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CORPORATE SOCIAL RESPONSIBILITY

Adapting Anti-Bribery and Corruption Tools to Manage ESG Risks

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The environmental, social and governance (ESG) performance of any corporate has assumed a new prominence in the minds of stakeholders, regulators and the wider public. Profitability and growth are no longer the only metrics that matter; issues that once were the focus of activists have become mainstream concerns, and commercial factors, such as share prices and strategic commercial decisions, are increasingly influenced by ESG considerations. New E.U. legislation, both proposed and recently adopted, will require companies to conduct extensive due diligence involving ESG risk assessments, and also audit their publicly reported information.

Legislators and regulators globally have responded to this shift of collective conscience by enacting and enforcing new laws in previously unregulated ESG areas to prevent companies from making misleading claims about their sustainability or environmental impact, commonly referred to as greenwashing. This shift across the world aligns with the long-term trend of reassigning responsibility for compliance matters to business over the last decade, as has been seen in anti-bribery and corruption (ABC) risk and other compliance areas such as anti-money laundering. Governments worldwide recognise that they do not have the resources to regulate the complex global economy in a growing number of risk areas and this legislative trend is likely to increase and continue.

ABC is increasingly seen as a necessary part of an ESG assessment for any corporate. Indeed, RBC Global Asset Management's 2021 Responsible Investment survey of 800 participants from the investment business identified anti-corruption as the top ESG issue they are concerned about when investing.

For more from Dechert, see "eDiscovery in Multi-Jurisdictional Investigations: Preparing to Play Multi-Level Chess" (Jan. 6, 2021).

ABC Measures Can Apply to ESG

A corporate's anti-corruption record is a key metric of the governance pillar of ESG. This is enshrined in legislation in certain jurisdictions such as the E.U.'s Non-Financial Reporting Directive (NFRD) but, in practice, good governance is always a prerequisite for managing ESG risk.

As most corporates already have sophisticated ABC and AML compliance systems in place, these controls can be adapted to integrate and

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manage the rise of ESG risk. Viewed in this way, the increased prominence of ESG performance provides corporates with an opportunity to integrate multiple risk matrices into a single holistic compliance programme that can contribute positively to business value.

Burden or Opportunity?

Corporates that seize this opportunity early will be rewarded with an agile, integrated and well tested programme to meet the demands of increasing ESG analysis and reporting obligations, as well as statutory defences to enforcement risk in some jurisdictions. Formal ESG requirements are only going to grow and are likely to expand to include an obligation that corporates remediate both internally and also across the relevant supply chain.

While this shift of responsibility may feel burdensome to business, this long-term trend indicates that the greater onus on corporates to self-regulate is undoubtedly here to stay. In addition to greater legislation, stakeholders in the form of investors, activists and the wider public are putting increasing commercial and societal pressure on corporates to adhere to positive ESG norms, in addition to black letter law. In parallel, ESG data is becoming increasingly accessible to the public via free platforms, thus providing the public with the tools needed for greater corporate scrutiny. As a result, there is a clear need for transparency in terms of adherence to ESG standards.

Corporates that ignore these pressures, adopting the approach of complying with the minimum legal requirements, are likely to find themselves facing greater scrutiny in the court of opinion. Conversely, corporates that publicly embrace ownership of their ESG impact, and articulate clear positive ESG aims and outcomes, have the opportunity to make their spending on compliance an investment in their brand. As a result, there is significant first-mover advantage for corporates that embrace the new legislation and evolved public sentiment as an opportunity to integrate and modernise their compliance programmes to encompass these expanding areas of business oversight. Applying resources to address ESG risk is not only a damage-prevention measure; the strengthening connection between traditional commercial metrics, such as share price, to ESG outcomes means that investing in quality ESG controls can add meaningful business value.

See "Taking a Measured and Forward-Looking Approach to ESG Compliance" (Dec. 1, 2021).

A Lack of Standardisation

While the risk and rewards of an ESG programme are clear, there remains a lack of general standardisation in ESG metrics despite the growth in outcomes-based regulation.

Attempts to standardise ESG reporting are growing at pace through both mandatory reporting legislation and voluntary pledges to disclose certain metrics. From 2018, the E.U.'s NFRD has required listed and large public interest companies with more than 500 employees and which have either a balance sheet total of more than €20 million or a net turnover of more than €40 million to disclose their performance and policies across five ESG areas (one of which is anti-corruption and bribery). In 2021, the E.U. proposed the Corporate Sustainability Reporting Directive (CSRD), which would increase the reporting obligations under NFRD, in terms of detail, auditing measures and the organisations affected by the legislation.

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In the U.S., the proposed Disclosure Simplification Act would similarly require mandatory reporting for certain corporates if enacted. In June 2021, it narrowly passed the House of Representatives. If enacted, this legislation would require certain publicly listed companies to report SEC-mandated ESG metrics in the future.

Alongside the growth in legislation, global corporates are voluntarily pledging to report certain agreed metrics via organisations such as The Task Force for Climate-Related Financial Disclosure.

Even as attempts to standardise the reported metrics proliferate, corporates are challenged to implement a practical ESG programme to address the specific ESG-related risk(s) that they face, without clear reference to standardised metrics across a particular sector or industry. A helpful starting point is the necessary link between good governance and positive ESG outcomes, and corporates must then consider how existing ABC measures can provide a useful framework for responding appropriately to ESG risk.

Good Governance: An Essential Starting Point

Good corporate governance is a prerequisite for being able to manage ESG risk. Corporates must consider whether current reporting lines, allocations of responsibility, management incentive structures and wider corporate culture contribute to a robust governance framework capable of addressing corporate behaviour that deviates from a company's legal requirements and publicly stated ethics. These considerations apply equally to the implementation of effective ABC and AML policies and procedures, and therefore are something that most corporates will have well in hand.

The addition of ESG risk adds further impetus to reassess the adequacy of existing corporate governance measures and consider whether further improvements can be made. For example, in the future it is likely that executive compensation will be linked to ESG key performance indicators, in addition to more traditional metrics such as growth and profitability. Corporates that implement such progressive measures early are likely to reap the most reward in terms of increased share prices and decreased long term ESG risk.

The Importance of Corporate Culture

Once good formal governance is embedded, a corporate must identify and articulate the outcomes, including ESG impacts, that a business is seeking to achieve through its integrated compliance programme. Legislation aimed at AML, ABC and the prevention of tax evasion has long provided certain outcomes which regulators expect a business to achieve, such as transactions being free from corruption and tax evasion at all levels, and robust Know Your Client procedures.

However, in addition to the clear proscriptions, current compliance legislation requires the incorporation of cultural principles into any system of adequate controls. Broadly, while the above proscriptions are legal minimums, a corporate must also have a genuine culture promoting 'doing the right thing' for a compliance programme to be effective. The increase prominence of ESG only increases the need for any corporate to have solid corporate ethics and a cohesive culture.

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Identifying ESG Outcomes

Recent and prospective ESG legislation guides what ESG impact businesses should be seeking to achieve as a legal baseline, both within their own business and wider business dealings. Companies will need to consider the jurisdictions and sectors they operate in, and the source of their equity, including whether they are listed on a public securities exchange, in order to identify their own applicable mandatory legal requirements.

For example, a manufacturing company with institutional investors that operates across the E.U. will need to consider what ESG data it will need to provide to its institutional investors (via the relevant fund(s) and asset manager(s)), in addition to its primary reporting requirements in respect of human rights and supply chain due diligence under both E.U.-wide legislation and country specific laws. A U.K. company may also need to consider all the above, in addition to U.K. specific reporting requirements, such as those under the Equality Act 2010 (Gender Pay Gap Information) Regulations 2017 and the Modern Slavery Act 2015. U.S. legislation is behind that of the E.U. and the U.K., but new requirements may be coming soon and would add additional complexity to the analysis.

Funds and asset managers must similarly consider the jurisdictions in which they market financial products to identify the relevant disclosures they are required to make to investors, and therefore what information they will require from companies in which they invest.

In addition to an analysis of applicable law, corporates and funds should assess what ESG outcomes would align with their published values and consider what additional disclosures could benefit the corporate's stated ethos in order to ensure maximum return for investing in an ESG programme.

See "The Global Modern Slavery Landscape: Standard Practice for Maintaining Compliance" (May 29, 2019).

Adapting Compliance Tools to ESG

Each of the individual elements of a corporate's existing compliance infrastructure can be adapted in different ways to assist with managing ESG risk.

Working ESG Into Existing Risk Assessments

In February 2022, the European Commission adopted a proposal for a draft Corporate Sustainability Due Diligence Directive (CSDD Directive) for European Parliament approval. Once passed, the final CSDD Directive must be transposed into national law by member states within two years of the Directive's entry into force for the largest companies covered, with a further two-year period being afforded to smaller companies operating in high-risk sectors specified by the Directive. The CSDD Directive will require relevant corporates to conduct extensive due diligence on human rights and environmental matters across their direct and indirect value chains. ESG risk assessments will therefore become mandatory in the future for certain E.U.-based and non-E.U. based corporates operating in the E.U., provided they meet certain thresholds and/or operate in certain sectors at high-risk of human rights breaches. The CSDD Directive

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will sit alongside the CSRD's enhanced reporting requirements, which will obligate relevant corporates to audit their reported information.

Corporates should start any ESG risk analysis based on their existing AML and ABC risk assessments, which should already reference the sector(s), jurisdiction(s) and types of transaction(s) that the business engages in, both with its end users and with its suppliers, sub-contractors and agents. Existing ABC risk assessments will need to be modified to incorporate both mandatory and the most relevant ESG reporting standards. Corporates with existing effective ABC and AML programmes are well placed to identify the vulnerability of a corporate to ESG risks in its primary business and wider supply chain and subsidiaries. The same analytical process can be applied to ascertaining ESG areas where a corporate may fall short in the course of its operations, including with any third-party relationships. As with ABC risks, a risk assessment allows corporates to identify material ESG risks and assess the effectiveness of any proposed ESG controls.

Code of Conduct, Policies and Management Plans

In order to encourage and document ESG controls, corporates should articulate their chosen ESG outcomes in a written code of conduct and elaborate on how to achieve these within policies and management plans. By doing this, companies will demonstrate that they have adequate controls for auditing and assessing ESG risk for which they are legally liable to report. Companies with an existing code of conduct that encompasses other compliance risks can simply modify their existing code to include their identified ESG outcomes. Operationally, this should allow a company to cascade their ESG aims relatively simply through existing compliance communication channels.

In developing and publishing certain ESG-related policies, such as how a company will proportionately mitigate the risk of human rights abuses in its supply chain, a corporate can achieve three benefits:

1. clearly documenting internal guidance for employees and sub-contractors to achieve the policy aim;
2. demonstrating that it is legally compliant with relevant disclosure legislation; and
3. in turn, this will help improve a company's ESG ratings, while remaining compliant with any mandatory reporting requirements.

A corporate's management may wish to consider articulating a long-term management plan that narrates how the corporate intends to meet its ESG outcomes over time. While a management plan may not be legally required, such a document will signal and illustrate to investors management's commitment to ESG and anticipated ESG outcomes, in addition to documenting a clear tone from the top, both of which are only more likely to impact a company's share price in future.

Corporates that adopt this comprehensive approach now will be better positioned to comply with future legislation that assigns responsibility for ESG impact to the most senior executives in the organisation. For example, the CSDD Directive states that it is the directors' duty to implement and oversee due diligence measures. Under the CSDD Directive, directors are also required to

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consider the short, medium and long-term impacts of their decisions on the environment, climate change and human rights.

See "Alisia Grenville of Oerlikon on Building Excitement for a New Code" (Jun. 9, 2021).

Contractual Warranties and Representations

Having conducted an ESG risk assessment and implemented ESG-related policies alongside existing compliance policies, a corporate may wish to consider whether it is appropriate to update any existing contractual representations and warranties in respect of ESG factors. While U.K. legislation makes certain false disclosures a criminal offence, which therefore cannot be circumvented through contractual means, it is best practice to consider whether contractual warranties and representations could apply in any third-party relationships, in order to bolster a corporate's defences against ESG risk.

Benefits of an Integrated Compliance Programme That Includes ESG

While the growth of ESG legislation, in terms of both pace and scale, may appear daunting, corporates have plenty of skills in existing compliance measures to adapt to the risk associated with the increase in regulation and public scrutiny. The inclusion of ESG into legislative compliance regimes should be viewed as an evolution, not a revolution. Corporates with existing robust governance measures and current ABC and AML controls are well placed to adopt effective ESG measures into an integrated compliance programme.

Similar to ABC and AML regulation, most corporates are subject to an overlapping patchwork of ESG legislation emanating from several jurisdictions, and this pattern of regulation is only going to increase in the future. By integrating ESG with other compliance risks, a corporate can streamline and harmonise its risk management across multiple jurisdictions in a manner that is usual when addressing ABC and AML risk. An integrated approach has clear benefits for risk mitigation, but also for remediation, the burden for which is highly likely to fall on corporates in the future, based on recent compliance legislation trends.

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