# Boardroom climate competence: Organizing for oversight

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# Thank you

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# Governance of climate change-related issues

The playbook on board oversight of climate change–related issues is still being written. Companies find themselves pushed and pulled by changing and often inconsistent forces—including geopolitical factors, short-term energy security concerns, demands by customers and employees, pressure from shareholders and activists, and the interests of rating organizations, standard setters, and regulators around the world. An understanding of the business impact of climate change–related issues is increasingly important, and corporate boards are expected to be on top of them as they guide strategy and oversee risk.

This paper follows Boardroom climate competence: Getting ahead of the curve, where we laid out a framework for board oversight of the business impacts of climate change. Here, we take a deeper dive into how board governance itself is evolving to address the issues: building boardroom awareness and understanding, coordinating oversight among the full board and its committees, and working with management to set the tone, guide the path forward, and provide oversight and accountability.

**The first paper in this series addressed six climate-related areas that are critical to board oversight:**

- Level setting
- Risk assessment
- Opportunity assessment
- Integration
- Board governance
- Communication

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# The business of the board: Where to start?

While in some companies the impetus to review climate issues with the board comes from management, boards often begin their climate change oversight journeys when the chair/lead director—or another individual board member—takes a strong interest. As discussed in our prior paper, the work of the board in climate change oversight includes level setting to focus the discussion; taking a comprehensive look at the company's climate-related risks; evaluating strategies in light of climate change to identify opportunities for growth and transformation; encouraging integration across the enterprise; ensuring that climate-related oversight is built into board composition, structure, and processes; and setting the tone for disclosure and stakeholder engagement.

"The journey [to net-zero emissions] is not always clear and rarely uniform," State Street Global Advisors President and CEO Cyrus Taraporevala wrote in his annual letter to corporate directors. "The transition will be very hard and non-linear for most," he continues. "Many companies will likely need to adopt approaches that require experimentation, innovation, and ongoing adjustments along this unchartered journey."[1]

Given the complexity of the issues and the knowledge needed to provide appropriate oversight, a common next step is for boards to convene a small group of board and management members, often with insights from outside experts, to engage in education on the topic and align on identification of material issues and priorities. While the heavy lifting is done by this group, "there's a lot of education that the committee(s) undergo that is best shared with the rest of the board," says Kristin Daley, a director on the boards of McCain Foods Limited and Blue Diamond Growers.

## The evolving stakeholder landscape

"There has been a social change in the world. If we do not demand it of ourselves, the world demands it of us. I think it is palpable and very clear that all stakeholders are aligned that sustainability, including climate, is important," says Lorrie Norrington, who serves on the boards of companies including Autodesk, Colgate Palmolive, and HubSpot. Indeed, investor pressure continues to increase with respect to climate change—for example, 54 percent of shareholder proposals that were voted on during the 2021 proxy season received majority support.[2]

Boards also need to be aware of the pressures from employees and customers, which is expected to increase as Gen Z gains influence. A Pew Research study found a 19-point generational difference in views about the importance of climate change as an issue: while 52 percent of respondents from the United States age 65 or older said they were very, or somewhat, concerned that global climate change will harm them personally at some point during their lifetime, 71 percent of those between the ages of 18 and 29 expressed concern.[3] The 2021 GlobeScan "Healthy & Sustainable Living" report, based on over 30,000 interviews across 31 markets, identified a generational shift as well: 56 percent from Gen Z, compared to 37 percent of Baby Boomers, indicated a desire to change their lifestyles to be a great deal more environmentally friendly.[4] These views are showing up in purchase decisions: A survey of 2,062 U.S. adults by The Harris Poll, in partnership with JUST Capital, found that more than half said they had supported a company that has become more environmentally sustainable, including by purchasing more of that company's products or services (30%), purchasing the company's products for the first time (23%), and recommending the company to others (23%).[5]

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[1] "CEO's Letter on Our 2022 Proxy Voting Agenda," State Street Global Advisors, January 12, 2022.

[2] "An overview of the trends from the 2021 proxy season," Freshfields Bruckhaus Deringer US LLP, July 2021.

[3] "In response to climate change, citizens in advanced economies are willing to alter how they live and word," Pew Research Center, September 14, 2021.

[4] Healthy & Sustainable Living: Global Consumer Insights, 2021 Highlights Report, GlobeScan.

[5] "Survey analysis: Corporations have a role to play in addressing climate change," Just Capital, accessed March 1, 2022.

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# On the full board agenda

Climate-related issues are increasingly part of the overall mix of external forces that impact the company's business and competitive environment. In other words, they are critical to company strategy. Therefore, the full board should integrate climate considerations into its guidance and oversight even if a deeper dive is delegated to a committee.

Boards should consider the following:

— Does management factor climate-related trends into the company's business model and strategic plans? Does planning account for potential physical impacts and adaptation needs as well as decarbonization trends potentially influencing reputation, customer loyalty, the ability to attract and retain talent, and access to capital?

— Is the company's position on climate aligned with its purpose and values? Has management assessed the company's engagement in climate-related public policy and trade association activity within this context?

— Does management incorporate evolving stakeholder interest in climate change as a lens for innovation and growth?

— In considering the company's risk appetite and processes, it is important to understand how management integrates climate into risk assessment. Is the enterprise risk management (ERM) process designed to capture long-term (five years or longer) risk as well as shorter-term impacts?

— When asked to approve capital for growth plans, acquisitions, or new facilities, do we assess whether climate change scenarios are integrated into management's decision-making? For example, has management applied a climate change lens to the location of a proposed manufacturing facility? How will short-term plans regarding energy security align with longer-term climate change goals?

— Research and development (R&D) counts for 5 percent or less of the total cost of a product, but influences up to 80 percent of the product's resource footprint, according to McKinsey & Company.[6] Do we ask how the organization integrates climate sustainability into R&D?

— What are the company's greenhouse gas (GHG) emission-reduction plans and net-zero carbon goals? How will they be measured and is there a viable path to reach them? Is the company moving quickly enough to decarbonize or should the board push management to move faster?

## Not just footprints, handprints

As described by Lynelle Cameron, former vice president of sustainability at Autodesk, the company unlocked value when it not only addressed its own carbon footprint but also assessed the wide impact its customers could make through their use of Autodesk's design and engineering software products. Like many software companies, the bulk of the company's carbon footprint included energy usage, events, travel, and commuting. The company reduced these impacts, and the leadership of Autodesk rallied around Cameron's thesis that there was a bigger opportunity because "the future was going to be about sustainable design." She collaborated across the organization to execute on their vision of "imagining, designing, and making a better world" through "energy and materials, health and resilience, and work and prosperity."

[6] "Product sustainability: Back to the drawing board," McKinsey & Company, February 7, 2022.



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# On the board committee agendas

For each of the three standard committees—nominating and governance (nom/gov), audit, and compensation—the analysis of the committee's involvement with climate-related issues is twofold: (1) how should climate change considerations be incorporated into the core work of the committee and (2) what broader responsibility should the committee take on?

Every board will differ depending on the issues, their potential impact, and the culture and capabilities of the board. As boards incorporate climate-related issues into the work of the committees, some considerations follow.

## Nom/gov committee

Regardless of where broader environmental, social, and governance (ESG) or climate oversight resides, the nom/gov committee should consider climate change issues as part of the mix of trends influencing its ongoing work related to board composition and continuous improvement.

— In a survey by Heidrick and Struggles, 85 percent of respondents said their board needs to increase its climate knowledge.[7] "How do we ensure that experience and skill is resident in the boardroom; how do we make those voices heard?" asked Jeremy Hanson, co-managing partner, global sustainability office at Heidrick & Struggles. Needs will differ by industry, and from company to company within an industry. Nom/gov committees should ask:

  – How do we define climate competence in the context of *our* company, its business environment, and strategies?

  – What mix of board education, outside experts, and recruiting board members with climate-related experience do we need now and for the future?

  – How do we tell the story about the board's climate competence externally?

— In discussing how best to incorporate climate oversight in the board's workload, the committee should ask:

  – Is there sufficient time on the board's agenda to adequately manage oversight of climate, or does the board require support from its committees?

  – What are the pros and cons of establishing a new committee (standing or ad hoc), developing an informal board/management working group, or expanding the responsibility of an existing committee?

  – How do we encourage robust reporting to the board and coordination among committees?

— As recommended by the Task Force on Climate-related Financial Disclosures (TCFD) reporting framework, the committee should ask: do we disclose whether the board and its committees take climate-related issues into account "when reviewing and guiding strategy, major plans of action, risk management policies, annual budgets, and business plans as well and setting the organization's performance objectives, monitoring implementation and performance, and overseeing major capital expenditures, acquisitions, and divestitures?"

— Is the nom/gov chair, lead director, or other designated board member prepared to engage with institutional investors and provide oversight in the event of significant climate-related shareholder proposals or activism?

— Do our board and committee evaluations take awareness and oversight of climate-related business impacts into account as part of our capability and effectiveness assessment?

The nom/gov committee is also frequently tasked with broader oversight of ESG, including climate. If this deep-dive work is assigned to the nom/gov committee, the committee may need to add a member with a relevant background.

[7] *Changing the Climate in the Boardroom*, Heidrick & Struggles and the INSEAD Corporate Governance Centre, December 2021.

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## Audit committee

Audit committee involvement typically falls into two areas: (1) oversight of climate-related risk, and (2) oversight of climate-related disclosures and controls over those disclosures. Climate-related risk should involve the full board whether or not a committee is involved. If the board is considering using the audit committee for a deeper dive, considerations should include how the audit committee will manage this additional workload and whether the deep dive into risk will result in a lesser focus on climate-related innovation and growth.

With respect to climate-related disclosure and controls, although some investors are calling for disclosure quality equivalent to financial disclosures, the rules remain unsettled. Nevertheless, oversight may logically fall to the audit committee given its deep familiarity with controls over disclosure and its oversight of internal audit. The following questions may be considered:

- Does the committee have the knowledge and expertise to oversee disclosure and internal controls over disclosure with respect to climate-related metrics? If not, how will it get up to speed?
- Do committee members have a working knowledge of the most prominent disclosure frameworks, such as TCFD, the Sustainability Accounting Standards Board (SASB), and the International Sustainability Standards Board (ISSB)?[8]
- Is the committee following the discussions with respect to independent assurance of reported climate metrics, and have the committee and management aligned on a position?
- Has the committee assessed climate-related disclosures and controls through these lenses:
  - How do the company's disclosures and the quality of its controls compare to its peers?
  - How do the company's disclosures and the quality of its controls compare to regulatory requirements and stakeholder expectations?
  - Has management made an informed determination as to what disclosures will be included in U.S. Securities and Exchange Commission (SEC) filings versus reports and other communications that will be publicly available but not filed?
  - Do the company's disclosures tell an accurate and consistent story across channels of communication including not only SEC filings and sustainability reports, but also sales and marketing materials and informal channels such as statements by company executives?
  - Is management proactively providing internal training and guidance to minimize the risk of allegations of "greenwashing," i.e., deceptively marketing the company as more climate friendly than it actually is?
- Does the committee receive regular updates from management on regulatory activity with respect to climate-related controls and disclosures, including SEC rule-making progress, comment letters, and enforcement activity, as well as international regulatory standards and other regulatory activity as applicable?

[8] Management should be tracking the work of The Value Reporting Foundation, home to the SASB standards, which has announced an intent to consolidate to a global ESG reporting standard (IFRS Sustainability Disclosure Standards) through a process led by the ISSB. There is no immediate impact as the standards will be developed through an iterative process of exposure drafts and stakeholder input.

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## Compensation committee

Climate change issues may not rise to the top of the agenda for many comp committees, yet, as a matter of strong governance, the implications of climate change risks and business model changes associated with carbon reduction/adaptation should be considered at least periodically, including assessment of the following:

— Do we understand how external perceptions about the company's stance on climate issues might impact management's ability to attract and engage key talent?

— Are we prepared for the impact on talent strategy of a climate-related transition? For example, if transition to a lower-carbon business environment requires the company to simultaneously manage a profitable legacy business while investing in technology-savvy talent to create solutions to reduce the company's overall carbon footprint, how is management preparing to manage the different types of skills and lifestyle/compensation expectations?

— According to Willis Towers Watson, 14 percent of S&P 500 companies incorporate environmental measures including climate in their short and long-term incentive plans.[9] Have we considered the impact of climate goals, metrics, and risks on the company's compensation philosophy, including discussion with management about the pros and cons of including climate-specific metrics in performance goals and compensation incentives at different levels of the organization?

[9] "How executive compensation can drive climate objectives," Willis Towers Watson, December 6, 2021.

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# Considerations for a deep dive

A deep dive into oversight of climate-related issues should include collaboration with management in determining which issues are of most significance to the company—guided by standards and frameworks from SASB, ISSB, and TCFD—with an eye to physical risks and also the financial, operational, regulatory, and reputation risks associated with the transition to a lower-carbon business environment. The discussions should not end at risk—companies are finding tremendous value-creation opportunities, and potential transition-enabling investments can benefit from guidance by board members who have the background and knowledge to understand the pros and cons of different options. While in the past, the specifics of GHG emission metrics may have seemed a matter for management alone, investors increasingly expect directors to speak knowledgeably about their companies' targets, progress against them, and how and where they are disclosed.

Every board needs to make its own determination of the best structure for this deep dive. It may be included in an expanded remit of an existing committee, allocated to a newly formed ad hoc or standing committee, or managed through informal engagement with management. Some boards choose to weave it into the work of the full board, though those who do so should consider how the board will find time on its agenda. See Appendix for committee breakdown for S&P 500 companies based on our review of charters.

Within the preferred structure, boards should consider how they will provide focused oversight and guidance, including the following:

- With respect to the company's carbon footprint:
  - What data is available and what more is needed?
  - How accurate is the data and what needs improvement?
  - Does the company need to allocate capital to invest in technology to improve tracking and analytics?
  - How does the company think about GHG emissions that are not easily trackable, such as emissions that the company may be considered indirectly responsible for up and down the value chain, also known as Scope 3 emissions?
- With respect to the company's decarbonization goals:
  - Are they specific, with alignment between a long-term goal and shorter-term transition goals?
  - How do they compare with external expectations and influences (competitive, stakeholder, regulatory, etc.)?
  - Is the strategy to achieve them sound—including with respect to investment in technology and talent? How will implementation be monitored?
  - Is management knowledgeable about the stakeholder interests relevant to "just transition," a concept "represent[ing] a host of strategies to transition whole communities to build thriving economies that provide dignified, productive, and ecologically sustainable livelihoods."[10]
- With respect to communication about the board's oversight:
  - Do the company's disclosures, including governing documents, charters, and proxy narratives, tell the full story about the involvement of the board and its committees so that the board receives credit with stakeholders for its work?

[10] Climatejusticealliance.org.

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## Beyond the boardroom

One of the greatest changes for boards as they evolve to modern stewardship is in their level of interaction with management. Effective climate change oversight involves proactive engagement with management regarding the company's climate risks and strategies. Directors who are able to look around the corner are well equipped to collaborate with management to translate climate risks into value creation opportunities. "To what degree is it a conversation between management and the board?" asks Harlan Tufford, vice president, Corporate Governance Research at MSCI.

Since climate change affects every aspect of companies' operations, board governance over climate-related issues should include guidance on how climate is addressed throughout the enterprise and communicated to the board. The best structures enable cross-departmental representation, such as a management-level committee, often led by a chief sustainability officer or head of ESG. This helps to ensure the consistent flow of information from the board to management and vice versa, but it does not—and should not—prevent the board from eliciting input from a range of senior executives on climate-related actions under their purview.

## From risk to opportunity

At the privately held construction company where D'Anne Hurd is a director, management first alerted the board to climate issues as a risk factor on the audit committee's agenda. One such risk was municipalities adding climate-forward requirements to eligibility criteria for contracts for the building of roads and bridges. Under Hurd's leadership, climate became central to the board's strategy considerations. For example, guided by the board, management invested in developing large parcels of land it owns into solar and wind farms, adding value from the sale of renewable energy and bolstering the company's reputation for commitment to the environment. The board also helped the company identify a risk to future sales of concrete from a decrease in construction of parking garages due to the decline in car ownership among younger city residents, and brainstormed a new revenue stream target in concrete used for the building of sea walls—a growth market as climate change exacerbates the rise of sea levels. "As you look at the money that you're spending, the return on investment from a reputational standpoint may be much sooner than the financial return and needs to be factored in," says Hurd.

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## Appendix

# Selected governance guidelines and committee charters

Historically, governance guidelines and committee charters used broad descriptions, often vague by design, that typically did not specify particular topics such as climate. To see how this is evolving, the KPMG BLC evaluated the disclosure of responsibility for oversight of climate change–related issues in governance guidelines and committee charters of S&P 500 companies.[11]

More than half (52%) of the companies included oversight of ESG in their governance guidelines or at least one board committee charter, and 36 companies specifically cited climate change or GHG emissions. Two companies included climate change or GHG in their governance guidelines; 19 did so in the nom/gov committee charter; 12 referenced such oversight in the charter for a committee charged with oversight for environmental, health, and safety; and 3 included GHG or climate change in a separate committee charter responsible for ESG, sustainability, or corporate social responsibility. The following illustrate a range of approaches.

**Corporate governance guidelines**: *The board "oversees, reviews and assesses the Company's environmental, social and governance (ESG) strategy, initiatives, policies, and progress towards goals or targets set by management,* ***including in the areas of climate****, environmental protection and sustainability, public policy and corporate philanthropy."*

**Governance and sustainability committee charter**: *"ESG Program. (1) Oversight. The Committee shall oversee, review and assess the Company's ESG strategy, initiatives, and policies,* ***including in the areas of climate change****…, to ensure they are consistent with the Company's long-term strategic objectives and good corporate citizenship; (ii) Metrics. The Committee shall review and oversee the development and implementation of targets, standards and metrics established by management…;(iii) Disclosures. The Committee shall review and approve the Company's material public disclosures with respect to ESG matters that are not otherwise reviewed and approved by the Board of Directors or one of its other committees and shall oversee the Company's engagement with stakeholders on ESG issues, including in response to any proposals or other concerns that have been submitted to the Company; (iv) Reporting. The Committee shall periodically report to the Board…."*

**Sustainability and corporate responsibility committee charter**: *"Review the Company's policies, programs and activities and oversee the Company's strategies and efforts with respect to the following environmental, social, economic and reputational matters: a. The Company's protection and improvement of the quality of the environment,* ***climate change programs*** *and broader environmental policies and programs; b. Community and stakeholder engagement, including but not limited to* ***environmental justice****…"*

[11] Review is based on the ESGAUGE database of S&P 500 corporate governance guidelines and board committee charters as of September 2021. Disclosures with regard to climate oversight also may appear in the proxy or other SEC filings as well as in documents such as sustainability reports; such disclosures were not considered for purposes of this review.

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The KPMG Board Leadership Center (BLC) champions outstanding corporate governance to drive long-term value and enhance stakeholder confidence. Through an array of insights, perspectives, and programs, the BLC—which includes the KPMG Audit Committee Institute and close collaboration with other leading director organizations—promotes continuous education and improvement of public and private company governance. BLC engages with directors and business leaders on the critical issues driving board agendas—from strategy, risk, talent, and ESG, to data governance, audit quality, proxy trends, and more.

### About Plan C Advisors

Plan C Advisors provides in-boardroom climate education and ongoing advisory services to advance board oversight of climate risks and opportunities. Our team consists of current board directors and seasoned top executives from iconic global brands who bring deep operating experience in climate and ESG across industry sectors. Our purpose is to equip business to play a pivotal role in accelerating action on climate, the most urgent and consequential concern of our times.

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