

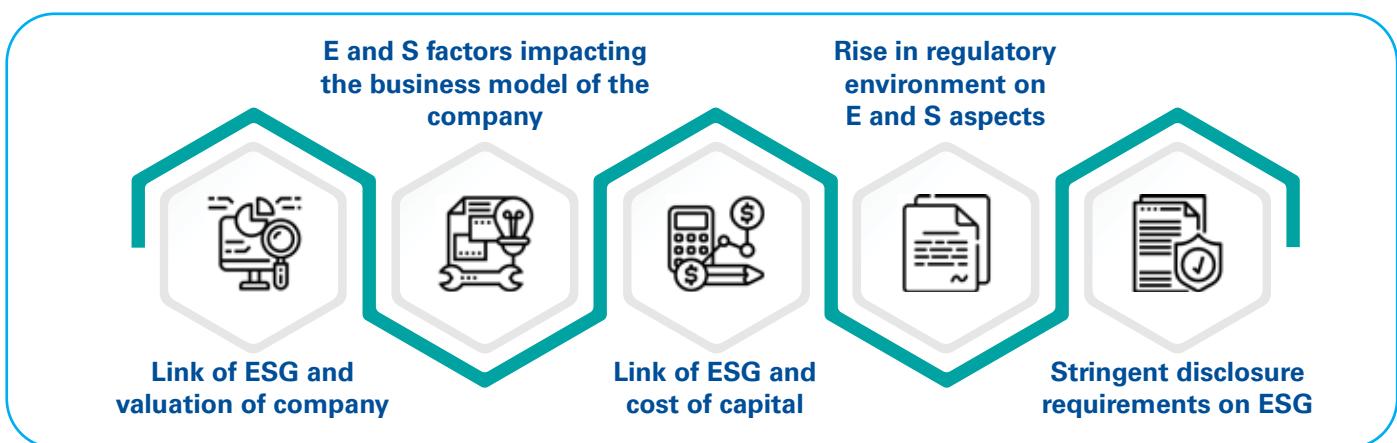
ESG: The board's perspective



Role of the board in shaping the ESG agenda

Since the onset of the pandemic, companies are increasingly recognising that mere pontification or rhetoric on ESG (environment, social and governance) matters no longer suffices. With intense scrutiny on the company operations by the stakeholders (investors, regulators, community, employees), companies now need to walk the talk and provide evidence of concrete actions as well as an articulation of their ESG strategy and plans.

Several factors have catapulted ESG into a mainstream agenda for the corporate boards and the boards can no longer be reticent on ESG matters.



Accordingly, this paper outlines an articulation of how the companies need to rethink the governance models to adapt to the evolving landscape. Our reflections are captured across the three questions:



Why ESG should be a board agenda?

Several factors make the case on why ESG must also be a board responsibility and not solely the remit of the executive management

Demand from investors

Investors are increasingly considering ESG as a pre-condition for engagement with companies. There is a rising expectation among the investors not only on the ESG performance of the company but also on transparency on the board's oversight on important ESG matters. This is largely because the pandemic has surfaced evidence and data points which reflect that companies with strong ESG fundamentals have been more resilient and have been able to better weather the market volatility for the past two years.

Alignment with the board's fiduciary responsibility

The board is charged with the 'duty of care' - to take decisions in a reasonably prudent manner which are financially, legally, and ethically sound. The pandemic has shone a light on the impact of ESG on the shareholder value reflecting that the business decisions cannot operate in silos and need to consider ESG risks and opportunities. This strengthens the argument of the need for board's consideration on ESG matters. Additionally, the fiduciary responsibility of the board towards ESG is also implicitly enshrined in the Companies Act, 2013.¹

Growing regulatory push for ESG disclosures:

We have seen several governments announcing more stringent disclosure requirements on ESG matters. Be it TCFD (task force on climate-related financial disclosures) by the UK Government or the SFDR (sustainable finance disclosure regulation) in the EU –there is a growing obligation on both companies and investors for disclosure on ESG risk and performance. Closer home, SEBI has announced the BRSR (business responsibility and sustainability reporting) expanding the scope and ambit of the earlier disclosures under the BRR (business responsibility report). The board's need to understand what this reporting means for the company and the risks, if any, that may surface on account of increased levels of transparency.

Litigation risk:

Heightened ESG awareness and demand for accountability are contributing to a rise in litigation. As per a report, there has been an increase in climate action lawsuits with governments, and firms in nearly 28 countries having been sued over the climate crisis.² It is becoming increasingly important for the boards to pay attention to the ESG risks and exposures.

Upending of business models:

The climate crisis has increased the focus on the heavy emitter industries which are being called to transition to low carbon requiring a massive overhaul/re-think of their business models. Where operational risks are now increasing, on account of ESG, at the same there may be potential opportunities for a few companies in terms of new markets or as supply chain actors, providing long-term benefit for early adopters and the board's need to be ready to leverage the same.



The strategic imperative of ESG and its influence on the business and operational drivers of a company in today's environment, as evident from above, clearly make ESG a board's agenda.

However, there is also a recognition of the limitations with which the board's function, namely - competing demands on the board's time, ability and access to percolate the changes to the lowest level of the operations, frequency of the board's meetings, specialist versus generalist knowledge coupled with the diversity of ESG topics, among others. Companies need to set a clear role of the board along with an enabling governance structure to support optimal oversight by the board on ESG matters.

1. Section 166(2) of the Companies Act, 2013 states. "A director of a company shall act in good faith in order to promote the objects of the company for the benefit of its members as a whole, and in the best interests of the company, its employees, the shareholders, the community and for the protection of environment"; Schedule IV of the Companies Act, 2013 Code for Independent Directors also makes a reference to the need for "Balancing the conflicting interest of stakeholders"

2. Governments and firms in 28 countries sued over climate crisis, The Guardian, Sandra Laville, July 2019, date accessed: 14 June 2021.

What should be the role of the board for ESG?

The past year has seen a flurry of corporates putting out ESG reports and disclosures and setting up their ESG strategy and roadmap in a bid to respond to numerous investor and stakeholder queries. While there has been a definitive increase in time commitment and focus that ESG is now receiving from the corporates, we cannot deny that the motivations vary. These can range from sincere commitment to be

a responsible company, to a more grudging adoption for avoiding a backlash from stakeholders or the fear of being left behind.

The board can play a critical role in more companies positively embracing ESG in both letter and spirit by bringing the required gravitas to the discussions on ESG strategy and performance.

Some elements of the board's support in ESG adoption that can be pivotal and effective include:

- Setting the 'tone at the top' for a perception shift of the management and the company towards ESG
- Integrating ESG in the fundamental construct of the corporate strategy, its vision and purpose
- Instituting mechanisms that enable effective monitoring on ESG KPIs and a suitable framework for ESG risk mitigation; ensuring that ESG is factored into the performance evaluation of the CEO and senior management
- Asking the right questions around the company's ESG strategy, progress and disclosures
- Allocating an appropriate level of board time to review and discuss material ESG issues that are trending e.g.: climate risks and diversity & inclusion
- Being more transparent and receptive towards set -up of mechanisms for an evaluation of their own performance on ESG matters.

While the role of the board on ESG parameters may vary from company to company factoring contextualisation arising from factors such as size, geography, industry, regulations etc., the above aspects can serve as a broad guidance for companies to consider while setting forth the expectations from the board on their role for oversight on ESG matters.

What are the emerging models of board oversight on ESG?

The new landscape of ESG has also resulted in companies rethinking the models for board oversight of ESG matters. The models that are being adopted globally and in India range from:

- A full board oversight and inducting the required skills, where necessary
- Delegating to an existing committee to support the board
- Setting up a separate committee of the board to focus on ESG
- Setting up stakeholder and external advisory councils to support the board with recommendations and insights on ESG.



The various models have their own respective advantages and there is no one-size-fits-all approach. Each model needs to be evaluated to determine the optimal fit for the company. While selecting an optimal board oversight structure, companies may consider the following questions:

- Does the existing board have the requisite knowledge, skill, experience, and capacity to consider ESG issues and matters?
- How engaged is the board currently on ESG matters?
- Would a separate ESG committee support the board in effective discharge of the ESG oversight or add more complexity to the oversight process?
- Can an existing committee of the board effectively support the board in the oversight function?
- Do we have identified members who have the skills and interest be a part of the separate ESG committee?
- How can we balance and integrate the stakeholders' views in the governance/oversight model?

The past few months have seen a slew of announcements by companies on the establishment of a dedicated ESG committee of the board. The rationale has been the need to consider a focused and specialised approach, at least in the initial years, to traverse through not just the risks but also the opportunities that the new ESG landscape has surfaced.

Another structure that has been considered is the creation of an external advisory council and/or stakeholder council. The advisory council comprises experts from different domain areas aligned to the industry to provide support and technical assistance to the board of directors and the senior management. Given the diversity of the topics and general lack of understanding on some of the current core ESG issues such as climate change, such councils can be effective when curated with the right expertise. The stakeholder council, on the other hand, consists of representatives from the material stakeholder groups relevant to the company viz., customers, employees, investors, community representatives etc. providing the direct access to the insights and perspective of the stakeholder to guide the board on the company's effectiveness in meeting stakeholder expectations.

While these structures hold certain merits, the construct of the charter to define the committees or council's role is critical. Aspects such as the purpose, authority and responsibility, delegation of duties, procedures and administration need to be crafted with clarity. Else, companies run the risk of setting up yet another additional committee without the commensurate benefits.

Another important consideration is the diversity of the ESG matters /issues which necessarily percolates across several committees of the board. For instance, different elements or dimensions of ESG may be considered by the CSR committee, the risk committee, audit committee and the nomination and remuneration committee. An effective oversight will typically require a cross-functional approach across the multiple board committees, and it is necessary to build the interconnection amongst the committees on ESG.

Companies will need to weigh in on the benefits and value add that the various structures provide to ultimately determine the best fit for themselves.



We would like to thank our ESG council members for their time in providing us with their valuable insights and perspectives that have contributed to building this PoV document.

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