KPMG

Climate change governance

The 2019 WEF guidance
KPMG Board Leadership Centre

At its 2019 annual meeting in Davos, the World Economic Forum (WEF) published guidance for corporate boards on how to establish climate governance at their companies.

Climate change is a complex topic and for many time-pressured board members, directors' responsibilities around climate change remain unclear. Indeed, some are unsure whether or not climate change is a board responsibility at all. However, despite the complexity of the subject, it is important for board members to engage and to understand their responsibilities to shareholders and the wider stakeholder community.

This briefing addresses some of the common questions board members may have on climate governance and summarizes the WEF guidance.

What is 'climate governance'?

Climate governance is the structure of rules and processes a company puts in place to manage its responses to the financial risks and opportunities of climate change. There are two primary types of climate-related financial risks for business:

i. Physical risks, i.e. the risk that physical effects of climate change - such as hurricanes, floods, droughts and sea level rises – could seriously damage or disrupt the company's operations and/or supply chain, and therefore reduce its capacity to operate profitably or, in extremis, its ongoing sustainability.

ii. Transitional risks, i.e. the risk that the company fails to anticipate and navigate the regulatory and market transformations brought about by the global transition to a low-carbon, clean energy economy.

It is important to be clear that climate risk in this context refers specifically to the financial risks the company and its shareholders face as a result of climate change. It does not refer to the risks society at large faces from climate change.

That said, there are increasing examples of companies – particularly oil and gas majors – facing legal action from city governments, citizens' groups and NGOs on the basis that their greenhouse gas emissions have contributed to climate change.

Why is climate governance a board responsibility?

Climate change is a potential strategic risk to companies, and it is therefore the duty of the board to identify and manage it in the same way as any other strategic risk.

Whether or not climate is specified as a fiduciary duty under the corporate governance code, directors have the duty to promote the success of the company and to act with due care, skill and diligence. Failing to identify, assess, deal with or disclose material climate risks is a potential failure of corporate governance.

Board members or their companies may expose themselves to legal action if they fail to identify, respond to or disclose material climate risks. The risk of exposure is particularly high for directors of companies that operate in sectors that are especially vulnerable to climate risks, namely energy; transportation; agriculture, food and forest products; materials and buildings and financial services.

Why is it important to have effective climate governance in place?

An effective climate governance structure is critical to ensure that a company properly assesses climate-related risks and opportunities, takes appropriate strategic decisions on how to manage those risks and opportunities, and sets and reports on relevant goals and targets. Without governance in place, a company will be ill-equipped to deal with the threats or to respond appropriately to shareholders.

Is climate change now accepted as a business risk?

Recognition of climate change as a financial risk to business has gained rapid momentum since 2015 when Mark Carney, Governor of the Bank of England and Chair of the Financial Stability Board, launched the Task Force on Climate-related Financial Disclosures (TCFD). The TCFD recognized climate change as a threat to the stability of the global financial system and is working to improve disclosure of climate-related financial risks by companies to their investors, lenders and insurers.

Since then, regulation related to the disclosure of climate risk is increasing. In France, asset managers and owners, and insurers, are required to disclose the climate risks inherent in their portfolios which in turn puts pressure on investee companies. In the US, UK, Canada and Australia, regulators have backed the view that existing corporate laws mandate the disclosure of material climate-related financial risks for example the environmental disclosures required by the 2014 EU Directive on disclosure of non-financial information and diversity information.

We are also seeing increasing numbers of shareholder proposals and campaigns to force companies to disclose their climate risks and the strategies they are putting in place to ensure resilience and protect long-term shareholder value.

What does the WEF guidance advise?

The climate governance guidance from WEF covers 8 principles:

- **Principle 1: Climate accountability on boards.** The board should take responsibility for ensuring the company's long-term resilience to climate risks.
- **Principle 2: Command of the subject.** The board should be properly informed about climate-related risks and opportunities and able to make relevant decisions.
- **Principle 3: Board structure.** The board should implement the right board and committee structures to ensure that climate risks and opportunities are understood, managed and reported.
- **Principle 4: Material risk and opportunity assessment.** The board should ensure that management fully identifies climate-related risks in the short, medium and long-term, assess their materiality, and takes appropriate action according to the materiality of the risks.
- **Principle 5: Strategic integration.** The board should ensure that management factors material climate-related risks and opportunities into the company's strategy, risk management process and investment decisions.
- **Principle 6: Incentivization.** The board should align executives' incentives with the long-term success of the business. This may include climate-related targets in executive incentive schemes.
- **Principle 7: Reporting and disclosure.** The board should ensure that the company discloses its material climate-related risks, opportunities and strategic decisions to all stakeholders –especially investors and regulators. These disclosures should be included in financial reporting.
- **Principle 8: Exchange.** The board should stay informed on current best practice in climate governance by maintaining dialogue with peers, policy-makers, investors and others.

The full WEF document – *How to Set Up Effective Climate Governance on Corporate Boards: Guiding principles and questions* – can be downloaded here.

For further information on how KPMG can help you establish effective climate governance at your company, contact:

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