Your Sustainability Journey

LeaderXXchange®
Investor-Director ESG Roadmap

LeaderXXchange®

Content

Introduction

As the scale and urgency of climate change and Environmental, Social and Governance ("ESG") challenges become more apparent, interconnected and feature on frontpage news, their relevance to investment and business communities has never been more important.

Since the release of the LeaderXXchange® ESG Roadmap in 2020, accelerated global disruption and multi-level upheavals have uncovered many critical ESG challenges and created a renewed sense of shared urgency[1]. Investors, management, and the boards of directors of portfolio companies see a pressing need to adopt robust frameworks to measure, manage and oversee ESG-related risks and opportunities and fast-track climate-related and ESG disclosure.

Governments, regulators, listing authorities and ratings agencies increasingly require additional ESG disclosure as well. This suggests that for the foreseeable future, the demand for extra-financial information will be integral to investor decision-making processes, as well as corporate capital allocation and strategic planning.

As we witness the current global crisis unfold, the need to accelerate ESG disclosure is compounded by the low level and slow pace of business action. These have not measured up to the size of the sustainability challenge, with too much "talk the talk " and too few concrete and innovative actions.

As a UNGC & Accenture study reveals[2] , frustrated CEOs underscore the imperative to commit to "doing the right thing" rather than just "saying the right thing".

To break the silos that separate investors from board directors, build a bridge of trust and increase knowledge on major ESG topics, LeaderXXchange®, together with Spencer Stuart's European Board Practice group, launched the "The Investor-Director Dialogue on Climate-related Risk Management Series" in 2016. The first meeting was held only weeks after the adoption of the Paris Climate Accord.

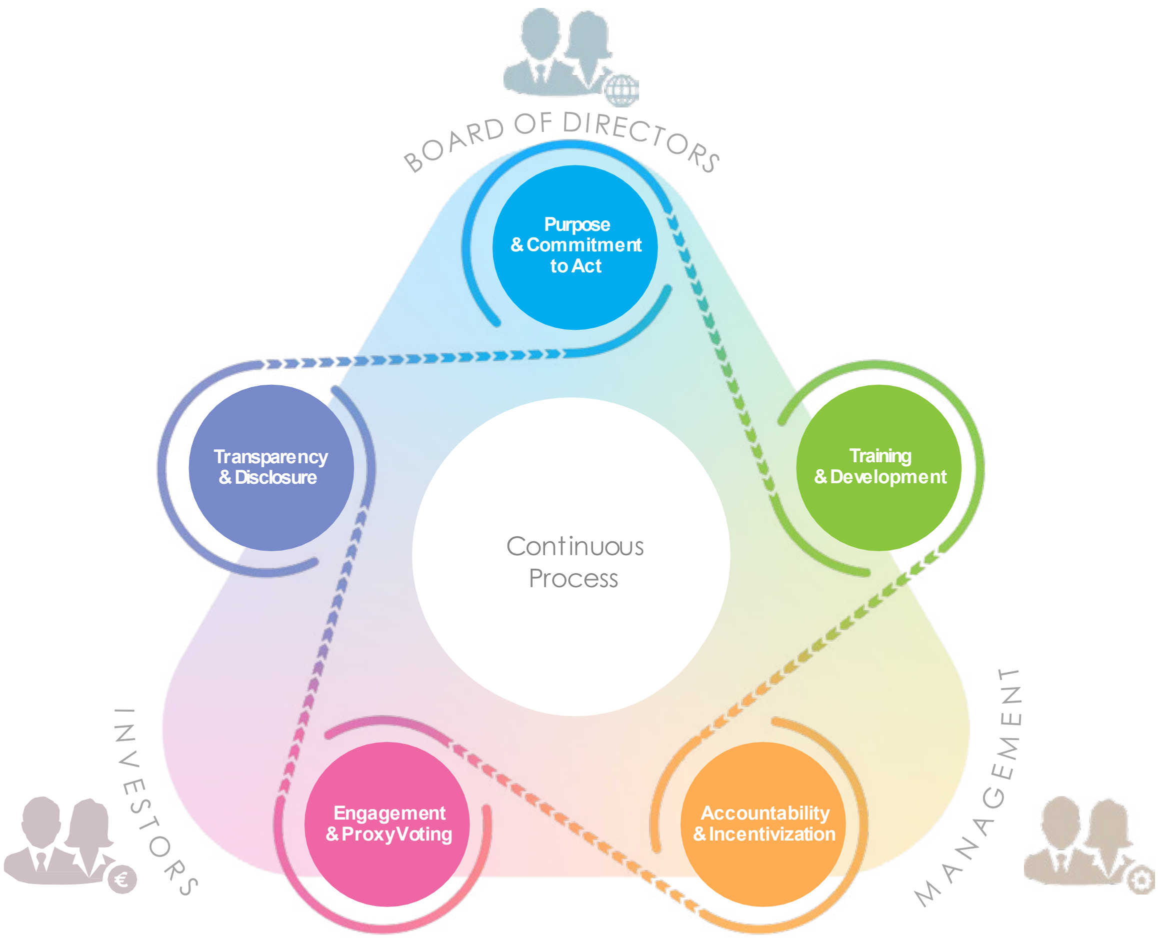
To complement the annual Investor-Director Dialogue Series, we formed an Investor-Director ESG Working Group (the "Working Group") in 2017 with Spencer Stuart. Operating under Chatham House rules, six directors and six investors participated in their personal capacity. The Working Group had a collaborative and structured approach to develop a set of best practices for boards of directors, management and investors to integrate ESG into strategy, business and decision-making processes.

The LeaderXXchange® ESG Roadmap

The LeaderXXchange® Investor-Director ESG Roadmap (the "Roadmap") illustrates how board directors, management and investors can work together to deliver better ESG outcomes, address unprecedented environmental and social challenges, and promote disruptive technological innovation that will strengthen business models and improve performance for all stakeholders.

A short version of the Roadmap was released in 2020. Its best practice recommendations are based on two years of discussions and research findings, including the global Investor-Director survey we conducted with Columbia University.[3] It also demonstrated its robustness during the COVID-19 pandemic.

This led us to develop the more detailed version found herein to present actionable solutions and best practices that better align boards of directors, company management, and investors to accelerate ESG integration and have a positive impact. Their actions will be meaningful and impactful if they engage one another and are aligned toward a common goal of a more sustainable future.



Who is it for?

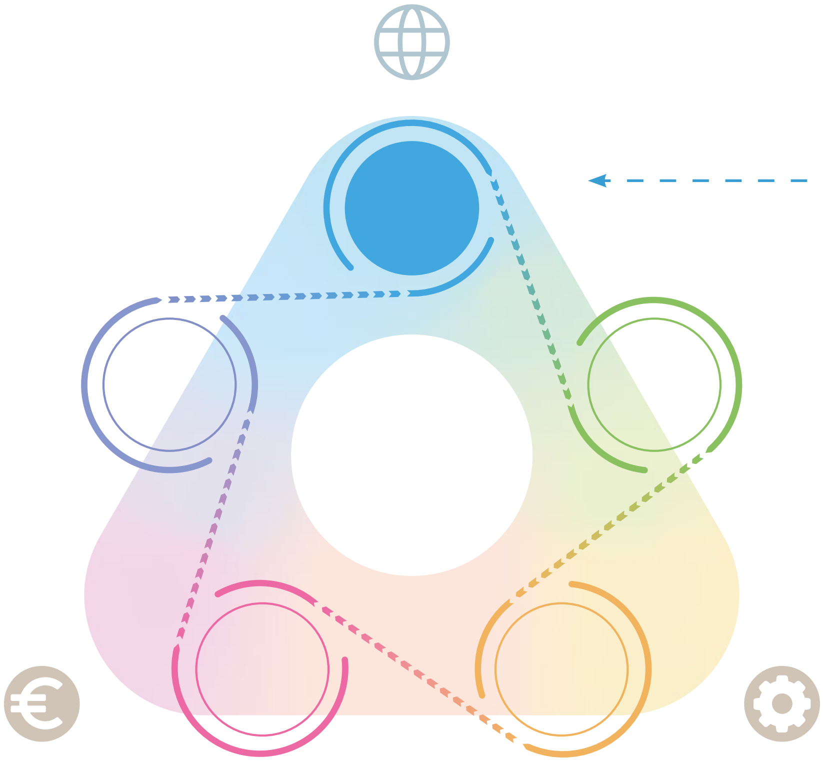
While the Roadmap is designed for board directors, company management, and investors, its key principles, best practices and recommendations are applicable to those who have a stake in building a more sustainable future. The Roadmap can guide non-profits, non-governmental organizations, academics, governmental agencies and policy-makers in their relations and expectations with businesses and the financial community more generally.

How can I use it?

The Roadmap is an actionable governance framework designed to guide boards of directors, investors and management on their sustainability journey. The framework is built on five critical areas that drive ESG outcomes: Purpose & Commitment to Act, Training & Development, Accountability & Incentivization, Engagement & Proxy Voting, and Transparency & Disclosure.

The Roadmap is also an actionable assessment tool designed to objectively evaluate the robustness of an ESG governance framework as it applies to a board of directors, corporate management or an investor and determine whether it is conducive to delivering meaningful outcomes.

Purpose & Commitment to Act



Tackling climate change and other ESG issues requires a clear purpose and commitment to act from the top of the organization.

Board of Directors

- Boards to take a long-term view, embed ESG into company's purpose while considering materiality and intentionality, and to approve corporate purpose with commitment to act.
- Board composition to include relevant ESG expertise in director skill sets.
- Integrate ESG topics in board and committee oversight of long-term strategy, risk, opportunities and remuneration.

Management

- Corporate purpose and commitment to act translates ESG into company strategy set by management while considering materiality and intentionality.
- Corporate mission statement requires approval by the board of directors.

Investors

- Top management of investor organization must take a long-term view, embed purpose and ESG into the investment philosophy while considering materiality and intentionality.
- Top management of investor organization to mandate integration of ESG topics into investment process.

Tone at the top matters, and a clear purpose and commitment to act from the leadership of an organization is a fundamental building block to tackle climate change and other ESG challenges. boards of directors, company management, and investors have a shared responsibility to work together to ensure effective internal governance and robust external reporting when it comes to ESG purpose and commitment.

The COVID-19 crisis fueled corporate purpose and commitment discussions and illustrated how "ESG" issues are fundamentally and intrinsically interconnected.

Moreover, investors brought an intense spotlight on employee welfare, health & safety concerns (the "S" in ESG).

In addition, the pandemic crisis led to multiple valuable initiatives and innovations that may well become best practice over time. For example, a Spencer Stuart Board Survey in France suggested that future risk-mapping and business resilience scenario analysis will incorporate simultaneous extreme events and their interconnections, as a result of the severe business disruptions caused by the crisis.[4]

Board of Directors

Boards of directors have a fundamental role in defining and reinforcing ESG purpose and commitment, as reflected in many initiatives. Noteworthy examples follow. The U.K. Corporate Governance Code was revised in 2018 to charge boards with establishing the company's purpose, values, and strategy. Similarly, in France, the Pacte Law also puts boards at the fore. The law requires that companies be managed to further the "social interest" rather than the interest of any particular stakeholder and recommends that their purpose ("raison d'être") feature in their by-laws. Finally, to guide boards of directors and senior executives, the Enacting Purpose Initiative published a simple framework to govern purpose.[5]

Best practice points to boards of directors formally approving a corporate purpose that integrates ESG to help translate commitments into tangible results. Companies have opted to integrate their purpose in board internal regulations, board committee charters, articles of incorporation or even by-laws, consistent with adopting a long-term perspective rather than focusing on the short-term.

Not all ESG topics are material or meaningful for a company, though board directors increasingly deem climate-related issues to be material. According to our Global Investor-Director Survey (the "2020 Survey") conducted by LeaderXXchange® and the Millstein Center for Global Markets and Corporate Ownership at Columbia Law School, 60% of board director respondents indicated that climate risk has an impact on their business.[6]

To evaluate whether a board of directors has the relevant expertise and experience to provide effective management oversight, investors expect companies to describe their competencies in a skill set matrix. It has become best practice to include this information in regulatory filings and investor communication in North America and Europe. Moreover, investors encourage companies to highlight any ESG literate directors - or experts on specific topics - and provide supporting information in the detailed director biographies they publish. This is particularly important for non-executive directors.

Figure 1: *Sample Industry Board Skills Matrix*

CONSUMER
(Retail/IT/Telecom/Utilities)

- Core Industry
- Financial/Audit & Risk
- Legal/Public Policy
- Senior Executive
- Cybersecurity/IT
- Communications/Marketing/Customer Service
- Environmental/Social
- International Markets
- Technical/Engineering
- Manufacturing/Supply Chain

FINANCIAL
(Banks/Insurances/Asset Managers)

- Core Industry
- Financial/Audit & Risk
- Legal/Public Policy
- Senior Executive
- Cybersecurity/IT
- M&A/Capital Market
- Communications/Marketing/Customer Service
- Environmental/Social
- International Markets

INDUSTRIALS
(Aerospace/Production/Manufacturing/Construction)

- Core Industry
- Financial/Audit & Risk
- Legal/Public Policy
- Senior Executive
- Environmental/Social
- Technical/Engineering
- Health & Safety
- Manufacturing/Supply Chain
- Cybersecurity/IT
- Communications/Marketing/Customer Service

*SKILL (orange): Applied across all sectors and companies
*SKILL (black): As applicable

Source: Glass Lewis (2020)[7]

Management

As more and more studies prove that companies can create both social value and profit, stakeholders increasingly want to see that financially healthy companies have clear corporate purpose and tangible commitment to ESG.[8] Purpose has occupied center-stage for companies over the past few years in Europe and Asia and increasingly in North America. Noteworthy examples are the 2019 statement on the purpose of a corporation by the Business Roundtable in the United States; and the global rise of the B Corp, businesses committed to pursuing better social or environmental performance alongside their financial targets.[9]

Our 2020 Survey findings confirmed the Working Group's belief that corporate executives are responsible for deploying ESG throughout the company's strategy and operations, with the CEO taking the lead as a key driving force and showing clear commitment to ESG. It showed the necessity to go beyond the merely aspirational and incorporate ESG into a company's mid-to-long term strategy and day-to-day operations.

It is best practice for CEOs to outline a company's ESG ambitions in a brief ESG purpose statement to employees to clearly spell out the essentials of what the company is all about and the direction of travel. Purpose statements are most valuable when they reflect company mission, vision and values to be deployed throughout the organization.

Successful ESG strategies require collaborative efforts across management and leadership teams. Company strategies and purpose/mission statements that are the result of a collaborative effort are ideal to reflect the thoughts, ideas and constraints of key business and functional managers of a company. Collaboration helps build an essential consensus on ESG objectives and identify the best feasible means to achieve them.

Best practice points to strategy and ESG ambition being effective when grounded in a set of actions with clear deliverables that include a timeline with the corresponding KPIs (key performance indicators), all of which would require board oversight.

Investors

Just like companies, investors need to articulate a purpose that goes beyond financial returns. Best practice points to top management of an asset manager or asset owner who takes a long-term view and embeds purpose into the investment philosophy that guides investment objectives. Creating societal impact should not be restricted to a few "impact" funds but part of an asset manager's DNA.

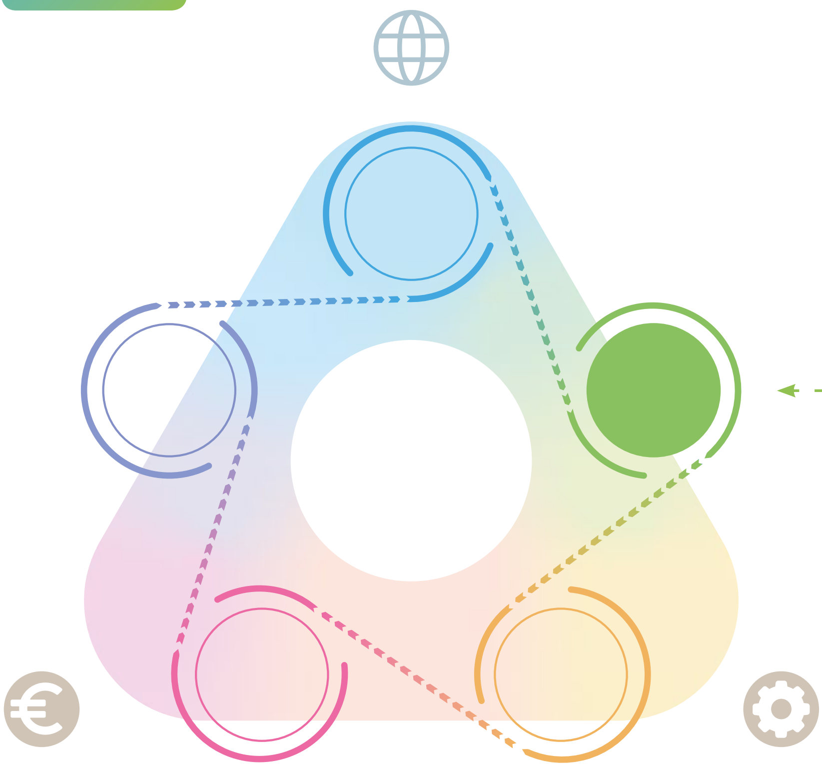
When top management of investor organizations mandate integration of ESG topics into the investment process, this creates the right mindset within the organization and signals clearly to the employees that there is a real ESG commitment from top management.

Investors increasingly incorporate company purpose into their evaluation of ESG risks and opportunities.

According to a survey conducted by SquareWell Partners, more than 60% of investors indicated they engage with companies on their purpose; and around 50% of investors surveyed indicated that they are already incorporating or considering incorporating purpose into their ESG analysis.[10]

When looking at the "Best to Work For" lists, one rarely finds financial institutions. Taking into consideration that millennials want their work to have a purpose and want to be proud of their employer, the financial sector will need to re-engage with society in order to attract the younger generation.[11] Purpose and commitment to act serves as a tool to recruit talent and to assure a good fit. It also helps to inspire and empower employees. Purpose can evolve over time as technologies and the industry change.

Training & Development



Training and development are crucial for raising awareness and understanding of ESG issues, enabling effective discussion and analysis of ESG

Board of Directors

- Board and committee agendas to include material ESG topics.
- Learn from internal or external experts as needed.
- Leverage in-house expertise to provide directors with customized training programs on climate change and other ESG topics.

Management

- Increase awareness and promote best ESG practices in company.
- Provide climate change and ESG training throughout the organization.

Investors

- Increase awareness and promote best ESG practices in the investor organization.
- Conduct ongoing climate change and ESG training for management and throughout the investor organization.

Training and development are crucial for raising awareness and understanding of ESG issues, trends and best practices, so that ESG topics can be effectively analyzed and discussed, and meaningful ESG objectives and measurable targets can be set. To have sway, training needs to be done on a regular basis.

Board of Directors

LeaderXXchange® findings show that whilst sustainability appears more frequently on the agenda of certain board committees, it is rarely on the agenda of the full board. ESG topics are more often discussed by committees that can dive deeper into these topics, such as CSR (Corporate Social Responsibility) and risk and compensation. However, putting ESG topics on the full board's agenda demonstrates their strategic importance.

Some boards do not view ESG as critical to business and strategy but rather as a "nice to have" and not a necessity. Others don't recognize that these issues matter to investors.

Moreover, studies point to a gender divide on boards with respect to ESG. According to the PwC's 2019 Annual Corporate Directors Survey more than half of directors surveyed say investors devote too much attention to environmental/sustainability issues. However, this view seems to be mainly shared by male directors: 64% of female directors think investors are giving environmental/ sustainability issues the right amount of attention, compared to just 33% of male directors.[12] This finding is also supported by our 2020 Survey and other academic research studies that suggest women are more engaged on climate-related issues and ESG more broadly than men.[13]

Environmental and social issues, in particular, were traditionally on the radar screen of SRI and impact investors but are now also clearly on the agenda of mainstream investors. Investors and directors increasingly engage directly. Their discussions often cover executive pay and governance matters, and increasingly climate change and sustainability topics as well.

A lack of board ESG literacy and expertise prevents a common ESG understanding and can significantly hinder effective board oversight on these topics.[14] Though some have extensive knowledge, many board directors lack knowledge on climate change and sustainability issues more broadly and would benefit from becoming more ESG and climate "literate". Of those who do have significant knowledge, this often stems from personal interest.

However, our Working Group found that few companies provide board members with training on climate change and other sustainability topics or encourage directors to acquire that knowledge externally. This, despite many market offerings such as conferences, online MOOCs or university programs, for example.

Companies can leverage their in-house expertise to provide directors with customized training programs on critical ESG topics for their company. This offers the added advantage to have board members learn from a wider group of executives and employees, better assess the company's commitment, and accelerate their own ability to understand the impact of ESG topics on strategy, risk management and operations as well as collectively improve management oversight.

Management

Corporate Management generally has a solid grasp of material ESG factors for the industry in which the company is operating and especially the relevant ESG aspects for the company itself.

While CEOs, certain division heads and especially heads of sustainability tend to have solid ESG expertise, CFOs and CROs and to a lesser extent investor relations officers tend to be less knowledgeable on these topics, though that is changing. ESG training enables management to have more meaningful discussions with investors who increasingly incorporate ESG factors into investment analysis and decision making.

Additionally, when company management ensures that (online) sustainability training is offered across the organization, employees acquire a basic knowledge of sustainability topics and their relevance to and for the company.

ESG training provides an important signal internally. It demonstrates that top management are "ESG Ambassadors" and truly committed to sustainability and promoting best practices. This can heighten and increase employee engagement and motivation.

There are various ways to gain required ESG knowledge depending on specific areas of interest.

Some examples follow. To gain insight on which ESG aspects are material for the industry/ company, an in-depth dialogue with investors or a specialized consultant can be beneficial. SASB (Sustainability Accounting Standards Board) has developed an ESG materiality framework, which is increasingly regarded as the materiality standard and is used by both investors and companies.[15] An effective way to learn more about specific ESG topics that a company's major stakeholder groups prioritize is by joining a stakeholder dialogue. To learn more about a particular topic, such as climate or cyber security, think tanks and academic research institutes provide useful insights.

Investors

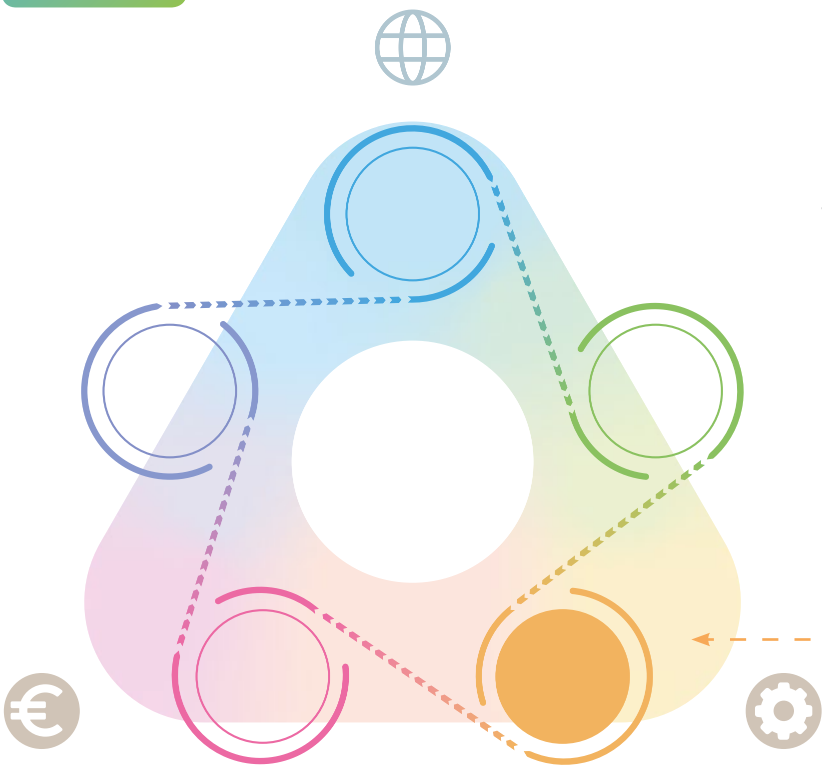
With responsible investing becoming more mainstream and therefore increasingly integrated into the mainstream investment process, asset managers and asset owners are looking for ways to properly train their professionals in this area. For example, it is essential for risk functions to gain expertise on ESG in order to effectively assess ESG risks, not just on the investment side, but also on the operational side.

According to our 2020 Survey, a majority of respondents believes that investors and directors should obtain their ESG knowledge and expertise through both internal and external training. In practice they have developed their current knowledge and expertise on climate change using various sources: Some investors have developed in-house ESG training, while others make use of external trainings, such as those offered by the CFA Institute and the PRI Academy. Some turn to think tank publications, follow current events in the media, and analyze company CSR reports. Some investors turn to sell-side reports and ESG rating agencies, more so than directors, as a source of information.

It is important to note, also, that while the whole organization, including top management, benefits from basic ESG training, portfolio managers and analysts need additional training on complex topics such as climate change. And for investment professionals it is necessary to continuously update knowledge and follow the latest ESG-related developments.

A combination of both internal and external trainings is becoming best practice. Some asset managers who have developed in-house ESG trainings are making these available to their clients. This is a great way to promote responsible investing. Best practice also points to heightened interest in sharing trainings with board directors of portfolio companies as a way to establish common understanding and to encourage further dialogue between investors and directors.

Accountability & Incentivization



There must be clear accountability on ESG topics, along with appropriate incentivization to ensure that both financial and ESG performance are monitored and rewarded accordingly.

Board of Directors

- Adopt clear board governance framework taking ownership of ESG oversight at the board and the CSR, strategy, audit, compensation and nominating committee levels.
- Ensure that compensation and rewards incorporate key ESG long-term performance objectives.

Management

- Adopt clear ESG governance framework and reporting structure to CEO and the board of directors.
- Compensation and rewards tied to disclosed company ESG targets and objectives for management and other employees.

Investors

- Adopt clear ESG governance framework and reporting structure to investor organization's management leadership.
- Compensation and rewards to incorporate ESG performance objectives.

Strong incentivization mechanisms can accelerate change and are most effective when they are structured to hold parties to account. There must be clear accountability for ESG issues, along with appropriate incentivization to ensure that both financial and ESG performance are monitored and rewarded accordingly.

Board of Directors

A clear Board governance framework that takes ownership of ESG oversight at the board and the committee levels ensures that material and meaningful ESG topics are integrated in company strategy and culture clearly and effectively. A wave of scandals combined with the global health pandemic have led boards to increasingly take a more proactive look at company culture. In the United States, for example, 38% of directors reported increased board-level reporting of culture metrics, according to the 2020 PwC Directors Survey.[16]

Intent is not by itself sufficient: Accountability and incentivization are important and effective steps that impact behavior. They redirect focus and resources to actions and measures that have a material and/or meaningful impact on strategy and sustainable business practices.[17]

The board of directors, as a whole, is responsible for management oversight. Board committees also have a critical role, especially on matters that require a deeper and more thorough focus. Often the corporate social responsibility, sustainability or similar committees are the primary committees responsible for ESG risks and opportunities. Yet, best practice would be to integrate material and relevant ESG topics in all committees - at different stages and for different reasons.

For example, audit and risk committees delve into risks – including ESG - that have a financial impact. Increasingly, compensation committees include ESG KPIs and targets in executive remuneration packages to incentivize management and reward long-term performance objectives.

Similarly, strategy committee members are called to integrate ESG in company strategy. Nomination committees ensure that the board and its committees have the right skills and experience to set a company's long-term strategy, determine remuneration and more generally provide effective management oversight.

Investors will increasingly hold committees or the board of directors as whole, accountable for a company's integration of ESG in corporate strategy and management oversight.

Management

For the first time, leaders are calling for business and industry to step up ambitions for their own companies and to reshape systems from within, using relevant targets.[18] CEOs also acknowledge their industries could play a greater role to mitigate climate change and increase gender equality, which they see as critical drivers of performance. A clear ESG governance and reporting framework to the CEO and the board of directors ensures that management integrates ESG at all levels - strategy, operations, talent management, etc. – and is held accountable for results.

The lack of a common definition of ESG explains growing market pressure to create common standards. According to a 2019 CFA study, 63% of investor respondents believed that securities regulators should either develop ESG disclosure standards or support an independent standard setter to develop such standards.[19] Moreover, 48% of investor respondents viewed that ESG disclosures should be updated more than annually.

Examples of KPI quantitative targets for management include objectives on gender diversity or pay gap, CO2 emissions and employee turn-over. These targets may be set by the board and included in executive remuneration for leadership or set by management to incentivize the entire organization. Disclosing these targets and sharing results allow investors, employees and other stakeholders to assess performance in achieving objectives and ensuring that these targets are meaningful, material and are aligned with the company's strategy.

While companies in the mining, energy and utilities sectors have a longer history of linking executive pay to specific ESG factors (such as occupational health and safety risks), other sectors are catching up. See below an example of a consumer goods company.

Figure 2: Illustration of how a company can link Chairman & CEO pay to ESG factors

Indicators		Weighting
Economic		60%
Social, societal and environmental	Employees sustainable engagement	10%
	Fulfillment of climate ambitions	10%
Managerial		20%
Total		**100%**

Source: 2020 compensation report of a consumer goods company

Incentivization objectives tied to climate and other ESG topics should be clear, specific and structured in a way to drive quantifiable outcomes, rather than vague descriptions and objectives that cannot be objectively assessed. This is particularly significant because increasingly investors see ESG performance as a proxy for management quality.[20]

Investors

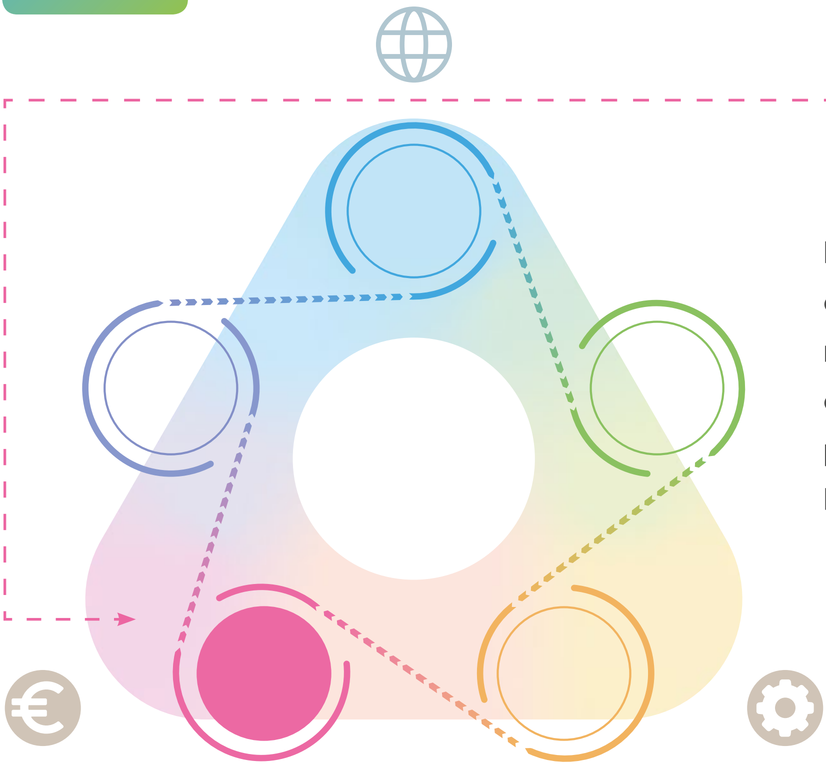
Investors are increasingly integrating climate change and other ESG topics in their investment decision-making and solutions for clients. Moreover, with growing pressure for investors to report their ESG strategy processes, stewardship and results, the reputational impact of investor action has never been greater.

Research suggests that investors primarily view incorporating climate related and other ESG risks as a good business opportunity and an effective risk-management tool. Our 2020 Survey found that nearly 80% of investor and 90% of director respondents believe that integrating climate factors helps identify opportunities and manage risks. Moreover, investors believe that incorporating climate risk into investment analysis and decision making is also a good proxy for management quality.[21]

Consequently, when investors also adopt a clear ESG governance framework and present the reporting structure to their management and leadership – including their board of directors - this ensures that material and meaningful ESG topics are effectively integrated in the investor organization.

In addition, compensation and rewards schemes that incorporate ESG performance objectives are effective tools to get leadership and employees to focus on achieving ESG objectives. They point to whether investors walk the talk. ESG objectives work best when they are meaningful, material and aligned with the investor organization's long-term strategy. Incorporating ESG in compensation schemes and long-term performance also sends a strong signal beyond the organization, with reputational impact: to clients of ESG products and solutions; to future employees attracted by ESG values; to portfolio companies' management that see investor incentives tied to ESG KPIs; and to stakeholders impacted by ESG outcomes.

Engagement & Proxy Voting



Engagement and proxy voting are effective ways for directors, management and investors to raise awareness, share best practices and progress and take action on material ESG topics.

Board of Directors

- Establish principles and policies that govern the board's approach to engagement and strive for best practice.
- Engage CEO, CFO and other members of management on material ESG topics and objectives.
- Engage investors on material long-term ESG topics and objectives.

Management

- CEO, CFO to actively engage on material ESG topics during meetings with investors and sell-side analysts, on earnings calls and investor days.
- CEO, CFO and other members of management to discuss material ESG topics and targets with the board and its committees.

Investors

- Establish principles and policies that govern the organization's approach to engagement and proxy voting.
- Engage with portfolio companies' CEO, CFO and independent directors on material ESG topics.
- Engagement and proxy voting consistent with long-term view and ESG disclosure.

While engagement requires significantly more time and draws upon more resources for all parties involved than proxy voting, both are effective ways for directors, management and investors to raise awareness, share best practices and progress, and take action on material ESG topics.

Board of Directors

Management and investors are critical sources of information for board decision-making and management oversight. Adopting principles that govern the board's approach to engagement with management and investors on meaningful and material ESG topics is board governance best practice.

Internally, directors receive most ESG information from the company's CEO and/or its head of sustainability, when that position exists. Engagement with the CFO - and other members of management more broadly – breaks information silos. Board-company management engagement supports ESG integration at the board and company levels, the development of a corporate purpose, and defining long-term ESG objectives and targets aligned with corporate strategy.

Externally, board-investor engagement on ESG topics gives the board an unfiltered view of topics that are meaningful to investors. Topics may include: ESG strategy and reporting (for example carbon footprint reduction, climate scenarios, human capital management, etc.); board composition (with a particular focus on diversity); the strength of ESG and other executive remuneration metrics that investors increasingly ask to be quantifiable and verifiable.

Boards frequently accept investor requests to engage with the independent board chair, lead independent director, senior independent director and/or a committee chair, as appropriate. These engagements give the board an opportunity to show how ESG is integrated at the board and committee levels. Investors seek to understand the methodology employed to select meaningful and material ESG topics for the company's long-term success, as well as the metrics used to assess management performance on strategic ESG issues. Shareholder engagement and ESG are increasingly included as a required experience for board directors in the United States.[22]

While proxy voting firms' voting recommendations continue to have a material impact on voting outcomes, investors increasingly share their proxy voting intentions privately with a portfolio company or publicly to inform other investors. Proxy voting topics are discussed by the board because they signal investor support for company management and the board and impact the long-term strategy and leadership of a company.

Management

Investor-management engagement is common practice through roadshows and "Investor Days" organized by investor relations teams. Engaging with investors and boards on governance ("G") topics is standard practice and no longer the only topic of discussion. The Conference Board and Rutgers Law School study found that fewer than 10% of boards of publicly traded companies in the United States stated that they did not engage with investors in a twelve-month period.[23]

Growing interest in - and disclosure of – "E" and "S" information has led management to discuss these topics with higher frequency and with a broader range of market participants such as investors, sell-side analysts, credit rating firms and ESG rating firms (who demand ESG disclosure).[24]

This requires that management adjust its toolkit and governance engagement model to effectively address these other material topics.

While more companies schedule ESG-specific roadshows and other events to engage investors, they also increasingly integrate meaningful and material ESG topics in their financial roadshows, on investor days as well as on earnings calls. Depending on the objective, the figure below illustrates best practice related to the type of meeting and the meeting participants.

Figure 3: Steps for effective investor-director dialogues

	Objective 1	Objective 2	Objective 3
Define objective	How is ESG integrated in the Strategy and business model?	How does company manage a specific ESG issue	How does oversight take place on ESG topics?
Type of meeting	Regular roadshow with company management	Thematic session or onsite visit	Roadshow with a board director
Meeting participants	Company: CEO, CFO Investor: mainstream portfolio manager, analyst	Company: specialists Investor: portfolio manager, analyst, ESG specialist	Company: board director Investor: portfolio manager, governance, specialist

Source: LeaderXXchange (as published by Financial Investigator, February 2019)

Broader management increasingly engages with investors, the board and its committees and other market stakeholders. ESG discussions generally include the CEO, the head of investor relations and the chief sustainability officer. Engaging with the CFO and heads of divisions and operations that manage meaningful or material ESG risks and opportunities is increasing, and on the way to become best practice. It provides management the opportunity to show success, explain shortcomings and collect investor and director feedback on material ESG topics and long-term strategic objectives.

Proxy-voting firms also incorporate ESG topics (including climate change, diversity and human rights) when recommending how to vote.

Moreover, ESG proxy voting outcomes at shareholder meetings show growing investor support for ESG-related shareholder resolutions, which substantially increased over the past five years. In the United States, across all fund families that Morningstar evaluated, average support was at 46% in 2019, up from 27% in 2015.[25]

This has led company management to engage with proxy-voting firms to understand their voting policies, get their feedback and assess their support for resolutions to be brought to a vote. Engaging with investors and proxy voting firms early, outside the proxy-voting season, before they make their decisions, can lead to a more constructive and effective dialogue.

Investors

Establishing principles and policies that govern an investor organization's approach to ESG in engagement and proxy voting – also called stewardship – is best practice that impacts behavior within the organization - and beyond.

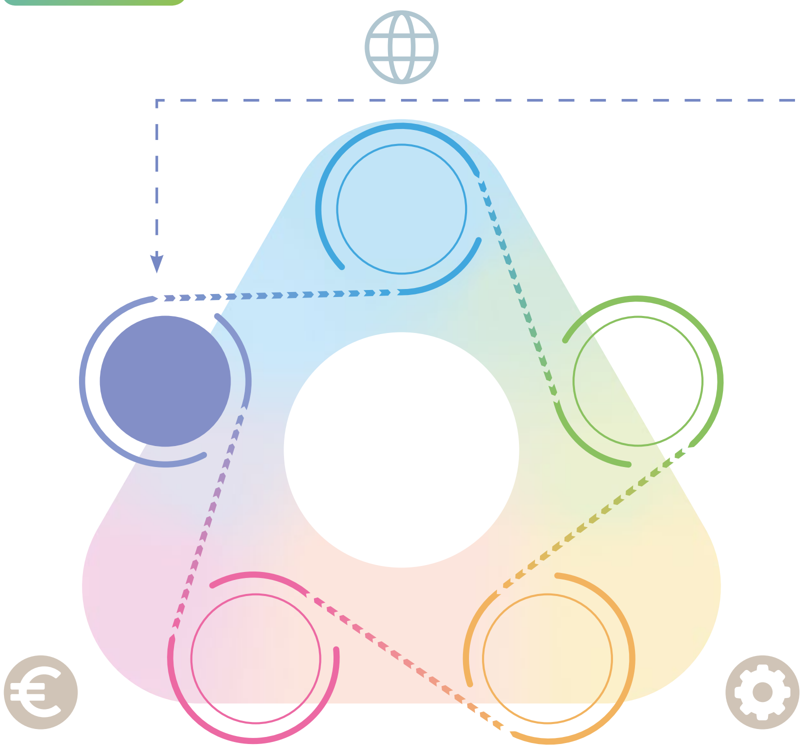
Clear investor principles and stewardship guidelines build adhesion, improve alignment and can break silos that hinder effective integration of ESG. Separately, these principles also serve to inform portfolio companies of investor values, priorities and proxy voting positions on key ESG topics. Finally, they inform investors' current and potential clients as well as other stakeholders committed to ESG and long-term investing.

The ICGN (International Corporate Governance Network) Global Stewardship Principles, updated in 2020, are a good resource for investors. They set current best practices and provide a framework for implementation.[26]
While engagements are most-often scheduled annually by management or at investors' request, some investors have multi-year engagements with portfolio companies on specific topics. Best practice is to engage portfolio-companies off-season, leaving parties more time for discussion to decide what actions they may take, and more time to invite investors' ESG specialists and portfolio managers to join discussions to signal and ensure alignment in investment decision-making.[27]

Engagements can take a variety of forms. For example, investors may engage alone or through an investor coalition - such as the PRI or Climate Action 100+ - with shared objectives, accelerating investor focus on climate-related topics and support for shareholder proposals.[28] Effective engagements set an objective and a time frame for management and boards to understand investor expectations.

Despite rapidly growing teams, underscoring the importance they attach to engagement, investors still do not have the resources to engage with all portfolio companies. That is why proxy voting remains the most used tool to signal the level of confidence in management and the board and support for a company's long-term strategy. In so doing, an investor's proxy voting should be consistent with its long-term view as well as its principles, policies and ESG disclosures. Moreover, there is growing scrutiny of the way investors exercise their votes on key ESG issues - such as the 2021 InfluenceMap report that analyzed the thirty of the largest asset management firms' proxy voting records with regard to climate-related resolutions in the United States.[29]

Transparency & Disclosure



Transparency and disclosure of ESG issues help to show intent, measure outcomes and better demonstrate commitment to ESG

Board of Directors

- Disclose experience and expertise of the board and individual directors on climate change and other material ESG topics.
- Disclose how the board and committees address climate change and other material ESG topics and track progress of disclosed ESG targets and objectives.

Management

- Adopt an integrated reporting framework.
- Publish an integrated report and clearly disclose long-term material ESG targets with intermediate steps.
- Clearly disclose results against set targets and objectives.

Investors

- Disclose principles and policies that govern the investor organization's approach to ESG, engagement and proxy voting.
- Consider ESG materiality and intentionality in all disclosure.
- Disclose proxy voting records and engagement activities to show alignment with investment principles and policies.

Providing transparency and disclosure is the final critical step in the sustainable journey. They are included in the Roadmap because they are key to demonstrating ESG commitments and sharing outcomes and progress. Better disclosure improves the effectiveness of oversight and accountability. This contributes to building trust - both internally and externally - with investors and other stakeholders. Companies that have a sustainable business model and generate trust are better positioned to attract long term capital, attract and retain talent and engage with their stakeholders and deliver meaningful impact.

Board of Directors

Providing transparency and disclosure on ESG issues is key to demonstrating proper oversight on these topics. Best practice shows the following two components as particularly useful when assessing boards on their commitment and management oversight of ESG topics: (1) experience and expertise of the board and individual directors on material ESG topics and (2) how the board and committees address climate change and other ESG issues. Disclosing a skills matrix that includes ESG is becoming best practice among companies.

Glass Lewis report "Disclosure of board skills and experience – emerging best practice" offers a good overview of the latest developments in this area including examples from various regions.[30] A skills matrix helps investors and other stakeholders better understand the areas of expertise that the board holds as a whole as well as the individual directors. It also enables investors to assess potential skills gaps. However, it should not be seen as the holy grail, but a means to initiate meaningful dialogue and have better understanding between directors and investors.

The next step is to assess how the board addresses material ESG issues. Information that is particularly useful includes the frequency of ESG topics on the full board's agenda as well as on different committee agendas. How does the board track disclosed ESG targets and objectives and to what extent do compensation and rewards incorporate key ESG long-term performance objectives? Companies are increasingly moving away from ESG statements of intent that make it more difficult to objectively determine whether management achieved ESG targets. Rather, best practice is shifting toward quantitative and meaningful publicly disclosed ESG targets, and how these are measured and approved by the board. This becomes an effective tool to change management behavior and hold it accountable.

While omitting financially material ESG information exposes directors to litigation risk, an increasing number of ESG data and research providers as well as rating agencies publish board effectiveness assessments based on public disclosures. Generally speaking, disclosure quality and assessment scores are linked. Knowing that investors make use of ESG ratings, data and research for their investment decisions and proxy voting, it is in the interest of directors to ensure companies provide high quality disclosure.

Management

Management plays a crucial role when it comes to being a vital source of information for all stakeholders and communicating meaningful information effectively. Integrated thinking and integrated reporting introduced by the IIRC (International Integrated Reporting Council) have been embraced by many companies.[31] Integrated reporting aims to provide meaningful information to investors in a format that is both useful and relevant for decision making. Not only does integrated reporting accelerate ESG integration in company operations, it also contributes to attracting capital when the company can show sustainable value creation, and facilitates integration of ESG investors in their investment decision-making. Integrated reporting, which involves the CFO, is a powerful signal to show commitment to ESG.[32]

With growing global market demand for ESG disclosure and the need for investors and companies to work with a common ESG framework, SASB and IIRC announced in 2020 their intention to merge and provide a combined framework for investors and companies.

Separately, the TCFD (Task Force on Climate - related Financial Disclosures) recommendations have also increasingly become a standard amongst investors. This signals that investors will increasingly turn to the companies in which they invest to provide climate-related disclosure in this area.[33] Other stakeholders committed to climate-related issues will join investors in the push for more company disclosure.

In 2020, the United Kingdom became the first country to make TCFD-aligned disclosure mandatory for listed companies, insurance companies, asset owners, life insurers and other institutional investors by 2025.[34] This governmental action could contribute to making TCFD standards best practice in other financial markets around the world.

According to our 2020 Survey, more than 50% of investor respondents in both North America and Europe are already asking companies to follow the TCFD. Investor respondents appear less receptive to boilerplate climate change disclosure, preferring that companies explain why climate change is material and how it affects their business operations. Investor respondents also expect issuers to quantify climate-related impact and disclose specific targets they set themselves. Some companies, particularly in the United States, appear cautious about providing too much information on climate-related risks because they fear it opens the door to litigation and are looking for regulatory guidance from Securities and Exchange Commission (SEC).

Another important development is increased transparency of a company's short term and long-term incentive structures to show alignment with the company's ESG strategy and objectives.

Market practice points to disclosure of long-term material ESG targets and reports on performance against these.

The CFA Institute argues that a consistent reporting system raises investor confidence, which ultimately strengthens capital markets.[35] Moreover, companies that provide proper disclosure are likely to benefit from a lower cost of capital as investors are better informed and more confident in their decisions. Increasing ESG disclosure takes time, effort and uses valuable company resources. Companies can better deploy existing cost-effective technology solutions to enhance the quality, timeliness and cost effectiveness of company reporting. All these developments are driving the shift to focus on the long-term.

Investors

Providing disclosure on responsible investment policies, key ESG activities, focus areas and outcomes is becoming a standard in the asset management industry. On one end there are the policies that investors put in place for their investment activities and on the other end there are the policies that investors put in place for their corporate activities (just like the companies in which they invest). Pension funds and other assets owners' growing commitment to responsible investing, and to sustainability in general, is driving their asset managers to ramp up their ESG disclosures as well. Other stakeholders are also increasing their scrutiny of the investor community's commitment to ESG. For example, non-governmental organizations such as ShareAction and WWF publish investor rankings to encourage greater transparency on ESG commitments, practices and outcomes.

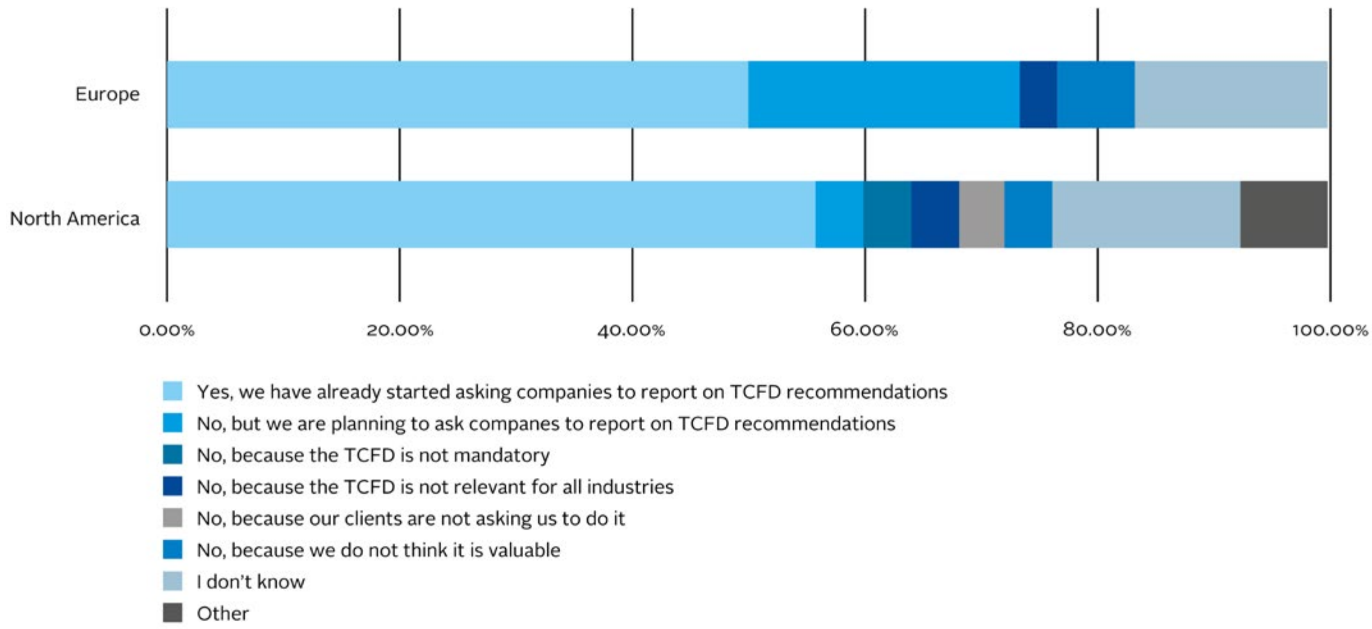
With more than 3,000 signatories (asset managers, asset owners and service providers) representing over USD 100 trillion assets under management, PRI (Principles for Responsible Investment) is the world's leading proponent of responsible investing.[36] PRI's reporting framework, which is mandatory for its signatories, has become the ESG reporting standard that applies to investors.

As previously mentioned, when it comes to climate-specific disclosures, TCFD is the leading reporting framework for investors (though it applies to companies as well).

Our 2020 Survey illustrates investors' growing international support for the TCFD. More than 50% of investor respondents in the United States and Europe their asked portfolio companies to follow the TCFD reporting recommendations.[37] The United Kingdom's decision to render the TCFD framework mandatory, will accelerate that trend.

Figure 4: *Investor Engagement on TCFD*

Survey Question to Investors: Are you asking your portfolio companies to report on recommendations of the Task Force on Climate-related Financial Disclosures (TCFD)?



Source: LeaderXXchange and Columbia Law School, Global Investor-Director Survey on Climate Risk

By focusing on meaningful and material ESG issues, investors can prioritize their ESG engagement efforts with portfolio companies. Publishing a responsible investment report is becoming common practice among both large asset managers and asset owners. They are increasingly expected to go beyond disclosing policies, processes and practices to also report on achieved outcomes.

Additionally, stakeholders are now asking investors to report on their own - internal - CSR practices and objectives and evaluate whether they are aligned with the responsible investment policies and objectives they apply to the companies in which they invest. This effort could lead to an improved alignment between what investors expect and require from companies in which they invest and what they expect for themselves. Future rankings could show how investors measure up.

Finally, investors also publish an engagement and a proxy voting report that describes the implementation of their stewardship policy and activities, with examples of engagement, results achieved, and topics prioritized.

Making proxy voting records publicly available on a continuous basis is a growing practice among investors and helps provide their clients, portfolio companies and other stakeholders with better insight into voting behavior. Sharing details of how various responsible investment activities are tied together - for example how proxy voting influences investment decision-making or how engagement influences proxy voting decisions – gives all stakeholders useful information to understand how an investor addresses ESG topics and to evaluate their commitment to ESG.

Conclusion

The LeaderXXchange® Investor-Director ESG Roadmap is an actionable solution designed to break the silos that separate boards of directors, management, and investors. It offers a systematic approach they can readily adopt using ESG best practices to help them on their sustainability journey.

The governance framework is designed to guide boards of directors, investors and management on their sustainability journey. The assessment tool is designed to objectively evaluate the robustness of an ESG governance framework as it applies to a board of directors, corporate management or an investor and determine whether it is conducive to delivering meaningful outcomes.

By working together, the investment and business communities, together with all stakeholders that are committed to building a more sustainable future, can take an active part in addressing the urgent environmental and social challenges and create long-term value for society and shareholders. We hope you find this roadmap useful and welcome your comments and suggestions.

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Sophie L'Helias is founder and President of LeaderXXchange®, a trusted advisory that develops value creating solutions through the integration of sustainability and diversity in strategy, leadership and investment. She is a recognized corporate governance and ESG expert who draws upon her experience as an investor, a lawyer and a board director of publicly traded and private companies in Europe, North America and Africa.

Ms. L'Helias is the recipient of the 2019 International Corporate Governance Network (ICGN) Lifetime Achievement Award in Corporate Governance; the 2019 New York Women in Asset Management Award - ESG; the 2018 Global Proxy Watch GPW 10 Award that designates the ten most salutary corporate governance influences in the world each year and was featured in Forbes 40 French Women Leaders list in 2019.

Ms L´Helias is a Fellow at The Conference Board ESG Center in New York and serves on the Advisory Board of the Hawkamah Governance Institute in Dubai. She holds an MBA from INSEAD, and law degrees from University of Pennsylvania, University of Pantheon-Sorbonne in Paris and the European Institute of Comparative Law in Saarbrücken Germany.

Nina Hodzic

Nina Hodzic is Director, Head of Sustainable Investment Office at Allianz Global Investors (AllianzGI). She is responsible for the shaping of AllianzGI's sustainable investment strategy and policy, sustainable product strategy and the coordination of cross-functional sustainability topics across the firm. Ms. Hodzic joined the firm in 2017. She is a member of the Advisory Board of LeaderXXchange® and regularly speaks and writes on various ESG topics, such as climate change, corporate culture and diversity.

Ms. Hodzic has over 15 years of experience in the financial industry. Before joining AllianzGI, she worked at NN Investment Partners in The Netherlands and Belgium, where she had global responsibility for ESG analysis and reporting, screening methods and communication with various internal and external parties on sustainability topics. She started her career at ING Group Market Risk Management developing and implementing stress testing practices and scenario analysis for ING Bank trading portfolio.

Ms. Hodzic holds a Master of Science in Financial Econometrics (Quantitative Finance) from Erasmus University in Rotterdam, The Netherlands and has also studied at the University of Technology Sydney, Australia. She is currently completing her postgraduate degree Management of Technology and Strategy at ESMT Berlin, Germany.

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Design support by Ivan Mosiichuk

Appendix LeaderXXchange®
Investor-Director ESG Roadmap
Executive Summary

Your Sustainability Journey

LeaderXXchange®
Investor-Director ESG Roadmap
Executive Summary

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Introduction

Climate change and other Environmental, Social and Governance (ESG) issues are becoming increasingly relevant to the investment and business communities, as the scale and urgency of the challenges become apparent.

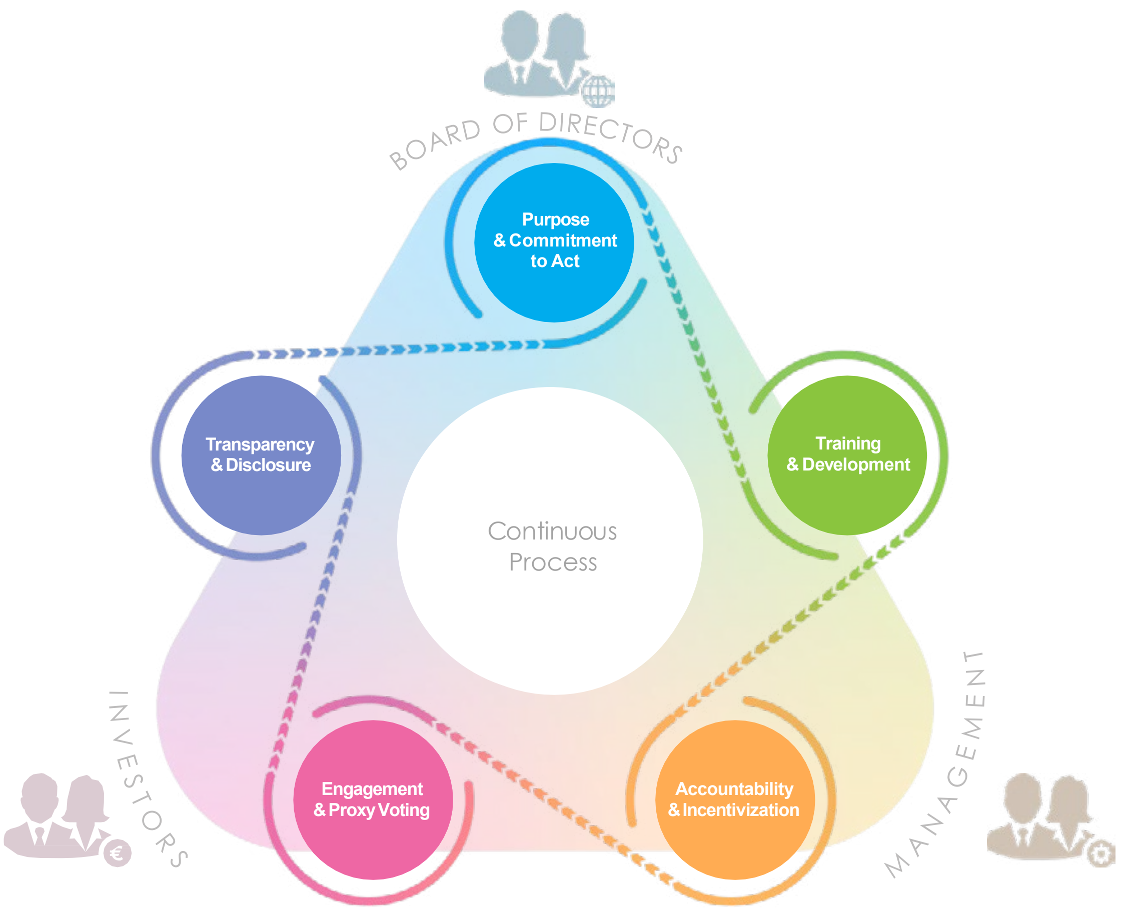
Investment decisions increasingly consider these issues to predict companies' long-term success. This provides an opportunity for both boards and management teams to incorporate ESG into long-term corporate strategies and create value for shareholders and stakeholders.

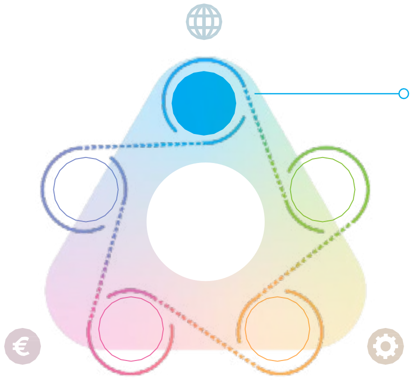
To break down the silos that separate investors from board directors and build a bridge of knowledge and trust on major ESG topics, LeaderXXchange® launched The Investor-Director Dialogue on Climate-related Risk Management Series in 2016 together with Spencer Stuart's European Board Practice group.

LeaderXXchange® formed an Investor-Director ESG Working Group in 2017, when the annual Investor-Director Dialogue Series showed its limits. Comprised of six directors and six investors, participating in their personal capacity and operating under Chatham House rule, the Group used a collaborative and systematic approach to help board directors, management and investors rapidly adapt to the "new normal".

The LeaderXXchange® Investor-Director ESG Roadmap illustrates how board directors, management and investors can work together to deliver better ESG outcomes, address unprecedented environmental and social challenges and promote disruptive technological innovation that will strengthen business models and improve performance for all stakeholders.

It is divided into five sections: Purpose & Commitment to Act, Training & Development, Accountability & Incentivization, Engagement & Proxy Voting and Transparency & Disclosure. For each section, the LeaderXXchange® Roadmap presents actionable best practices for board directors, company management and investors, respectively, to accelerate positive impact.





Purpose & Commitment to Act

Tackling climate change and other ESG issues requires a clear purpose and commitment to act from the top of the organization.

Board of Directors

Boards to take a long-term view, embed ESG into company's purpose while considering materiality and intentionality, and to approve corporate purpose with commitment to act

Board composition to include relevant ESG expertise in director skill sets

Integrate ESG topics in board and committee oversight of long-term strategy, risk, opportunities and remuneration

Management

Corporate purpose and commitment to act translates ESG into company strategy set by management while considering materiality and intentionality

Corporate mission statement requires approval by the board of directors

Investors

Top management of investor organization must take a long-term view, embed purpose and ESG into the investment philosophy while considering materiality and intentionality

Top management of investor organization to mandate integration of ESG topics into investment process

Training & Development

Training and development are crucial for raising awareness and understanding of ESG issues, enabling effective discussion and analysis of ESG topics.

Board of Directors

Board and committee agendas to include material ESG topics

Learn from internal or external experts as needed

Leverage in-house expertise to provide directors with customized training programs on climate change and other ESG topics

Management

Increase awareness and promote best ESG practices in company

Provide climate change and ESG training throughout the organization

Investors

Increase awareness and promote best ESG practices in the investor organization

Conduct ongoing climate change and ESG training for management and throughout the investor organization

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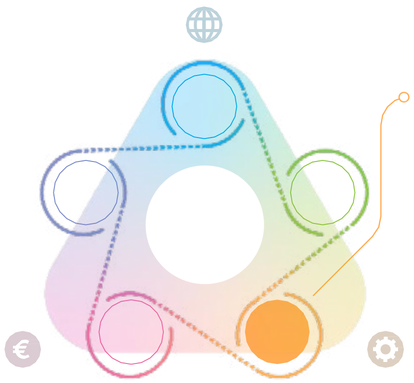


Accountability & Incentivization

There must be clear accountability on ESG topics, along with appropriate incentivization to ensure that both financial and ESG performance are monitored and rewarded accordingly.

Board of Directors

Adopt clear board governance framework taking ownership of ESG oversight at the board and the CSR, strategy, audit, compensation and nominating committee levels

Ensure that compensation and rewards incorporate key ESG long-term performance objectives

Management

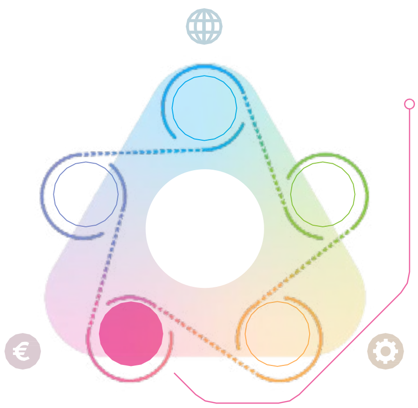
Adopt clear ESG governance framework and reporting structure to CEO and the board of directors

Compensation and rewards tied to disclosed company ESG targets and objectives for management and other employees

Investors

Adopt clear ESG governance framework and reporting structure to investor organization's management leadership

Compensation and rewards to incorporate ESG performance objectives



Engagement & Proxy Voting

Engagement and proxy voting are effective ways for directors, management and investors to raise awareness, share best practices and progress and take action on material ESG topics.

Board of Directors

Establish principles and policies that govern the board's approach to engagement and strive for best practice

Engage CEO, CFO and other members of management on material ESG topics and objectives

Engage investors on material long-term ESG topics and objectives

Management

CEO, CFO to actively engage on material ESG topics during meetings with investors and sell-side analysts, on earnings calls and investor days

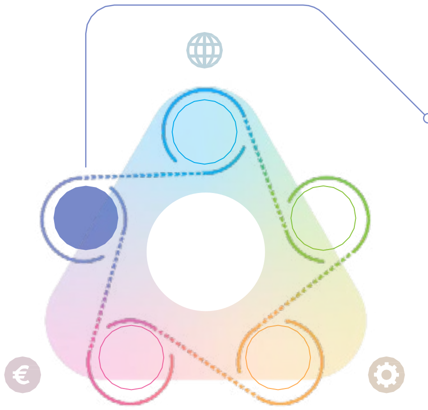
CEO, CFO and other members of management to discuss material ESG topics and targets with the board and its committees

Investors

Establish principles and policies that govern the organization's approach to engagement and proxy voting

Engage with portfolio companies' CEO, CFO and independent directors on material ESG topics

Engagement and proxy voting consistent with long-term view and ESG disclosure



Transparency & Disclosure

Transparency and disclosure of ESG issues help to show intent, measure outcomes and better demonstrate commitment to ESG

Board of Directors

Disclose experience and expertise of the board and individual directors on climate change and other material ESG topics

Disclose how the board and committees address climate change and other material ESG topics and track progress of disclosed ESG targets and objectives

Management

Adopt an integrated reporting framework

Publish an integrated report and clearly disclose long-term material ESG targets with intermediate steps

Clearly disclose results against set targets and objectives

Investors

Disclose principles and policies that govern the investor organization's approach to ESG, engagement and proxy voting

Consider ESG materiality and intentionality in all disclosure

Disclose proxy voting records and engagement activities to show alignment with investment principles and policies

In conclusion…

The LeaderXXchange® Investor-Director ESG Roadmap is an *actionable* solution designed to break the silos that separate boards of directors, management, and investors. It offers a systematic approach they can readily adopt using ESG best practices to help them on their sustainability journey.

The *governance framework can* guide boards of directors, investors and management on their sustainability journey.

The *assessment tool* helps objectively evaluate the robustness of an ESG governance framework as it applies to a board of directors, corporate management or an investor and determine whether it is conducive to delivering meaningful outcomes.

By working together, the investment and business communities, alongside other stakeholders that are committed to building a more sustainable future, can take an active part in addressing the urgent environmental and social challenges and create long-term value for society and shareholders.

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In remembrance of **Richard Ferlauto** who planted the seeds of board climate competency and oversight, and tragically left us before he could see his ideas go mainstream.

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While we have made our best efforts to accurately quote and reference this report, please send any comments, suggestions or corrections contact@leaderxxchange.com

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LeaderXXchange® is a purpose-driven organization that advises and promotes diversity and sustainability in governance, leadership & investment.

We focus on understanding market and societal trends to develop award-wining investment and strategic solutions designed for impact.

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