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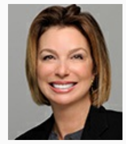

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From vision to implementation: Harnessing ESG best practices for stronger compliance in LATAM

By Emanuel Batista, Patricia Marinho, and Chris DeSa

Over the past decade, environmental, social, and governance (ESG) standards and metrics have become an increasingly important methodological framework for assessing a company's management of— and performance on—various environmental, social, and other sustainability-related factors. Despite the recent anti-ESG backlash in the United States, on the global stage, recent research by Kroll found that ESG leaders had annual returns of 12.9% vs. 8.6% for ESG laggards.[1] Moreover, ESG on the global stage continues to rapidly evolve as a key indicator of good corporate governance and social responsibility—and, relatedly, compliance. That is also true in Latin America (LATAM). The global financial community, investors, and other stakeholders have increasingly focused on the broader social and environmental impact of an enterprise's operations, goods, and services. Investors and companies in LATAM have also responded by attempting to adopt and align with global and local ESG best practices to enhance their performance on the sustainability spectrum (both on an absolute and relative basis).

However, although ESG has clearly risen to the top of corporate agendas, it is still a work in progress—both globally and in LATAM. Fundamental questions about the proper functional ownership of ESG and sustainability issues within an organization, for example, as well as the related governance roles and responsibilities, continue to be hotly debated. Many significant ESG factors—like those related to anticorruption, antitrust, and various business ethics issues—have historically been addressed by the compliance function. Others—particularly those related to environmental or climate-related issues—have not traditionally fallen under the purview of compliance (or any other senior executive function) and often require new technical and subject matter expertise. Many ESG proponents argue that a dedicated sustainability-focused professional (such as chief ESG officer or chief sustainability officer) is necessary, while others continue to advocate in favor of having traditional executive management and teams in legal (general counsel), compliance (chief compliance officers), finance (chief financial officer), or risk (chief risk officers) oversee ESG.[2] These debates are not likely to be resolved in the near future.

However, what is clear is that ESG is cross-functional by nature, and whoever is ultimately responsible for it in

LATAM will eventually play a critical role, not only in ensuring their organization operates sustainably and responsibly, but also in understanding and aligning their programs with the constantly evolving regional and global ESG regulations, norms, and best practices. Compliance should clearly play a lead role in these issues. That includes advancing a company's long-term sustainability-related goals and objectives, providing key inputs on materiality assessment processes and procedures, protecting its reputation, and ensuring it is operating in a socially responsible and sustainable manner.

The importance of compliance in advancing ESG and sustainability is only likely to grow significantly in the region. Investors, regulators, creditors, and other financial stakeholders focused on LATAM increasingly rely on nonfinancial sustainability information and ESG factors to assess an organization's performance on long-term value creation and maximization criteria, as well as their core commitments to broader environmental and social objectives and goals. However, in addition to traditional financial stakeholders, broader stakeholder groups are also highly focused on ESG and sustainability—in most cases more so than investors or financial firms. ESG will, therefore, continue to play an essential role in this region, and compliance will and should be an essential partner in its advancement. With that in mind, it is imperative that compliance leadership and teams in LATAM understand the evolving global and regional best practices when thinking about ESG and sustainability. After all, ESG best practices are still evolving in LATAM and face organizational obstacles concerning implementation. Compliance can and should assist in ensuring that the ESG norms, goals, objectives, and targets discussed below are effectively and adequately implemented and executed within an organization.

Best practices for ESG and sustainability

To begin addressing ESG and sustainability-related risks and opportunities, executives responsible for ESG in the region—whether within or outside of traditional compliance functions—will need to improve and enhance traditional corporate governance and compliance programs to include specific ESG-aligned policies and guidelines. The subsequent best practices should be followed for ESG-related improvements and enhancements to help companies ensure that their operations and decision-making align with long-term sustainability goals and objectives.

Develop a clear, high-level, sustainability-aligned purpose

ESG must start with an introspective look at the enterprise's ultimate point or purpose for adopting a sustainability program. This is a fundamental step frequently misunderstood or bypassed. Understanding the purpose of an ESG program is what ensures it is not simply a check-the-box exercise. The board and executive management must first understand and articulate why they are adopting an ESG program at all and what they hope to achieve with ESG (e.g., long-term value-preservation or maximization). Best practices require taking a close internal look at the expanded purpose that incorporates the enterprise's broader stakeholder concerns, long-term value-preservation, and value-creation objectives surrounding sustainability awareness. These may involve management, investors, customers, suppliers, employees, regulators, community groups, and civil society organizations, among others, which are specifically affected by an enterprise's core activities and operations.

Set an ESG strategy to achieve defined goals and objectives

Once the high-level purpose of ESG and sustainability is clearly defined and understood, the board and executive management should develop a targeted ESG strategy that outlines specific goals and objectives in this area. Best practices recommend that these goals and objectives be determined through a comprehensive materiality assessment that identifies individual ESG factors (i.e., risks and opportunities) most vital to the company as well as the impacts of its products, services, and operations on its key stakeholders (often described as "double materiality"). This also should reflect the enterprise's strategic competitive positioning on material ESG factors as well as defined risk tolerances and capital allocation decisions. The strategy should also outline the company's formal commitments to ESG frameworks, guidelines, and standards and how they plan to measure and report their ESG performance.

Implement ESG-related policies and procedures

To implement and execute the organization's strategy—in addition to traditional policies recommended for long-term value creation—good sustainability-aligned governance includes adopting a new or augmented set of corporate structures, responsibilities, and policies. This strategy improvement relies on enhancing the board, committee-executive structures, sustainability-related roles and responsibilities, ESG-related policies, and procedures—many of which may be relatively new or unfamiliar to the company. Here, companies will have to decide whether to have a dedicated chief sustainability officer or house the function in traditional legal, compliance, or risk leadership. In addition, key procedural improvements should be implemented, including improvements around annual or biannual materiality assessments (to assess evolving ESG factors) and reviews by internal audit.

Establish ESG metrics and targets

Based on the materiality assessment—and in line with the organization's defined goals and objectives—companies should establish clear ESG metrics, key performance indicators, and targets that can be used to track progress and assess the effectiveness of their ESG program. There is no single approach or solution for metrics and targets, and specific metrics should reflect the material factors most significant to its business and key stakeholders as reflected in the materiality assessment. This includes metrics for the company's specific material factors related to environmental performance, such as renewable energy use and carbon emissions, as well as metrics related to social and governance performance, such as labor practices and diversity and inclusion.

Engage with key stakeholders

Companies should develop a stakeholder engagement plan with their key stakeholders. Best practices for materiality assessments recommend surveying key stakeholders to understand their ESG and sustainability expectations and interests, thereby providing a roadmap for developing ESG outreach initiatives oriented toward their expectations. This can include conducting direct stakeholder consultations, developing partnerships with ESG-focused organizations, and participating in impact initiatives.

Report on ESG performance

Lastly, companies should regularly report on their ESG performance and communicate their ESG initiatives on material factors to the board, key committees, and external stakeholders, which, among others, including investors and other financial stakeholders. Periodic external reporting helps build transparency and accountability, and it also helps demonstrate a commitment to ESG. Formal reporting on certain ESG factors may be mandatory for publicly held companies. Others may voluntarily report their ESG performance through annual sustainability reports, sustainability-focused websites, or participation in ESG-focused initiatives and organizations.

Converging standards, the "triple combo," and ISSB

At a global level, the past decade has seen the emergence of a sporadic patchwork of voluntary frameworks and standards that were initially designed to provide methodological guidance around managing and reporting on nonfinancial sustainability information, material ESG factors, and related accounting and activity metrics.[3] By far the most critical of these efforts has been the following standard setters and initiatives:

- **Global Reporting Initiative (GRI)**, primarily focused on providing an internationalized framework for sustainability reporting and material sustainability factors that impact people and the planet (so-called “impact” materiality).
- **Sustainability Accounting Standards Board (SASB)** primarily focuses on rigorous guidance for material sustainability accounting standards and activity metrics to provide investors with comparable, consistent, and decision-useful information.
- **Task Force on Climate-Related Financial Disclosures (TCFD)** , focused on assisting with enhanced disclosures and governance frameworks around climate and environmental-related risks, opportunities, metrics, and targets.

Known as the “triple combo,” these efforts have emerged to help define clearer best practices and standards—especially for publicly held multinationals—each offering unique focal areas and strengths; however, there is also significant overlap on and identification of material ESG factors and nonfinancial sustainability information. However, perhaps the most important ESG development of the last several years has been the convergence and consolidation of SASB and TCFD—both of which primarily focus on traditionally (or financially) material sustainability issues—under a single organizational umbrella: the International Sustainability Standards Board (ISSB)—set out and overseen by trustees of the International Financial Reporting Standards Foundation (IFRS). For proponents, the creation, internationalization, and consolidation of best practices and standards under a single roof signifies the most meaningful advance for sustainability management in recent years. On the other hand, the recently adopted European Sustainability Reporting Standards (ESRS)—which are now required for certain public and private entities with defined exposures to the EU—have embraced a “double materiality” approach that includes “impact” considerations in line with GRI. Collectively, these standards and requirements should go a long way toward assisting with increased levels of discipline, competence, and rigor associated with the reporting and auditing financial information. Companies with even modest global ambitions should strongly consider embracing sustainability-related processes and procedures that include both traditional and impact perspectives. While significant fine-tuning will, no doubt, still be required in the coming years, for the first time, organizations now have a clearer picture of effective reporting and metrics on nonfinancial sustainability information.

Driving sustainable transformation: ESG in LATAM’s socioeconomic landscape

Although more empirical research should be conducted on the actual impact channels and benefits of specific ESG factors in the region (both as it pertains to long-term shareholder value-maximization and on the environment and society at large), the benefits to LATAM will likely reflect, or perhaps even surpass global trends. As seen elsewhere, ESG should help regional businesses and investors mitigate risks and maximize opportunities to improve long-term financial performance.[4] In addition, ESG will hopefully make meaningful contributions to sustainable and equitable economic growth and social development in the region, helping companies address key historical environmental and social challenges. These include biodiversity, deforestation, water scarcity, racial and gender disparities, inequality, and poverty, just to name a few.[5]

Compliance’s key role ahead

One thing is certain for organizations that embrace ESG: The compliance function can and should play a crucial and fundamental role in integrating and implementing sustainability goals and objectives—along with the related policies and procedures—into companies' business operations. Implementing ESG policies and procedures can be especially challenging, particularly in LATAM, where the regulatory landscape around ESG and clearly defined best practices are still in the early stages of development. However, in many ways, the lack of a clear definition creates meaningful opportunities for compliance professionals in the region to assist in overcoming the key ESG challenges.

There are also numerous challenges ahead. According to Kroll's *Fraud and Financial Crime Report 2023*, for Brazil and Mexico, the main ESG challenges include lack of standardization (63%), cost (63%), and limited data (60%).[6] Given the crackdown on greenwashing and potentially false and misleading ESG information and disclosures, ensuring the accuracy, transparency, and integrity of an enterprise's ESG story is more critical than ever. Each of these challenges touches on areas where compliance leadership and teams will be extremely relevant if an organization wants to effectively address them.

Conclusion

Following global trends, ESG has already become imperative to businesses in LATAM, and regional compliance leadership and teams will be crucial partners in this transformation—a trend only likely to increase in the foreseeable future. Compliance will play an increasingly important role not only in ensuring that companies operate in a sustainable and responsible manner but also that their broader ESG and sustainability programs align with the constantly evolving regulations, norms, and best practices. This includes playing a critical role in the adoption and implementation of each element of an effective ESG program (e.g., purposes, strategy, design, operations, reporting) and ensuring alignment with best practices for global frameworks and standards such as GRI, SASB, and TCFD (now the ISSB).

Individual enterprises will continue to grapple with fundamental questions around designated roles and responsibilities for ESG and sustainability (and the extent to which different factors are owned and overseen by existing legal, compliance, risk management, or audit personnel or are managed on a standalone basis). That will depend on myriad considerations, including an organization's overall vision, material ESG factors, high-level purposes, objectives and goals, internal capacities and competencies, allocated budgets, implementation tools and systems, etc. Moreover, an individual organization's time horizon and roadmap for implementation will also dictate the who, what, where, and when of a given ESG program. However, effective implementation of long-term ESG goals, policies, and procedures requires significant cross-functional collaboration and coordination, irrespective of an organization's particularities. In that sense, the alliance of ESG and compliance will hopefully not only help an organization with its long-term value-creation and value-preservation goals and objectives in LATAM, but they will also meaningfully contribute to the region's much-needed environmental and social improvements.

On that front, it is worth noting in passing that to meaningfully advance ESG and sustainability in the region, the voluntary corporate efforts described herein need to be buttressed with increased support from civil society organizations, governments, and regulators by raising awareness and implementing rules and regulations that incentivize and promote long-term social-environmental goals and objectives. For example, business, accounting, and financial associations and standard setters in the region should assist by advancing more widespread adoption of evolving global best practices like the new ISSB standards as well as frameworks that advance an impact perspective on sustainability issues. Relatedly, securities regulation can and should be augmented to include consistent and comparable disclosures of corporate performance on material ESG factors—and regulators and courts can assist with increased regulatory enforcement actions around greenwashing. Ultimately, while voluntary corporate efforts to implement effective ESG strategies and policies (and compliance's key role in the process) will no doubt be critical in the years to come, societal and regulatory alignment will be equally significant to ensure a more sustainable, equitable, and prosperous region in the future.

Takeaways

- Despite some backlash in the US, environmental, social, and governance (ESG) metrics have become a crucial framework for assessing companies' sustainability efforts globally and in Latin America.
- Ownership of ESG issues within companies and related governance roles remain debated, highlighting the cross-functional nature of ESG.
- Compliance plays a key role in advancing ESG goals, ensuring sustainable practices, and aligning with evolving regulations and norms.
- Clear purpose, defined strategy, policies, metrics, stakeholder engagement, and regular reporting are essential for effective ESG implementation.
- Although global efforts have converged under the International Sustainability Standards Board, providing coherent standards for reporting nonfinancial sustainability risks and opportunities, businesses should also strongly consider adopting processes and procedures that include the impact of their products, services, and operations on people and the planet.

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