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ESG risk management – why law firms of all sizes should act now

Law firms ignore ESG risks at their peril and should, in fact, embrace this area of compliance as a potential point of competitive advantage for their business and implement a well-considered strategy that contributes to sustainability, writes Annette Beashel.

The area of compliance known as ESG (environmental, social and governance) is a hot topic and of growing concern for law firm clients.

But don't make the mistake of thinking that this is just something your clients should be worried about. Law firms need to show a commitment to this issue with their own risk-management efforts, regardless of the size of the firm. Clients want to know that their lawyers are on board with ESG as part of their supply chain. External stakeholders, such as community groups, prospective jobseekers and government groups, are also putting pressure on businesses to have greater awareness of ESG risks. Developing a sound ESG strategy may just give your firm a competitive edge.

What is ESG?

While law firms have been developing corporate social responsibility programs for many years, ESG goes well beyond such initiatives. It's not just about managing regulatory and legal risks; it requires the consideration of broader sustainability risks as detailed below:

- **environmental** includes climate-change risks, pollution and waste, lowering carbon emissions and land use and deforestation;
- **social** includes modern slavery, health and safety, human capital development, and stakeholder and community engagement; and
- **governance** includes business ethics, tax transparency, anti-bribery and corruption, and privacy and data protection.

Essentially, ESG is a way of measuring how your business is performing against each of the three categories, and success in all three categories will underpin the creation of a sustainable business.

There can be real financial impacts and reputational damage to a firm if it gets it wrong.

Why should you care?

Put simply, it's just good business to do so.

For a start, it's important to your clients. Given that most big firms are developing practice groups to advise clients on ESG risks and sustainability issues, there is also a business opportunity with ESG. Law firms (even the smaller ones) form part of their clients' supply chains and, increasingly, clients are requiring their law firm to complete supply chain questionnaires to ensure it meets a minimum standard. In many cases, showing this minimum standard is a prerequisite to doing business with the client, or getting your bill paid.

It's important to your employees and potential employees, too. There has been a visible shift of graduates and junior lawyers wanting to work for firms or companies who conduct their business in a responsible and ethical way. If you want to attract the best talent, having a strong ESG strategy may make you appear more of an attractive employer than your competitors.

Furthermore, a recent research paper, called ESG and Financial Performance, published this year by the NYU Stern Center for Sustainable Business, found that taking ESG issues seriously is an indicator of good financial performance. According to the report, businesses which pursue ESG initiatives are generally also committed to innovation, R&D and risk management, which then leads to improved financial performance.

Increasingly, regulation will force some of these issues onto businesses, including law firms, so it's better to be a frontrunner and prepare early (for example, with the recent introduction of modern slavery reporting in Australia).

Let's not forget about the feel-good factor, either. You will know that your firm is contributing to making the world a better place if it seriously addresses ESG.

What actions should your firm take?

To start implementing an effective ESG strategy, go beyond compliance and focus on performance. Each firm will need to determine its own needs and approach, but some practical steps could include:

1. Undertake a review of your current position on ESG risk issues and your supply chain. For example, have you checked what your supplier's policies are on ESG-related risks? Could you improve on diversity? How could you lower your firm's carbon emissions footprint?

2. When selecting new suppliers, undertake a due-diligence exercise with respect to how they address ESG-related risks. Set minimum standards that they must meet.
3. Ensure that you have policies in place which address and set out your firm's position on ESG risk areas. For example, at a minimum have policies on anti-bribery and corruption, anti-money laundering, data protection and privacy, recycling and effective waste management, health and safety, modern slavery and carbon emissions. Define your firm's risk appetite in relation to these issues.
4. Ensure that your policies and strategy have a way of being implemented through clear, achievable and measurable actions. The NYU Stern research noted that merely disclosing ESG initiatives did not improve financial performance; it was the implementation and measuring of those initiatives which brought the financial benefits.
5. Make yourself accountable. Publish your firm's ESG strategy on your website, including goals or targets you have set and regularly update progress against those. Have effective grievance procedures in place.
6. Speak to your clients about what they are doing in the ESG space and ensure you are aligned, or discuss with them how you could support each other's initiatives.
7. Weave ESG risk into your reputation risk assessment for new client intakes. It could reflect badly on law firms which are seen to be aligned with clients on the wrong side of ESG.

Why act now?

If you look at reports on the top risks facing business, for the past year or two ESG-related risks have topped the list. Law firms are not immune from these risks.

In addition, COVID-19 has accelerated the focus of big corporates, stakeholder groups and governments on ESG risks and issues. This is not just something for big or international law firms to worry about. It's a matter for all law firms, big or small. Those firms that don't embrace ESG now will be left behind.

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