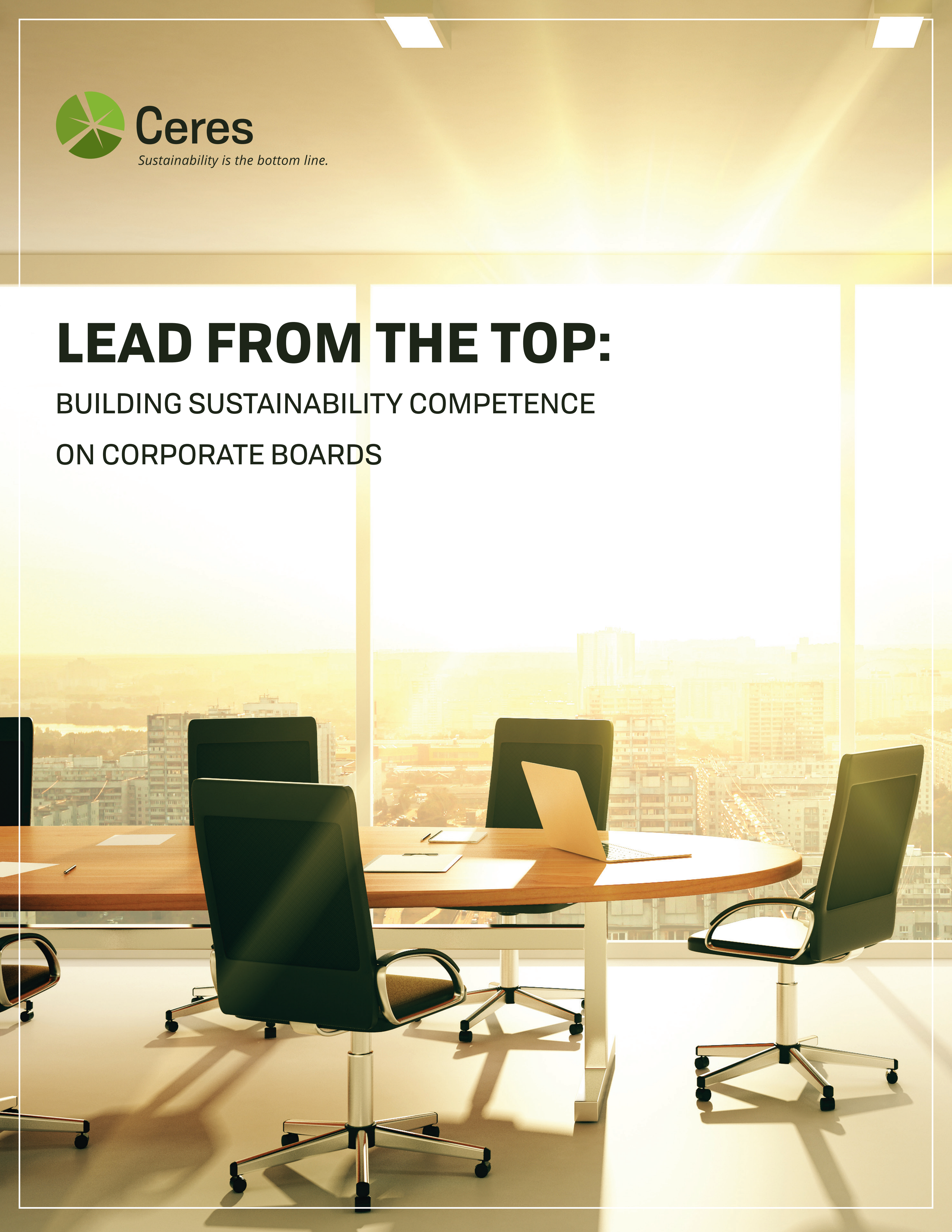
Ceres

Sustainability is the bottom line.

LEAD FROM THE TOP:

BUILDING SUSTAINABILITY COMPETENCE ON CORPORATE BOARDS



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FOREWORD

Carol Browner

former EPA administrator; board member, Bunge

Companies are beginning to experience first-hand the financial impact that unaddressed sustainability risks can have on their business.

Climate change is the clearest example. Nearly every sector of our economy is feeling the effects of a warming planet. Energy companies are dealing with changes to their demand forecasts and insurers are facing record losses from extreme weather events. Food and apparel businesses are struggling to adapt to climate disruptions to their supply chains brought on by drought and changing weather pattern.

Yet, as these issues are hitting companies in their bottom lines, corporate boards for the most part do not have the expertise they need to address the business challenges driven by climate change. Companies must treat sustainability as they do other significant business threats like cybersecurity and financial reform by building up the sustainability expertise on their boards. When sustainability is material to a company, it is essential to recruit directors with expertise to build a sustainability-competent board.

One of the biggest stumbling blocks in building sustainability-competent boards is the selection system. Current practices too narrowly define the traits that constitute strong board members. For boards to serve companies and investors well, that definition must change to include candidates with experience and exposure to environmental and social issues affecting corporate performance.

But recruitment is only the first step. Companies should plan for the future by empowering board members with expertise in sustainability to serve as decision makers. This expertise will empower companies to make informed, smart decisions on climate change policies that impact strategy, risk and corporate business models.

Sustainability should be a primary matter for all board members, not just those with environmental or energy backgrounds. Expanding board expertise on sustainability should be part of every company's board strategy. Boards that are open to hearing from outside influencers, even detractors, make smarter decisions that govern the success of companies. Bring them in, listen to them and let boards be informed as they weigh important decisions. Understanding the material risks and opportunities for the company is inherent in a director's responsibility to ensuring long-term value creation and resilience. As a board member, I have encouraged and helped make these interactions possible. All boards should be utilizing this approach.

This Ceres report lays out practical steps for approaching these and other options that companies can consider ways to make their board competent in addressing climate change and other environmental, social and governance issues.

FOREWORD

Rakhi Kumar

head of ESG Investments and Asset Stewardship at State Street Global Advisors

At SSGA our mission is to invest responsibly to promote economic prosperity and social progress. We do this by helping clients achieve their investment goals, whether it is saving for retirement, funding research and innovation or building the infrastructure of tomorrow. Most, if not all, of these desired outcomes are long-term in nature. As one of the largest global providers of index strategies, we are a supplier of quasi-permanent capital for listed companies. Therefore, we need to monitor long-term risks. We view material environmental, social and governance (ESG) factors as 'low probability, high impact' factors, where the probability of something going wrong from a sustainability or ESG perspective is low but when it does goes wrong, the financial impacts for shareholders are high.

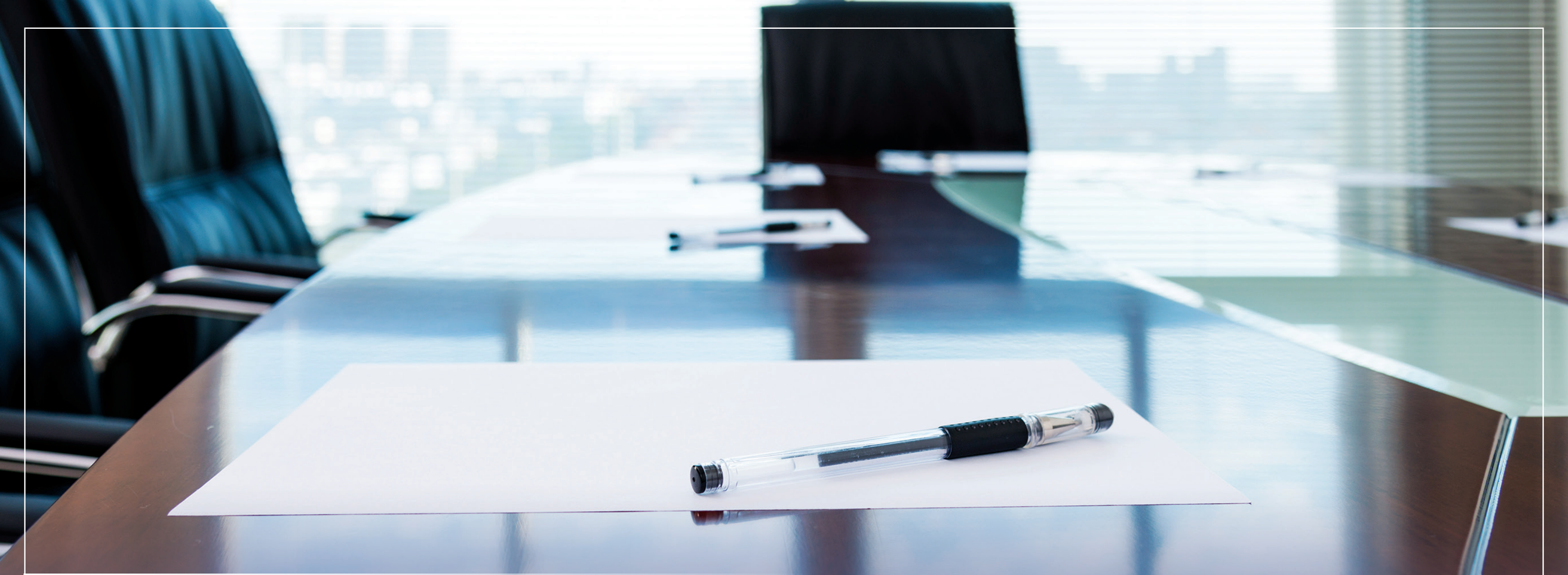
In recent years, incidents such as oil spills, poor food safety management and aggressive sales practices at various companies have highlighted the negative financial impacts that the lack of oversight of sustainability-related risks can have on long-term shareholder returns. In our 2017 letter to the boards of our portfolio companies, we called on directors to incorporate sustainability into long-term strategy. As an investor, our overarching focus is board quality and composition. We want our boards to be strong, effective and independent and recognize that sustainability competency is an important element of board effectiveness. Boards must ensure that they have the skills and expertise to be successful in their oversight of long-term strategy.

The ability to fully and systematically incorporate ESG considerations into our investment process is impacted by the availability of consistent, comparable and material ESG data. This is why we have urged boards to incorporate sustainability issues into their long-term strategy and report in a detailed and consistent way on their actions. We hope that through our continued engagement, more companies will report the kind of data needed to integrate ESG issues into the investment management process.

This report gives boards a practical guide on how companies have enhanced the sustainability competence of their boards. By defining what it means to be a 'sustainability-competent director' and a 'sustainability-competent board,' it helps anchor investor expectations of boards, while giving boards the freedom to pursue their own path to enhancing their sustainability competency.

As explained in the report, there are many ways for boards to improve their sustainability competency. By identifying key principles that focus on the director nomination process, director education and stakeholder engagement, Ceres has provided companies with a roadmap for strengthening board quality as it relates to sustainability.

Finally, the paper also serves as an excellent training tool for investors who wish to understand the many ways in which companies can improve the sustainability competency of their boards.



EXECUTIVE SUMMARY

Environmental and social issues are disruptive forces that companies—led by their boards—must keep at the forefront when assessing their business strategy. Today's directors shoulder a new set of tasks. They need to be able to determine which sustainability risks are the most material to the companies they lead. They also need to help direct their companies to capitalize on the market opportunity created by tackling sustainability challenges.

In a climate of unpredictability, building sustainability competence into corporate boards—where directors are skilled at assessing business risks and growth opportunities in light of evolving environmental, social and governance factors —is the way forward.

The Business Case for Board Sustainability Competence

Sustainability risks—including climate change, water crises, human rights and inequality—are creating new challenges for board members to meet their fiduciary responsibilities and ensure long-term shareholder success and overall value creation.

- **Sustainability disruptors could materially affect corporate financial performance.** Environmental and social issues have the potential to impede corporate plans, performance and even business models. The experiences of major global insurers, mining companies and food companies demonstrate the financial impacts of climate change, water scarcity and stakeholder expectations on supply chains, business expansion and capital investments.
- **Where sustainability is material to a company, boards have a fiduciary responsibility to act.** A key part of the fiduciary responsibility of boards is the duty of care, or the duty to adequately inform themselves of material issues prior to making business decisions. To discharge this responsibility, directors need to be able to understand and evaluate material risks facing the business. When a social or environmental force poses material risks, directors now need to consider those risks in decision-making in order to adequately discharge their fiduciary responsibility.
- **Investors are increasingly focusing on board sustainability competence.** Investors are making connections between sustainability and materiality on one hand, and financial performance on the other. As a result, they are focusing on the critical role the board plays in ensuring the resilience of a company's assets and its long-term business strategy. Consequently, investors are putting pressure on boards to show themselves as "competent" in environmental and social issues.

This report builds upon Ceres' 2015 report, "View from the Top: How Corporate Boards Engage on Sustainability Performance," which recommended two linked approaches for incorporating material sustainability considerations into core board functions: integrating sustainability into board governance systems and into board actions.

This follow on report, "Lead from the top: Building Sustainability Competence on Corporate Boards" provides greater detail on how boards can successfully integrate sustainability into their governance systems by raising their own competence on material sustainability issues to enable effective oversight. This report focuses on the skills and experience needed for board members to provide thoughtful oversight of sustainability risks and opportunities, in addition to the tools and processes that can help foster deeper engagement at the board level around these issues.

What Makes a Board Sustainability Competent?

An ideal sustainability-competent board has the requisite knowledge about material environmental and social issues that affect the business. It is able to ask the right questions, support or challenge management as needed, and ultimately make informed and thoughtful decisions affecting strategy and risk.

A Sustainability-Competent Board:

- » Integrates knowledge of material sustainability issues into the board nominating process to recruit directors that ask the right questions;
- » Educates all directors on material sustainability issues to allow for thoughtful deliberation and strategic decision-making at the board level; and
- » Engages regularly with external stakeholders and experts on relevant sustainability issues.

It is important to make the distinction between a sustainability-competent director and a sustainability-competent board: A sustainability-competent director has relevant expertise in or exposure to the material environmental, social, and governance issues that affect the company. The distinguishing feature of a sustainability-competent board, on the other hand is its ability to engage thoughtfully on material social, environmental and governance issues as one cohesive deliberative body. A sustainability-competent board integrates sustainability into broader board conversations and functions. Rather than being isolated or marginalized, sustainability becomes part of the fabric of board oversight and is integrated into decision-making on strategy, risk and compensation.

> "The biggest challenge is that we as directors don't always know what we don't know. When sustainability issues come up, directors believe in being environmental stewards but most people in the board room do not know the right steps to take. It's difficult for the board room to assess how they are doing, what are the trade-offs, and what lines of business are being impacted. There is a lot that is needed beyond the broad commitment to sustainability."
>
> — **HELENE GAYLE**
> chief executive officer at McKinsey Social Initiative; board member at The Coca-Cola Company; board member at Colgate-Palmolive

How to Build a Sustainability-competent Board: Leading Practices

Integrate sustainability into the nominating process by:

- **Creating regular opportunities to bring new directors with relevant expertise onto corporate boards.** To remain relevant, especially with a view to including sustainability priorities, boards must be periodically "refreshed." The board nominating or governance committee could affirm the importance of board refreshment in their charters by developing mechanisms that ensure consideration of refreshment, for example, through a regular board evaluation process.
- **Incorporating material sustainability issues into qualifications for potential board candidates.** By thinking about recruiting for sustainability in a systematic way, boards can look beyond their short-term needs. Nominating committees can make sustainability issues important qualifications they consider when recruiting new directors and track the qualifications via a board skills matrix.
- **Finding directors that can make the connections between environmental and social issues and the business context.** Nominating committees should recruit effective sustainability-competent directors that can assess the potential impact of sustainability issues on a business and "translate" it to provide context for a board's decision-making. Directors who cannot make the connections between the appropriate social and environmental issues and the relevant business context risk being marginalized.
- **Identifying directors who represent key stakeholder groups relevant to a company's sustainability impacts.** Nominating committees should recruit directors who have experience with interacting or representing stakeholder groups that offer insights into a company's material sustainability impacts. This provides the advantage of bringing both relevant expertise and background diversity to the boardroom.
- **Recruiting candidates representing a diversity of backgrounds and skills to improve decision-making.** Nominating committees should seek out candidates who bring a range of attributes, expertise and desired skills to the table, and

> "At the end of the day, sustainability must be integrated into core business strategy. Sustainability competent directors need to be bilingual: able to speak the language of both sustainability and business."
>
> — **KARINA LITVACK**
> board member at Eni

represent a mix of gender, ethnicity, nationalities, and backgrounds. This will help the board avoid "group think" and foster robust, thoughtful deliberations when making a decision. Research also shows that diverse boards are better boards.

Educate directors on material sustainability issues by:

- **Integrating new directors with sustainability competence into current board deliberations, especially on strategy and risk.** For sustainability-competent directors to be effective and for sustainability to be integrated into board decision-making, they must participate in board functions, structures and processes. Mentoring by existing directors is another effective method of helping new directors succeed in their roles.
- **Requiring regular education on material sustainability issues for the whole board.** Boards and company leadership could mandate that all directors need to be up-to-date on material sustainability issues. Education, training programs, and site visits should build knowledge over time and make connections to operational or management realities.
- **Providing boards with information on the materiality of sustainability to their business.** Boards need information to help them understand the materiality of specific sustainability issues to their business, so they can make the connection between sustainability and corporate strategy and risk. Materiality analyses could prove useful in helping directors understand how certain environmental and social issues relate to business strategy and how they may materially affect operations.
- **Driving board discussion on how sustainability impacts corporate risk, strategy and business models.** Identifying risks and opportunities created by environmental and social issues helps companies adapt their models. By becoming more resilient, integrated and circular, businesses can tap into more sustainability-related business opportunities.

> "You can be an issue expert on climate, water, or toxic chemicals but that doesn't mean you can think about those issues in a way that is strategic to a business. Some level of sustainability expertise should be foundational to recruiting new members of a corporate board—but that knowledge must also be fundamentally linked to meeting the needs of the company."
>
> — **JEFF HOLLENDER**
> co-founder and former chief executive officer at Seventh Generation; member of Institute for Sustainable Investing Advisory Board at Morgan Stanley

Deepen engagement with stakeholders and experts on relevant sustainability issues by:

- **Finding regular opportunities for boards to engage stakeholders on environmental and social issues.** Regular participation in stakeholder engagements with internal and external stakeholders—including investors and advocacy groups—can help boards gain a holistic understanding of the key issues that affect a company. This can help the company not only mitigate adverse impacts on external shareholders, but also pinpoint opportunities for creating long-term value.
- **Leveraging sustainability advisory councils as a critical board resource.** To deepen communication between a sustainability advisory council and a company's board, board members could be involved in the deliberations of these councils more systematically. Such councils could also provide recruitment opportunities for new board members.
- **Incorporating material sustainability issues into board-investor dialogues.** Investors increasingly expect boards to engage directly and systematically with them on critical issues. Given the growing focus of the investor community on sustainability writ large and the role of boards for sustainability in particular, material environmental and social factors should be made a part of any board-investor dialogue.

Sustainability has never been more important. Business leaders have never been so engaged. As fiduciaries to the corporation and stewards for its long-term performance, boards have a fundamental responsibility to be able to engage on relevant sustainability issues in a thoughtful manner. Competence in sustainability is the bedrock to all of this.

This report points to concrete, actionable recommendations on how boards can raise their overall sustainability competence in both the short term and the long term. Now is the time for boards to rise to the challenge and use their positions as opportunities to be leaders.

> "Having the company's sustainability experts present at board meetings on a regular basis and enabling the board to undertake site visits and meet with external stakeholders helps to develop a shared understanding of the company's material sustainability risks and opportunities, and provides opportunities for the full board to discuss these together."
>
> — **JANE NELSON**
> director of the Corporate Responsibility Initiative at the Harvard Kennedy School; board member at Newmont Mining; board member of the Abraaj Group

INTRODUCTION

Environmental and social factors—or sustainability factors--are starting to significantly reshape business. Climate change, water crises, extreme weather events and other major natural disasters rank as some of the world's biggest risks, according to the World Economic Forum's 2017 Global Risk Report.[1] But sustainability isn't just about risk—business solutions to these sustainability challenges also represent a market opportunity worth at least $12 trillion.[2] For the executives and boards of directors responsible for corporate strategy and longevity, effective stewardship of company resources in the face of these risks and opportunities is crucial. Not only crucial for creating and maintaining profitability, it is critical for ensuring the business' survival (see box 1).

As directors become increasingly aware of their need to position companies in the midst of a changing reality, they find themselves without reliable guides to this challenging business landscape. They are struggling to lead their companies toward a longer-term, more sustainable way of doing business. Building sustainability competence into corporate boards—where directors are skilled at assessing business risks and growth opportunities while keeping evolving environmental, social and governance factors in mind —is the way forward.

In this report, we provide guidance for corporate boards by defining sustainability competence, explaining its relevance to the current environment of financial, environmental, and social disruption, and offering concrete steps that boards and companies

> "The biggest challenge is that we as directors don't always know what we don't know. When sustainability issues come up, directors believe in being environmental stewards but most people in the board room do not know the right steps to take. It's difficult for the board room to assess how they are doing, what are the trade-offs, and what lines of business are being impacted. There is a lot that is needed beyond the broad commitment to sustainability."
>
> **— HELENE GAYLE**
> chief executive officer at McKinsey Social Initiative; board member at The Coca-Cola Company; board member at Colgate-Palmolive

can take to increase both their competence and their competitive advantage for sustainability.

The Business Case for Board Sustainability Competence

Sustainability disruptors could materially affect corporate financial performance

Research from global consultancies, business schools and investment firms overwhelmingly makes the case that environmental and social issues have the potential to materially affect corporate performance. Companies committed to sustainability perform as well as their less sustainability-minded competitors, and, in many cases, are outperforming them (see box 2). According to an article by McKinsey & Company, the business values at stake from sustainability risks can be as high as 70 percent of earnings before interest, taxes, depreciation and amortization.[6]

Investors that do not address sustainability issues as opportunities will leave money on the table. Morgan Stanley analyzed its own data and found that "sustainable equity mutual funds had equal or higher median returns and equal or lower volatility than traditional funds for 64 percent of the periods examined."[7]

In a 2015 survey of more than 200 institutional investors, 80 percent of respondents—up from about 36 percent in 2014—said they consider mandatory board oversight of sustainability disclosures "essential" or "important" when deciding whether to invest in a company. Another two-thirds said they are concerned about the risk of stranded assets. Additionally, more than a third reported cutting their holdings of a company in the past year because of such a risk.[8]

BOX 1: SUSTAINABILITY RISK AND BUSINESS IMPACTS

The potential scale of environmental and social forces is global and far-reaching, significantly impacting business performance.

- In North America, the number of weather events that posed serious losses to insurance companies rose nearly five-fold in the past 30 years, equaling a total loss burden of $1,060 billion.[3]
- In 2016, multinational corporations disclosed facing $14 billion of water-related risks, a five-fold increase since the previous year.[4]
- 81 percent of agricultural producers - who produce the commodities that end up in consumer products ranging from ice cream to toothpaste, footballs and lipstick – disclosed having experienced deforestation-linked impacts that have led to substantive changes to operations, revenue or expenditure in the past five years.[5]

Where Sustainability is Material to a Company, Boards have a Fiduciary Responsibility to Act

In their role as fiduciaries, corporate boards have oversight over a company's assets, and are required to steward these assets for the benefit of the corporation itself, and in turn, for the benefit of the corporation's shareholders. A key part of this responsibility is the duty of care, or the duty to adequately inform themselves of material issues prior to making business decisions. To act on this responsibility, directors need to be able to understand and evaluate material risks facing the business.

When a social or environmental force poses risks that are material to a company and its operations, directors now need to consider these issues a part of their fiduciary responsibility. Doing so protects both the interests of shareholders and the corporation from business disruptions over the short and long term, and promotes business resiliency.[13]

Investors are Focusing on Board Sustainability Competence

Investors increasingly expect boards to demonstrate competence in sustainability issues. The socially-responsible investment community led the charge on this for years, achieving notable outcomes in issues like board diversity. More recently, some of the largest institutional investors and asset managers have entered the fray. In 2016, both the California Public Employees' Retirement System and the California State Teachers' Retirement System updated their global governance principles, calling for the boards of their portfolio companies to have "expertise and experience in climate change risk management strategies."[14] In 2017, State Street Global Advisors recommended that "boards should regard climate change as they would any other significant risk to the business and ensure that a company's assets and its long-term business strategy are resilient to the impacts of climate change."[15] Blackrock, the world's largest asset manager, endorsed the importance of "climate-competent boards" for companies in sectors that are materially at risk for climate change.[16] These calls from investors are generating dialogue between boards and management, sometimes resulting in the filing of shareholder resolutions on board competence for environmental and social issues.

What is a Sustainability-competent Board?

A sustainability-competent board is one that has, or is able to access, the requisite knowledge about the material environmental and social issues that affect the business. Such a board is able to ask the right questions, support or challenge management as needed, and make informed and thoughtful decisions that integrate sustainability into strategy, risk and compensation.

A Sustainability-competent Board:

- » **Integrates knowledge of material sustainability issues into the board nominating process to recruit directors that ask the right questions;**
- » **Educates all directors on material sustainability issues to allow for thoughtful deliberation and strategic decision-making at the board level; and**
- » **Engages regularly with external stakeholders and experts on relevant sustainability issues.**

About This Report

This report builds upon Ceres' 2015 report, "View from the Top: How Corporate Boards Engage on Sustainability Performance."[17] In that report, we

BOX 2: WHAT DOES THE RESEARCH SAY ABOUT SUSTAINABILITY AND PERFORMANCE?

Recent data on the financial performance of companies that incorporate sustainability into strategy counters the widespread notion that sustainability is merely an added cost. Among the findings, these conclusions are particularly noteworthy:

- The results of a review of nearly 2,200 individual studies since 1970 show that the business case for environmental, social, and governance investing is empirically very well founded. Roughly 90 percent of studies find a positive ESG–corporate financial performance relation. More importantly, the large majority of studies report positive findings. The positive ESG impact on CFP appears stable over time."[9]
- By incorporating ESG issues into a corporate sustainability framework, corporations will ultimately be able to realize cost savings through innovation, resource efficiency, and revenue enhancements via sustainable products."[10]
- Firms with good performance on material sustainability issues significantly outperform firms with poor performance on these issues, suggesting that investments in sustainability issues are shareholder-value enhancing. Further, firms with good performance on sustainability issues not classified as material do not underperform firms with poor performance on these same issues, suggesting investments in sustainability issues are at a minimum not value-destroying."[11]
- ESG scores have been strongly correlated with companies' future earnings volatility, both at a market level and within sectors. And companies that ranked well had, on average, a five percent higher subsequent return on total equity than did their poorly ranked counterparts."[12]

BOX 3: CERES WORK ON BOARDS AND SUSTAINABILITY

The "Ceres Roadmap for Sustainability," our vision for corporate sustainability leadership in the 21st century, recommends that corporate boards provide formal oversight for corporate sustainability strategy and long-term performance. Sustainability considerations are expected to be integrated into board discussions on strategy, risk and revenue.[18]

The Ceres report "View from the Top: How corporate boards can engage on sustainability performance" leverages interviews conducted with dozens of corporate directors, senior corporate leaders and governance experts, to go even further and explore how effective board engagement can produce tangible, positive environmental and social impacts.[19]

Specific strategies recommended include:

- Formalize sustainability as a board priority
- Incorporate sustainability in relevant board charters
- Develop informed sustainability oversight
- Align sustainability priorities with management approach, business performance
- Incorporate sustainability in strategic planning
- Include sustainability in risk oversight
- Incentivize management for sustainability performance
- Disclose the role the board plays in prioritizing sustainability

In 2016, Ceres updated the Roadmap, and now recommends that corporate boards provide formal oversight for their sustainability strategy and long-term performance. Sustainability considerations are expected to be integrated into board discussions on strategy, risk and revenue.[20]

examined how board sustainability oversight can be made more effective, and recommended two linked approaches for incorporating material sustainability considerations more deeply across core board functions: integrating sustainability into board governance systems, and integrating sustainability into board actions (see box 3).

This follow on report, "Lead from the top: Building Sustainability Competence on Corporate Boards," provides greater detail on how boards can successfully integrate sustainability into their governance systems by raising their own competence to enable more effective oversight of material sustainability issues. It focuses more directly on the necessary skills and experience for board members to provide thoughtful oversight of sustainability risks and opportunities, in addition to the tools and processes to foster deeper engagement at the board level around these issues.

This report is not issue-specific and could be applied to any relevant environmental or social issue that affects corporate performance (see box 4).

This report is intended to serve as a helpful guide to company and corporate director audiences, raising greater awareness of the importance of sustainability issues to board-level decision-making. It also highlights specific, tactical steps that can help incorporate critical sustainability issues into decision-making by corporate boards. This report is not intended to offer a single framework that companies should follow in approaching sustainability competence–rather it is intended to provide a menu of options that companies and boards should consider and customize. Where companies and boards have already incorporated the report suggestions in their structures, the report could serve as a framework on what to disclose to investors and other stakeholders interested in this issue.

This report could also be useful for investors who are interested in examples of how companies could approach the issue of board sustainability competence in a holistic manner. Although most of the guidance is primarily oriented at publicly traded companies and countries with single tiered board systems, the recommendations are relevant to all ownership structures, local legal frameworks and all sectors.

Report Methodology

Research for this report included a review of the most up-to-date literature on corporate governance best practices, as well as interviews with nearly three dozen board members, corporate leaders, investors and governance experts. Questions focused on the following:

- What does a sustainability-competent board look like?
- How can boards build their sustainability competence?

BOX 4: WHAT DO WE MEAN BY SUSTAINABILITY?

The Brundtland Commission provided the most widely accepted definition of sustainability:

"Sustainable development is development that meets the needs of the present without compromising the ability of future generations to meet their own needs. It contains within it two key concepts: the concept of needs, in particular the essential needs of the world's poor, to which overriding priority should be given; and the idea of limitations imposed by the state of technology and social organization on the environment's ability to meet present and future needs."[21]

For the purposes of this report, we define sustainability as the economic, social, and environmental issues that affect corporate strategy and performance over the long term. Depending on the company and industry in question, the determination of what issues are most material will vary.

INTEGRATE SUSTAINABILITY INTO THE BOARD NOMINATING PROCESS

> "It's important for the board to understand what sustainability measures are in place and why. You don't need to be a water expert, but you need to understand how being water-neutral impacts your company, how management performs on this and how to compensate management for their performance on this."
>
> — **MARIA ELENA LAGOMASINO**
> chief executive officer and managing partner at WE Family Offices and board member at The Coca-Cola Company

Inviting prospective directors with the right expertise represents an important starting point for building a sustainability-competent board. But what constitutes relevant sustainability expertise? Some companies look to build board competence in sustainability by recruiting one or more people with technical expertise in a key social or environmental issue. In early 2017, oil giant ExxonMobil added noted climate scientist Susan Avery to its board in response to investor concerns about climate change.[22] Other companies use an integrated approach, such as Prudential Financial's Summary of Director Qualifications and Experience which includes "Environmental/Sustainability/ Corporate Responsibility" in its categories of desired director qualifications and skills.[23]

It is important to make the distinction between a sustainability-competent director and a sustainability-competent board:

- **A sustainability-competent director has relevant expertise in or exposure to the material environmental, social, and governance issues that affect the company.** They don't need to be a technical expert, though they need to have the ability to jumpstart a conversation between management and the whole board on these issues.
- **A sustainability-competent board,** on the other hand, refers to a group of directors that displays a fundamental understanding of sustainability

issues material to their business sector. A sustainability-competent board integrates sustainability into broader board conversations and functions. Rather than being siloed or marginalized, sustainability becomes part of the fabric of board oversight and is integrated into decision-making on strategy, risk and compensation.

A board of directors can have one or more sustainability-competent directors without being competent in sustainability as a whole. What distinguishes a sustainability-competent board is its ability to engage thoughtfully on material social, environmental and governance issues as one cohesive deliberative body.

This section provides a number of suggestions on how companies and boards can integrate sustainability into the board nominations process, including thoughts on the right attributes for effective directors, and integration with board diversity.

» Takeaway: Create Regular Opportunities to Bring New Directors with Relevant Expertise onto Corporate Boards

Boards should create regular opportunities to bring directors with relevant expertise onto corporate boards. The board nominating or governance committee could affirm the importance of board "refreshment" in their charters and develop mechanisms to ensure it is considered, such as through a board evaluation process.

Board refreshment is a complex issue and a number of factors play into the rate of refreshment in corporate boards:

- Rising director compensation incentivizes directors not to cycle off boards, leaving fewer positions open to new candidates who may bring more diversity of thought. Research shows that director pay has risen 16.8 percent between 2010 and 2016[24]. The average compensation per-director in S&P 500 companies in 2016 was $285,065.[25]
- Directorships do not often have term limits. Only 5 percent of S&P 1500 companies have terms limits in place.[26]

> "There are many consequences of not refreshing a board regularly. In the United States, the majority of public companies rely on mandatory retirement age to trigger turnover in the boardroom. Boards that regularly assess their composition can achieve a better mix of skills and experience as well as a balance of newer and longer-serving directors."
>
> — GEORGE ANDERSON
> leader of Board Effectiveness Services at Spencer Stuart

- Mandatory retirement ages keep rising. Over the past 10 years, 73 percent of S&P 500 boards reported that they have a mandated retirement age for directors. However, retirement ages continued to increase, with 39 percent of S&P 500 boards encouraging retirement at ages 75 and higher, compared to just nine percent in 2006.[27]

To remain relevant, including for sustainability priorities, boards must be periodically "refreshed." This helps strikes a balance between leveraging the institutional memory of longer-serving directors and making room for critical new perspectives. While it takes time for board members to get to know a company well, and even though longer tenure can provide invaluable institutional memory and insight, research shows that modest turnover leads to improvements in shareholder value. Between 2003 and 2013, S&P 500 companies that replaced three to four of their directors over a three-year period demonstrated higher shareholder returns than their peers.[28] The addition of one or two new directors also appears to have also led to more independent boards.[29]

In our interviews, some experts recommended that companies can make better use of director performance evaluations as a way to both assess the effectiveness of individual directors and highlight gaps for the board to fill, for instance, in sustainability expertise. Where possible, the results of these evaluations should be shared with shareholders and stakeholders.

» Takeaway: Incorporate Material Sustainability Issues into Qualifications for Potential Board Candidates

When environmental and social issues are identified as material to a company, nominating committees should incorporate these issues into the qualifications they consider in new director recruitment.

> "We need to change board mindset and board culture when recruiting for new directors, so that thinking about sustainability is intentional and strategic, not just done in crisis mode. Boards then can look beyond the short-term and focus on cultivating potential directors in service of long-term value creation."
>
> — TANUJA DEHNE
>
> board member at Advanced Disposal Services, Inc; board member at Granite Point Mortgage Trust Corporation; former board member at Silver Bay Realty Trust Corporation

Issues and qualifications prioritized in this manner could be disclosed through the board skills matrix.

The National Association of Corporate Directors Blue Ribbon Commission on Building the Strategic-Asset Board suggests that boards conduct a gap analysis to match the directors' areas of expertise to the board's organizational priorities.[30] When environmental and social issues are identified as material to a company, these issues should be incorporated into the list of qualifications. That list can, in turn, inform a board skills matrix.

Skills matrices can be an effective way to identify and recruit qualified candidates that boards need. A skills matrix lists desired board qualifications along one axis, and directors' names along the other. A matrix gives the nominating committee a holistic view of the board's capabilities and its needs. In their report on board governance and corporate responsibility, Business in the Community, a UK-based, business-led charity, recommends that nominating committees should include the following criteria[31] in their skills matrices:

- Understanding of how companies can embed sustainability;
- Familiarity with individuals and groups working in the field;
- Experience with board oversight of corporate sustainability;
- Knowledge of how to create and implement metrics for corporate sustainability; and
- Ability to engage with stakeholders, make use of their advice and manage public commitments toward sustainability.

Companies should disclose the skills matrix and how the qualifications of their directors match against this matrix as part of proxy statements and other financial disclosures. The U.S. Securities and Exchange Commission currently requires that public companies disclose how they consider board diversity in their nomination process. Companies could expand this disclosure to include specific sustainability competencies.

It is important to note that corporate directors recruited using this approach do not need to necessarily be "pure" or technical sustainability experts. Companies and corporate boards could adjust the interview

> “At the end of the day, sustainability must be integrated into core business strategy. Sustainability competent directors need to be bilingual: able to speak the language of both sustainability and business.”
>
> — KARINA LITVACK
> board member at Eni

process to assess the sustainability competence of all directors, including directors who are recruited for other business skills. For instance, when recruiting a director for expertise in mergers and acquisitions, nominating committees could include questions about their thoughts on approaches to evaluate environmental and social factors as a part of the M&A process.

» **Takeaway: Finding directors that can make the connections between environmental and social issues and the business context.**

Nominating committees should recruit effective sustainability-competent directors, who can speak the language of environmental and social issues alongside the language of materiality, business risk and opportunity. Such directors should be able to assess the impact that sustainability issues may have on a business and "translate" that into the context of the board's decision-making. Directors who cannot translate how social and environmental issues are material in a business context risk marginalizing themselves and the issues in question as well.

Business savvy and financial acumen are essential skills for any director, but they are particularly important when discussing sustainability issues and their impact on the health of a business. That is why it is important to distinguish between directors who have sustainability issue expertise and those who are truly

BOX 5: CASE STUDY - PRUDENTIAL FINANCIAL

Prudential Financial is an insurance and financial services company with a deep commitment to sustainability and corporate social responsibility. Peggy Foran, chief governance officer, senior vice president and corporate secretary; Mary O'Malley, vice president of corporate governance; and Suzanne Klatt, director of sustainability and environment, share the positive results that the company has seen through identifying sustainability as a board qualification.

As a company that specializes in life insurance and other enduring financial instruments, Prudential Financial's products are rooted in long-term value creation. In the company's risk-assessment process, products like a life insurance policy create decades long-duration liabilities for the firm. As a mutual insurance company founded in the 1870s, the concept of mutual care—thinking about the broader societal impacts of their work—has been a part of the company's culture since its founding. With that perspective, formalizing board oversight of environmental and social issues, or what the company refers to as "Sustainability," was a natural fit.

The board looked at both the short and long-term goals for the business and worked backwards to assess the core skills necessary at the board level to oversee and monitor those goals. Sustainability/Environment/CSR expertise is recognized to be a core skill, as is financial expertise. Instead of onboarding "one-trick ponies," the board aims to recruit directors who have complementary skills. In turn, this helps to ensure that these disciplines are integrated into business thinking, not siloed and separate.

Because "sustainability/environment/CSR" is a board priority at Prudential Financial, management takes its cues to transform discussion into concrete policies. As such, integration of sustainability/CSR does not just trickle down from the board to management; it also trickles back up from employees and management to the board. These feedback loops are mutually reinforcing, making sustainability/CSR a deeply embedded part of the company's board culture.

> "You can be an issue expert on climate, water, or toxic chemicals but that doesn't mean you can think about those issues in a way that is strategic to a business. Some level of sustainability expertise should be foundational to recruiting new members of a corporate board— but that knowledge must also be fundamentally linked to meeting the needs of the company."
>
> — **JEFF HOLLENDER**
> co-founder and former chief executive officer at Seventh Generation; member of Institute for Sustainable Investing Advisory Board at Morgan Stanley

sustainability-competent. Directors with sustainability issue expertise have purely technical backgrounds related to one aspect of sustainability. On the other hand, a sustainability-competent director has the ability to combine their knowledge of sustainability with their responsibility as a member of the board to oversee business risks and opportunities and deliver positive business outcomes. Such directors bring a number of competencies – both business-related and sustainability-related – to the table.

However, having just one director with competence in sustainability could run the risk of tokenism. Boards should consider various options to achieving critical mass, and change the tenor and quality of board deliberations. For instance, boards could bring on more than one director that possess not only other board-critical skill sets, but are knowledgeable in the relevant environmental and social issues facing the business. In short, they would be able to act as "translators" on these topics for the full board. By broadening the slate in this manner, boards can incorporate a diverse range of perspectives and knowledge on these key issues, leading to better decision-making. As noted earlier, these do not necessarily need to be technical experts in environmental or social issues, but rather individuals with sustainability built into their DNA, and able to marry their knowledge of environmental and social issues with business skills.

This ability to be a "sustainability translator" links to another desirable characteristic that almost all of our interviewees identified in an ideal effective director: the ability to engage and influence others by socializing sustainability issues within the board. Directors need to have the right temperament. They must possess the ability to make the right arguments, but in a collegial manner that will not alienate others.

Other interviewees noted that an ability to see the big picture or to be a systems thinker is crucial. In this context, a systems thinker is someone who understands the interrelated nature of the impacts of corporate decision-making, as well as the potential unintended consequences of the board's actions.

» Takeaway: Identify Directors Who Represent Key Stakeholder Groups Relevant to a Company's Sustainability Impacts

Nominating committees should recruit directors who have experience with interacting or representing stakeholder groups that offer insights into a company's material sustainability impacts. This has the advantage of bringing both relevant expertise and background diversity to the boardroom.

According to the New York Stock Exchange Corporate Governance Guide, "The ideal board mix will vary depending on the needs of the company and could include directors with significant public company board experience, directors with relevant sector and geographic experience, and directors with international business experience."[32] Companies that want to bring environmental and social experience onto their boards might look to the public policy or nonprofit sectors for individuals with the right mixture of sustainability and leadership experience. Recruiting from these sectors is a way to both incorporate issue knowledge and build relationships with a critical constituency.

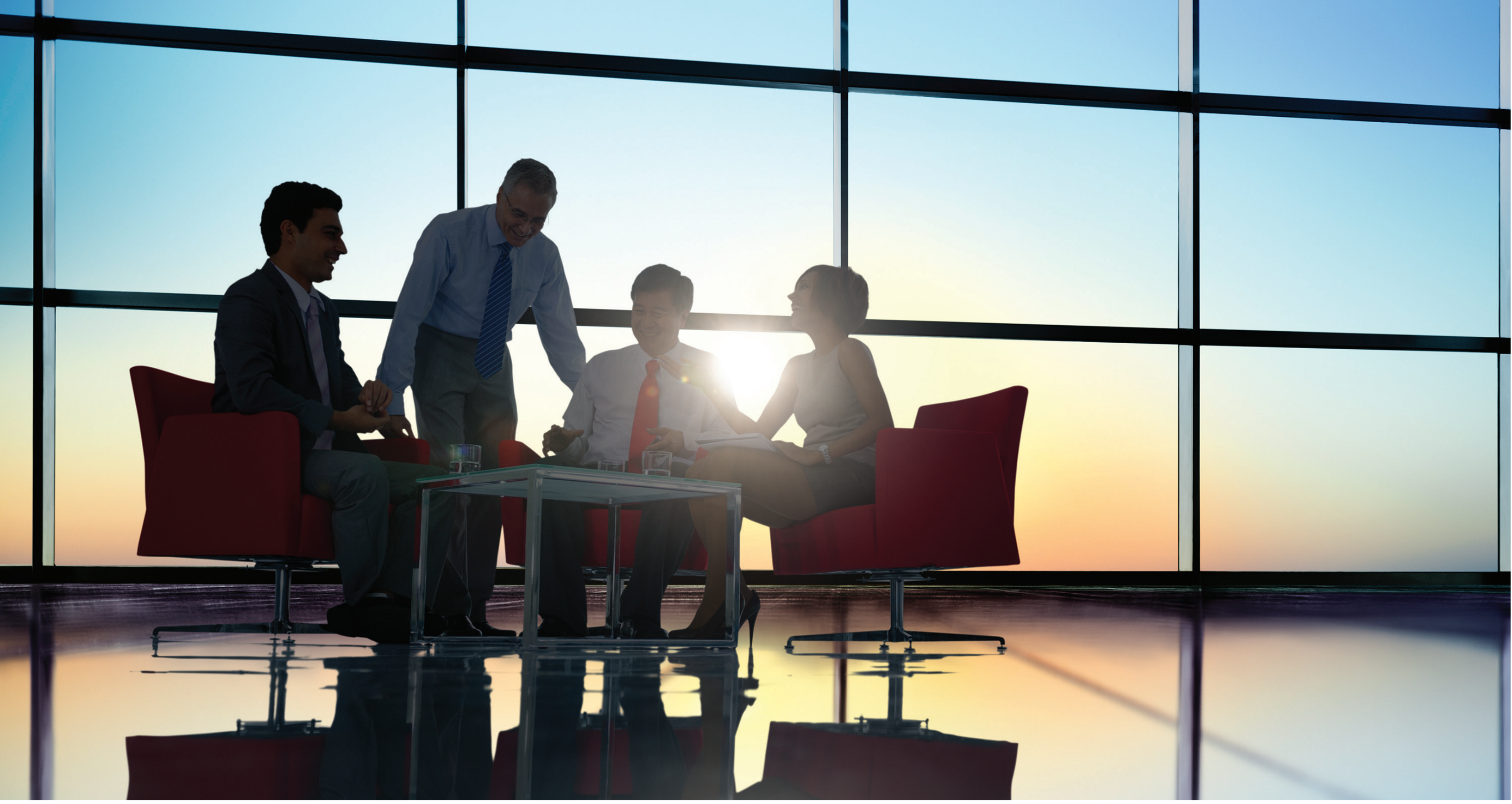
Multinational corporations will want to recruit people with relevant global backgrounds to ensure awareness of country-specific environmental and social risks. Some observers fault Volkswagen's homogeneous board for failing to effectively oversee the company's performance as a part of the recent emission testing scandal. They note that 17 of the 20 board members are either German or Austrian and that many of them have ties to the majority shareholder Porsche and Piëch families. It has been speculated that this "lack of diversity and expertise on the company's supervisory board," and the attendant lack of awareness about related regulatory and political risk contributed to Volkswagen's issues.[33]

> "How do you build a strong board? Principles, passion and practical experience. Principles: be crystal clear on how they support the business and how sustainability goals link to it. Passion: directors have to bring energy to the board to bring inspiration to the team. Practical experience: diverse applicable experience stemming from directors' backgrounds and expertise."
>
> — **JOHN REPLOGLE**
> chief executive officer at Seventh Generation; board member at Cree Inc., Counter Brands LLC

» Takeaway: Recruit Candidates Representing a Diversity of Backgrounds and Skills for Better Decision-Making

When recruiting sustainability-competent directors, nominating committees should seek out candidates who bring a range of attributes and desired expertise to the table, including a mix of gender, ethnicity, nationalities, backgrounds and skills. This will help the board avoid "group think" and foster robust and thoughtful deliberations and decision-making, including on sustainability issues.

Although many boards say they want to be more diverse, most corporate boards remain very homogeneous.[34] As many as 94 percent of all



> "Boards need to get beyond thinking about the one group or the one issue, and instead think about things in an interconnected way. Where corporate boards are today is radically different than decades ago. But the nomination process can help advance interrelated thinking even further."
>
> **— RINALDO BRUTOCO**
> founding president of World Business Academy; board member at Tailored Brands, Inc.

nominees to S&P 500 company boards have professional or personal connections to an existing director at the company. These links can improve board coordination, but they "also help entrenched management to perpetuate their control of boards."[35] Ceres' research echoes these findings. According to many interviewees, current board directors often instruct the search firms they hire where to prospect for potential new board candidates, amplifying this trend. By proactively engaging with search firms toward a more holistic approach to director recruitment, boards will be able to access a diverse pool of independent director candidates with the requisite skills or expertise.

Diversity of background and perspectives helps to avoid harmful "group think." Boards are best able to make informed decisions and properly carry out their fiduciary duties when they contain a diverse mix of business attributes, backgrounds and skills.[36]

Research also shows that diverse boards are better boards. When boards tap into a wide range of insights, they provide more effective oversight, better risk management and stronger connections with stakeholders.[37] For instance, having more women on a board contributes to better outcomes. From 2011 to 2016, U.S. companies that reached the "tipping point" of having three women on the board experienced median gains in return on equity of 10 percent, compared to -1 in companies with no women on boards.[38]

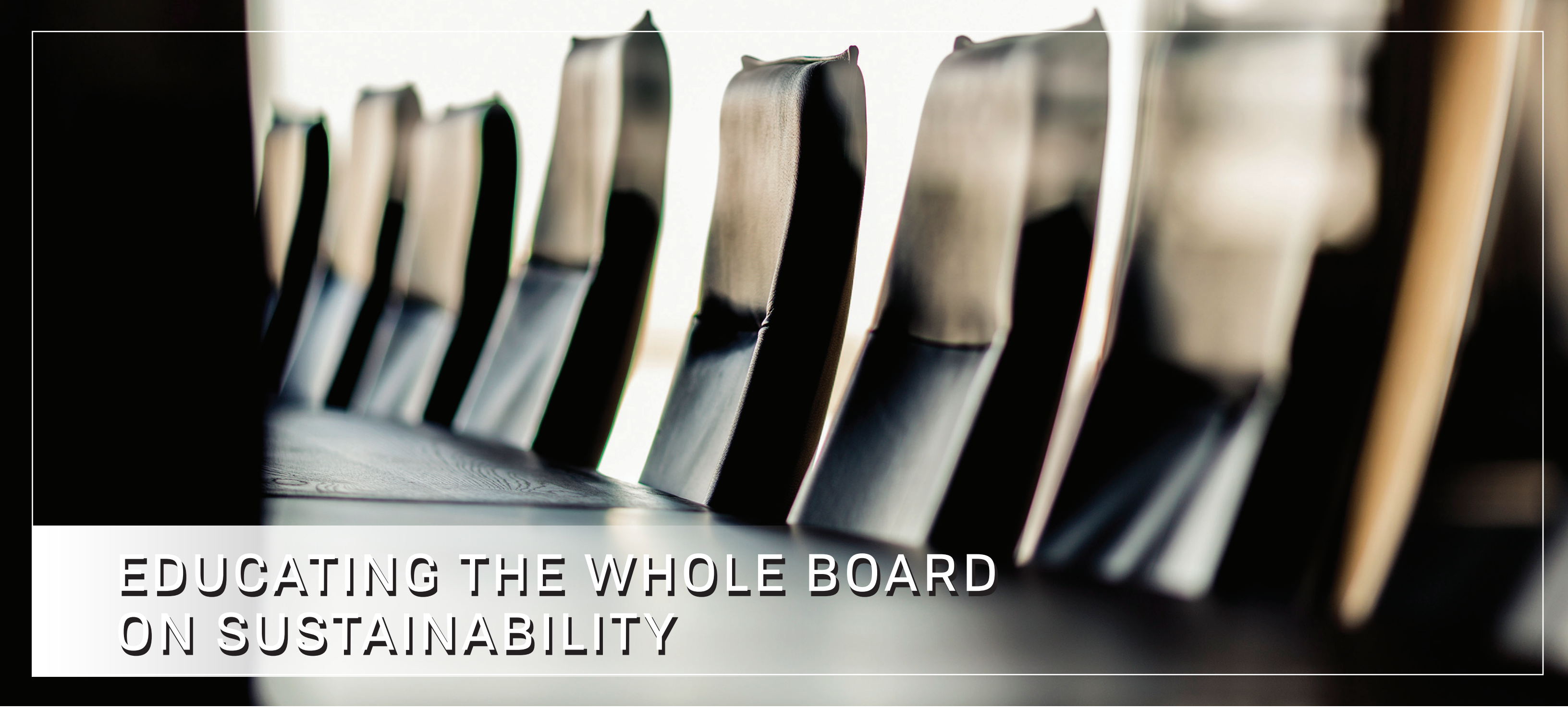
While boards today predominantly look for new members among their existing personal and professional networks, research shows that they're starting to turn to other sources for ideas on possible candidates. The number of boards engaging with investors in their search for new board candidates rose to 18 percent from 11 percent between 2016 and 2012, for instance.[39]

> "Don't just consider the 'right person' to bring on to the board—also consider the diversity mix of the folks that you have and how the group deliberates. It goes way beyond just gender and race. The Enron board is a good example—they had the 'right qualifications,' but missed this huge risk that the company was facing."
>
> — **JULIE GORTE, PH.D**
> senior vice president for Sustainable Investing and portfolio manager at Pax Ellevate Global Women's Index Fund

BOX 6: SOURCES FOR DIVERSE DIRECTORS

Organizations that help increase gender diversity on boards, like Catalyst Women on Board and the 30% Coalition, have been successful in helping boards recruit more women. Some investors also focus on building lists of climate- and sustainability-ready candidates for companies. In 2012, the California State Teachers' Retirement System and the California Public Employees' Retirement System partnered with GMI Ratings, an independent provider of global corporate governance ratings and research. Together, they founded the Diverse Directors Datasource, also known as 3D. Now partnered with the Equilar Diversity Network, 3D is part of a searchable database of potential board members who bring a diversity of backgrounds, expertise and worldviews.

Mary Hartman Morris, investment officer of Corporate Governance at California State Teachers' Retirement System, says that 3D helps boards follow the "Rooney Rule." Originating with the National Football League, the rule requires teams to interview minority candidates for senior coaching and operations jobs. "3D is instrumental in delivering a vital service to companies searching to strengthen the depth of expertise on their boards, while also achieving diversity of thought, experience, and innovation. Two-thirds of the potential candidates in 3D are women, with nearly a quarter having international experience and speaking over 40 languages- imagine what company board tables will be like if this level of diversity is reached," says Morris. "As one of CalSTRS Corporate Governance Principles, we believe that companies should embed a commitment within their search and nominating process to include women and underrepresented minority candidates in every pool from which board nominees are chosen."



EDUCATING THE WHOLE BOARD ON SUSTAINABILITY

To foster sustainability-competent decision-making, along with recruiting directors with expertise on key issues, it's also important to educate the entire board on key issues and their relevance to corporate business and financial performance. Education and training expands competence on sustainability from a few individuals to the whole board, fostering thoughtful deliberation and decision-making on key issues.

This section will clarify the range of approaches that companies should consider to level up their entire board on material sustainability issues. Recommendations include strategies for leveraging sustainability expertise on the board and management, company-specific training and providing boards with the right information to drive decision-making.

» Takeaway: Integrate New Directors with Sustainability Competence into Ongoing Board Deliberations, Especially on Strategy and Risk

After recruiting sustainability-competent directors, boards should work to integrate them into all aspects of decision-making, especially deliberations on strategy and risk. Getting an individual with the right expertise on corporate boards is important, but for them to be effective and for sustainability to be integrated into decision-making, they have to participate in relevant board functions, structures and processes.

A robust onboarding and training program will ensure that new directors understand how to translate their expertise into expected oversight responsibilities. Mentoring by existing directors is an effective method of helping new directors succeed in their roles. Mentoring is especially important for new directors who have different backgrounds than their peers, including women, ethnic minorities or people from the sustainability world. In a study of 2,000 of the largest U.S. companies, researchers found that a lack of mentoring could significantly affect the reception of new directors by other board members and company executives, especially for minorities and women.[40]

Onboarding new directors serves two functions: it helps familiarize incoming new members with the current board and helps the current board get to know the new recruits. Boards should assign new directors to roles that leverage their expertise, which gives them the opportunity to share their knowledge with their peers and build their credibility as experts deserving a seat at the table.

When directors have been recruited for their sustainability expertise, boards should consider options to integrate them with committees responsible for business strategy and risk. That way, the directors can develop insight into decision-making on critical business elements, like strategy, risk, or compensation, and are able to demonstrate the connections between environmental and social issues and business decision-making on strategy and risk.

For example, on Coca-Cola's board, the Public Issues and Diversity Review Committee handles sustainability issues.[41] Of the three sitting directors on that committee, one also serves on the board's Compensation Committee. Another sits on the Corporate Governance Committee and the Finance Committee. This cross-pollination of expertise across board committees allows for sustainability issues to be regularly brought up in board conversations across multiple committees and integrated into larger decisions on risk, governance and compensation.

» Takeaway: Require Regular Education on Material Sustainability Issues for the Whole Board

Boards should require that all directors be regularly educated on material sustainability issues. A clear mandate that directors need to be kept up-to-date on all issues related to materiality—including those focusing on sustainability performance—sends the message that these issues are important to the company. For instance, in General Motors' 2017 proxy statement, the company specifically identifies sustainability within their "Director Orientation and Continuing Education" section as a topic that new directors need to understand.[42]

While education of any kind is helpful, interviewees explained that one-off training events often have limited effectiveness. Just as once-a-year performance evaluations are far less effective than ongoing conversations, boards that are serious about becoming sustainability-competent will look for programs that build knowledge over time.

The goal of board education is to provide directors with tools that can help them do their jobs better. Since good governance requires directors to apply judgment to specific company contexts, board education should move beyond general, high-level introductions to sustainability and ultimately focus on how particular issues arise in an operational or management setting. This can help the board focus on what sustainability means from the perspective of strategy or risk and how a given issue can affect performance. Some interviewees suggested that companies should invest in customized trainings to make optimal use of the board's time and garner maximum business benefit. These sessions should be targeted to the competency and expertise levels of the board and tailored to fit company or industry challenges.

> "Having the company's sustainability experts present at board meetings on a regular basis and enabling the board to undertake site visits and meet with external stakeholders helps to develop a shared understanding of the company's material sustainability risks and opportunities, and provides opportunities for the full board to discuss these together."
>
> — **JANE NELSON**
> director of the Corporate Responsibility Initiative at the Harvard Kennedy School; board member at Newmont Mining; board member at the Abraaj Group

Interviewees recommended additional ways to provide directors with exposure on sustainability issues, including:

- Engaging regularly with a panel of external sustainability experts, whom they involve in board discussions many times over the course of a year.
- Leveraging sustainability experts on management to provide important insights to the board.
- Giving board members the responsibility of reviewing and approving annual sustainability reports so directors could have an overview of the pressing issues and full sweep of sustainability issues their company is managing.
- Sending directors to conferences, including conferences devoted specifically to sustainability issues and governance conferences where

BOX 7: CASE STUDY: THE CO-OPERATORS

The Co-operators Group Limited is a Canadian insurance and financial services cooperative: a company where business decisions are guided both by profitability and the needs of member communities. Barbara Turley-McIntyre, vice president for Sustainability and Citizenship and Carmel Bellamy, corporate secretary and senior director for Governance, Member and Co-operative Relations, share how prioritizing and incorporating sustainability into board training results in more informed decision-making.

In 2012, the Co-operators Board of Directors affirmed its commitment and focus on sustainability by including a Sustainability and Citizenship Committee within its board committee structure. The chair of the board often attends these meetings, which benefit from ongoing education from management, as well as external experts. Topics include emerging areas related to the longevity and competitive position of the company, such as impact investing, climate-related financial disclosures, carbon pricing and integrated reporting trends.

Together with the rest of the board, the sustainability committee works in step with management to guide the company's decision-making on material matters of sustainability. Board training in sustainability has made a concrete impact: in April 2015, then-CEO, Kathy Bardswick, wanted to be more public in the company's advocacy for carbon pricing in Canada. The Board received a comprehensive briefing from the Vice President, Sustainability and Citizenship on this topic to inform its decision-making. As a result, the board passed a resolution in favor of both management and directors advocating publicly for this initiative.

sustainability issues are discussed in breakout sessions. Organizations like the International Corporate Governance Network, the Council of Institutional Investors, and the National Association of Corporate Directors are increasingly offering dedicated sessions on sustainability at their conferences.

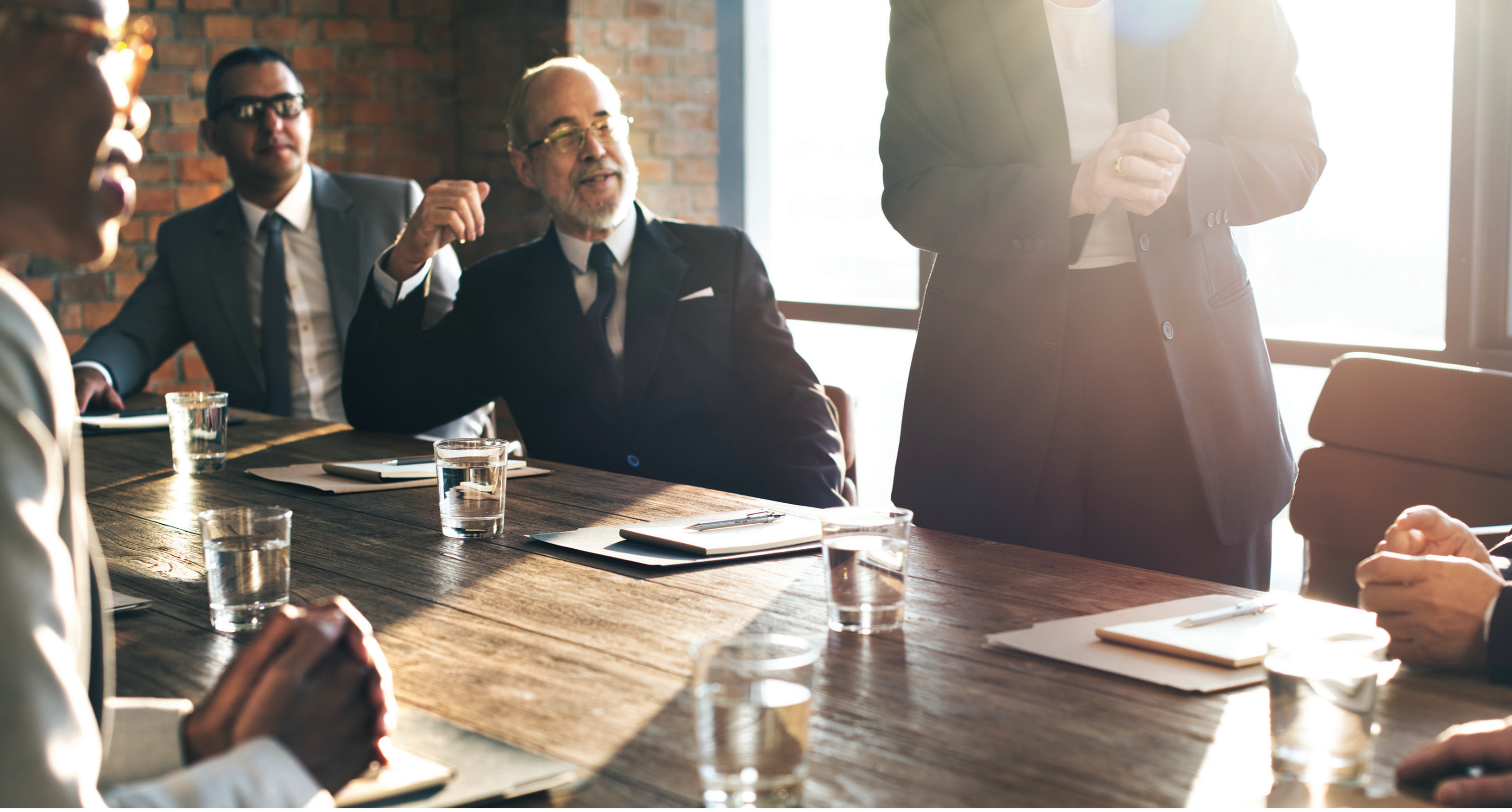
Peer engagements provide another way for directors to receive training. Director affinity groups and gatherings, such as meetings of compensation committee chairs, gives directors the opportunity to learn from one another and acquire new governance tools. Some nongovernmental organizations, including Ceres and the B-Team, convene corporate director meetings on sustainability and climate change. The Cambridge Institute for Sustainability Leadership offers its "Earth on Board" program to help boards ensure they have the time, tools, expertise, and structure to advise their executive teams on the fiduciary implications of sustainability issues.[43]

Additionally, directors could be offered opportunities to participate in site visits and sustainability projects as a form of "on-the-ground" training. For example, having directors accompany management on site visits to stores, factories, mines or other enterprises in a company's value chain provides direct experience of sustainability issues that may give directors a more tangible feel of their impacts.

» Takeaway: Provide Boards with Information on the Materiality of Sustainability to their Business

Boards need information that helps them understand the materiality of specific sustainability issues to their business so they can make the connection between sustainability and both business risk and strategy. Materiality analyses could prove useful in helping directors understand why certain environmental and social issues are related to business strategy and how they may materially affect business operations.

Despite evidence that sustainability issues are creating substantial risks and opportunities for business, research shows that this connection is still unclear to most boards. As we highlighted in "View From the Top," outside of heavy industries like oil, gas and mining, most companies see sustainability issues primarily in terms of reputational risks. In a



survey of 15 possible risk categories, directors ranked social and environmental risks alongside fraud at the bottom, with a mere six percent. Yet, the top risk—"strategic/disruptive"—garnered 72 percent.[44] This demonstrates that many boards have not yet linked social and environmental risks as disruptive forces (see Introduction).

Most sustainability materiality analyses, when they are done at all, are not necessarily integrated into general business materiality analyses and do not typically involve the corporate board in a significant way. But recent research argues that determining materiality is essential to the fiduciary duty of corporate directors and that directors should be driving the integration of material sustainability into financial factors. Professors Robert Eccles and Tim Youmans at the Harvard Business School assert that materiality is "ultimately based on the judgment of the board of directors… Determining materiality is at the essence of directors' fiduciary duty and it is the basis for establishing the legitimacy of the corporation's role in society." The authors ask corporate directors to issue an annual "statement of significant audiences and materiality" to be transparent about the business's priorities and which audiences they determine are most important to serve.[45]

Knowing which issues are material to a business provides an anchor for directors in the current business environment where disruption and a near-exclusive focus on short-term financial performance can reign supreme. As we noted in "View From the Top," directors, under tremendous pressure to demonstrate short-term returns to investors, are often responsible for overemphasizing short-term results. The NACD 2015 Blue Ribbon Commission has given useful guidance to directors seeking to hold long-term performance in mind amidst the pressures of short-termism. Its report, "The Board and Long-Term Value Creation," offers directors a set of tools on risk-appetite frameworks, long-term performance metrics, the role of the board in capital allocation, executive compensation, and long-term value creation systems.[46] Boards can consider integrating these tools into their planning and materiality processes.

» Takeaway: Drive Board Discussion on how Sustainability Impacts Corporate Risk, Strategy and Business Models

Given that environmental and social issues pose risks and opportunities to businesses, boards should consider how these issues affect corporate

BOX 8: SAMPLE QUESTIONS FOR DIRECTORS TO ASK ON CLIMATE CHANGE

In their 2017 publication, "Climate Change Briefing: Questions for Directors to Ask"[53] Chartered Professional Accountants Canada identifies a number of questions that directors can pose to management to understand how climate change affects the company's business model, and associated risks and opportunities.

- How are climate change issues likely to affect the company's business, operations and value creation in the foreseeable future?
- What is the likelihood and impact of changes in demand for the company's products and services due to climate change, and their implications for its business model?
- What are the reputational risks related to the company's approach in dealing with and communicating about climate change issues?
- What innovation and technology-related opportunities have been investigated to reduce greenhouse gas emissions or adapt to climate change?
- How does management assess the difficulty of meeting greenhouse gas emission reduction targets, and how is progress monitored and reported?
- How has the current and potential future impact of climate change issues (including carbon pricing) been determined on revenues, expenditures and cash flows?
- How does management ensure that information reported on corporate websites or in voluntary reports is consistent with government filings and continuous disclosure filings provided to securities regulators?
- Do the board's structure, the knowledge and skillsets of board members enable appropriate oversight of climate change issues?

strategy and business models. Responding to these issues helps business adapt their models to become more lean, social, integrated and circular—and tap into the $12 trillion opportunity that sustainability presents.[47]

"Risk maps" are one way companies identify core operations most susceptible to certain environmental or social risks. Property developer and investor British Land created a risk map for categories throughout its supply chain, demonstrating where risks are more or less likely to occur.[48] NGOs can also provide resources to help companies identify their sustainability risks. For instance, the World Resources Institute's Aqueduct platform offers a mapping tool to plot global water risk and identify water "hotspots," and is developing similar tools to address other issues like deforestation and supply chain emissions.[49]

Once risks are identified, companies can set up systems that let boards integrate sustainability into their oversight on corporate strategy and risk. As we noted in "View From the Top," the boards of retail companies offer the best examples of how to make sustainability a business differentiator. Unilever's Sustainable Living Plan outlines its ambitious goal of doubling the size of its business by 2020 while improving its environmental and social performance. Unilever's board reviews the implementation and progress of the plan through a committee, and the audit committee oversees the independent assurance of the plan. The company's Sustainable Living brands accounted for nearly half of Unilever's growth in 2015 and grew faster than the rest of its business.[50] Additionally, U.K. retailer Marks & Spencer's board reviews the company's risk profile every six months, and receives annual updates on the company's integrated sustainability and business strategy, which responds to these risks.[51]

Business line leaders can play an important role in helping to provide the context between sustainability and strategy. At Nike, business line executives appear before their board's sustainability committee every 18 months in order to demonstrate how their units contribute to the company's overall sustainability goals.[52] Benchmarking against industry peers and leading companies can also offer directors reference points and guidance on asking the right questions of the company and of management. Directors need to able to confer with and question management to gain the information necessary for determining materiality and ultimately setting strategy from a holistic vantage point.

DEEPENING STAKEHOLDER ENGAGEMENT ON SUSTAINABILITY

Competence in sustainability can be deepened through robust engagement with a diverse array of external stakeholders. Conversations between directors and others—including investors, customers, suppliers and community partners—can paint a fuller picture of the pitfalls and possibilities that companies face in today's disruptive business environment, as well as act as an effective risk-management strategy.

This section includes thoughts on how boards can systematically and effectively inform shareholders and stakeholders on material environmental and social issues, thereby deepening their competence.

» Takeaway: Find Regular Opportunities for Boards to Engage Stakeholders on Environmental and Social Issues

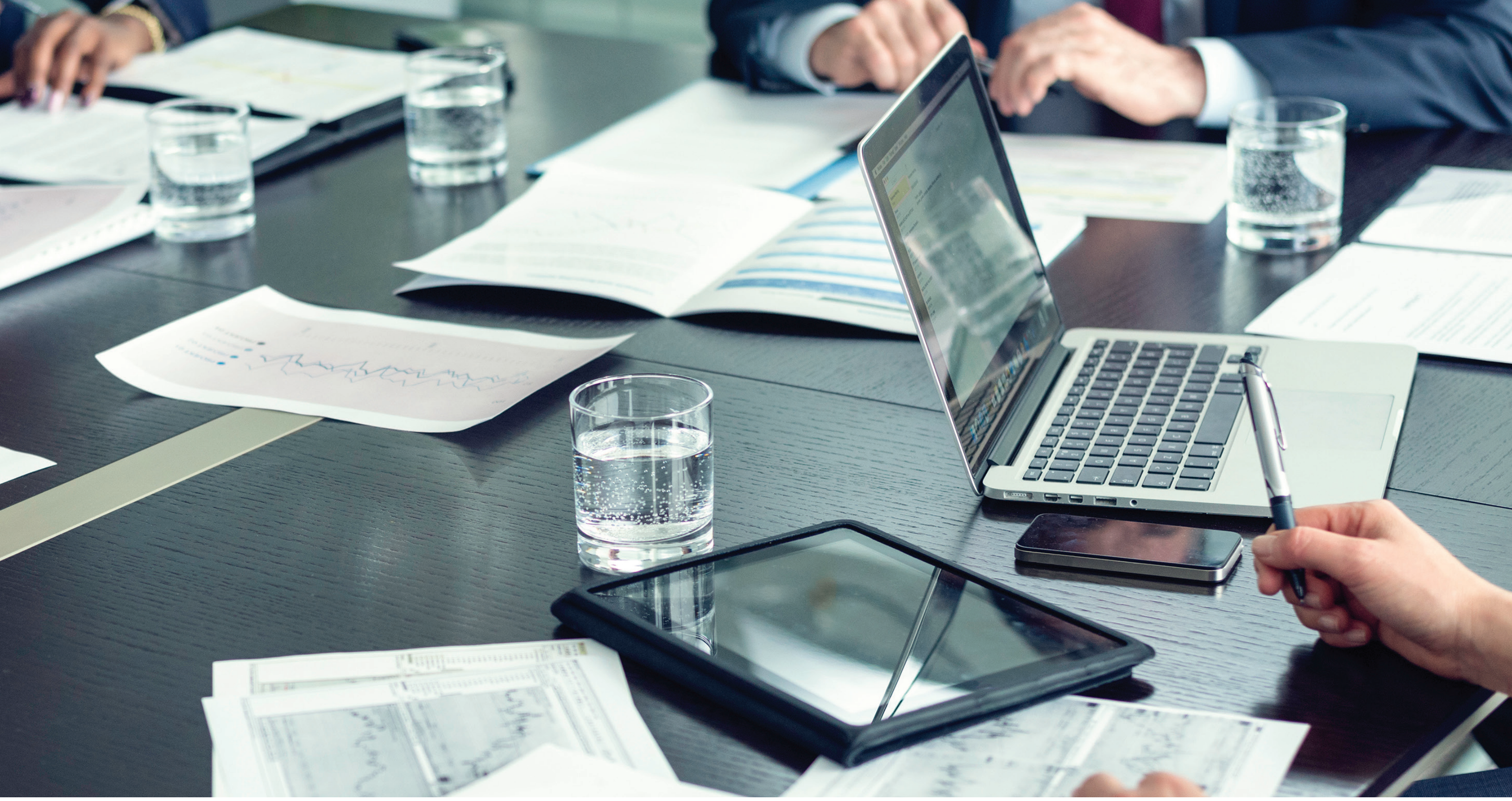
Regular participation in stakeholder engagement processes on sustainability can help boards gain a holistic understanding of the key issues that affect a company. This can help the company not just mitigate adverse impacts on external constituencies, but also pinpoint opportunities for creating long-term value. Engaging with external stakeholders may also lead to a shift in mindset from a short-term primacy to a broader framework of value creation.

Sustainability reporting frameworks commonly recommend that companies should conduct stakeholder engagement as a fundamental tool to build internal competence and manage risk for sustainability. For example, the Global Reporting Initiative's Sustainability Reporting Standard[54] recommends that companies systematically address:

- Who are the company's key stakeholders;
- What issues are material for stakeholders;
- How these issues relate to the priorities of the company;
- What are the risks of adverse impacts to external stakeholders; and
- How sustainability is evaluated in the company's value creation model.

External stakeholders represent a variety of viewpoints and regular, ongoing engagement with them brings these viewpoints into better focus for boards. For instance, directors at EMC (now Dell-EMC) attended meetings with external stakeholders, including investors and advocacy groups focused on the company's sustainability strategy, approach and performance.[55]

Examples of stakeholders that boards could engage with include shareholders, advocacy, consumer and community groups. Shareholders, while important, form just one of the key audiences for a company. A more inclusive approach is needed.



» Takeaway: Leverage Sustainability Advisory Councils as a Critical Board Resource

Sustainability advisory councils (SACs) can provide board members with a valuable opportunity to monitor external perspectives on environmental and social issues that materially affect a company.

A growing number of companies have put in place sustainability advisory councils – formal groups of senior sustainability experts or representatives from sustainability organizations - to advise the chief executive officer and management team on crucial environmental, social and governance issues. Typically, board members do not participate in these councils, as these are not connected to board processes or deliberations, and the extent to which SAC discussions are shared with the board is unclear. However, in a small but growing number of companies, such as Pacific Gas & Electric and Morgan Stanley, CEOs are starting to attend SAC deliberations to provide the perspectives of the board to the council and to translate the council's feedback and reflections back to the board.

To deepen communication between a council and a company's board, board members should consider opportunities to contribute in the deliberations of councils in a more systematic manner. Given the board's mandate to govern and determine issues of materiality, including one or more board representatives in SAC deliberations —especially where there is a board committee also tasked with maintaining competence or expertise in sustainability issues—becomes important.

Sustainability advisory councils can also act as a potential recruitment pool for open director positions. Council members are a natural bridge between boards and the material sustainability issues their companies face. Through regular interaction with the board, SAC members can essentially train and prepare themselves for a role on the board.

» Takeaway: Incorporate Material Sustainability Issues into Board-Investor Dialogues

Investors increasingly expect boards to engage directly and systematically with them on critical issues. As the focus of the investor community increases on sustainability writ large and the role of boards for sustainability in particular, material environmental and social factors should be incorporated into board-investor dialogue.

Specifically, boards should be involved in discussions about sustainability with their largest shareholders and investors who are focused on long-term performance in addition to those who have dedicated expertise in this issue area.

Vanguard, one of the world's largest asset managers, has advocated for the creation of "shareholder liaison committees" in the boards of companies it invests in. Vanguard believes that consistent exchanges between shareholders and directors help anticipate risks and inform boards about best practices in other companies.[56] Such processes could be leveraged for robust dialogue on sustainability.

This need for direct investor-director engagement becomes particularly pronounced as the shareholder focus on sustainability issues grows. Between 2010 and 2014, more than 250 shareholder resolutions were filed, calling for explicit board oversight of a range of sustainability issues, indicating a growing connection between material sustainability issues and the fiduciary responsibility of directors.[57] This trend has only increased. In 2016 there were a record number of proposals relating to climate change, making sustainability "the fastest-growing cause for shareholders."[58] As fiduciaries to investors, boards need to understand the sharpening investor focus on environmental and social issues, including how this attention could potentially affect the company or its industry.

Interviewees emphasized the importance of shareholder proposals as signals for key issues of interest to investors. "Shareholder proposals are one of the most important ways to make sure that boards are getting to hear about risks directly from investors," says Michael Garland, assistant comptroller for New York City.

Given the importance of investor engagement, Ceres is concerned about proposals submitted in late 2016 by the Business Roundtable and the U.S. Chamber of Commerce to modify Security and Exchange Commission Proxy Rules.[59] The proposed modifications would curtail shareholders' ability to engage by proxy, and would harm the interests of investors, companies, society and the capital markets. In April 2017, Ceres released The Business Case for the Current SEC Shareholder Proposal Process to articulate the investor perspective on the positive value of the current shareholder proposal process, for both investors and for companies.[60]

> "Boards need directors that know when to seek external expertise given that it is impossible for them to be an expert in everything."
>
> — **PEGGY FORAN**
>
> chief governance officer, senior vice president, and corporate secretary at Prudential Financial, Inc.; board member at Occidental Petroleum Corporation

CONCLUSION

A generation ago, few executives or board directors embraced the concept that sustainability issues could be material to a company's survival and success. But times have changed. As just one example, when the U.S. announced its withdrawal from the Paris Climate Agreement, over 1,500 businesses and investors joined hundreds of U.S. governors, mayors, colleges and universities to say, "We Are Still In," declaring their businesses would move ahead with strategies related to climate change—confirming they clearly viewed the issue as material to their business interests and to society.[61]

Some companies are at the forefront. They are transforming their businesses into sustainability-competent organizations that are financially successful and beneficial to society over the long run. For companies and boards seeking a place to begin or accelerate their transformation, this report offers practical steps and critical resources to jumpstart decision-making for resilience.

Other companies are sticking to "business as usual," hewing to a short-term focus on profits that prevents them from seeing the potential long-term impacts—both positive and negative—of social and environmental issues on their bottom line. These companies must weigh the risks when institutions do not effectively manage sustainability issues, as well as lost opportunities from failing to invest in sustainability-competent leadership.

The bottom line is this. Corporate boards will have a difficult time performing their fiduciary duty to the companies they lead and the shareholders that they represent without basic competence in sustainability. For companies that want to raise their board's overall sustainability competence, this report points to concrete, actionable steps boards can take in the short and long term to proactively assess and address environmental and social disruption. Sustainability has never been more important. Business leaders have never been so engaged. Now is the time for boards to rise to the challenge and use their positions as opportunities to be leaders.

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