



EXECUTIVE SUMMARY

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Anne Sheehan

*Director of Corporate Governance,
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FOREWORD

A unique dynamic exists between investors and board members. Directors are responsible for ensuring value for us, the shareholders. Yet, even the most patient investors must become involved these days in helping directors focus on the long-term. Because in an increasingly volatile, global, tech-driven, and competitive economic environment, short-termism often overwhelms planning for sustainable growth and returns.

Sustainability, though, is precisely where business needs to focus. Sustainability issues create risks, as well as meaningful investment and market opportunities. As investors, we have a responsibility to prepare corporate boards for this sustainability imperative.

At the California State Teachers' Retirement System, we have focused on the corporate governance of our portfolio companies for two good reasons: our investors deserve it and it produces results. As the nation's largest educators-only public pension plan in the U.S., we're the definition of long-term, patient capital. We see it as our duty to actively monitor and engage the investments in our portfolio for risks. Given the role of corporate boards in corporate planning and performance oversight, we pay very close attention to what the board is and is not doing on sustainability.

As long-term investors, we are looking for a company to be managed for resilience and sustainable growth. Investors can help develop informed board oversight of sustainability by assessing if directors have the appropriate sustainability expertise, encouraging directors to engage with stakeholders on sustainability priorities, and promoting the recruitment of diverse candidates capable of meeting the challenges of a diverse world.

If board directors are ultimately responsible to shareholders, institutional investors are ultimately responsible to our own investors. Our mandate is to ensure that we use every means possible to safeguard and increase the value of our investors' holdings. By being partners, activists, and analysts when it comes to board directors and sustainability, we can take a big step forward in delivering on that mandate.



Margaret Foran

*Chief Governance Officer,
Vice President and Corporate
Secretary of Prudential Financial*

FOREWORD

At Prudential Financial, we use the term sustainability to describe how we create enduring value. As a provider of life insurance, retirement and other investment products for our clients, having this long and broad view is crucial to our mission, and is an integral part of our business.

As the steward of our long-term value creation, our board has been a key driver of our commitment to sustainability. The Corporate Governance and Business Ethics Committee of our board oversees our sustainability efforts. The Committee receives regular updates on our progress towards sustainability and expertise in sustainability is among the skills represented on the board. Our board engages regularly with stakeholders, including investors, and the feedback and dialogue has resulted in changes to our governance approach.

Over the past several years, there has been an evolution in the understanding of the role of boards for sustainability. Traditionally, as part of their oversight duties, boards have focused on preparing for changes in the environment in which their company operates, as well as creating sustainable value for shareholders. More recently, best practices have included the board's oversight of including social and environmental risks into their company's overall business risk assessment and strategy.

The Ceres report "View from the top: How corporate boards can engage on sustainability performance" is both helpful and timely in this regard. With a combination of practical recommendations, and case studies, it will be a good guide for boards who want to better incorporate sustainability into their processes and action.

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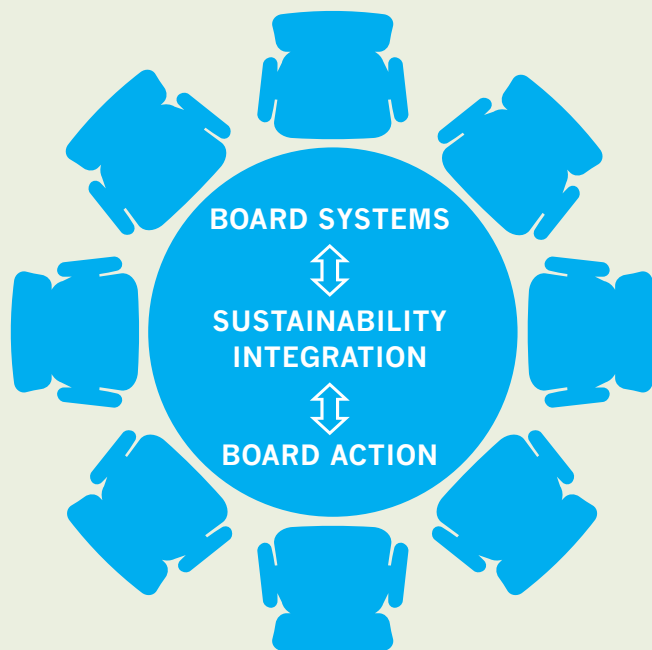
Today's corporations, faced with the extraordinary challenges of global climate change, water scarcity and workplace inequality, are at a crossroads. They can take proactive steps to adapt to pressing environmental and social issues – the two core categories of “sustainability” – or they can risk being left behind.

Sustainability is a critical business issue that all companies must focus on. Wall Street research, academic papers, corporate reports and trends from major investors all underscore the same message: companies that adopt sustainable practices deliver superior financial results and can face the future with more resilience.

Corporate boards must take a leading role in championing sustainability across the entire business enterprise. More than executives and other employees, members of corporate boards are responsible for ensuring long-term shareholder success and overall value creation. Directors have a duty and a mandate to promote sustainability priorities in corporate strategy, risk management and performance in order to meet this fiduciary responsibility.

Yet, while there has been a measurable uptick in director engagement on sustainability issues, it is still largely the exception rather than the rule among most companies. A 2014 Ceres analysis of 600 of the largest publicly traded U.S. companies found that only 32 percent oversee sustainability at the board level. Additionally, except in the case of a few leading companies, it is often unclear whether board sustainability oversight is achieving meaningful performance improvements.

Building on interviews conducted with dozens of corporate directors, senior corporate leaders and governance experts, this report identifies key strategies for effective board engagement that can produce tangible environmental and social impacts. **Specifically, the report recommends two inter-related approaches for weaving sustainability more deeply across board functions: 1) Integrating sustainability into board governance systems, and 2) Integrating sustainability into board actions. By combining robust systems and meaningful actions, boards will have a far better chance of achieving substantive performance improvements.**



TO DEVELOP ROBUST SUSTAINABILITY OVERSIGHT, CORPORATE BOARDS CAN:

- **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**

RECOMMENDATIONS

Among the report's recommendations for effective board sustainability oversight systems:

⇒ **RATHER THAN CONSIDERING “SUSTAINABILITY” TOO BROADLY, FOCUS ON COMPANY-SPECIFIC MATERIAL ISSUES THAT SIGNIFICANTLY IMPACT OPERATIONS AND REVENUES.**

The most uptake of sustainability at the board level is in industries where environmental and social issues are well understood to pose regulatory or reputational risks. For instance, the 2013 Rana Plaza factory collapse in Bangladesh spurred board-level conversations about worker safety in the supply chain at a number of apparel companies. Additionally, companies are expanding board-level discussion of sustainability to include long-term business opportunities. *Unilever's* board is responsible for monitoring the implementation of the company's Sustainable Living Plan, its strategy for doubling their business while reducing their environmental footprint and improving their social impact.

⇒ **EMBED SUSTAINABILITY IN COMMITTEE CHARTERS, AND IN DISCUSSIONS ON STRATEGY, RISKS AND INCENTIVES.**

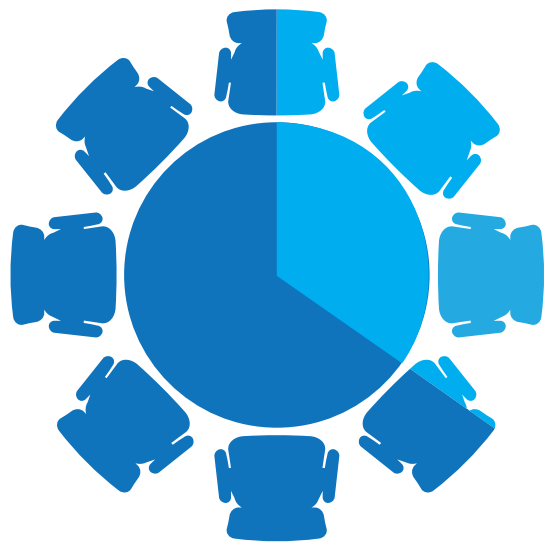
Integration in this manner is essential for ensuring that sustainability is not considered in a silo. *Gap Inc.* embeds sustainability into the mandate of its Governance Committee, which includes the Board Chair, and Chairs of the Compensation and Audit and Finance Committees, thereby allowing for both integration and meaningful dialogue.

⇒ **RECRUIT DIVERSE CANDIDATES WITH EXPERTISE AND BACKGROUNDS ON KEY SUSTAINABILITY ISSUES AND OFFER SUSTAINABILITY TRAINING.**

Ceres found that only 19 percent of directors serving on board sustainability committees of large U.S. companies have discernible expertise in relevant issues. *Prudential Financial* identifies experience in “environment/sustainability” as a board qualification.

⇒ **INVOLVE KEY STAFF RESPONSIBLE FOR ENTERPRISE PROFIT AND LOSS IN BOARD DELIBERATIONS ON SUSTAINABILITY.**

Management sets the framework for effective conversations at the board level by sharing the right information, and using board input to enhance organizational approaches on key issues. *Nike's* senior executives regularly appear before their Sustainability Committee to discuss how the sustainability and business strategies are aligned.



A 2014 CERES ANALYSIS OF **600** OF THE LARGEST PUBLICLY TRADED U.S. COMPANIES FOUND THAT ONLY **32** PERCENT INCORPORATE SUSTAINABILITY AT THE BOARD LEVEL

Recommendations for board action towards stronger sustainability performance improvements:

➤ **AVOID OVER-EMPHASIS ON SHORT-TERM RETURNS BY EMBEDDING SUSTAINABILITY AND LONGER-TERM THINKING IN STRATEGIC PLANNING.**

Boards have the responsibility to move company leadership away from a preoccupation with quarterly earnings targets, and should focus instead on planning for long-term performance. A growing number of company boards, including *Coca Cola*, *Unilever* and *National Grid*, have taken steps to move away from quarterly reporting. Intel has explicitly noted the board's responsibility on "long and short-term trends," while *Prudential Financial's* board considers a "long-term value creation model."

➤ **INTEGRATE SUSTAINABILITY IN RISK OVERSIGHT.**

Boards are responsible for systematically reviewing corporate exposure to material sustainability risks and scrutinizing management strategies to mitigate risks. *Marks and Spencer's* board regularly reviews a group risk profile in which environmental and social issues are identified as contributing to broader risks, such as reputation and supply chain risks.

➤ **ESTABLISH STRONGER LINKAGES BETWEEN EXECUTIVE COMPENSATION AND SUSTAINABILITY GOALS.**

Only 25 percent of large U.S. companies link executive compensation with sustainability issues. *PG&E* links 50 percent of the short-term compensation of its executives to its safety performance.

➤ **DISCLOSE THE ROLE OF THE BOARD IN PRIORITIZING SUSTAINABILITY.**

While integrating sustainability in board systems and actions is important, it is also crucial for companies to provide robust disclosure on board sustainability oversight. In addition to helping investors and other stakeholders gauge such activity, better disclosure will also allow stakeholders to identify linkages between robust accountability systems and sustainability performance impacts.

"The Board should be the first line of defence against the dominance of short-term thinking by a company. While management tends to be focused on the crisis of the moment, it is the responsibility of the Board to ensure that company leaders also give due attention to the next five years and beyond."

— IAN DUNLOP

Independent Adviser & Commentator -
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To read the full report visit:
www.ceres.org/viewfromthetop

