A CORPORATE BOARD MEMBER AND NASDAQ RESEARCH REPORT

DISSECTING THE ESG LANDSCAPE

What the most recent environmental, social and governance trends mean for boards

CORPORATE BOARD MEMBER | Nasdaq

The U.S. Securities and Exchange Commission's (SEC) proposal, in March 2022, to mandate certain climate disclosures for public companies signaled a maturation in ESG matters facing corporations. Under these proposed rules, public companies would be required to disclose the climate-related risks that are likely to have material impacts on a company's business or consolidated financial statements, as well as the greenhouse gas (GHG) emissions metrics that could help investors assess those risks.

Companies would also be required to disclose details of their boards' climate oversight, including ownership, board expertise, depth and frequency of discussions, as well as how those matters are integrated into the strategy, financial planning and risk management processes.

If these rules are approved, the impact and costs for companies are expected to be significant.

Similarly in the EU, the Corporate Sustainability Reporting Directive (CSRD) will soon succeed the Non-Financial Reporting Directive (NFRD), requiring many EU companies and international companies with significant operations in the EU to further disclose across E, S and G topics. It is anticipated that the first set of draft standards for the CSRD will be proposed to the European Commission in November 2022.

There are cost and resource impacts for companies related to these disclosures yet, research published by *Corporate Board Member* (*CBM*) has found nearly three-quarters of U.S. public company directors polled believe the proposal, if approved, would have minimal impact on their company, rating the level of impact a 2.85 out of 5, on a 5-point scale where 5 means "great" impact and 1 means "little".

While this may seem to be a somewhat surprising result, given the high-profile and broad reach of the SEC's proposed actions and the forthcoming updates to EU ESG reporting requirements, a closer look into boardroom behaviors on ESG topics in recent years reveals that it probably should not be. *CBM* has long chronicled the challenges for boards to reconcile the perspectives of management, investors and regulators on the importance of ESG matters. And while most boards now schedule regular conversations around ESG, our research finds that despite public scrutiny and increasing investor pressure, it remains a secondary concern overall, best characterized as "important but not pressing."

For example, when asked in the spring of 2021 whether they believe environmental matters have the potential to materially impact their company's business value, 43% of directors participating in a survey conducted in partnership by *CBM* and EY said no—with an additional 26% who said they were only considering these issues because compliance requirements, disclosure obligations and shareholder pressure compel them to do so. Another survey, conducted in the fall of 2021, found just 6% of board members believed ESG goal setting and reporting would have influence on the success of their company's strategy in the coming year.

To better understand what directors across sectors are doing about ESG today and uncover best practices that may be emerging, *CBM* partnered with Nasdaq to survey and then benchmark the boardroom practices of more than 300 U.S. public company directors around this high-profile subject.

KEY FINDINGS

Targets and Conversations Without Timelines
Most boards report having identified E, S and G targets for the company to achieve, but half of them said they do not have defined timelines to achieve them. The great majority reported meeting with management periodically to review progress toward ESG goals, with most commonly doing so on a quarterly basis.

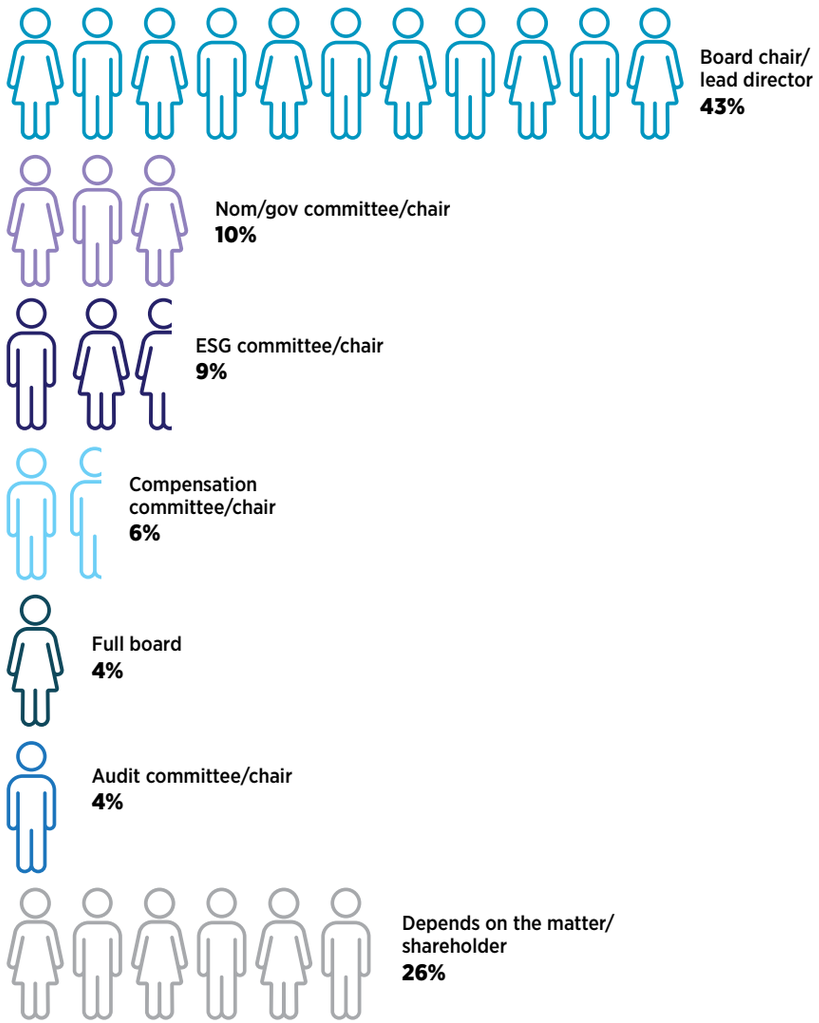
Reporting Standards Still Non-Standard
The most common measure of progress toward ESG goals are company-specific frameworks (68%), followed by the Sustainability Accounting Standards Board (SASB) framework (41%).

Overlooking Oversight
The majority of boards have delegated the oversight of the E, S and G to a committee. Less than one-third of polled board members said it is a top priority for their board to enhance its ESG oversight and understanding of how these issues tie into strategy.

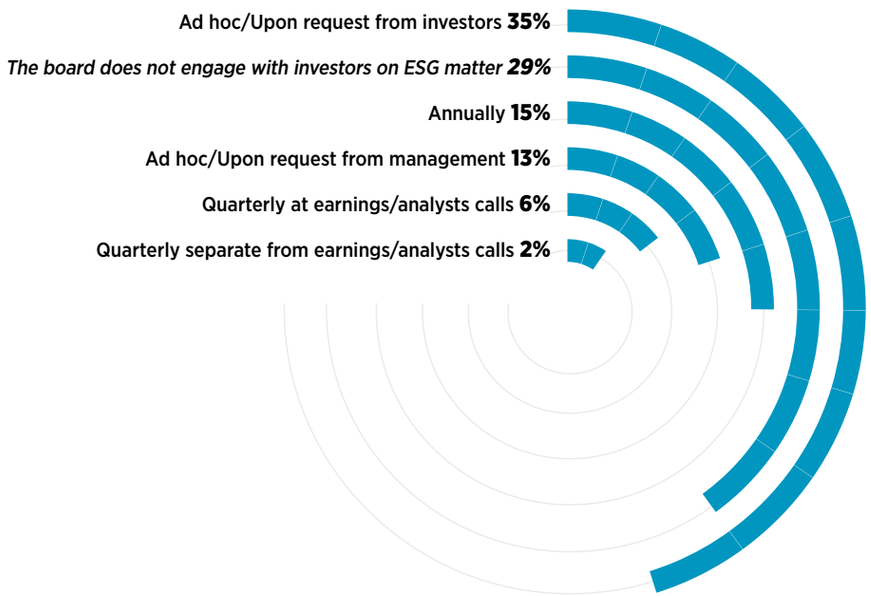
Education Needed
Directors said they rely on various sources of information to become educated on ESG issues, but the primary ones are internal ESG experts (32%) and the general counsel (21%). While there is a need for ongoing education on ESG topics, boards have yet to determine who should own this.

Rules of Shareholder Engagement Changing
Just 30% of directors said their board does not engage with investors on ESG matters, with an additional 35% who only do so upon request. For those approximately 70% of boards who do engage with shareholders on ESG, almost half (43%) have the board chair or lead director represent the board in the engagement.

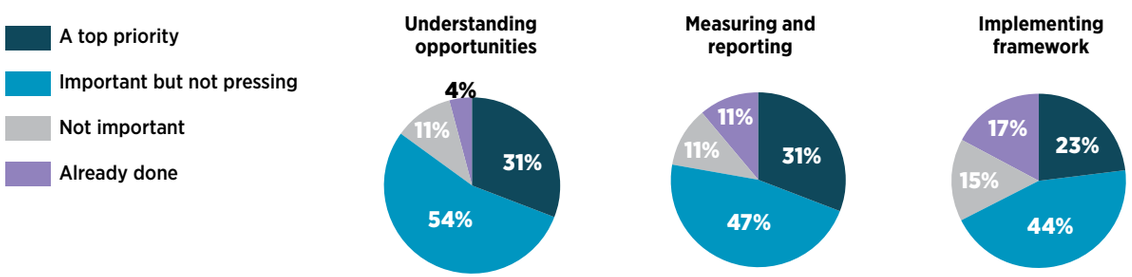
Board Representation with Shareholders on ESG



Frequency of Board-Shareholder Engagement on ESG



Importance of Improving ESG in General



E: CLIMATE AND SUSTAINABILITY

THERE IS GROWING consensus over corporate accountability as it relates to a company's impact on the environment. Yet, much of what is being talked about surrounds the issue of climate. This singular focus has led many companies to equate the E of ESG to climate alone.

But while climate is an in-focus component of E, it is not the only one. Rather, boards may want to examine E across its business functions to identify and prioritize those issues that are most critical (material) to their business. For example, an electric utility may want to focus on emissions and fossil fuels as the primary environmental impact of their business, while a paper company may instead seek to address forestry practices.

What our research shows is that shareholders on the whole are demanding for companies, with board oversight, to own their respective ESG goals and narrative. As varying environmental issues such as biodiversity and water rise in focus, companies and their boards are expected to regularly assess and commit to managing the most critical aspects for their business.

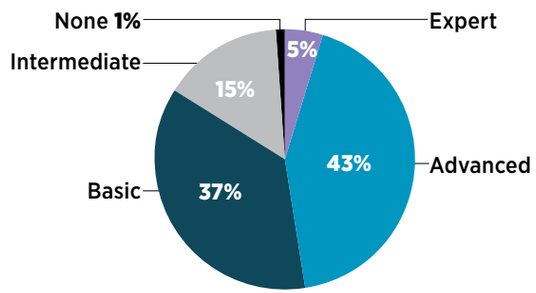
Considering the range of issues and impacts this can encompass, it's perhaps not surprising that most directors seek guidance on what topics to prioritize—and what they mean for their business. When asked to rate their level of understanding of the environmental risks and opportunities for their company, a greater proportion of directors surveyed by *CBM* said they had basic to no understanding of these matters, compared to the small percentage who rated themselves as experts.

Digging deeper into how directors get educated about E matters, 32% of those participating in our survey said they rely on an internal ESG expert (e.g., chief sustainability officer or chief responsibility officer) for their primary ESG education, and 21% said they instead turn to the general counsel or corporate secretary for knowledge. While these individuals provide valuable and essential viewpoints on the impact of ESG issues on the company, directors should also seek outside perspectives.

Having an independent party conduct an audit of the risks and opportunities for the company, for instance, can go a long way in demonstrating the depth of oversight in that area, particularly as reporting requirements increase. Similarly, benchmarking the company's practices against peers or attending expert conferences on emerging trends can help the board develop a stronger, proactive shareholder engagement strategy and build directors' knowledge on the matters—both of which would help support new disclosure requirements.

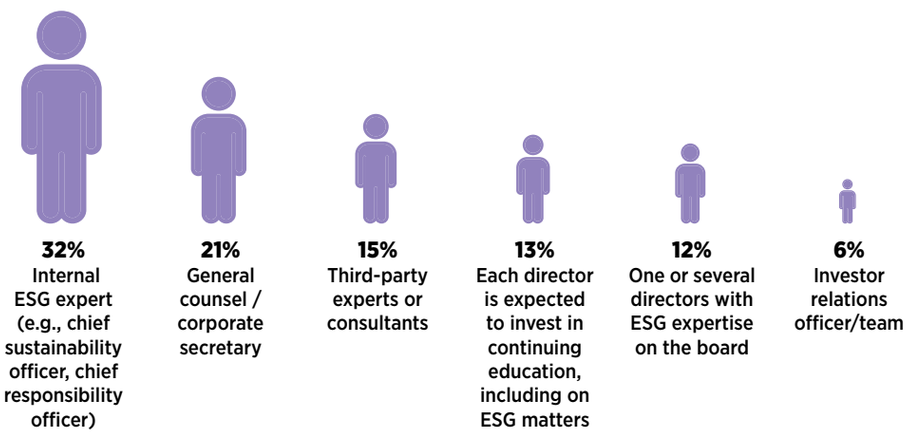
The bigger challenge still may be recognizing the critical importance of setting E goals on the

Directors' Level of Understanding of Environmental Risks and Opportunities



* Source: Director Confidence Index, BoardMember.com/Director-Confidence-Index

Who primarily educates the board on ESG matters?



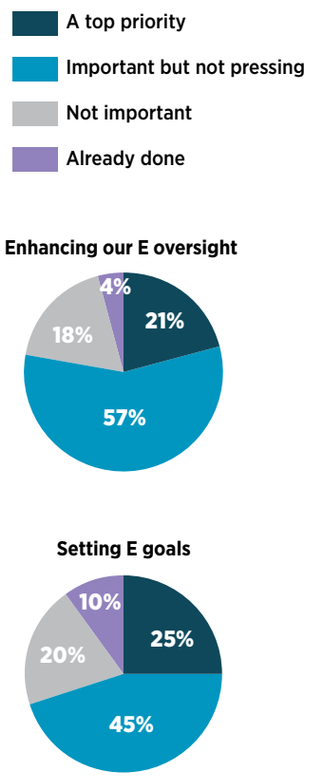
E

company's performance. Fifty-seven percent of the directors surveyed said while they understand that environmental considerations are an important part of their oversight responsibilities, they are not pressing at this time. Only 21% said enhancing their environmental oversight is a top priority, and 25% prioritize setting environmental goals.

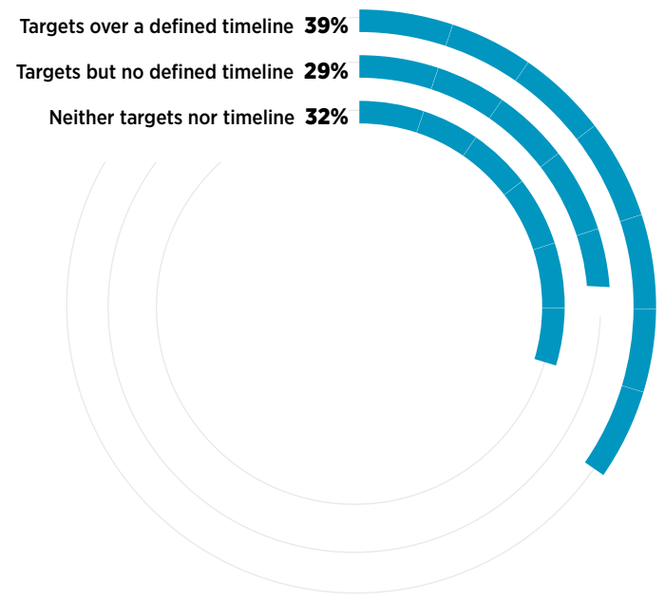
Instead, what the data shows is that the weight given to environmental matters in the boardroom is highly sector dependent, as one would have expected. While 39% of directors overall reported having set environmental targets over a defined timeline, that proportion jumps to 74% among energy companies specifically—and 67% among utility companies. In contrast, only 16% of IT board members said they had set targets over a defined timeline, and 47% said they had neither targets nor timelines.

While it is understandable that some sectors may play a bigger role in the environmental discussion, it is nevertheless important for board members of all industries to remember that E reporting in the U.S., particularly on climate, may become a regulatory requirement and should therefore be taken into serious consideration. Frameworks like the Task Force on Climate-Related Financial Disclosures (TCFD) can help board members think about and communicate the company's approach in reporting to shareholders and regulatory agencies as they navigate evolving disclosure requirements.

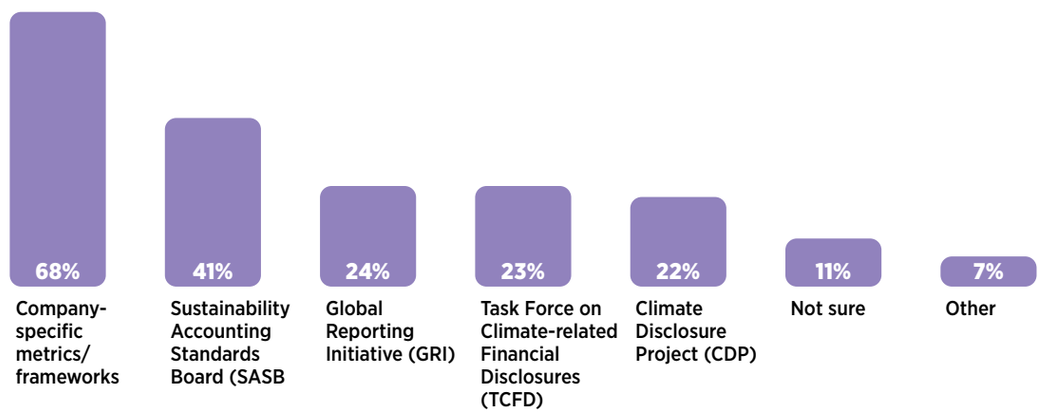
Importance of E for the Board



Environmental Targets and Timelines



Frameworks Boards Use to Measure Progress on ESG Goals



S: HUMAN CAPITAL

THE S COMPONENT of ESG has been a topic of discussion for decades at the board level, but it strongly emerged at the forefront of the agenda in 2020. There has since been growing pressure for companies to address inequalities within their ranks and report externally on what they are doing to support their employees and the communities in which they operate.

Years of research from *CBM* has shown directors remain divided on the idea of regulating this space. On one hand, some board members say they believe regulation has become necessary due to boards and management teams' inaction to improve their diverse representation. At the other end of the argument are directors who say regulation that dictates how companies should operate is an absolute overreach and yields no real results.

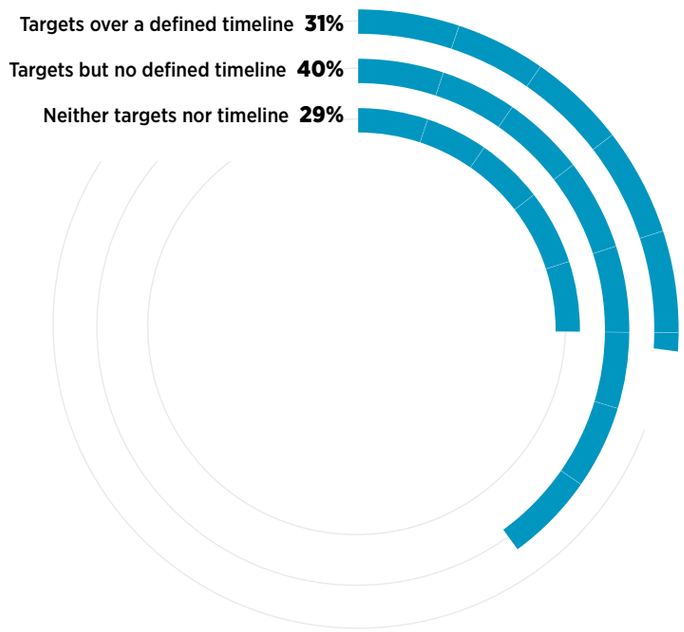
When polled in December 2020, on the heels of newly proposed legislation to require companies to include members of underrepresented groups on their boards, 46% of public company board members said they were in support of diversity mandates, versus 38% who were opposed and 16% who were not convinced either way yet.

Despite the debate, there is encouraging data that shows progress is being made. According to the 2022 *CBM* and Nasdaq research, 71% of directors said that their boards have set social-related targets. The caveat is that 40% of them have no defined timeline for achieving those targets.

Setting a target without a formal progress-monitoring intent can signal that the goal and matter are not of significance. Only 29% of directors said they are making enhancing their S goal-setting and related oversight a top priority. Once again, the majority said they, instead, recognize the importance of these issues but are not prioritizing them at the time.

The value of diversity—at all levels of the company—has been talked about a great deal in recent years. Few business leaders today question the need for a diverse set of perspectives at the table, whether that is based on gender, age, racial, professional or cultural backgrounds. The prominence of the issue may serve to explain why our research found 69% of directors who said they consider their understanding of the social risks and opportunities for the business to be of expert or advanced level.

Social Targets and Timelines

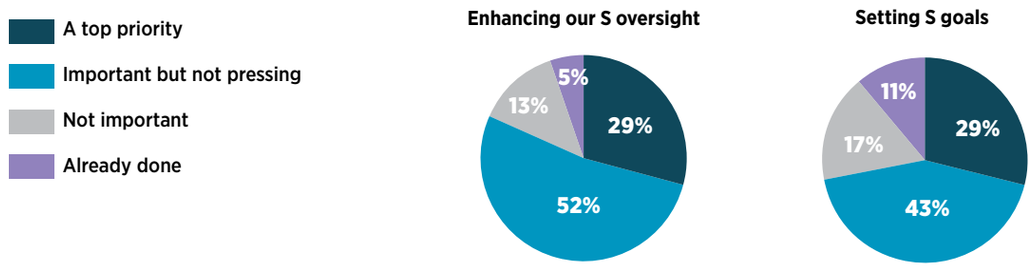


S

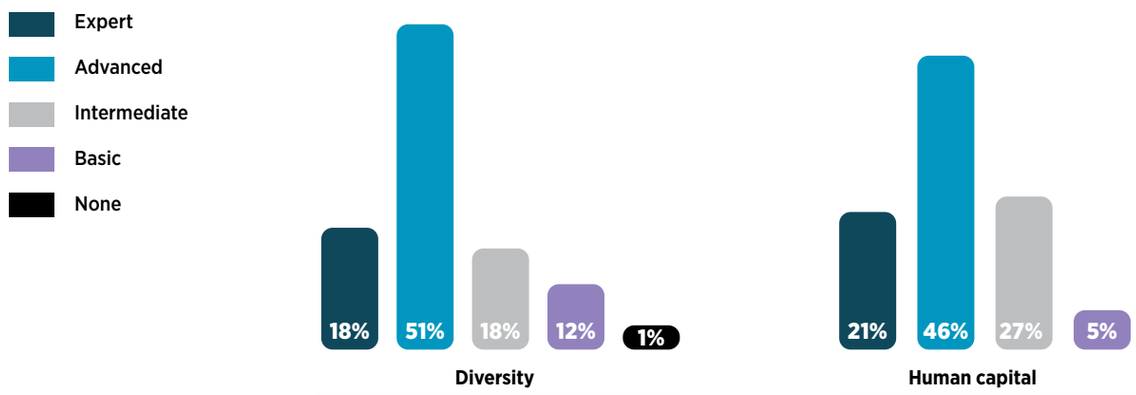
The broader issue of human capital management, however, is only beginning to take shape across industries. The pandemic has affected companies' approach to talent, from recruiting and retention to wellbeing and career pathing. Matters that used to be exclusively within the realm of the HR director have since moved up to the board, in part due to the legal, financial and reputational risks they carry today, but also because of the shifting dynamics in the labor market.

An increasing number of CHROs now attend board meetings regularly, and the role is becoming critical in providing thorough oversight of the growth strategy in general. Our research shows directors, overall, are cognizant of the importance of a well-thought-out and adaptable human capital strategy for the bottom line. Boards are deepening their understanding of their workforce and reviewing relevant data, which enables them to work more effectively with management in setting human capital goals, understanding related progress and challenges, and messaging these areas to internal and external stakeholders.

Importance of S for the Board



Directors' Level of Understanding of Social Risks and Opportunities



G: OVERSIGHT AND ACCOUNTABILITY

THE GOVERNANCE COMPONENT of ESG encompasses a wide range of issues, mainly because of the very definition of governance. Corporate governance is the structure of cultures, values, policies, rules, practices and processes by which a corporation is led and controlled to balance the interest of its stakeholders. Governance, by its nature, is intended to change.

Findings from the *CBM* and Nasdaq survey show that 74% of directors said their board has governance targets, and of those, 38% have a defined timeline to achieve them, while 36% reported they do not have defined timeline for achievement. More than a quarter (26%) of directors said their board has neither governance targets nor timelines, which raises concerns over the number of boards that may be taking a complacent approach to governance and creating risk for the corporation.

Evolution of a company's governance is critical to foster board effectiveness and support corporate success. However, the types, degree and rate of change of the governance structure, practices and approach necessarily vary and must be aligned to the trajectory and timeline for the business and its strategy.

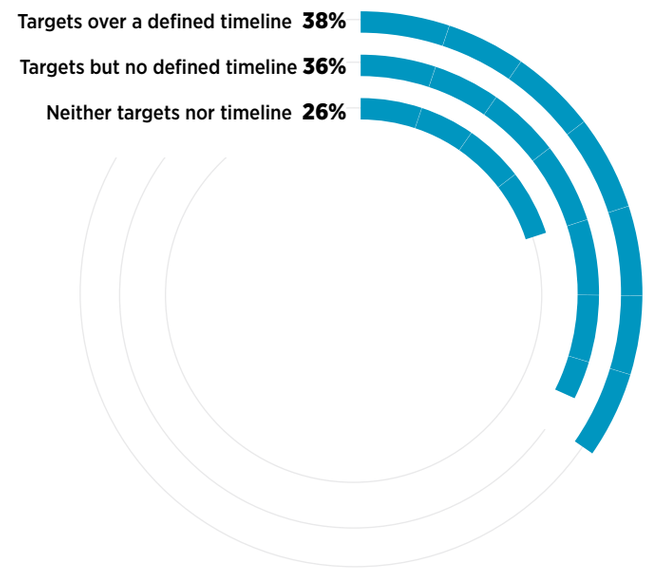
A significant proportion of directors surveyed said it is important for them to enhance their governance practices (81%) and set governance-related goals (71%). Yet, of those, only 30% and 28% said, respectively, they were top priorities, which may indicate a mis-prioritization of an important area that can be a strategic differentiator to a corporation.

Additionally, 13% and 17% of polled directors said they have already achieved their goals in that regard. The perception that governance goals can be "already done" or fully achieved misses the inherent trait of many critical governance practices as recurring, cyclical and impacted by ever-changing internal and external circumstances for the board and the business. For example, a board may update its bylaws, governance principles and committee charters and consider it "done" at that time. However, those documents will have to be reviewed and updated again in the future, as the company evolves and new requirements or pressures necessitate future changes in them.

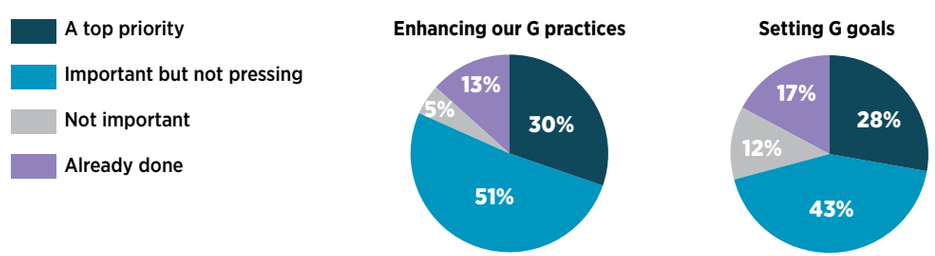
Boards must identify what governance practices are required to enable high quality, effective and independent oversight of the company. This requires regular, iterative and thorough review and analysis of the strengths, weaknesses and opportunities of the company's governance and deliberate actions by board members—often in collaboration with their management team—to address weaknesses and avail themselves of the opportunities.

Highly effective boards set annual strategic governance goals and report, at least quarterly, on progress toward those goals. Moreover, they incorporate educational information into every meeting on topics that will enable board

Governance Targets and Timelines



Importance of G for the Board



members to get better informed on governance best practices and matters relevant to the business and its industry, which help foster greater board effectiveness.

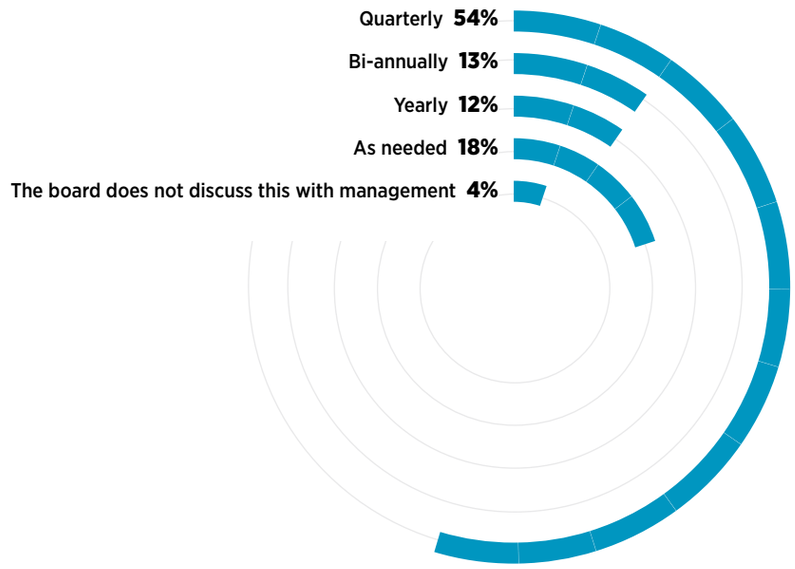
Beyond the work that the board (and/or its governance committee) does to enhance the quality of its governance practices, directors also may want to seek support from key partners on the management team who often have responsibility for effectuating board practices. Nearly all (96%) of directors noted that they have discussions with management on progress toward governance objectives. The 54% who reported these discussions with management occur quarterly are most likely more agile in making proactive changes that may support the board's ability to operate at the same speed as the company's strategy.

Governance has become more complex and dynamic. A robust and thoughtful approach to governance indicates the importance the board places on upholding its responsibilities and fiduciary duties in promoting the interests of the company's stakeholders and its long-term sustainability.

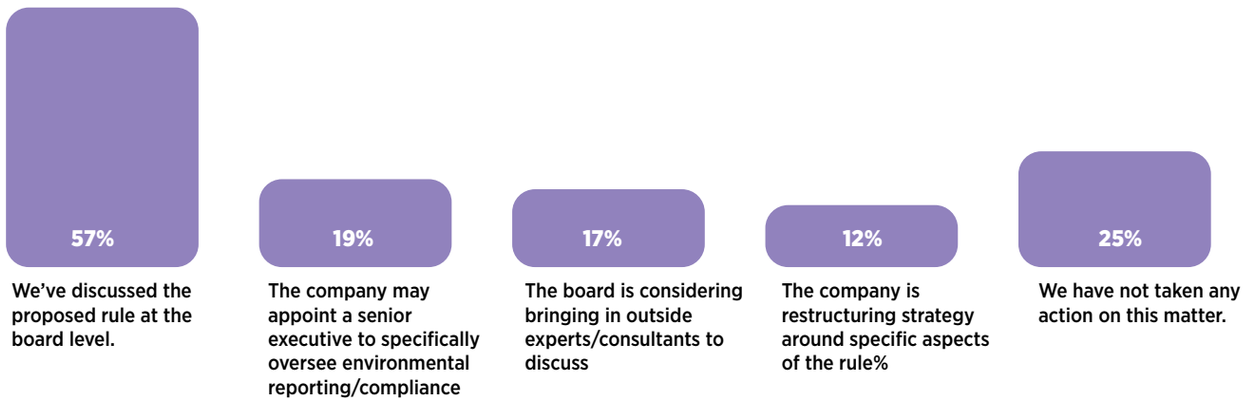
The next advancement is for boards to realize the opportunities related to the E and S factors. Only 11% of directors polled reported that it was not important to them to understand ESG opportunities and how they tie into strategy. The same minority also said measuring and reporting ESG progress was not important, meaning the majority of directors do recognize the importance.

The 35% of directors who reported their boards have already done or place a top priority on understanding ESG opportunities and the 42% who are measuring and reporting on ESG seem to be receptive to these perspectives and making efforts to set their companies up for greater success in the marketplaces of today and the future.

Frequency of Discussions with Management on G Progress



Has your company taken any of the following actions in light of the SEC's climate disclosure proposal?



Next Steps: Correlating Value and Future Growth

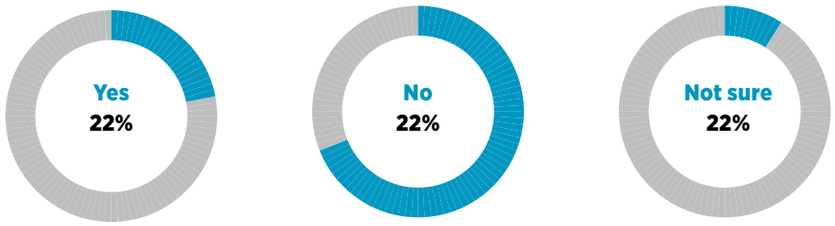
IF BOARDS UNDERSTAND how and what E and S factors are integral to their business and strategy, as well as what governance is required to provide effective oversight—as demonstrated by our survey results—then ESG becomes core to successful companies and effective boards with independent, high-quality oversight.

The view that ESG matters are wrought with risk is shifting to the perspective that they are rich with opportunity to create more efficient, competitive, profitable and valuable businesses. As boards' understanding and the paradigm of ESG continues to shift, directors will be more effective, shareholders will profit, and companies will be more sustainable.

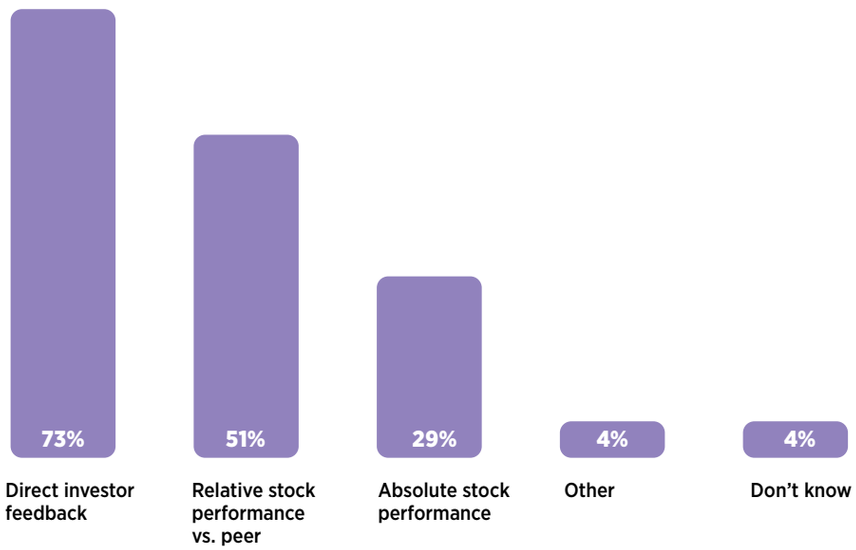
In taking a more holistic view of indicators of success, boards can then measure changes in shareholder value correlated against progress on ESG objectives and disclosures. According to our data, the most common methods through which that correlation is ascertained is through direct investor feedback (73%) and relative stock performance versus peers (51%). But these are only the starting points for enhancing understanding of how companies benefit from improving ESG broadly.

Although the primary demands for improvement have traditionally come from institutional investors and regulators, the stakeholders demanding progress are expanding. Executives are growing their understanding of competition for talent and loyal customers, and how those groups assess a company's environmental impact and social practices when determining whether or not they support the company. These same management teams are determining how goals and progress on ESG can make the company more competitive in the short- and long-term, and then bringing those perspectives and priorities into the strategy they develop and implement.

Boards that Assess Correlation of Changes in Shareholder Value to Company Progress on ESG Objectives or Disclosures



How Correlation Is Assessed

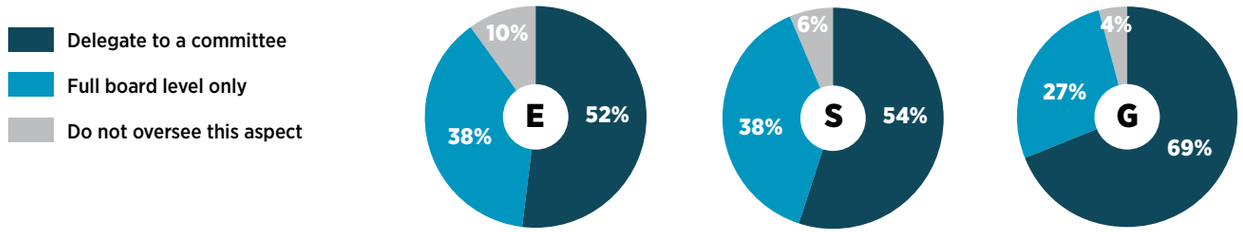


For some companies, a number of these issues may fall within the scope of committees or smaller working groups. Delegating these important board responsibilities to a standing committee can help ensure appropriate attention and detailed review of these matters. But ESG is a shared responsibility, and committees must relay the discussion points back to the full board so that every director, as part of their fiduciary duties, can not only be informed of these facts when making material decisions but also have the opportunity to develop the knowledge needed to challenge assumptions and progress.

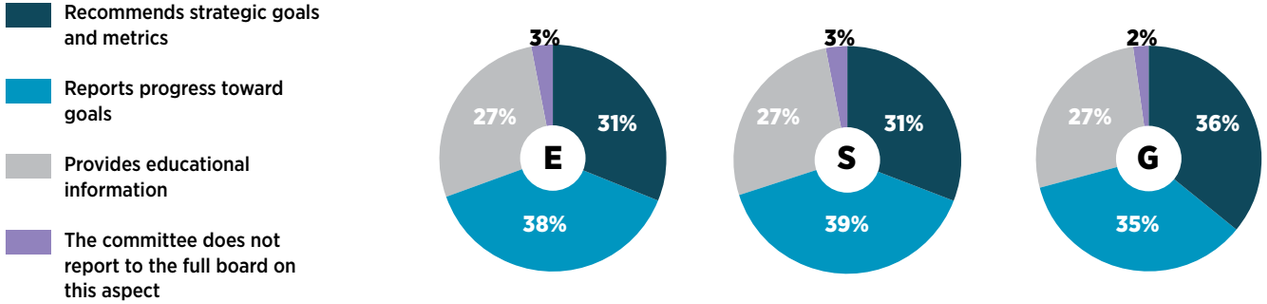
Beyond responsibilities at the board-level, many companies have put executive ESG working groups into place to help align strategy and goals across different business initiatives. Overall, it is important to define the best strategy for the board or company, and document it in charters and proxy statements, including which group or committee is responsible for each aspect of ESG oversight.

Boards with a healthy, holistic approach to governance understand that ESG is the responsibility of the full board. They understand the roles that the board's committees and management team play in supporting effective governance and creating efficiencies to implement changes and enhance the company's ESG strategy.

How Boards Oversee ESG Issues



How Committees Report Discussions to the Board

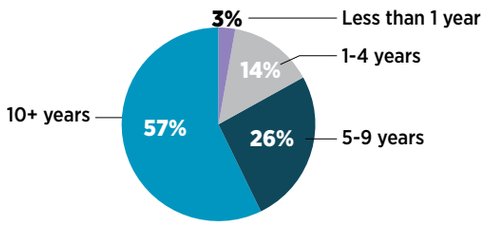


SURVEY METHODOLOGY

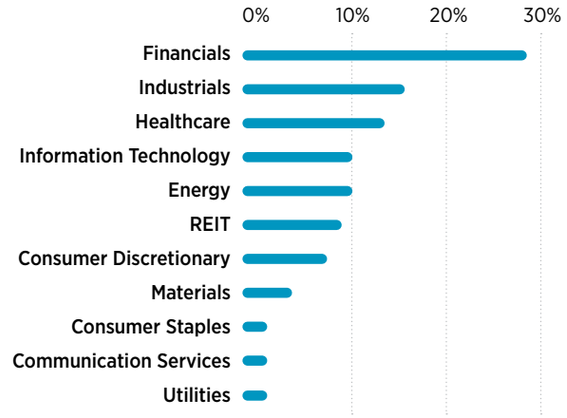
The *CBM* and Nasdaq survey was conducted online from April 4 through May 6, 2022. Participants were screened prior to the survey to confirm their role as directors on the boards of U.S. public companies. Each participant received an invitation via email, and a total of 311 U.S. public company board members participated in the survey.

TITLES

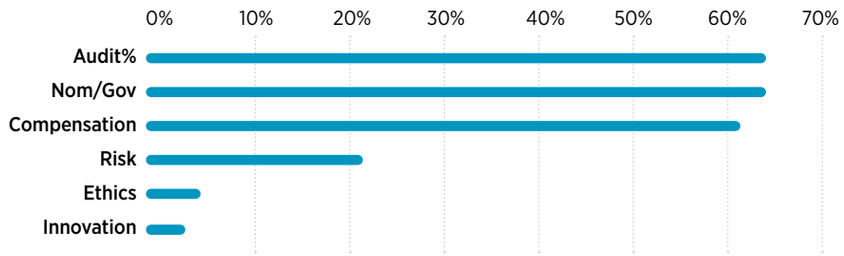
PUBLIC COMPANY BOARD TENURE



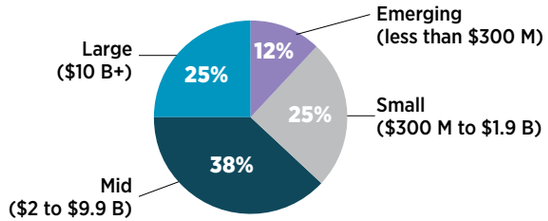
SECTOR (GICS)



COMMITTEE REPRESENTATION



MARKET CAPITALIZATION



CORPORATE BOARD MEMBER®

About Corporate Board Member

Corporate Board Member, a division of Chief Executive Group, has been the market leader in board education for 20 years. The quarterly publication provides public company board members, CEOs, general counsel and corporate secretaries decision-making tools to address the wide range of corporate governance, risk oversight and shareholder engagement issues facing their boards. *Corporate Board Member* further extends its thought leadership through online resources, webinars, timely research, conferences and peer-driven roundtables. The company maintains the most comprehensive database of directors and officers of publicly traded companies listed with NYSE, NYSE Amex and Nasdaq. Learn more at BoardMember.com.

Chief Executive Group

About Chief Executive Group

Chief Executive Group, a leading community for business leaders worldwide, exists to improve the performance of U.S. CEOs, CFOs, CIOs, CHROs and corporate directors. We publish *Chief Executive* magazine (since 1977), ChiefExecutive.net, *Corporate Board Member* magazine (since 1998), BoardMember.com, StrategicCFO360.com, StrategicCIO360.com, StrategicCHRO360.com, and run some of the nation's most essential peer-networking communities, including The CFO Leadership Council and Chief and Senior Executive Networks and The Corporate Board Member Network and American College of Corporate Directors. Our research, journalism, conferences and roundtables enable CEOs, CFOs, board members and other members of the C-Suite to share experiences with their peers to grow companies, build communities and strengthen society.
Learn more at ChiefExecutiveGroup.com

Nasdaq

About Nasdaq Governance Solutions

Nasdaq Governance Solutions supports public, private, and nonprofit organizations worldwide on their journeys to achieve board effectiveness and drive governance excellence. Our user-friendly Nasdaq Boardvantage® board meeting management software helps prepare boards and leadership teams for in their collaboration and decision-making processes. Our compliance solutions transform paper-based directors' and officers' (D&O) and conflict of interest questionnaires into data-driven processes. Plus, our Board Advisory team works directly with organizations to facilitate board evaluations that promote alignment and continuous improvement.

We also provide a platform for board members, executive leaders, educators, and knowledge-seekers to share experiences and gain insights. The Nasdaq Center for Board Excellence helps deepen board engagement through community, content, and collaboration.

For more information, visit: nasdaq.com/solutions/governance