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The Evolution of Fiduciary Duty: Bringing Boards of Directors Into the Future

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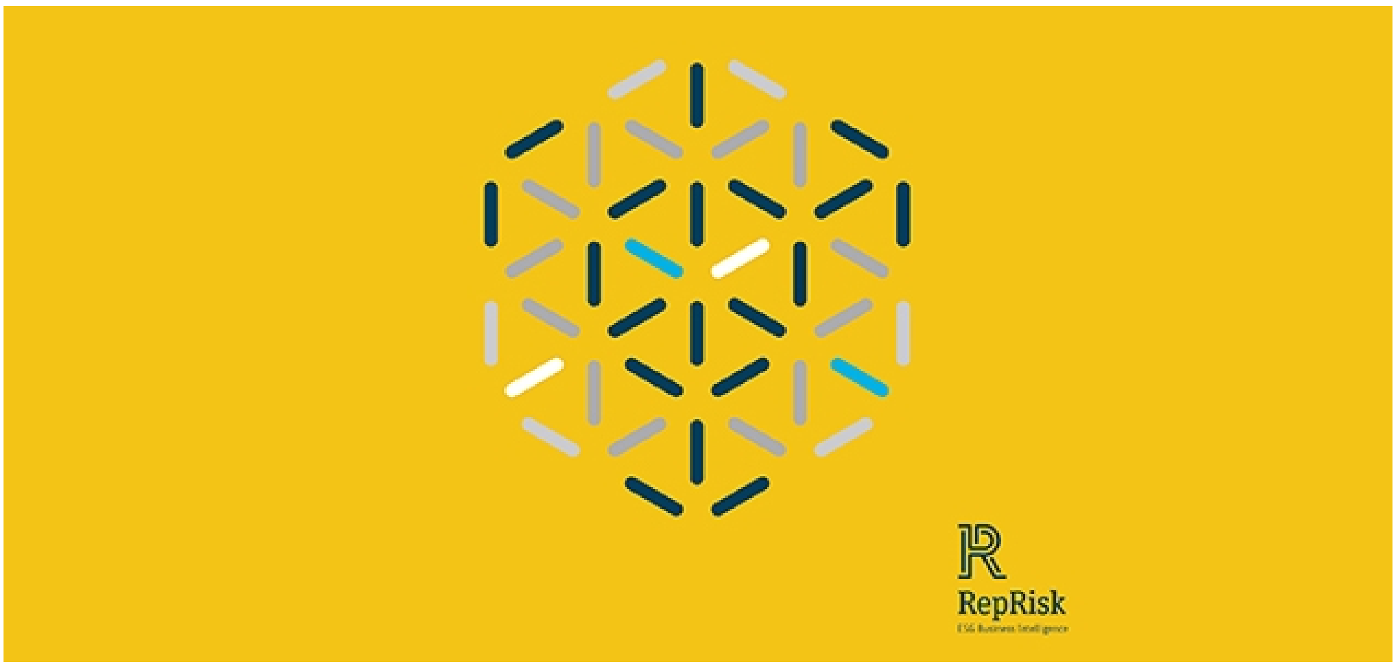

“Boards should understand the broader environmental and social consequences of business operations, and must set their own priorities and account for the associated outcomes.”

This sentence was included in the guidance document entitled, “Human rights: expectation towards companies,” released in February 2016 by **NBIM**, which manages the assets of the Norwegian Government Pension Fund Global, the world’s largest sovereign wealth fund. This is one of the many examples that clearly show how shareholders increasingly expect the topic of sustainability to be an integral part of business strategy and decision-making at board level.

To meet future challenges and to ensure that business models are sustainable, various international and national initiatives have called for the role of the board of directors to be strengthened, to allow them to

guide their company's sustainability efforts. International organizations such as the **UN Global Compact** (Global Compact Board Programme), as well as the **Responsible Business Initiative** in Switzerland, have recently addressed, or have announced that they will be addressing this issue.

Since October 2015, the UK Modern Slavery Act has required boards to approve and publish an annual slavery and human trafficking statement on their website if the business has a turnover of at least GBP 36 million and carries out any operations in the UK.

September 2015 saw the launch of the updated **G20/OECD** Principles of Corporate Governance, which were endorsed by the G20 two months later. They specifically address the need to link environmental and human rights issues with corporate functions such as disclosure, board responsibilities, and internal controls. They also state that "boards are expected to take due regard of, and deal fairly with, other stakeholder interests" and that "observance of environmental and social standards is relevant in this context."

In early 2017, the OECD released its "Responsible business conduct for institutional investors: Key considerations for due diligence under the OECD Guidelines for Multinational Enterprises," which encourages institutional investors to seek engagement with companies' boards on the matter of business conduct risk (also referred to as environmental, social and governance [ESG] risk) whenever adverse impacts related to ESG issues have been identified. The document further states that part of companies' fiduciary duty, for which boards carry responsibility, is considering long-term value drivers that also include ESG issues.

Despite these wide-ranging initiatives, only 22 percent of respondents to a survey conducted in 2015 by **MIT Sloan Management Review**, in partnership with the **Boston Consulting Group** and the UN Global Compact, confirmed that their board of directors were engaged in sustainability efforts. The research found that the biggest obstacles to stronger board commitment were: uncertainty of economic value, a lack of sustainability expertise by board members, and a prioritization of short-term success and shareholder value.

Furthermore, the research indicated that board members have little awareness of the increasing materiality of soft and hard law requirements relating to environmental and human rights issues. The authors of the study concluded that board members who fail to consider sustainability issues can be perceived by stakeholders and the public as negligent and potentially accountable.

All too often a question about ESG produces a glazed stare from senior management, followed by a polite invitation to speak to the Corporate Social Responsibility department. Brazilian construction firm **Odebrecht** and South Korea's **Daewoo Shipbuilding & Marine Engineering** – two companies ranked in **RepRisk**'s MCC 2016 Report – were pillars of society in their respective countries, but in both cases, their public image of respectability seems to have obscured an ingrained culture of corruption. The directors of both companies are now scrambling to sign plea bargains to avoid long prison sentences. Yet NGOs had linked the companies to corruption two years before the scandals hit the headlines.

The Board of Directors for the Future

To meet these challenges and developments, changes need to be promoted at board level. **RepRisk**, together with the UN Global Compact Network Switzerland and Swiss consulting firm **engageability**, hosted two events in early 2017 to engage with board members and work together on defining solutions.

The board members agreed that the most important change is driven by education, meaning improving the board's understanding of sustainability issues and how they relate to business. While looking for opportunities, boards need to understand the associated ESG risks that can damage a company's reputation or lead to financial or legal consequences. It is therefore important for boards to be open to further education and training, given that the landscape of sustainability, emerging risks and opportunities, and technology and innovation is constantly evolving.

What is certain is that board members are expected to have an increasingly challenging and growing portfolio of competencies, such as expertise in law, national regulations, soft law, digitalization and globalization. Such responsibilities can be overwhelming for honorary board members and can possibly only be fulfilled by a professional board.

A board's preparedness for risks and opportunities presented by sustainability-related issues can be strengthened including ethical values and social engagement in the board member selection process. So far, companies mainly look at strengths according to the potential board member's education and experience, and what attributes they bring to the board's composition. The scope of a board's mandate could also be enlarged by integrating ESG and sustainability objectives into its fiduciary duties.

Board members of the future will be increasingly perceived as representatives of the business and will be questioned and criticized accordingly by shareholders, stakeholders and the general public. They will have an incentive to be personally engaged in the sustainable development of businesses and society.

RepRisk allows Boards to know – and act

Even if new megatrends and global challenges are already an integral part of a board's strategic discussions and decision-making, there is room to strengthen corporate responsibility (CR) or the duty of care. Boards are faced with increased transparency related to corruption, environmental disasters, or human rights violations. **Volkswagen**'s 2015 emissions scandal damaged the company's reputation, and the big question was, "Who knew what beforehand?" The question is also, though, how much do boards *want* to know? Due to increasing transparency, the pressure of investors, and the availability of monitoring systems, boards now have a duty to know – and to act.

There are tools available for boards to identify, understand, and prevent adverse impacts related to human rights and other ESG issues linked to their business operations, products, and partnerships. RepRisk is one such provider. For over ten years, RepRisk has leveraged big data on ESG risk and business conduct, which helps to reduce blind spots and shed light on risks that may, in turn, translate into reputational, compliance or financial risks. RepRisk has worked to build a comprehensive database on ESG risks, and now delivers risk analytics and metrics to the largest corporates and financial institutions around the world.

Banks, insurance agencies, asset managers and owners, and corporates use RepRisk to screen, flag and monitor potential ESG and reputational risks related to their clients, business transactions, investments or suppliers.

Corporate benchmarking is an important tool for proactive risk management and stakeholder engagement

To respond to the challenges posed to the boards of the future, RepRisk recently launched a new product called the **Director's Brief** – a corporate benchmarking report that assesses a company's exposure to ESG risks, and benchmarks it with a customizable peer list. In essence, the brief helps identify the key ESG challenges and hot spots for a specific company and shows where the company stands vis-à-vis its peers. It was created to serve as a strategy and decision-making tool internally for board members and executives, as well as corporate affairs and sustainability teams.

RepRisk also offers Company Reports, which provide a deep dive into one company's risk exposure. Special bundle offers are available for a limited time at www.reprisk.com/report