The Spotlight

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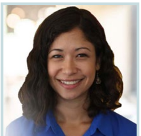

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Climate Governance: The Board's Role in Overseeing Climate Strategy

If proposed rules in the U.S. and Europe are adopted in their current form, over the next few years, most public companies in these regions will be required to disclose their climate governance information, along with climate risks, emissions, business impacts and progress towards climate targets. Given the substantial efforts to comply with these potential obligations and evolving stakeholder expectations, boards should embrace climate governance now by establishing strong and ongoing climate oversight.

To discuss this further from both a board and C-suite perspective, we spoke with Anna Barrera, ESG Director in Aon's Human Capital Solutions Governance and ESG Advisory practice.

What is climate governance and how is it different than corporate governance?

Climate governance encompasses the practices and processes that a company uses to manage climate opportunities and risks for the business. These risks are generally divided into two categories: physical risks that result from climate events (like storms, floods, droughts and wildfires) and transition risks that result from actions taken to transition the economy away from fossil fuels. Boards oversee the management of these risks through various processes, including reviewing climate-related risks, weighing their materiality, and then evaluating the appropriate course of action. While principles of good corporate governance should apply to any material risk, including climate, it's helpful for boards to address a significant emerging risk like climate on its own. Doing so can reveal how dynamic (or stagnant) the board's accountability systems are when it comes to capturing and integrating evolving risks. Climate change is a rapidly changing risk, the impacts of which warrant nearly universal board scrutiny to ensure businesses are making future-looking decisions with the best information available.

What expectations do institutional investors have for boards on the topic of climate?

Directors are facing a litany of pressures to get a handle on climate risk. From an investor perspective, the big three — BlackRock, State Street Global Advisors and Vanguard — all endorse the use of climate disclosure frameworks. They also put forth general guidance on how they may vote against directors that are falling short on climate oversight and in which scenarios they'd consider supporting climate-related shareholder proposals that enhance disclosures. But of these asset managers, only State Street Global Advisors provides specificity on board member accountability, stating that they will vote against the independent board leaders of S&P 500 companies that don't provide sufficient disclosure on their board oversight of climate-related risks and opportunities, emissions and targets. I have no doubt that these investors and others will strengthen guidance on director accountability around climate issues even if regulators delay in adopting climate disclosure rules.

What will companies be required to disclose under newly proposed rules with respect to board oversight of climate?

Under newly proposed U.S. and E.U. regulations, most public companies will be required to describe how the board oversees climate issues. The reigning climate disclosure framework, Task Force on Climate-Related Financial Disclosures (TCFD), is integrated into both proposed rules. It asks companies to consider discussing the processes and frequency by which the board and/or its committees are informed on climate-related issues and whether climate issues are considered across the range of business operations, like reviewing strategy, risk policies, budgets, capital expenditures, and acquisitions and divestitures. If these rules are adopted as proposed, investors will soon find out if a board is not properly informed on climate issues, or if it's not taking climate issues seriously in key business decisions.

What first step can boards take if climate has not yet landed on their agenda?

Formalizing climate responsibilities at the board level is the first step toward effective climate governance. Depending on how material climate is to stakeholders and the business, boards might codify responsibility for climate oversight within the audit and risk committee charter or create a standalone sustainability committee. Alternatively, some boards have elected to take on various facets of climate responsibility and spread tasks across several committees.

What, specifically, can boards do to create an effective learning culture on climate?

At any point on a company's climate maturity curve, the board may elect to conduct a board climate review to identify different opportunities that would both strengthen climate governance and better carry out climate-related duties and responsibilities. A board climate review typically involves director surveys and interviews that assess board fluency on climate topics and current performance of climate duties and responsibilities. The outcome of this type of review provides a clear course for board education, opportunities to strengthen climate governance, and actions to assign or optimize climate-related duties.

For more information about governance topics and how we advise boards of directors, please visit our Future-Ready Boardroom hub.

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