



International Corporate Governance Network

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ICGN Viewpoint

Climate Change: governance implications for companies and investors

As the World Economic Forum has set out in its annual global risk reports, climate change is one of the most significant risks facing our global economy. Climate change presents both threats and opportunities for enterprises in all sectors of the economy and will require them to adapt their business models accordingly. It can also bring more systemic challenges to economies and financial markets.

The International Corporate Governance Network (ICGN) takes the view that climate change is a corporate governance issue as well as a matter of social, economic, trade and public policy. In a governance context, this calls for diligent oversight by company boards as well as for investor awareness of what companies need to do to position themselves sustainably in a dynamic climate policy environment. To this effect, companies need to disclose the material business issues related to climate change. ICGN believes that integrated reporting with its focus on sustainable value creation offers a good framework for how companies can disclose their strategic approach to addressing the risks and opportunities related to climate change (including public policy) to their investors and other stakeholders. Beyond disclosure, companies will need to enter into dialogue with investors and other relevant stakeholders.

Public policy with a private sector impact

The Paris Climate Alliance¹ that is taking shape at the core of the COP-21 meetings has four key components relating to an internationally agreed climate strategy to limit global warming to 2°C by 2050. The first three pillars--relating to policy agreements, finance packages and national climate mitigation efforts - are largely government focused. However, a fourth pillar -- representing an action agenda for groups includes companies, investors and civil society—makes it clear that the private sector has a role to play and that businesses stand to be impacted by climate policies both in global and national country contexts. A governmental agreement expressing political will towards addressing climate change is likely to be signed at the COP-21

¹ The Paris Climate Alliance was articulated by Laurent Fabius, Minister of Foreign Affairs and International Development, France, and President of the 21st session of the Conference of Parties to the UN Framework Convention on Climate Change: <http://www.climate2020.org.uk/the-paris-climate-alliance/>

meeting. This would be a positive development; however the scope of such an agreement remains in question and it is unlikely that a clear carbon price framework will emerge from these discussions. From a governance perspective this requires boards to continue monitoring, and, where appropriate, to contribute to the development of climate policy in order to be better equipped to deal with long term strategic issues relating to climate change.

Notwithstanding ongoing uncertainty about carbon pricing and how to quantify the effects of climate change on business more broadly, it is clear that government policies and market mechanisms must be anticipated by companies in their strategy formation, business planning and risk management. Investors are also increasingly assessing the nature of climate related risks and opportunities in companies and how to position their portfolios in relation to climate change in both the short term and long term. In doing so, investors find it is important to engage with companies to understand how companies have assessed their exposure to climate change risks and any potential adaptations to their business models. Investors expect boards to both understand these issues and to be able to explain to investors how they have factored climate change into their oversight of strategy and its implementation.

For companies in specific sectors climate related risks can be direct and obvious. For example, fossil fuel providers must consider the impacts of potential carbon prices on the economics of their reserve base. Users of energy – both energy utilities and other manufacturers -- will increasingly anticipate the needed levels of adjustment to energy mix, consumption and efficiency. Insurers face particular exposure in providing insurance coverage to companies and regions exposed to the ravages of weather events triggered by climate instability.

While climate related risks may impact some sectors more than others, companies in all sectors must develop greater sensitivity to the impacts of climate risk and global climate policy, both in a systemic and individual company context. The same holds true for investors. Guidance for investors exists to help the investment community better understand the potential risks and to guide investment analysis and behaviour.²

Climate strategy at the company level: what should boards and investors be looking for?

Approaching climate change from a business model perspective takes into consideration strategic, financial and operational factors. It is critical for companies, their boards and their investors to understand how climate related risks or

² The Institutional Investors Group on Climate Change (IIGCC) provides a range of reports for investors. See: <http://www.iigcc.org/publications/category/investor-guides>

opportunities might affect sustainable value creation. Companies will be forced to adapt to both public policies and the direct impacts of climate change, as well as take action to mitigate greenhouse gases that are attributable to an individual firm. The materiality of these risks is already high in many sectors, and is poised to grow further in years to come. In this context executive management, boards and investors collectively need to build understanding of climate risk in several fundamental ways, particularly with regard to operational continuity, capital spending, access to capital and access to insurance.³ Basic building blocks include:

- Understanding how the individual business (or group of businesses) stands to be affected by physical, regulatory or reputational aspects of climate change.
- Linking this understanding to risk management at the executive level and risk oversight at the board level.
- Building a strategic understanding of areas of risk and opportunity in a low-carbon economy. This can include anticipation of carbon pricing scenarios or the impact of emissions reductions targets. Depending on the sector, this can relate to decisions around siting major fixed assets, capital allocation decisions that might be impacted by climate change or contribute to climate change, as well as research and development into climate solutions.
- Building understanding of financial exposure to climate risk which can include impacts on cost structure, exposure to regulatory fines, capital spending relative to cash flows and the adequacy of insurance coverage.

Reporting on climate strategy and risk management

While certain corporate disclosures relating to climate change may be mandated by capital markets or regulatory requirements, companies do have considerable discretion with regard to reporting on how a company addresses climate strategy and policy. With its building importance and magnitude as a risk factor and as a strategic issue, reporting on material climate matters becomes an important area of governance, and disclosure, for companies.⁴ Integrated reporting affords the opportunity to make climate change a central component of the company's main report and other market communications.

³ For a more complete statement on climate change issues from a board perspective, see: *Climate Change Briefing: Questions for Directors to Ask*, Canadian Institute of Chartered Accountants, authors Julie Desjardins and Alan Willis, 2009.

⁴ In North America, there are requirements for mandatory disclosures of material climate change issues in filings with securities regulators. For the US, see SEC 2010 Interpretive release - <https://www.sec.gov/rules/interp/2010/33-9106fr.pdf> - and in Canada, see CSA Staff Notice 51-333 https://www.bcsc.bc.ca/Securities_Law/Policies/Policy5/PDF/51-333_CSA_Staff_Notice__October_27__2010/

Investors will increasingly seek to understand how climate risks are defined and governed. Corporate governance reports can provide an opportunity for companies and their boards to provide disclosures to give colour to this process, including the extent to which climate change appears as an item of the board agenda, whether companies have integrated different energy and climate scenarios into business planning, have developed their own carbon pricing model or formally assess the impact of climate risks on the company.

This viewpoint singles out climate change here due to its materiality and given the forthcoming COP-21 discussions in Paris. While climate risk is building in strategic importance and commercial materiality, climate risk should not be addressed at the expense of other material issues such as human rights or anticorruption. All these issues must be addressed by companies and disclosures should reflect “integrated thinking” by their boards. The ability to create and sustain value depends on a broad set of factors – factors that are not purely financial in the traditional sense – and companies ought to be able to articulate this in their value creation story.

About ICGN Viewpoints

ICGN Viewpoints provide opinion on emerging corporate governance issues and are intended to generate debate, whilst not defining a formal ICGN position on the subject.

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