ESG—friend or foe?

Environmental, social & governance: Clare Hughes-Williams & Sarah Crowther on why law firms should keep all three top of the agenda if they want to keep the lights on in the long term

ESG (Environmental, Social and Governance) has become a hot topic for businesses across the globe and has seen a meteoric rise in the attention that it receives from business leaders. Law firms are no exception, and there are numerous reasons why they too are (or should be) paying ever closer attention to their ESG credentials.

Although its rise to prominence is a recent phenomenon, ESG and its component parts are not new. ESG emerged as a concept in 2006 when the then secretary-general of the United Nations, Kofi Annan, launched the Principles for Responsible Investors. Those principles were developed with the co-operation of institutional investors and formed the bedrock of ethical investment. This is what we now call ESG.

ESG remained an investment concept until fairly recently. Social inflation has played a prominent role is its development—particularly movements such as Black Lives Matter and #MeToo which sparked huge public interest. These movements transformed the concept from investment term to a critical topic applicable across many other areas. This includes the work that professional services firms undertake, their relationships with their clients and employees, and their risk management strategies.

When we think of ESG, our focus tends to be on the environment, including concepts such as climate change, pollution and biodiversity. High-profile climate-related litigation is an increasingly common occurrence in the US, and we are starting to see the green shoots of these types of claims in the UK. Although directors and officers are perhaps the most obvious targets for this litigation, all business leaders need to take note and play their part in mitigating their exposure to such claims.

Although perhaps less well-publicised, the other component parts of ESG should not be overlooked. 'Social' is hot on the heels of the environment in terms of the attention given to it by regulators, businesses, their clients and employees. The Parker Review, focused on the ethnic diversity of UK boards, made recommendations in 2017 relating to increasing diversity at board level; while some progress was made, those suggested targets were not met. Last summer, the Financial Conduct Authority issued proposals on mandatory diversity and inclusion (D&I) reporting; these are due to come into force this year. The momentum behind ESG means that strong D&I credentials are no longer just a 'nice to have'; they are non-negotiables.

Good governance

Although it currently grabs the fewest headlines, the concept of 'governance' is very relevant to professional services firms, including law firms.

There is currently a well-documented war for talent facing law firms, with candidates having the pick of the market. Firm culture is becoming an increasingly important consideration for lawyers when deciding where they want to forge their careers. Those firms with an inclusive, diverse and psychologically safe culture are likely to attract and retain the best talent. In a competitive recruitment market, candidates will actively seek out employers who they feel have values that align with their own.

Employee retention is high on the agenda for most professional services firms as a high turnover can lead to greater claims, with issues liable to slip through the 'net' of supervision when files are moved between fee earners. Moreover, clients' interests are best served where there is continuity.

Some professional regulators, including the Solicitors Regulation Authority (SRA), impose obligations on firms which necessitate strong ESG credentials. The SRA, for example, requires law firms to act in a way that encourages diversity and inclusion. The SRA's guidance provides that law firms are responsible for upholding the reputation of the profession and treating people fairly and with dignity and respect. To demonstrate compliance with these obligations, law firms should ensure that appropriate and well-documented policies are in place. Perhaps more importantly, all staff need to be given ongoing training to ensure compliance with those policies, and that any behaviours which are not in line are addressed.

The bottom line

Prioritising ESG makes good business sense; according to McKinsey, 'companies that perform poorly in environmental, social, and governance criteria are more likely to endure materially adverse events'. For law firms, this may manifest in a number of ways, including the quality of work it is able to attract. Although there is currently no UK legislation requiring businesses to interrogate their supply chain (which includes law firms), prospective clients are already enquiring about ESG credentials, with the expectation that firms will be well-versed in their current performance and future targets.

We understand that professional indemnity insurers are also considering law firms' policies, and the extent to which they are responding to ESG issues, when assessing the risk they present. Strong ESG credentials could positively impact premiums and policy terms.

Comment

Although ESG poses a threat to firms who do not engage with the concept, it also represents a great opportunity. There has never been a better time for firms to reflect on their culture and how they are run, and to use ESG to make them places where their people can thrive and attract the best work. ESG also provides a basis on which to engage meaningfully with clients.

Law firms can improve their ESG credentials by:

- implementing meaningful social mobility initiatives such as vacation schemes and apprenticeships;
- addressing the gender pay gap;
- embracing flexible working;
- having clear, measurable ESG policies;
- creating a psychologically safe place to work; and
- engaging with clients on ESG initiatives and targets.

Evidencing appropriate governance through well-documented policies, regular targeted training and a no-blame culture will also be important when the time comes to renew the firm's professional indemnity policy. **NLJ**

Clare Hughes-Williams & **Sarah Crowther** are partners at international law firm DAC Beachcroft (*www.dacbeachcroft.com*)