A guide to climate governance: Changing of the guard or guardians of change?

Why company boards are key to steering companies towards a low-carbon economy.

Climate change has far-reaching implications for companies. Extreme weather can disrupt operations and supply chains, while new climate policies, clean technologies and changing consumer attitudes stand to challenge established business models.

Following the Paris Agreement on climate change, companies are expected to reach zero carbon emissions on a net basis. Achieving this extensive overhaul over relatively few business cycles presents significant risks. But importantly, this also brings opportunities.

**Options for companies:**

- **low-carbon innovation**
  - More efficient operations
  - Lower regulatory burden
  - Opportunities from low-carbon products
  - Access to talent
  - Resilience to climate change

- **or**
  - Higher costs
  - Risk of fines and litigation
  - Lost demand for goods and services
  - Barriers to recruitment
  - Disruption to operations and supply chain

**Having the right debate**

Under existing mandatory reporting requirements in jurisdictions including the UK and the US, companies should disclose in detail the business impact of material issues such as climate change.

For this to be an informed assessment, boards should ensure the proper governance of climate change. In practice, this means that:

- The board should have the levels of independence and diversity of skills, gender, and experience needed for the robust oversight of the company. The nomination, remuneration and audit committees play a key role in ensuring that board appointments, pay practices and procedures promote long-term success.

- Climate change should have a clear and formal place on the board’s agenda.

- Accountability for material climate issues should be held at the most senior executive level.

- The board must be aware of key trends in regulation, technology and consumer attitudes which could materialise faster than expected.

- Boards should seek out the expertise needed to understand the likely climate impacts given the company’s operations and geographical footprint. This might require external advice, but companies may already have significant internal knowledge and appetite to drive the implementation of climate-related projects.
Taking action

Companies should ensure that climate is linked to business planning as a core strategic issue, which requires an evaluation of materiality. On the risk side, the results can be captured in the form of a risk register. On the opportunity side, the assessment can illuminate areas of opportunity in developing new products and services. Companies should ensure that they are engaging with their customer base to understand where they might be able to offer novel solutions or innovations, filling a business need which in turn helps customers address their own exposure to climate change.

The end objective is to help the company in adopting commitments and targets in support of the Paris Agreement. Companies should also review any pay incentives which may work counter to their efforts on climate change. A growing area of focus for investors, boards should also closely scrutinise the lobbying activity undertaken by the company, either directly or through trade bodies, to ensure it is aligned with public stance on climate change.

Disclosing decision-useful information

By omitting financially material climate risks from their annual reports, we believe companies are not fulfilling their legal reporting obligations. Without this information and an understanding of the company’s prospects over adequate time horizons, investors cannot make fully informed investment decisions. Disclosures should be sufficiently granular and comprehensive. The impact of climate to both suppliers and customers, as well as the emissions embedded in supply chains and associated with customers’ use of products and services must be considered.

Climate disclosure: Best practice

Companies should:

- Disclose climate-related risks as narrative reporting in their annual reports and accounts
- Report in line with the recommendations from the Task Force on Climate-related Financial Disclosures, ensuring the availability of relevant data and analysis necessary to report comprehensively and meaningfully
- Disclose ‘green’ revenue streams, R&D spending allocated to sustainability initiatives and other positive efforts, which can be captured as data points and used by investors seeking to allocate capital to companies beneficial to the low-carbon transition

Preparing for a low-carbon future

Bolstered by improved climate disclosures, a growing number of investors are increasing their investments into funds with environmental, social and governance criteria. Thus, companies which can demonstrate a credible climate strategy are likely to gain easier access to capital and talent and markets. Conversely, the global direction of travel with regards to regulation and technological development, set against the pressure from rising temperatures, mean that companies ignoring the imperative of climate resilience are likely to face sustained headwinds.

This is why discussions on climate change must be held at the most senior levels, in order to build resilient and successful business strategies as the world transitions to a low-carbon economy.

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