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Inspiring good governance & stewardship

ICGN Viewpoint

De-carbonising the Global Economy: The Just Transition

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The monumental shift to a de-carbonised energy system should happen in a way that shares the benefits of the transition while supporting those who will be negatively impacted.

The issue

Institutional investors are aware that rising temperatures and changed weather patterns are having adverse impacts on water security and food production, health and well-being, and cities, settlements, and infrastructure. The systemic risk presented by climate change is a fiduciary concern, particularly for long-term investors, given how these risks stand to affect the ability of investment institutions to generate long-term sustainable value for shareholders and other corporate stakeholders.

Evidence of significant environmental challenges has triggered urgent calls for nations and businesses to transition towards greener, resilient, climate-neutral economies and societies. Yet, despite clear evidence and compelling calls to action, the issue remains highly politicised. While governments struggle to gain consensus on workable policies and solutions, businesses have been asked to play an even greater role in addressing climate-related challenges.

For the transition to a greener economy to be achieved and sustainable it must be ‘just’ — aiming to be fair and inclusive, able to create decent work opportunities, and aspiring to leave no one behind. This ICGN Viewpoint focuses on the role of good corporate governance and investor stewardship in contributing to a just and sustainable transition to achieving a resilient, net-zero economy.

Today, it is recognised that climate change is a systemic risk with significant environmental, financial, political, human, and social impacts. Successfully navigating the transition from emission-intensive and fossil fuel industries, toward cleaner or ideally zero-emission alternatives, will require the best and combined efforts of all stakeholders, including investors. While investors have long considered climate change in terms of financial costs and stranded assets, this ICGN Viewpoint considers broader aspects of good governance, stewardship, sustainability, and accountability. For the transition to be successful and sustainable it must be just, it must consider environmental and social costs alongside financial costs, and it must minimise negative social impacts while maximising opportunities and positive impacts.

The latest Report of the Intergovernmental Panel on Climate Change (IPCC) concluded that to prevent the worst physical impacts of climate change, urgent action is required to deal with increasing risks.¹ Though as economies mitigate and adapt to the complex impacts of climate change, tough decisions will be required.

¹ <https://www.ipcc.ch/report/ar6/wg3/>

Stakeholders impacted in a Just Transition

Various countries, sectors, markets, communities, and individuals will face uneven exposure to the risks and challenges associated with the net zero transition – the potential impact on workers, business and suppliers, communities, and consumers is discussed below, as is its linkage with investor concerns and fiduciary duties.

Workers

The nature of work changes constantly. Where this has previously been driven by factors like industrialisation, globalisation, automation and, acutely by the recent Covid-19 pandemic – the required transition to net-zero is now also having an impact.

Jobs in emissions-intensive industries will likely be lost, making way for new opportunities in the lower-emissions industries. The OECD refers to some or all of the employment in these activities as 'green jobs.'²

Although no consensus has yet been achieved on the definition, the US Department of Labor is advancing a major effort to collect better information about emerging green jobs, and since 2013 has been tracking 215 detailed occupations in 12 sectors (e.g., recycling & waste management, transport, vehicle manufacturing, mining, information, and communications technology) that have been identified as either new or existing green occupations. Among the jobs with the most projected openings between 2019 and 2029 are environmental scientists and specialists, chemists, hazardous materials removal workers, environmental science and protection technicians, environmental engineers, geoscientists, biochemists and biophysicists, solar photovoltaic installers, and conservation scientists.³

It is expected that many jobs in fossil-fuel related industries will make way for new ones in renewable energy, and jobs relating to beef and other animal products may transition to the production of more plant-based proteins. Other 'brown jobs' (e.g., non-eco friendly) will be at risk. The OECD has identified two energy producing sectors (electricity & gas, coking coal, refined petroleum products and nuclear fuel), three transport sectors (including inland, water, air, and supporting and auxiliary transport activities), three manufacturing sectors (basic metals, other non-metallic mineral products, and chemicals), as well as agriculture and mining as the sectors with most 'brown occupations.' Workers in these sectors are likely to be particularly vulnerable to displacement if carbon taxes are significantly increased or other measures are taken to sharply reduce greenhouse gas emissions.⁴

How quickly and sharply industries experience job losses will depend on how successfully businesses and governments manage the transition. The University of Leeds and the London School of Economics have estimated that in the UK, the transition will impact around one job in five, notably in construction, transport, and manufacturing. Around 10% of jobs will be in higher demand in the transition than now, and another 10% of workers will require up-skilling. As such, enabling sustainable businesses to prosper and create jobs should be one of the key priorities for policymakers around the world.⁵

² <https://www.oecd.org/employment/greeningjobsandskills.htm>

³ <https://www.bls.gov/green/>

⁴ <https://www.oecd-ilibrary.org/sites/81ebdb4c-en/index.html?itemId=/content/component/81ebdb4c-en>

⁵ <https://www.lse.ac.uk/granthaminstitute/news/green-economy-how-the-transition-to-net-zero-could-affect-uk-jobs-across-the-country/>

Business and Suppliers

While businesses already deal with extreme weather events, supply chain disruptions, increased insurance costs, and staff shortages, it is likely the transition to net-zero will bring a new set of challenges. Businesses will not only need to learn to navigate regulatory and policy change but will also need to adapt to new costs and new constraints impacting their ability to raise capital.

Businesses that stand to gain from the transition are those that can already offer low emission products and services. However, to achieve a complete transition to the low carbon economy, businesses will have to strive for net-zero not only in relation to their own operations, but across their whole supply chain. It will therefore be imperative that businesses assess and address gaps in processes and business functions including product design, manufacturing, transport, and recyclability.

Many suppliers, especially those in developing countries and in industries such as food, retail, energy, and infrastructure appear far from being ready to measure and disclose their Scope 1 and 2 emissions, let alone set targets toward net-zero or assist their workers in the transition.⁶ Supporting suppliers in taking account of social impact on the path to net-zero, strengthening local supply chains, applying labour and human rights, and environmental due diligence along the supply chain will be crucial in ensuring the pathway to net-zero.

Communities

The transition to a green economy and phase out of fossil fuels will send a ripple effect through the communities associated with these industries, particularly coal mining, oil and gas extraction and exploration. In addition to the loss of direct 'fossil-fuel' jobs, small businesses that serve that industry will also suffer – including local retail, hospitality, property, and service providers.

To be effective and sustainable, a just transition must be grounded in people and communities. To assist communities already affected, a coordinated response would be needed to promote new opportunities and alleviate adverse impacts. To that end, policymakers, businesses, and investors must make it a priority to understand the spill-over effects for communities, while also respecting rights around impacts and involvement, focusing on vulnerability, and enabling innovations such as community energy.

Consumers

There has been an unprecedented shift in how consumers make decisions about the products and services they buy, particularly in developed markets. However, not everyone will be impacted equally.

Some consumers have been forced to make new spending decisions because of climate change, i.e., after changing weather patterns caused food, fuel, and insurance costs to rise. Other consumers are choosing to make new spending decisions, with the prime purpose of reducing their contribution to climate change, i.e., by buying greener products such as solar panels and electric vehicles.⁷

⁶ <https://www.weforum.org/agenda/2022/06/jobs-growth-and-social-justice-for-transformative-climate-action-a-just-transition/>

⁷ <https://www2.deloitte.com/uk/en/pages/consumer-business/articles/sustainable-consumer.html>

The World Bank states that the climate crisis is a deeply unfair one – with the countries that contribute least to climate change being hit hardest by its impacts.⁸ In addition, poorer consumers can neither access nor afford sustainable goods and services, including energy. In the short-term, consumer prices are elevated due to the higher cost associated with green products, operational cost, renewable energy prices, carbon tax, and increased disclosure requirements. Prioritising implications for consumers with inadequate access to sustainable goods and services, addressing the potential increase of cost of doing business, and removing barriers to consumers to support the transition will be required to achieve the common goal of low carbon economy.

Role of investors

For investors, given their duties as stewards for their beneficiaries, a just transition relates to the question of human capital and the long-term systemic risks at stake relating to climate change and how it is addressed. Investors can play a significant role in contributing to a just transition by fully integrating this in their climate change strategies and investment plans.

Asset owners can signal just transition expectations by specifying that mandates will be awarded only to asset managers with just transition policies who will then be required to incorporate just transition conditionality into their investment decisions. The ICGN-GISD Alliance Model Mandate can facilitate this process, as it integrates the United Nation's Sustainable Development Goals into investment management agreements between asset owners and asset managers.⁹

Asset managers should address the just transition in engagement with their portfolio companies – particularly in sectors most impacted by the risks of climate change, such as energy, mining, construction, transport, infrastructure, agriculture, and food. Investors can also implement negative and/or positive screening to invest in companies committed to just transition and positive social impact and could consider establishing bespoke 'just transition' funds to overcome investment issues around scale.

Just transition tools and benchmarks

To assist investors in assessing the level and progress of just transition across their portfolios, and to bolster engagement, various benchmarking and rating tools are being developed. The World Benchmarking Alliance has developed a methodology for assessing companies on the just transition, applying its existing low-carbon and social indicators complemented by newly developed just transition indicators. The framework covers issues such as human rights, social dialogue, just transition planning, job creation, retaining and retraining, social protection, and policy advocacy.¹⁰

Further, since March 2022, the Climate Action 100+ initiative has included the just transition as one of the key indicators in its net-zero company benchmark.¹¹ The indicator covers four key areas of business behaviour:

1. Whether the company has acknowledged the just transition.
2. The commitments it has made.
3. The stakeholder engagement it has undertaken.
4. The specific actions it has taken to support the just transition.

⁸ <https://www.worldbank.org/en/news/feature/2020/10/07/global-action-urgently-needed-to-halt-historic-threats-to-poverty-reduction>

⁹ <https://www.icgn.org/icgn-gisd-alliance-model-mandate-guidance>

¹⁰ <https://www.worldbenchmarkingalliance.org/just-transition/>

¹¹ <https://www.climateaction100.org/net-zero-company-benchmark/>

Just transition initiatives

Across the financial sector, there is a growing commitment to a just transition, with several global and local initiatives created over the past few years. In 2021, 161 investment institutions with US\$10.2 trillion in assets under management committed to support a just transition, through capital allocation, investment strategies and policy advocacy positioning.¹²

In November 2020, more than 40 UK banks, investors, and other financial institutions joined forces with universities, civil society, and trade unions to launch the Financing a Just Transition Alliance, the first grouping of its kind in the UK.¹³ In addition, the UK's presidency of the G7 has established an Impact Task Force, focusing on just transition investment mechanisms.¹⁴ Delivering on the recommendations of the Green Jobs Taskforce will also catalyse vital investment in skills and human capital and support workers in high carbon sectors.¹⁵

Ahead of the COP26 in 2021, the Paris Financial Centre's sustainable finance initiative, Finance for Tomorrow, launched 'Investors for a Just Transition', the first global engagement Coalition for a just transition, bringing together asset managers, asset owners, and corporates. The aim of the initiative is to promote the fairest possible transition to low-carbon economies.¹⁶

Investors can also join the Just Transition Initiative, a partnership developed by the Energy Security & Climate Change Program at the Center for Strategic and International Studies and the Climate Investment Funds, to investigate how to achieve a just transition through the transformational change necessary to address climate change.¹⁷

Further, the Council for Inclusive Capitalism, founded in 2016, is leading a CEO initiative to develop unified principles and a framework for a just energy transition by companies. In 2021, the Council published a framework to guide companies in delivering a just energy transition.¹⁸

Considerations for companies

In addressing the issues associated with a just transition, companies are encouraged to work together with their various stakeholders and providers of capital. Key areas for businesses to consider are as follows:

1. Strategy and risk management

Where material, the ICGN considers it necessary for companies to incorporate just transition into the company strategy with the aim of delivering net-zero and resilience goals. The topic of climate change should form part of every strategic and investment decision and not be confined solely to the agenda of Sustainability Committees. This will require embedding just transition goals in planning, risk management, capital allocation, acquisitions, and restructuring. Companies are also encouraged to ensure social dialogue and the

¹² <https://www.climateaction100.org/news/a-need-for-robust-just-transition-planning/>

¹³ <https://www.lse.ac.uk/GranthamInstitute/financing-a-just-transition/>

¹⁴ <https://gsgii.org/2021/07/uk-creates-impact-taskforce-under-its-g7-presidency/>

¹⁵ <https://www.gov.uk/government/groups/green-jobs-taskforce>

¹⁶ <https://financefortomorrow.com/en/>

¹⁷ <https://justtransitioninitiative.org>

¹⁸ <https://www.inclusivecapitalism.com>

representation of workers and trade unions in company-level climate decision-making and implementation.

2. Governance

A 2021 report commissioned by the Investor Group on Climate Change calls for company board directors to lead the transition to net-zero emissions. The report states that boards that fail to recognise the risk of climate change and their role in driving the company transition to a low carbon business, will leave the company and investors exposed to unacceptable financial, strategic, and market risks.¹⁹ Not to mention, they will miss out on the opportunities on the de-carbonisation pathway, including jobs for regional communities.

To ensure investor confidence, board members should be equipped with the necessary skills and resources to reflect the climate challenges ahead, including skills in disruption and transition; the ability to challenge existing business models; knowledge of climate change; and change management skills. The board should also ensure climate change is regularly on the board agenda and discussed by the board accordingly.

In addition, climate change should be fully integrated into the company strategy, with capital allocation decisions, risk management approaches, and disclosure to investors. Companies will be expected to ensure the strategy incorporating just transition is adopted and approved at the board level with clear board oversight.

3. CEO and executive remuneration

CEO and executive remuneration should reflect climate change targets, where material, and a just transition strategy by incorporating social measures and targets (e.g., developing and managing the workforce) into at-risk pay. Specific measures to consider include:

- workforce satisfaction and engagement (e.g., voluntary turnover, level of engagement and satisfaction),
- workforce development (e.g., recruitment for talent and development programmes, internal appointments), and
- working conditions (e.g., diversity, pay equity, health & safety).

It is acknowledged that the extent of the social metrics will depend on the company's long-term strategy, the nature of the company's sector and operations and its development stage. Not all companies or sectors will have the same level of exposure to just transition risks.

4. Human capital management

It will be crucial for companies to create jobs aligned with their purpose and values – jobs that also resonate with their workers and wider stakeholders. New generations approach their career paths differently, and the knowledge of what motivates and engages different workers will be key in companies' ability to hire the right people.

A lack of decent work in the transition and respect for worker and human rights would be detrimental for the transition. This includes fair pay and benefits, development and training, health and wellbeing, diversity and inclusion, freedom of association, and collective bargaining. Companies that provide options for reskilling, retraining, redeployment, or retirement support, stand to gain a competitive advantage when it comes to attracting and retaining high quality employees.

¹⁹ <https://igcc.org.au>

5. Supply chain

To ensure an effective and timely transition to a low carbon economy, it is expected that companies will work with their suppliers and support them through access to skills, finance, and technology. It is noted that many companies have already started to apply labour, human rights, and environmental due diligence and policies along the supply chain, particularly in relation to suppliers in developing countries. Many countries have adopted policies that aim to remove instances of modern-day slavery in their region and in the supply chain of their companies.

6. Communities

The ICGN encourages companies, particularly in extractive industries and energy, to engage with local communities to address social risks of transitions to regional economies and promote local wellbeing, with a particular focus on vulnerable groups as well as wider sustainability considerations (such as biodiversity). Companies also have an opportunity to partner with local communities to share value in net-zero and resilience investments, including engagement and respect for the rights of Indigenous communities.

7. Consumers

The transition to net-zero will force many companies to re-evaluate their relationship with and knowledge of their customers. Understanding the changing needs at the consumer level is a determining factor for competitiveness amongst businesses and their ability to implement sustainable business strategies. Supporting vulnerable consumers by ensuring affordable access to key goods and services in the transition and enabling consumers to actively participate in the transition should be a part of every company's business and engagement strategy in the short and long-term.

8. Policy and partnerships

A just transition cannot be achieved through isolated efforts. Companies are encouraged to work together to advocate for the just transition to net-zero via industry associations, government lobbying, and by supporting partnerships at the local, sectoral, national, and global levels. It is recommended that lobbying and all public messaging be consistent with the company's stated climate plans.

9. Transparency and disclosure

It is crucial that companies measure and report on their progress against the net-zero targets and just transition policies, including through the Task Force on Climate-related Financial Disclosures (TCFD). Aside from the common metrics and reporting on workforce (e.g., turnover, training & development, health & safety, etc.), TCFD suggests considering and disclosing shifts in consumer preferences, stigmatisation of sector and increased stakeholder concern or negative stakeholder feedback as risks mostly impacting workforce management and planning. On the other hand, use of more efficient modes of transport, use of more efficient production and distribution processes, use of recycling, move to more efficient buildings, and reduced water usage and consumption are some of the opportunities that may benefit the workforce management and planning, as well supply chain and impact on communities. For those companies identified by Climate Action 100+ as the key contributors to climate change, we also recommend the CA 100+ Benchmark methodology and disclosure expectations.

Engagement questions for investors

Questions that investors should consider asking when engaging with portfolio companies on a just transition can include:

1. What does the board see as its role in overseeing the management of climate change and human capital risks, including just transition? Is just transition on the agenda for the board or committee meetings? Where does the issue fall on the agenda and how often has it been discussed over the last year?
2. Is the board receiving training and regular updates on key developments in relation to transition to green economy and just transition? Is there anyone on the board with relevant experience, or experience in human capital management?
3. If the company operates in a jurisdiction with employee representation on the board, what is the nature of the board discussions on human capital management and just transition? Are the two groups aligned? What are the key challenges for employees?
4. Does the board discuss just transition with the CEO, CFO and/or HR executives? Who else within the company is involved in monitoring and addressing the risks associated with human capital management?
5. Is the board satisfied with the company's ability to attract skilled workers? Is the company at a risk of shortage of skilled workforce and how is that being addressed? Is the company involved in any initiatives or programs for up-skilling workers to cope with changes associated with the move to a lower carbon economy?
6. What is the extent to which the company's consumers will be impacted by the transition to a low carbon economy? How is this reflected in changing consumer preferences?
7. How will the company's supply chain be affected by the transition to a low carbon economy? Could it limit the number of available suppliers? If these risks have been identified, what has the company done to mitigate them in the short and medium term?
8. Does the company have a publicly disclosed policy on human and workers' rights that includes just transition? What are the key features of the policy?

Investors can also use proxy voting to signal their dissent at general meetings. This can be achieved through developing focused proxy voting policies and casting their votes against directors of companies demonstrating lack of action on climate change and just transition.

In addition, investors play a key role in engagement with local and state governments. Individually, or in collaboration with other investors, they can encourage policymakers to implement policies and frameworks that can direct financing for the just transition.

Investors should consider robust and comparable reporting frameworks to inform their stakeholders on how they are contributing to and managing climate-related financial risks and opportunities, including the social risks and just transition.

Conclusion

It has become clear that the only sustainable transition to net-zero, is a just transition. The just transition is a global goal, firmly set out in the 2015 Paris Agreement and elaborated in guidelines produced by the International Labour Organisation.²⁰

Integrating fairness into climate action is a fundamental matter of principal, one that will secure wider support for the dynamic, though disruptive and challenging, road ahead. At the same time it also links directly with the fiduciary duties of investors to address systematic risks that threaten sustainable value creation. Investors share a broad social goal to avoid an unjust and poorly planned transition which could slow progress and generate unnecessary opposition to the much-needed action on climate change.

ICGN recognises that the transition to a net-zero emissions economy will require fundamental transformation in fossil fuel and other emissions intensive industries. While the challenges are great, the costs of inaction would be far greater.

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. ICGN Viewpoints are produced by our member-led Policy Committees and we encourage dialogue by contacting Committee chairs directly or the ICGN Secretariat as follows:

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Further Reading:

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²⁰ <https://unfccc.int/process-and-meetings/the-paris-agreement/the-paris-agreement>

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