Organizing the board for climate oversight

KPMG Board insights podcast

Susan Angele of the KPMG Board Leadership Center and Amanda North of Plan C Advisors discuss board governance for oversight of climate change and the SEC's proposed rule.

Announcer: This is the KPMG Board Insights podcast, and this episode is about board governance of climate change.

Welcome to the KPMG Board Insights podcast, brought to you by the KPMG Board Leadership Center. The KPMG Board Insights podcast series features conversations with directors, business leaders, and governance luminaries to explore the emerging issues and pressing challenges facing boards today.

In this episode, BLC Senior Advisor Susan Angele talks with Amanda North, founder and CEO of Plan C Advisors, about board governance for oversight of the company's response to the issues posed by climate change.

Susan Angele: Hello, and welcome to our podcast. I'm Susan Angele, senior advisor with the KPMG Board Leadership Center. And joining me today is Amanda North, founder and CEO of Plan C Advisors. This is our second podcast on the issue of climate change. And this time, we're going to focus specifically on board governance.

We are pleased to introduce the second paper in our series on board oversight of climate change. The paper is called *Boardroom climate competence: Organizing for oversight.* Like our first paper, *Boardroom climate competence: Getting ahead of the curve,* this paper draws on insights from a number of board directors and business leaders, as well as our own collective experience. This could not be a more important time to focus on this topic.

As stewards of long-term value, boards have often wrestled with a difficult task of positioning their companies for the long term while providing practical and prudent oversight in the face of immediate challenges. And indeed, the window to address long-term consequences of climate change continues to narrow—as evidenced starkly by the recent collapse of an ice shelf the size of New York City.

Yet, companies, of course, face real issues today—inflation, supply chain concerns, and most critically, the impacts of the war in Ukraine. As boards work to oversee these issues and also maintain focus on the long-term, governance practices that enable the necessary agility could not be more important. And indeed, the recent SEC rule proposal on climate change disclosure will require many companies to accelerate their focus on these issues.

So, Amanda, thank you for joining me. Let's start with the SEC. How does the recent proposed rule help ensure that climate stays on boards' radar amid fast-moving developments?

Amanda North: Well, thank you, Susan. It's always a pleasure to collaborate with you. And let's talk a bit about the SEC proposal. Essentially, they're proposing that public companies need to provide disclosures that address specific aspects of climate-related risk, emissions, targets, goals, and transition plans. So, they're calling for changes in Regulations S-K and S-X to provide for both qualitative and financial climate-related disclosures and financial metrics in company filings, and also financial statements.

So, you could look at it as the SEC elevating climate to the same level of importance as other matters which it [has required] financial disclosure in the past because they're considered to be significant to investors. Now, at a minimum, this SEC proposal would keep climate top of mind for boards out of compliance—just meeting these mandates. It's [an] important function of the board.

However, proactive boards will instead use these disclosures as a tool for good governance. Having a consistent standard like the ones proposed that are based on the [Task Force on Climate-related Financial

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Disclosures] TCFD—which is commonly used by many companies around the world—really helps boards communicate with management what their expectations are for climate action and how to monitor progress against those goals.

So, you could say that these proposed climate-disclosure mandates can help boards incorporate climate into ongoing considerations of business strategy, risk management, and financial oversight. So, Susan, then, since climate will be an increasingly important part of board discussions, that brings up the question, how are boards best structured to accomplish that? Should every board have a special climate committee?

Susan: So, Amanda, those are great questions, and they're questions that we get all the time. First of all, there's really no single right answer. The most important consideration, of course, is to have a mix that avoids the silos and integrates the climate considerations into discussions about strategy, risk, talent, corporate values, and also purpose.

And for that reason, climate change really should be addressed by the full board. But usually, that's not enough. And, particularly for boards that are newer at the issues, let's face it, there's a significant amount of work that's needed upfront as boards start to dig into the issues.

So, understanding the existing carbon footprint of the company, and really understanding and assessing how the company gathers the data, how it verifies the accuracy of its emissions data—and also, to understand the targets that the company is proposing, how realistic they are, how they're going to be implemented, and what the transition plans are. So … this level of oversight, as I said, it's a lot of work. It's just not realistic at the full board for most companies. So, it's certainly helpful if a board is able to assign accountability. And, what we're seeing in some of the practices that have emerged include adding to the charter of an existing committee, typically either the nominating and governance committee or some sort of a committee devoted to health and safety.

Some boards use a more informal method, either an ad hoc committee or a working group. And as we looked at companies that were specifically mentioning climate in their committee charters, we found that really most of the mentions fall into one or the other of the existing committees, either nom/gov or a health and safety committee. And again, there's, there's no right way to do it, but the right way is to make sure it gets done, and whatever is consistent with the culture and other workload of the board. And again, when a committee does take on the bulk of the work, it's of course, important to keep the full board engaged.

So, Amanda, as we know, the board's role is oversight. What does the SEC say about management interaction and what are you seeing as best practices?

Amanda: Well, Susan, one of the things we're seeing is that this is really changing in some respects, the way that boards do engage with management and the SEC proposal specifically calls this out. It talks about governance and it requires a description of board- and management-level oversight and governance of climate-related risks. And this includes, in the SEC proposal, not just the processes, but also the frequency by which the board or board committees are informed of, and discuss, climate-related risks. And so, for many companies, this will require an ongoing updating by management of climate risks because effectively, it affects the entire enterprise. There [are] so many different facets of the business that are potentially impacted by climate.

So, for example, if you look at disclosure requirements by the SEC on Scope 1 and 2 alone, that really talks about all the direct and indirect emissions from produced and purchased energy. So, in other words, how a company consumes energy to run its business.

Now, the SEC proposal also talks about Scope 3, which is potentially even a lot broader than Scope 1 and 2, because that regards emissions from upstream and downstream value-creation activities and value-chain activities … like your supply chain. Now, currently, that's mandated in the proposal only if those emissions are material to the company, or accounted for in one of their climate-reduction targets. But outside of the SEC, increasingly, critical stakeholders—like employees and customers—they want to know about these Scope 3 impacts too.

So, even in industries where direct greenhouse gas footprint is relatively low, increasingly, boards have to understand the full impact of their emissions—not just Scope 1 and 2, the direct emissions—but indirectly through their whole ecosystem. So, beyond reporting against specific targets, the SEC is also proposing a broad range of disclosures that require close communication between boards and the management to understand, monitor, and decide appropriate action.

And so, these include things like physical risks, such as exposure to droughts and severe weather. And those are the ones we tend to focus on because they may be the most obvious or … have the most short-term financial impact. But there's the important topic of transition risks—things like regulatory changes, shifting consumer preferences—and how does that impact your business operations and financials over time? How will that affect strategy, business models, and outlook? And all of that is looked at in the SEC proposal because it's material to investor considerations. So, we painted a picture here about looking at risk, and that's really where the SEC is focusing, but smart boards won't constrain themselves to looking just at that aspect of climate.

Boards will keep climate on their radar because it also may provide opportunities to create value and differentiate as we look at a climate-impacted world

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in the future. And that's why, as you were saying earlier, climate needs to be interwoven with board and management strategy discussions, not just risk.

So, Susan, if management is properly engaged, what level of competency do you think that board directors themselves need to have? We've heard terms like climate competency, climate fluency, [and] climate expertise. What level of climate-related experience or expertise do you think boards really need? And … along with that, what's the role then of having experts in-house or even third-party consultants to help develop that expertise?

Susan: So, you started with, 'if management is properly engaged.' And go back a few years, and if management is properly engaged, that's all you need—management would report to the board probably once a year, and that would be the end of it.

Now, obviously, we're in a completely different situation. And the board really needs to know the issues in order to be able to ask the right questions and to assess the answers … to know what's going on externally and what the competition is doing; what the investors are interested in; what the consumers and the customers, as you mentioned, are interested in—and bring all of that knowledge and sense into the boardroom in order to have some … really rich discussions.

So, what that means is going to depend on the board and the company. And in fact, in the SEC proposal, in their section about governance, they do request that companies disclose whether someone on the board—or … someone from management has [the] expertise and describe the nature of the expertise.

So, what does that mean? In some companies, you might well need a climate scientist or one or two or more climate scientists. That's obviously not going to be true in every company, but every company needs to have something that can make the board climate competent and able to answer and … look at those questions. So, it may be someone who's had experience in another company that's been very progressive on the issues. It may be having a third-party consultant.

Board education is a tremendous part of it, also. There are so many opportunities for continuous learning and improvement. And, even if a board member is not the 'designated climate expert,' to be in rooms where others who have that expertise are discussing how it impacts their board and their company and how they think about it is tremendously valuable. It's really key to … make sure one way or another that the board is able to assess the company's goals and performance on climate-related issues and also use their knowledge of the issues as a lens for strategy. So, I know we're getting close to the end of our time. So, Amanda, would you offer your final thoughts … one or two considerations for board and management?

Amanda: Sure … Listening through this conversation, my first reaction as a board director would be, 'Wow, this sounds like a lot more work. That's not what I need right now. I've got so many issues—as we talked about at the beginning of this call—so many things I'm paying attention to, it seems really, really daunting.'

Well … the good news is that many companies already have anticipated that there'd be some form of mandated climate disclosures. And so, this SEC proposal, in effect, is just solidifying and clarifying some of the things that people had already been working on. It will give people very clear signals for what the expectations are. However, it will require, for some companies, additional costs for increased data collection and maybe employee training to make sure that the appropriate data is collected and is communicated effectively to be able to disclose.

Certainly, if Scope 3 is included, then … resources have to be deployed across your value chain to make sure that data is recorded, and that can be non-trivial. Sometimes, you'll need to hire an outside accounting firm to verify the accuracy of the data. So, these are all some question marks, and again, can seem pretty onerous as well as, as you were talking about before, just the whole process of considering the near-, mid-, and long-term impacts of climate.

Talking about that in strategic planning sessions … will consume significant board and management time, and that's the truth. However, while these costs may be substantial, the return for companies that do the hard work and take climate action can be considerable. Working with management, boards can help navigate their companies to benefit from the transition to a low-carbon economy.

And by preparing adequately, boards are fulfilling their fiduciary responsibility because they're enabling their companies to be financially sustainable in the future. But they're more broadly helping all their stakeholders prepare for the climate-impacted world that we are just beginning to see the tip of the iceberg, so to speak. So, that's, how I see it. There's a lot of work to be done, a lot of cost, but on the other hand, it's like everything we've bitten off in the past. For those who do it well, anticipate, and take action, you can potentially have a lot of economic and social value come out of it as well.

Susan: Absolutely. And, just to build on that, my top consideration is to really use the platform of the board as an influencer to focus the company on the work to be done, set the tone, and just keep plugging at it. Put in place—as we talked about—the processes, the structures, the expertise, and recognize—as you said, Amanda, that there is a lot of work to be done, but a lot of benefit from it in terms of long-term value. And the sooner that the companies start, the better they'll be positioned for the long term. So, on that note, thank you so much again for joining me. This has been a great conversation.

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Amanda: Always a pleasure, Susan. Thank you.

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