AGENDA

Is Climate Change Too Hot for Boards to Handle?

By Lindsay Frost   January 4, 2022

Although board members recognize the urgency and importance of climate change to their companies, they question their understanding of the subject and don't think they're getting the right information from management, according to a recent survey of corporate directors.

It's critical that boards prod management to provide the information they need to assess climate risk and strategy, sources say. But boards shouldn't depend entirely on management to get educated. Boards are getting flooded with resources from accounting firms, consultancies, nonprofit organizations and others, and directors say it's hard to escape the wealth of educational information out there on climate.

"A good board member is a lifelong learner and someone who is proactively seeking information about topics as they begin to emerge as well as ensuring they are staying current on the evolution of more established topics," said Jan Babiak, audit committee chair at Walgreens Boots Alliance and a board member at Bank of Montreal.

"I think it's our responsibility [as board directors] to begin to educate ourselves on a similar timeline or maybe even before management does. Of course, management should also be briefing the board specific to the company's position on a given topic, but the board should be prepared to contribute to the discussion."

Indeed, board members face numerous consequences if they don't catch up and act on climate issues, sources say, including lawsuits and calls for their removal. For example, BlackRock voted against 255 directors between July 1, 2020, and June 30, 2021, for climate-related concerns. Similarly, shareholders are also expected to continue to file and vote for environmental proposals, as Agenda has reported. A number of climate-related proposals also received majority support last year.

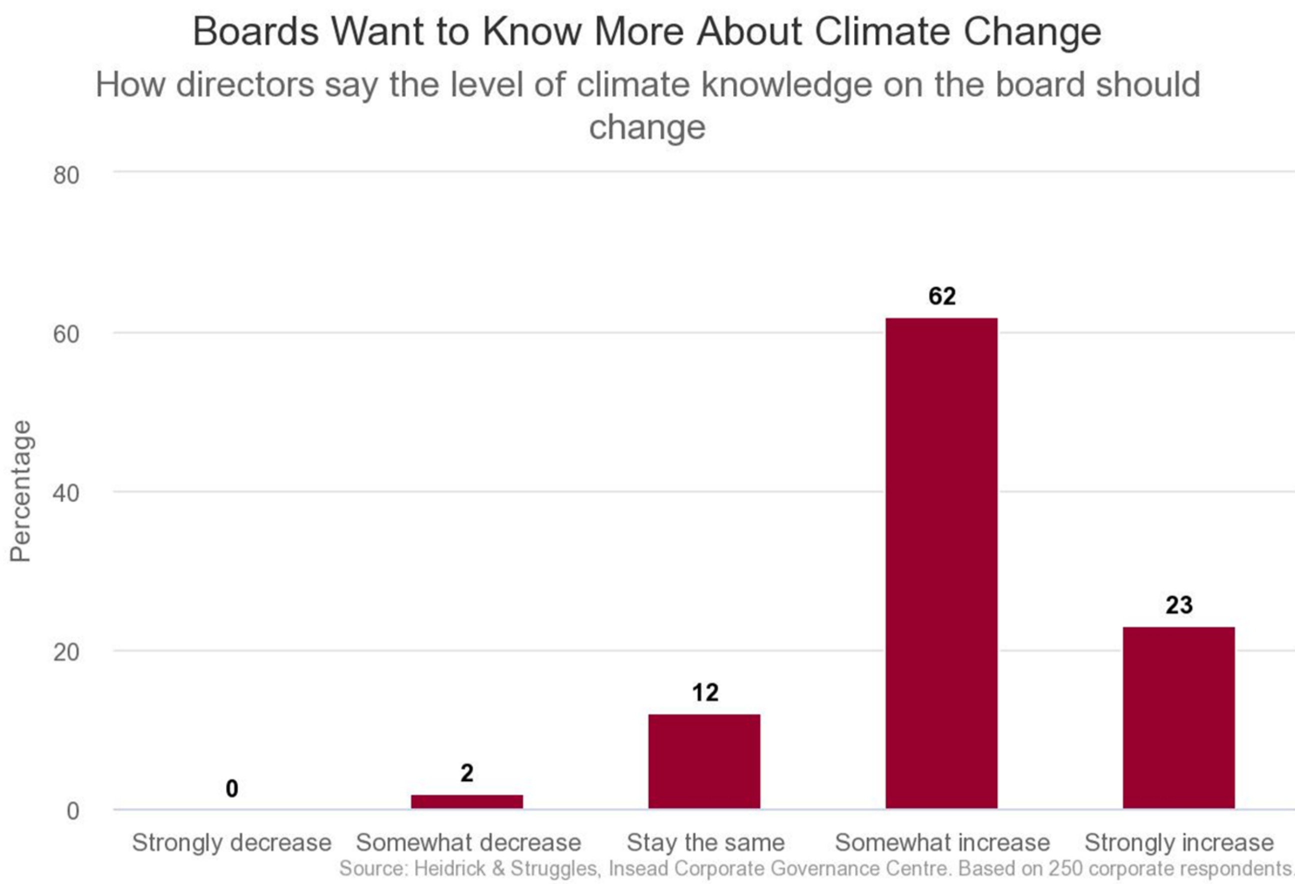
Board members could become "irrelevant" if they don't keep up with environmental risks, warned Babiak.

"If you ask a board member if they are committed to [environmental, social and governance issues] or sustainability or climate issues these days, they have to say that they are, but it gets murky when you ask what that commitment looks like," said Jeremy Hanson, co-managing partner of Heidrick & Struggles' global sustainability office and a member of the firm's global CEO and board practice.

"Board members are accustomed to getting hired for their expertise, but now we have a long list of issues they are expected to be experts on. They need more from the company and are scrambling for information from external sources as they face more and more pressure."

Increasing Climate Anxiety

A majority (63%) of more than 300 global board members surveyed by Heidrick & Struggles and the Insead Corporate Governance Centre said that their board "has a very or entirely clear understanding of the strategic risks and opportunities presented to the company by climate change." However, 85% said their board needs to increase its climate knowledge.



Directors seem to be feeling increasingly anxious about their understanding of climate-related issues. According to PwC's annual corporate directors survey released in fall 2021, only a quarter (25%) of more than 800 directors said they understand the material

ESG risks facing their companies very well. That's half the percentage of directors who answered affirmatively to a similar survey question posed by PwC in 2020, 51%.

Rob Fisher, KPMG Impact leader, said in his experience, it's not that corporate leaders, including board members, are uneducated. The challenge, he said, is gaining an appreciation for how complex climate issues are. They also have big ambitions that companies are struggling to turn into action.

"Leaders are grading themselves harder and appreciating that the problem is bigger than they thought," Fisher said.

Broadly, in order to enhance their climate education, boards should first check their inboxes, sources tell Agenda. "If board members are monitoring generic board-related daily news feeds, it would be nearly impossible to not be exposed to opportunities to learn more about climate change," Babiak said. "This just requires board members to have an interest in and a willingness to make the effort to educate themselves."

They can also tap their accounting firms and consultancies on hand for more industry-specific information, sources noted. Indeed, Fisher said, KPMG is "fielding a ton of questions from boards to get educated."

"It's a compounding problem of needing expertise and needing that expertise to be industry-specific," Fisher said.

One of the key connections directors say they are missing is the link between climate change and financial performance, according to the Heidrick & Struggles survey. Nearly half (46%) of directors said they had insufficient or no knowledge of climate-related implications to financial performance.

Tensie Whelan, director of the Center for Sustainable Business at NYU Stern School of Business, pointed to several examples of how climate change impacts company financials.

"Companies dependent on natural resources for any or all of their value chain must understand the impacts of extreme weather and ecosystem changes on their business as it will cause increasing volatility in terms of price and availability," Whelan wrote in an email to Agenda. "In addition, companies that use a lot of energy in any part of their value chain or manufacturing will see increasingly steep carbon fees and other regulatory impacts."

What Boards Need from Management

Additionally, boards are not satisfied with the data and reporting on climate change they are getting from management. According to the Heidrick & Struggles survey, half of the directors surveyed said they are not yet very or entirely satisfied with the company's reporting to the board on progress on climate issues.

"The best piece of advice I've heard on this is that companies in 2022 are going to have to measure these externalities, ESG or climate, with the same rigor and discipline that they produce their financial results and that everyone can understand," said Hanson. "If you haven't asked your CFO to get involved, you probably should."

Specifically, when it comes to what information the board needs from management, 43% of directors surveyed by Heidrick & Struggles said their companies did not yet have clear emissions reduction targets. Only 16% said their companies had targets for Scope 3 emissions, i.e., emissions beyond the company's control.

"The impact of climate change on financial reporting consists of many uncertainties," Babiak said. "Progress has been made in defining Scope 1 and Scope 2 emissions, but Scope 3 can be very challenging. We are some years away from fully understanding how this is going to play out."

Joseph Bower, board member at Loews Corp. and professor emeritus at the Harvard University Business School, said it's important to note that every company is different — and how climate change impacts the company, including the risks, opportunities and the disclosure needed, "varies dramatically."

Yet investors and regulators are clamoring for consistent, comparable and reliable data on emissions and other climate-related issues, sources say. Indeed, more companies are disclosing climate issues in line with established frameworks such as the Taskforce on Climate-related Financial Disclosures and the Value Reporting Foundation (formerly the Sustainability Accounting Standards Board) and need properly vetted data to do so, sources say. The majority of the largest 100 companies in the U.S. (77) report using the SASB metrics, and 56 disclose using the TCFD framework, according to Shearman & Sterling.

"Until we have uniform standards that can be verified, I advise taking a 'less is more approach,' and advise companies to focus on disclosure where they have good and verifiable data and particularly where it links to operations and financial performance," wrote Suz Mac Cormac, partner at Morrison & Foerster and chair of the firm's energy and social enterprise and impact investing practices, in an email to Agenda.

Wanted: Climate Expert in the Boardroom?

Governance experts offer a variety of viewpoints on whether boards need to recruit climate experts. While Babiak, for one, warned against "one-trick ponies," she said all directors should be working to hone their skills and understanding regarding climate.

According to the Heidrick & Struggles survey, 69% said climate knowledge is not part of their board skills matrices and 69% said climate knowledge is not a formal requirement for joining the board.

Mac Cormac recommends that companies expand the board competency matrices when selecting new board members to include those who can "see around corners" when it comes to climate change.

Similarly, said Whelan, "board members need help with knowing what questions to ask, what risks to focus on and what opportunities to develop. A climate scientist is not necessary, but someone who understands the trends and implications for business will be critical."

Whelan conducted research in January 2021 on ESG expertise in the boardroom and found that only 6% of roughly 344 directors sitting on Fortune 100 boards in 2019 with ESG experience had environmental experience, as Agenda has reported.

"In addition, when reviewing industries with significant climate exposure such as property and casualty, we found a lack of climate credentials," Whelan wrote. "The recent Engine No. 1 action to substitute more climate knowledgeable board members at Exxon underscored that lack of climate expertise."

Meanwhile, numerous companies have revamped board committees to address climate and other ESG issues. Whelan believes boards should have separate ESG committees and doesn't think other established committees "that already [have] a full load" should take on ESG. "It will not receive the attention it deserves."

Mac Cormac disagrees. She believes boards should "integrate decisions on climate (and ESG more broadly) into the work of their committees — governance, audit/finance and compensation — not silo climate considerations in a separate impact or ESG committee."

Companies including Centene, Dell, MGM Resorts, Nike, Signet Jewelers, Steve Madden and Wells Fargo have dedicated committees that address ESG and sustainability issues such as climate change. Other companies, including Colgate, Hasbro, Humana and PG&E, have added responsibilities for climate change and general sustainability oversight to other already established committees, such as the audit committee and nominating and governance committee, according to committee charters published on the respective companies' websites.