related risks and accounting and maintained two sets of books – one public and one private – for estimating the cost of complying with future climate regulations. The court dismissed the suit, holding that the New York AG had not produced any investor who was harmed and failed to show that "ExxonMobil made any material misstatements or omissions … that misled any reasonable investor". These lawsuits and enforcement actions highlight the importance of ensuring that companies can stand behind their ESG disclosures.

In this legal and regulatory climate, companies should be working to develop a suite of appropriate controls and procedures to gather and validate ESG data. This should include developing and documenting rigorous reporting procedures that are consistent across the company's operations and geographies; formalising data management systems for ESG-related data in software and technology environments (including incorporation of ESG data into traditional enterprise resource planning software used to manage and integrate the essential parts of a company's business, moving beyond the simple spreadsheets underlying much traditional ESG reporting); ensuring processes for ESG data are reviewed, sampled and verified by appropriate functional areas (such as internal audit); and implementing steps to monitor ESG reporting policies over time to ensure consistency and make improvements.

Note that, as described above, quantitative ESG reporting can be complicated by unclear or inconsistent definitions of relevant metrics or data collection that may lag behind the customary reporting cycles for a company's financial information, and implementing ESG control procedures may expand the workload and responsibilities for certain internal functions, such as finance or internal audit teams. Accordingly, creating and maintaining these procedures and controls will likely involve numerous discussions with management across a number of operational, accounting, internal audit and legal functions, as well as with controllership, the disclosure committee, the audit committee (and any other board committees with ESG oversight – or potentially the entire board of directors) and external advisors.

B Cross-Functional Management Oversight

Previously, ESG disclosure may have been the responsibility of a company's investor relations or public relations department. Accordingly, the responsibility for ESG data tracking, oversight and reporting may have resided in functional areas without deep experience in these sorts of tasks. However, with the increased importance and amount of data that needs to be collected, overseen and reported, a cross-functional team with disclosure experience should be given the collective responsibility for the ESG reporting process.

Although it is not required, most public companies have "disclosure committees" (composed of management, not directors) to accumulate and evaluate information for potential disclosure, helping to support principal executive officers and principal financial officers in making their mandatory certifications under the Sarbanes-Oxley Act.[10] Disclosure committee members typically include the principal accounting officer, general counsel or other senior legal officer, principal risk management officer, chief investor relations officer and other officers or employees as the company deems appropriate.

Practices vary as to how disclosure committees are established and operate, but, in general, best practices include operating under a charter that sets out duties and responsibilities; holding regular meetings and keeping minutes; running meetings according to focused agendas (*i.e.*, not just holding a drafting session, but acting in a review and oversight role); engaging with the audit committee; and reporting to both the chief executive officer and chief financial officer. As companies begin to incorporate ESG data and disclosures into their disclosure controls and procedures, companies should carefully consider whether to either give their existing disclosure committee responsibility for oversight of ESG data gathering and disclosure or establish a formal ESG disclosure committee operating in a similar fashion.

Under either approach, the relevant committee should have clear ESG-related responsibilities, including: developing and reviewing the policies and procedures related to ESG data gathering and disclosure; ensuring that appropriate controls are in place for gathering ESG data; identifying and assessing ESG risks and opportunities; liaising with and reporting to the board and relevant board committees on ESG matters; coordinating with internal audit and controllership teams to ensure review of ESG data; and reviewing ESG disclosures and managing internal and external communications of ESG matters. If management's ESG disclosure team is separate from the traditional disclosure committee, both groups should interact on a consistent, timely basis (*e.g.*, on a quarterly basis prior to periodic SEC filings) and as frequently as needed (*e.g.*, whenever ESG disclosure is being released, such as in a standalone report or posted on the company's website).

A cross-functional management committee tasked with supervising a company's substantive efforts related to ESG may be prudent as well. This may be the same body that evaluates ESG disclosure, but if it is a separate committee, it should remain closely aligned with the ESG disclosure committee. The management team in charge of ESG has an important role in maintaining effective cross-functional coordination on ESG matters to allow ESG considerations to be more effectively incorporated into decision making for the business. It is important for this group to foster and maintain partnerships both "up" (with the board and its committees with ESG oversight responsibility) and "out" (with third-party advisors), but it is also critical for the management team in charge of ESG to work closely with "on the ground" operational teams. For example, if the company has a goal of reducing its GHG footprint from operations, then the ESG management team will need to work closely with its manufacturing teams.

This team should also be fully aware of the data requirements for the company's ESG reporting. For example, if the company decides or is required to report its Scope 3 emissions, the ESG management team will need to work with its purchasing and supplier teams and other relevant parties to obtain the necessary third-party customer and supplier data, including negotiating appropriate information rights in contracts. Indeed, functional areas within a company that may not have previously reviewed disclosures may need to take a more active role in reviewing and preparing ESG disclosures to ensure that the company maintains a consistent approach as to what metrics and disclosures are significant across the company's reporting and to avoid inaccurate, misleading or unsupported disclosures.

Hiring or designating a chief sustainability officer ("CSO") or head of ESG matters can ensure there is centralised responsibility for monitoring developments in ESG, coordinating information gathering and reporting across business segments or operating units and understanding how the company may be affected by ESG developments. Indeed, investors are tracking how companies and their boards manage and oversee ESG concerns – some ESG metrics use the company's status as having a CSO or equivalent, or a dedicated board-level committee, as a way to approximate the company's engagement with ESG.[11] The role of a CSO is becoming more common; 95 Fortune 500 companies had a CSO in 2020, up from 29 in 2011.[12] While a CSO may not yet be necessary for companies of all sizes and industries, it is critical to establish responsibility for the maintenance of a company's core ESG knowledge base and awareness of significant developments. Empowering a CSO or other officer can keep the company abreast of the most relevant day-to-day developments in this active space.

It is important to note that, if the Proposed Climate Rules are adopted, disclosure of a number of management governance items would be required, including (i) management's role in assessing and managing any climate-related risks (including identifying the positions or committees within management and the relevant expertise of such individuals), (ii) the processes by which the responsible managers or management committees are informed about and monitor climate-related risks, and (iii) whether the responsible positions or committees report to the board or board committees on climate-related risks and how frequently this occurs. The cross-functional integration and coordination we suggest here would bolster presentation of robust disclosure in response to these requirements.

C Metric Selection and "Materiality"

A key responsibility of management with respect to ESG data is determining what needs to be collected in the first place. As discussed above, however, this can be a daunting exercise given the significant fragmentation in the ESG disclosure environment. ESG data that companies may track can include different environmental metrics (*e.g.*, GHG emissions or waste generated or reduced), social metrics (*e.g.*, employee and board diversity statistics or safety incidents) or even governance metrics (*e.g.*, quantified ethics or anti-corruption violations). Companies need to be thoughtful in their selection of the metrics they elect to track. When determining which ESG data to collect, management should consider a number of factors to determine what is most significant to the company's business, including:

- requirements of law (*e.g.*, the Proposed Climate Rules or European ESG Regulation, which companies may either be subject to already or should expect to be subject to in the near future);
- established frameworks or standards (*e.g.*, the Sustainability Accounting Standards Board (the "SASB") or the Global Reporting Initiative (the "GRI")[13]);
- the stated preferences of significant shareholders (*e.g.*, by consulting their voting and engagement guidelines) or metrics that have been discussed with the company during shareholder engagement sessions; and
- the practices of peers (*i.e.*, benchmarking) to assess what ESG data and disclosure peer companies provide (particularly since companies are at greatest risk of adverse shareholder actions if they are deemed to be lagging among their peer group, often regardless of the utility of the particular metrics being disclosed).

A number of companies have completed a so-called "materiality assessment" to determine the most significant ESG-related topics. Such assessments can also help show which ESG metrics may be most significant to track. While we recognise that the terminology of "materiality assessment" is well established in ESG circles, we suggest that companies instead refer to these with a different term, particularly in their public-facing disclosures. The extent to which ESG disclosures intersect with traditional financial "materiality" standards applicable for other reporting purposes, such as SEC disclosure, is a complicated topic. For example, in September 2021, the SEC staff issued a number of comment letters to registrants regarding climate change disclosures. In these letters, the SEC staff asked a number of questions about the materiality of various ESG-related items or expenditures, noting a more expansive disclosure in companies' sustainability reports than provided in their SEC filings.[14]

Use of the term "material" and its derivatives in standalone ESG reporting invites questions along this line. For example, if an item or topic is affirmatively described as material in one context, it may be difficult to justify to a sceptical SEC why it has been omitted entirely in another context. Accordingly, avoiding the use of the term "material" in standalone ESG reporting, including in the context of conducting a "materiality assessment", may reduce the risk of unintended consequences, such as being forced to disclose certain ESG data in a traditional periodic report subject to SEC scrutiny and penalties. We suggest companies refer to "significance" or "prioritisation" assessment and generally avoid the use of "materiality assessment" or "material" in standalone ESG reporting.

Management must identify or hire, train and oversee the appropriate personnel to collect the relevant data. As previously mentioned, ESG data may historically have been overseen, tracked or reported by various groups, but utilising a cross-functional team with experience in disclosure allows this group to effectively oversee the collection of data. Management may also consider consulting an external validator of its ESG data.

D Summary of Practical Recommendations for Management

- Incorporate ESG-related information into robust disclosure controls and procedures and make sure the processes for traditional disclosures (such as disclosure committees) are mirrored to produce appropriate, accurate and complete ESG disclosures.
- Align operational teams with management's ESG team to ensure goals are reflected in operations and relevant data is being obtained from the business.
- Avoid using the terminology "material" or "materiality assessments" in connection with ESG data and disclosure and instead conduct and refer to "significance" or "prioritisation" assessments.

4 Board of Directors Supervision

Although a company's management is on the front lines of ESG data gathering and disclosure, boards of directors – and their respective committees tasked with some or all ESG oversight – have significant responsibilities for supervising such data gathering and ensuring accurate and appropriate ESG disclosure is made where required or advisable.

A "Tone at the Top"

Having an effective ESG strategy starts with the board's "tone at the top", and this applies equally to data collection and management practices. Because the board lays the foundation for how management and the rest of the company views, prioritises and implements the company's ESG strategy, including how ESG data is gathered and the resulting disclosures, it is vital for the board to have a clear dialogue with management about the company's approach to ESG. Just as the board would have a regular dialogue with management regarding long-term operational risks and goals, the board should regularly review and discuss with management ESG-related risks and goals. Since accomplishing long-term ESG-related goals, such as achieving net-zero emissions, may require significant investment and changes to long-term business strategy, boards should play an active role alongside management in setting these goals, even though day-to-day responsibility for reaching them will remain the responsibility of management. Setting and tracking progress to these goals requires robust and reliable ESG data, meaning that strong ESG data practices are critical for the board to fulfil its responsibilities.

The board plays a critical role in encouraging honest, reliable and ethical data gathering and disclosure. In some instances, employees may be hesitant to report unfavourable ESG data or may become aware of abuse or mishandling of ESG data. Traditional whistleblowing structures may increasingly find themselves being used for ESG-related reporting as ESG data gathering and disclosure is increasingly prioritised. Establishing a strong and ethical tone at the top with respect to ESG data collection can be important to the company's success in fostering awareness of meaningful problems that need to be addressed and avoiding potential liability and backlash.

Boards may instil a positive "tone at the top" culture by, among other things, giving significant ESG topics a regular spot on their agenda; placing well-informed, trained and capable employees in charge of ESG matters; and encouraging management to dedicate sufficient resources to ESG, including in data gathering and review functions.

B Board and Committee Oversight

There are a number of competing approaches to the optimal allocation of ESG oversight among the board of directors. The entire board may be tasked with ESG oversight, reflecting the incorporation of ESG factors into all aspects of the company's business and strategy, but in practice, this may mean that ESG is seldom reviewed in depth. A standalone ESG committee may be formed, demonstrating focus and dedication to ESG oversight, but this may be criticised for "dumping" ESG in one place, rather than weaving oversight into a company's other substantive areas. ESG may be supervised by the audit committee, reflecting the historical role that the audit committee plays in supervising significant risks to a company, but this approach will add another agenda item to the plate of the busiest board committee. Many companies place ESG oversight responsibility with the nominating and governance committee, reflecting the key role played by the "G" in "ESG". Finally, it may be possible – and in some circumstances, preferable – to split up ESG oversight among different committees, with each committee taking responsibility for the ESG aspects of its core committee mission.

However ESG responsibility is divided, it is important that some part of the board take responsibility for oversight of the ESG data gathering and disclosure functions. If ESG is spread across the board, the audit committee will typically have the most experience in terms of supervising controls and procedures, so assigning the oversight of ESG data collection and disclosure procedures to the audit committee may be the most logical choice. If such responsibility is delegated to the audit committee, they should consider whether the internal audit team is or should be responsible for auditing ESG-related disclosures in public filings and ESG-related information shared in voluntary communications (*e.g.*, sustainability reports). The audit committee should also evaluate which systems are in place to ensure that all external ESG communications are consistent and reliable, ensure that documented controls are in place for external ESG communications, and consider whether any other oversight functions should review external ESG communications, including compliance, management and external assurance providers.

If the SEC's Proposed Climate Rules are adopted as proposed, the audit committee may be best positioned to take on additional ESG data collection and disclosure oversight. The Proposed Climate Rules would require oversight of the previously discussed Article 14 climate financial statement metrics and the attestation of ESG data, both of which could logically fall within the audit committee's jurisdiction.

However, there are also reasons for other board committees to have at least some responsibility for supervising certain ESG data. For instance, board diversity and political lobbying may be logically supervised by the nominating and governance committee given its mission, and each of those topics requires the collection and supervision of related metrics and data. Human capital management and related employee diversity and social metrics may be supervised by the compensation committee, particularly if its function is conceptualised as a more general "people committee". As more companies incorporate ESG metrics into executive pay packages, the compensation committee will need to engage more with ESG issues and the tracking of metrics necessary to evaluate whether award milestones have been achieved.

Additionally, because the SEC has indicated that it intends to propose rules requiring enhanced human capital management disclosures, there may be enhanced board or committee oversight responsibilities for human capital management-related data collection and disclosures, such as gender or ethnicity statistics or labour metrics such as unionisation or rates of utilisation of contract workers. If human capital management matters reside with the compensation committee and the SEC proposes such rules, the compensation committee may need to increase its supervisory role in this area, such as in connection with pay.

In determining which types of delegation of ESG board oversight (if any) would be appropriate, a company should consider the amount of ESG data and the disclosure it makes or must make, as well as the ESG-related risks and opportunities facing it. However the company elects to divide ESG oversight responsibility, particular attention must be paid to oversight of data gathering and controls-related processes.

C Disclosure Requirements and Internal Governance Data

The Proposed Climate Rules would also have a significant effect on how companies disclose their processes of considering ESG-related matters, particularly as to the functioning of the board. Companies would need to disclose a number of board governance items, as applicable, including (i) identification of any board members or board committees responsible for the oversight of climate-related risks, (ii) whether any member of the board has expertise in climate-related risks, (iii) the process and frequency with which the board or board committee discusses climate-related risks, (iv) whether and how the board or board committee considers climate-related risks as part of its business strategy, risk management and financial oversight, and (v) whether and how the board sets climate-related targets or goals (including interim targets or goals) and how it oversees progress against such targets or goals.

These requirements are not expressly substantive ESG requirements (*e.g.*, no particular board member with ESG expertise is actually required, and there is not even an express "comply or explain" requirement to disclose why no member has climate expertise). However, it is clear that companies and boards will modify their behaviour in response to these disclosure requirements. Just as disclosure requirements regarding an audit committee financial expert has made that a *de facto* substantive requirement, we expect that disclosure requirements for climate-related governance structures and expertise will drive companies' behaviour in this space (with similar effects felt as a result of recently proposed cybersecurity disclosure rules).

These disclosure requirements introduce an additional data gathering burden: the collection of information about internal climate-related governance processes itself will require companies to collect and manage additional ESG data. Companies will need to invest in efforts to track climate expertise, deliberation processes, the frequency of discussion of climate-related risks and other metrics to make even the more conceptual governance and risk-management disclosures.

D Summary of Practical Recommendations for Boards

- Appropriate ESG tone at the top by the board plays a critical role in encouraging honest, reliable and ethical data gathering and disclosure.
- Boards must consider and determine what type of allocation of ESG board oversight (if any) would be appropriate, but however oversight is divided, it is critical to provide for board oversight of ESG data collection and maintenance processes.
- If adopted as proposed, we expect that the Proposed Climate Rules will drive companies' behaviour in terms of climate-related governance structures and expertise and will introduce an additional data gathering responsibility to track climate expertise, deliberation processes, the frequency of discussion of climate-related risks and other metrics.

5 Conclusion

Companies must identify ESG data gathering and disclosure strategy, policies, controls and procedures as a priority area for board and management attention. To produce and manage disclosure-ready data, management should develop and maintain robust procedures and controls around ESG data gathering, utilise a cross-functional team (which may include a CSO) to determine what ESG data to collect, oversee the gathering of such data and take a thoughtful approach to making appropriate ESG disclosures. The board of directors has a critical role to play in supervising the ESG data gathering and disclosure processes, including instilling a positive "tone at the top" culture, providing oversight of ESG (including with respect to ESG data gathering and management) and overseeing ESG disclosures. Even as the debate between pro- and anti-ESG forces continues to escalate, companies of all types will be expected by a number of constituencies to continue to report ESG data, and as private litigants and enforcement regulators continue to carefully scrutinise companies for errors in ESG-related disclosures, identifying, tracking and disclosing ESG data must be an urgent priority.

Endnotes

1. *See*, *e.g.*, BlackRock's proxy voting guidelines for U.S. securities, available at https://www.blackrock.com/corporate/literature/fact-sheet/blk-responsible-investment-guidelines-us.pdf, Vanguard's proxy voting policies, available at https://corporate.vanguard.com/content/dam/corp/advocate/investment-stewardship/pdf/policies-and-reports/US_Proxy_Voting.pdf, and State Street's proxy voting and engagement guidelines, available at https://www.ssga.com/library-content/pdfs/ic/proxy-voting-and-engagement-guidelines-us-canada.pdf.
2. Greenwashing is the act or process of conveying a false impression or providing misleading information to make a product, policy, activity or organisation appear more environmentally friendly than it actually is.
3. The NFRD aims to make non-financial, including ESG, information available to stakeholders and investors. The SFDR applies to investment firms and credit institutions that provide advice and/or portfolio management and aims to provide transparency on the degree of sustainability of financial products and to help direct investment toward sustainable investments while avoiding "greenwashing". The EU NFRD generally requires EU-listed companies with 500 or more employees to include certain ESG disclosures as part of their annual reporting obligations. The CSRD would amend the existing reporting requirements of the NFRD, and, if adopted, it would (i) extend the scope of the NFRD to all large companies and all companies listed on regulated markets, (ii) introduce an audit requirement for reported sustainability information, (iii) introduce more detailed reporting requirements, and (iv) require companies with securities listed on EU-regulated markets to disclose sustainability-related information. The CSRD has not been adopted as of the time of the writing of this chapter.
4. The Spring 2022 Reg. Flex Agenda is available at https://www.reginfo.gov/public/do/eAgendaMain?operation=OPERATION_GET_AGENCY_RULE_LIST&currentPub=true&agencyCode=&showStage=active&agencyCd=3235&csrf_token=ABBAA84824C29E01B566B0472A6E99E59C730916821A14613C79DE7F48AC8EAEF4CA3A7C929E9B10E667F119BAA4958D5293.
5. These two rulemakings include: (i) proposed rules to enhance and standardise climate-related disclosures for public companies (the "Proposed Climate Rules"), available at https://www.sec.gov/rules/proposed/2022/33-11042.pdf; and (ii) likely forthcoming proposed rules to enhance disclosures regarding human capital management. Note that each of these rules is proposed or planned to be proposed as of the time of the writing of this chapter, but final rulemaking or proposed rulemaking may have occurred by the time of publication (*e.g.*, the Spring 2022 Reg. Flex Agenda indicates that final climate rules are planned to be adopted by October 2022 and human capital management rules are planned to be proposed by October 2022).
6. The Great Resignation is an ongoing economic trend that began in early 2021 when employees voluntarily resigned from their jobs in large numbers.
7. *See*, *e.g.*, Marsh & McLennan Advantage, *ESG as a workforce strategy*, available at https://www.marshmclennan.com/content/dam/mmc-web/insights/publications/2020/may/ESG-as-a-workforce-strategy_Part%20I.pdf.
8. Rules 13a-15(a), (b) and (e) of the Securities Exchange Act of 1934, as amended.
9. *See*, *e.g.*, *Dwyer v. Allbirds, Inc.*, 7:21-cv-05238-CS (S.D.N.Y. Apr. 18, 2022) and *Commodore v. H&M Hennes & Mauritz LP*, 7-22-cv-06247 (S.D.N.Y. July 22, 2022).
10. In 2002, when adopting disclosure controls and procedure regulations, the SEC recommended, but did not mandate, that companies form disclosure committees. The SEC's adopting release for the Certification of Disclosure in Companies' Quarterly and Annual Reports is available at https://www.sec.gov/rules/final/33-8124.htm.
11. For example, CDP Worldwide, a non-profit organisation that maintains a global disclosure system for environmental reporting, includes in its corporate climate change scoring methodology more favourable scoring for companies that have a CSO, available at https://guidance.cdp.net/en/guidance?cid=13&ctype=theme&idtype=ThemeID&incchild=1&microsite=0&otype=ScoringMethodology&tags=TAG-599%2CTAG-605%2CTAG-646.
12. *See* Weinreb Group, *The Chief Sustainability Officer: 10 Years Later, The rise of ESG in the C-Suite* (2021), available at https://weinrebgroup.com/cso-chief-sustainability-officer-esg-report-2021.
13. SASB develops, issues and maintains standards that are designed for companies to communicate to investors the ways in which sustainability issues drive their long-term value. GRI provides sustainability reporting standards setting forth their view of best practices for reporting economic, environmental and social issues.
14. The SEC's *Sample Letter to Companies Regarding Climate Change Disclosures* is available at https://www.sec.gov/corpfin/sample-letter-climate-change-disclosures.

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