

ESG, A NEW CHALLENGE FOR THE BOARD

Q&A WITH DENIS TERRIEN

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Non-executive directors are elemental to developing ESG strategies and overseeing their implementation. How should directors engage with the various stakeholder groups? Or should they leave direct outreach to management?

The French Institute of Corporate Directors (IFA) is working on this topic with a specific group of board directors focused on ESG and climate. Last year, IFA published updated recommendations on the board of directors' role concerning climate change and more broadly CSR matters. Below were the main findings.

The board should first grasp its full responsibility on the issue of sustainable value for the company, map out strategic directions and work on a roadmap for the major changes that are needed to reduce negative externalities and develop positive ones.

The board should then develop its view on sustainability challenges with a material impact on the corporate mission on both side of the ESG:

- On the risk side, the board should work on an expanded risk map to include relevant sustainability issues. This risk map and actions to mitigate these risks is to be prepared by management, and then reviewed and challenged by the board.
- On the opportunity side, the board should work on the paradigm changes that ESG implies and develop strategies to take advantage of new opportunities.

In order to do so, the board should prioritise issues to be dealt with by the executive team by taking into

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consideration stakeholders' expectations, each action's impact on the sustainability of the company and its environment and the extent to which the company is already mastering these actions.

More specifically, the board should:

- factor CSR into its major decisions like capital allocation, business transformations, entering new markets and managerial choices;
- promote environmental footprint control to achieve carbon neutrality in order to contribute to the objective of a global warming less than 2°C in 2030;
- validate the CSR/ESG indicators used to calculate variable executive remuneration by ensuring their relevance, fairness, and transparency. IFA released recommendations to include CSR/ESG criteria in addition to financial criteria;
- report to the shareholders' meeting on the company's sustainability and social responsibility strategy and ensure that this transparency of results is an objective in its own right.

Based on these recommendations, the board is responsible for ensuring that the company's senior management is implementing the aforementioned

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policies and issuing regular and detailed reports on the measures taken and results achieved.

At this stage, it is not recommended that board members and stakeholders be in direct contact as the relationship with stakeholders is mostly dealt with by management.

Some companies may want to set up stakeholders’ instances. However, such instances should be well thought of in advance as it should not disrupt the role and responsibility of the board and board members who are fully and legally liable, which is not the case with stakeholders. This topic is currently being looked at by IFA’s Legal Affairs Committee.

The number of employee representatives on French company boards has steadily increased over recent years.

Why do you think more companies are appointing such nominees to the board?

This topic has also been reviewed by IFA on a regular basis since 2013, canvassing opinion from the marketplace on the extent to which employees should be involved in board matters. IFA believes that:

- employee directors offer a different viewpoint during board meetings and thereby enhance the board’s decision-making process;
- employee directors usually have an intimate knowledge of the business and how it develops in real time and can be an additional source of information on the company ecosystem for independent and non-executive directors;
- their field experience allows employee directors to interpret information and recommendations in a different way than other directors and contribute to discussions on the practical issues involved when implementing decisions.

To ensure effective participation, it is critical that all the other directors, especially the board’s chairman, are actively requesting employee director participation on board discussions. To ensure constructive participation, it is critical that employee directors are properly trained in the legal and governance rules that dictate how a board of directors or a supervisory board function.

For several years, IFA has offered well-established training courses for employee directors. Moreover, IFA hosts a special commission solely composed of employee directors which focuses on a number of more specific topics and their impact.

From what you have seen, do French companies generally take a different view on ESG strategy and priorities given their particular governance features, such as employee representation?

The PACTE Law of May 2019 requires that companies are managed taking into consideration social and environmental issues and that board of directors of large companies include two employee representatives as directors. It is believed that it will give French corporate governance a solid framework to address ESG issues in a way that is noticeably different to other EU countries. The practicality of these new laws is being worked out and full impact should be felt in the medium term (2 to 3 years).

Once the ESG strategy and priorities are clear, how do you assess management performance against this strategy? Do you see a trend emerging as relates to ESG-related KPIs?

This is a complex question. It depends on the company’s line of business and the reciprocal effects between this business and its environment. There is a major difference between a worldwide multibillion-euro oil corporation and a small family-owned wood furniture business. Each company needs to establish relevant, concrete, measurable and reliable criteria that will constitute a



specific commitment to shareholders and stakeholders. Evidently, this information should be included as part of non-financial reporting.

At IFA, we do not believe that it is a one-size-fits-all issue. Although some issues that companies face are similar, such as climate change, other issues are vastly different, such as the impact on a local community for example. Our current thinking goes along with the idea that certain KPIs can be shared and others can be specific to each company or industry. A group of directors is working at IFA on this topic and should come back with some recommendations soon.

How do you ensure all board members maintain a good understanding of recent trends? What advice can IFA provide to its members?

IFA recommends that CSR/ESG matters be taken into account during board discussion and when board decisions are made at both plenary and specific board meetings to ensure that CSR/ESG are viewed across various topics.

Some companies are considering setting up a committee specialised in CSR topics. However, IFA does not recommend having too many committees as it dilutes the role and responsibility of the board. The strategic committee seems to be the appropriate place to discuss CSR policies and ESG issues due to its cross-functionality and long-term vision. It is in this committee that input from stakeholder instances may be welcomed. Other companies may ask the governance committee to look at this topic.

Although certain directors may be experts in CSR, all board members and senior executives need to be competent in the subject. IFA recommends training all directors and

executives on CSR/ESG topics and appointing directors with specific knowledge in CSR. This can be done in several ways:

- Putting the topic on the agenda for strategic board sessions, particularly in relation to monitoring relevant CSR indicators such as sustainability KPIs.
- Listening to independent experts, stakeholders' representatives or senior managers mostly impacted by these issues.
- Following specific courses on CSR.
- Studying the remuneration committee's work on factoring CSR/ESG targets into the variable pay of corporate officers.

Looking ahead 5 to 10 years, what do you consider to be the most pressing challenges in terms of ESG for French boards?

One of the most important and urgent challenges is undoubtedly getting the board of directors to take climate change into serious consideration. However, as the Covid-19 pandemic or recent extra territoriality laws have revealed, other urgent topics will seriously impact businesses considerably.

In 2019, IFA updated its recommendations on climate issues following the work of a group of board directors and external advisors. IFA training courses were updated to help directors better understand, and anticipate, the risks associated with current and future climate change issues.

In 2020, IFA will continue its work on ESG and its impact on corporate governance. So stay tuned.