THE B TEAM

PLAYING OFFENCE: CORPORATE BOARDS AS CATALYSTS FOR CLIMATE ACTION

As the Paris Agreement enters into force, leading companies are elevating issues of climate risk and opportunity to the highest level of a corporation: the board of directors.[1] Financial institutions, regulatory agencies, institutional investors, and shareholders—all members of the corporate ecosystem—are increasingly expressing concerns and demanding action on the risks associated with global climate change. Furthermore, company net-zero emissions targets trigger significant changes at all levels of the company: the top-down strategic direction must be set by the board and the bottom-up technical implementation must be carried out throughout the company.

In the face of this shifting corporate ecosystem, The B Team is a strong proponent of climate competent boardrooms. A climate competent boardroom requires knowledgeable and forceful "Climate Champions" coupled with an overall board that is educated and informed on the risks and opportunities presented by climate change to the company.

In a post-Paris world, a climate competent boardroom must be forward-looking and proactive—playing offence in the face of global climate change. This requires new conversations and actions by the board, such as: prioritising and integrating climate change into the strategic planning process; requiring rigorous climate-related disclosure; engaging with shareholders and other stakeholders on climate issues; holding the board and management accountable on climate issues; embracing diversity and changing board composition; and inculcating climate change in committee charters and corporate governance guidelines. Through actions such as these, a climate competent board can enable a company to make the challenging transition to net-zero greenhouse gas (GHG) emissions during the first half of the 21st century.[2]

This brief is intended to help business leaders understand: (1) why climate competence in corporate boardrooms is good for business and necessary to make the transition to net-zero greenhouse gas emissions during the first half of the 21st century; (2) the actions "Climate Champions" and climate competent boards must take; and (3) what they, as business leaders, can do next.

1. "Paris Agreement – Status of Ratification," United Nations Framework Convention on Climate Change (October 2016), *available at* http://unfccc.int/paris_agreement/items/9444.php

2. A net-zero greenhouse gas economy is the long-term emission reduction goal at the heart of the Paris Agreement. "Net zero" is synonymous with greenhouse gas (GHG) emissions neutrality. Or net-zero anthropogenic GHG emissions from all sectors. The World Resources Institute explains, "(Net zero) is achieved first and foremost by reducing total GHG emissions to as close to zero as possible. Any remaining GHGs would be balanced with an equivalent amount of removals (such as enhanced sequestration in the land sector) or negative emissions (possibly using future technologies…)." The B Team strongly advocates companies to make this transition by the first half of the century in order to avoid the most damaging effects of global climate change and limit global temperature rise by 1.5 degrees Celsius.

WHY SHOULD CORPORATE BOARDROOMS BE CLIMATE COMPETENT?

The Paris Agreement has brought to the forefront a macro-trend that business and science have been tracking for years. Climate change is no longer a risk that is coming, but one that is upon us. Companies, financial institutions, regulatory agencies, institutional investors, and shareholders—critical members of the corporate ecosystem—are increasingly expressing their concerns and demanding action on the business risks associated with global climate change.

Corporate boards should be starting to transition their companies to zero anthropogenic emissions ("net-zero GHG") by the first half of this century—and many have already begun to do so.[3] Across all business sectors, companies will need to reduce their emissions, as enabling national legislation brings countries in line with the Paris Agreement.[4] This transition requires big changes at all levels of the company—from the strategic direction set by the board to the technical implementation carried out throughout the company. New types of intentional corporate leadership are required to navigate this system-wide transition to rapidly and justly decouple businesses from GHG emissions.

As concerns about the risks associated with climate change grow, stakeholders are demanding more corporate disclosure and discussion on the topic at the highest level. The Financial Stability Board (FSB) Task Force on Climate-Related Financial Disclosures is finalising its recommendation for companies to integrate climate-related and carbon disclosures into main financial reporting of all sectors;[5] such disclosures would require approval and support at the corporate board of directors level. Moody's Investors Services announced it will add "carbon transition risk" to its criteria list for companies in 13 sectors. The United States Securities and Exchange Commission (SEC) and other market regulatory bodies are moving toward requiring more climate-related disclosures. In April of this year the SEC issued a "Concept Release" on mandatory business and financial disclosure,

WHAT IS CORPORATE GOVERNANCE AND HOW CAN IT BE USED IN SERVICE OF CLIMATE ACTION?

Corporate governance is the foundation of boardroom climate competence. Corporate governance is defined as, "the system by which companies are directed and controlled."[6] It is the framework to determine who has the authority to make decisions for a corporation and within what guidelines. It is the infrastructure, the rules of engagement, and the language spoken among the key players in the corporate decision-making process—boards, management teams, and shareholders. All conversations and decisions in corporate boardrooms, including those around climate competence, are grounded in corporate governance.

Corporate governance can be a powerful catalyst to transform companies, and enable them to thrive in a net-zero economy. Corporate governance creates the rules and incentives to not only strategically address company risks and opportunities posed by climate change, but also technically implement the solutions. Corporate governance creates the contours of long-term strategic planning processes; governs incentive structures through executive compensation; provides the framework for financial and climate-related disclosures; forms board committees; and addresses risk mitigation and strategic opportunities for the company. These are all necessary and appropriate tools to create long-term shareholder and other stakeholder value and successfully transition a company to net-zero emissions.

3. "Out of the starting blocks: Tracking progress on corporate climate action," CDP (October 2016) *available at* https://b8f65cb373b1b7b15feb-c70d8ead6ced550b4d987d7c03fcdd1d.ssl.cf3.rackcdn.com/cms/reports/documents/000/001/228/original/CDP_Climate_Change_Report_2016.pdf?1477993118.
4. Wei, D.; Cameron, E; Harris, S.; Prattico, E.; Scheerder, G.; and Zhou, J. (2016) The Paris Agreement: What it Means for Business; We Mean Business; New York *available at* http://www.wemeanbusinesscoalition.org/sites/default/files/The-Paris-Agreement.pdf.
5. Task Force on Climate-Related Financial Disclosure, FSD *available at* https://www.fsb-tcfd.org/about/#.

6. Cadbury Committee, 1992. For purposes of this briefing, the focus will be on corporate governance of for-profit organizations, particularly publicly traded corporations on the U.S. and European stock exchanges.

and sought comments on more than 340 topics including climate change, resource scarcity and good corporate citizenship.[7] Such future disclosures would be in addition to existing SEC regulations requiring disclosures of potentially material effects of climate change on companies. Pending legislation in the European Union would require companies to prepare non-financial disclosure statements on environmental, social, and employee-related topics, as well as human rights, anti-corruption, and bribery. The EU member states would be required to enact the legislation into law within two years.[8]

Institutional investors' climate concerns also are reaching the corporate boardroom. In May 2016, CalPERS—the California Public Employees' Retirement System that manages pension and health benefits for more than 1.6 million California public employees, retirees and their families—updated its Global Governance Principles to state that the companies in which it invests should have "expertise and experience in climate change risk management strategies" with oversight responsibly at the board level.[9]

Support is growing for shareholder proposals on climate risk. Environmental and social issues were the leading shareholder proposal categories during the 2016 proxy season.[10] In the wrap-up of the 2016 proxy season, Fiona Reynolds, Managing Director of Principles for Responsible Investment (PRI) observed, "In a post-Paris world there has been a particular appetite for climate resolutions, as investors feel increasingly confident that the world is beginning to transition to a low-carbon future."[11] These trends in stakeholder concerns around climate risk are expected to continue.[12]

WHAT IS A CLIMATE COMPETENT BOARDROOM?

A climate competent boardroom can enable a company to make the transition to net-zero emissions during the first half of the 21st century. Developing a climate competent boardroom requires two things: knowledgeable and forceful "Climate Champions", coupled with an overall board that has become educated and informed on the company's climate change risks and opportunities.

"Climate Champions" are current or potential board members who understand the sense of urgency around climate change. These climate-competent directors understand the imperative to transition to net-zero GHG in line with the timeline laid out in the Paris Agreement, if not sooner. He or she has relevant experience, or a willingness to acquire it, in the challenges and opportunities facing business brought about by climate change. Additionally, they have the appetite and aptitude to think through company, industry, and system-wide solutions.

A boardroom comprised of single-solution "Climate Champion" directors is not a climate competent board. Instead, all directors must have a working understanding of the risks and opportunities that climate change and the transition to net-zero GHG emissions creates for their company and the world. It is not only important for boards to have a champion with the vision to push forward, but also important to ensure that the whole board is equipped to handle climate issues together. A company cannot be expected to navigate an issue as far-reaching and complex as climate change without this.

7. "SEC Solicits Public Comment on Business and Financial Disclosure Requirements in Regulation S-K," Press Release, SEC (15 April 2016) *available at* https://www.sec.gov/news/pressrelease/2016-70.html.
8. "The SEC Revisits Sustainability: Will Sustainability Reporting Become Mandatory for Publicly-Traded U.S. Corporations," Husch Blackwell LLP (October 2016) *available at* http://www.lexology.com/library/detail.aspx?g=8148a821-b3d0-4e23-b7de-55b06f9ed7da
9. "Controller Leads CalPERS' Move to Seek Climate Change Expertise on Corporate Boards," California State Controller's Office, Press Release (14 March 2016) Sacramento, *available at* http://www.sco.ca.gov/eo_pressrel_17109.html.
10. EY Center for Board Matters: Four takeaways from proxy season 2016, (June 2016) *available at* http://www.ey.com/Publication/vwLUAssets/EY-four-takeaways-from-proxy-season-2016/$FILE/EY-four-takeaways-from-proxy-season-2016.pdf.
11. "What does 2016 proxy season tell us about responsible investment?" Principles for Responsible Investment *available at* https://www.unpri.org/news/what-does-2016-proxy-season-tell-us-about-responsible-investment.
12. See E.g. George Serafeim, "The Fastest-Growing Cause for Shareholders is Sustainability," HARVARD BUSINESS REVIEW (12 July 2016), *available at* https://hbr.org/2016/07/the-fastest-growing-cause-for-shareholders-is-sustainability

WHAT ACTIONS MUST "CLIMATE CHAMPIONS" AND CLIMATE COMPETENT BOARDS TAKE?

The responsibilities of a climate competent board and its "Climate Champions" are not new: it is a board's duty to identify, monitor, and mitigate risks in the business and to keep informed on how effectively management is dealing with these risks.[13] In a post-Paris world, however, a climate competent boardroom must be forward-looking and proactive to play offence in the face of global climate change. This will require some new conversations and actions by the board, for example:

• **Integrate climate change into the strategic planning process:** Especially during the current economic transition to dramatically reduce GHG emissions, climate change needs to be a regular item on board agendas either through strategic planning or enterprise risk management (ERM). Company net-zero emissions targets trigger big changes at all levels of the company that require a top-down strategic direction be set by the board thus allowing for bottom-up technical implementation by the company. Through these processes management and boards can, for example, scenario plan based on their sector's emissions reductions required to limit global temperature rise to 2° Celsius above pre-industrial levels.[14] While climate issues do not have to be discussed at every board meeting, companies should have a framework that provides regular updates to the board and drives management action.

• **Support rigorous climate-related disclosures:** Climate competent boards support rigorous climate-related disclosures including those outlined in the United States SEC 2010 Climate Guidance and other market disclosure frameworks (such as the FSB Task Force on Climate-related Financial Disclosures).

• **Engage with shareholders and other stakeholders on climate issues:** Boards must establish policies for director or appropriate committees to engage with institutional investors and shareholder proposals on climate issues. Additional policies may be necessary for engagement with other stakeholders, including local communities, which are affected by company-related climate issues.

• **Hold the board and management accountable on climate issues:** Climate competent boards must include the management of climate issues as a regular component of the board evaluation process. They must also hold the executive team accountable through appropriate short, medium, and long-term incentive structures. This accountability must permeate the entire company. For example, company political spending and lobbying should be aligned with GHG reduction targets.

• **Continue to educate on climate issues affecting the company:** The board should have access to independent climate experts who will provide education and advise on climate risks, trends, and data. A board can also create an Expert Task Force that provides guidance and counsel on how to make the net-zero transition manageable and actionable. This group, ideally comprised of a mix of scientists and business experts, would advise the board on technical questions and break down the transition into concrete steps. Additionally, new directors should be evaluated and on-boarded based on experience in climate issues and business transitions.

13. *In re Caremark International Inc. Derivative Litigation*, 698 A.2d 959 (Del. Ch. 1996), see also, *Stone v. Ritter*, 911 A.2d 362 (Del. 2006). Risk Governance: Balancing Risk and Reward, National Association of Corporate Directors (NACD) Blue Ribbon Commission, October 19, 2009, *available for a fee at* www.nacdonline.org.
14. The first installment of the IPCC's Fifth Assessment Report quantified a global "carbon budget," or the amount of carbon dioxide emissions humans can emit while still having a likely chance of limiting global temperature rise to 2 degrees Celsius above pre-industrial levels. The world is on track to exceed its carbon budget in only 30 years putting communities and entire populations increasingly at risk due to forest fires, extreme weather, drought, and other climate impacts. Fifth Assessment Report of the Intergovernmental Panel on Climate Change (IPCC AR5).

• **Embrace diversity and change board composition:** In order to build out a board's climate competence, the boardroom's overall diversity must be addressed. The business world is in uncharted territory, which cannot be navigated with a status quo perspective. A climate competent boardroom has a board with a variety of lenses, voices, and types of courageous leadership that challenges conventional thinking in service of climate action and long-term shareholder and stakeholder value. Richard Ferlauto discusses the importance of board diversity in a recent article in Corporate Secretary magazine: "Diversity of experience, background, skills and thinking are key to board dynamics that facilitate big-picture thinking for the long term."[15]

• **Inculcating climate change in committee charters and corporate governance guidelines:** Committee charters and corporate governance guidelines should include specific mention of climate issues relevant to the committees' duties and guidelines' roles.

A good resource for different tactics, strategies, and examples of how boards can engage more on sustainability topics is Ceres, a non-profit organisation that works with many of the world's largest companies and investors to take stronger action on climate change, and recently published *View from the top: How Corporate Boards Engage on Sustainability Performance*.[16] The report is based on interviews with dozens of corporate directors, senior corporate leaders, and governance experts,[17] and provides salient examples including embedding sustainability into committee charters, strategy, risks, and incentives; recruiting a diverse board with expertise and background in sustainability; and offering board sustainability training.

CLIMATE COMPETENCE IS ALSO ABOUT OPPORTUNITY

Climate competence in the corporate boardroom is a critical tool for transitioning to a net-zero GHG economy, avoiding a more extreme global climate crisis, and enabling the private sector to drive and benefit from the largest economic opportunity since the industrial revolution. Many corporate stakeholders are highlighting the risks associated with climate change; however, it is incumbent on directors to highlight the opportunities.

A huge new market is being opened: how do we supply the products and services that support the transition to net-zero emissions; what do we do with our existing, obsolete infrastructure; how do we make this transition fast and just in order to lessen social inequality instead of exacerbating it? A climate competent board enables companies to thrive though this transition.

WHAT IS THE NET-ZERO BY 2050 COMMITMENT?

On February 5, 2015, The B Team made a call for a long-term global goal to achieve a just transition to a net-zero greenhouse-gas economy by the year 2050. This call included an open letter to the UNFCCC in the months preceding the Climate Agreement, aligning the most recent scientific evidence of what civilisation must do to limit global warming to well below 2° Celsius. Ten companies associated with The B Team have committed to reach net-zero greenhouse-gas emissions in their own operations, by 2050.

15. "Building climate competency into corporate governance structure," Richard Ferlauto, CORPORATE SECRETARY, (24 August 2016).
16. Ceres is a non-profit organization advocating for sustainability leadership. It includes a coalition of more than 130 institutional and socially responsible investors, environmental, and social advocacy groups, and other public interest organisations.
17. Veena Ramani, *View From the Top: How Corporate Boards can Engage on Sustainability Performance*, CERES (October 2015), *available at* https://www.ceres.org/resources/reports/view-from-the-top-how-corporate-boards-engage-on-sustainability-performance/view. In the report, Ceres defines sustainability as, "economic, social, and environmental issues that affect corporate strategy and performance over the long term." Id., 8. In other words, issues that require a board to be climate competent.

"A practical guide to help boards become more climate competent"
by Richard Ferlauto, Corporate Secretary

http://bit.ly/2eVebW8

ABOUT THE B TEAM:

The B Team is a not-for-profit initiative formed by a global group of business leaders to catalyse a better way of doing business, for the wellbeing of people and the planet.

The team includes Richard Branson, Jochen Zeitz, Oliver Bäte, Marc Benioff, Gro Harlem Brundtland, Sharan Burrow, Kathy Calvin, Bob Collymore, David Crane, Arianna Huffington, Mo Ibrahim, Yolanda Kakabadse, Guilherme Leal, Andrew Liveris, Strive Masiyiwa, Arif Naqvi, Ngozi Okonjo-Iweala, François-Henri Pinault, Paul Polman, Mary Robinson, Ratan Tata, Zhang Yue, and Muhammad Yunus.

WHAT CAN YOU DO?

As a director of a corporate board or a member of a management team, ask yourself the following three questions to determine if you have a climate competent board:

1.Does your board and management team recognise the immediate business risks and opportunities associated with the need to reduce GHG specific to your business?

2.Does your board have oversight of a strategic corporate plan to achieve net-zero GHG emissions by 2050?

3.Does your board and management team recognise the interplay between reducing emissions and other board decisions?

CONCLUSION

The world must limit global temperature rise or we face severe consequences.[18] Companies must help to achieve this, which requires long-term strategic planning and technical implementation throughout the organisation. Companies will not make the required technical and strategic decisions if they don't have climate competent boards, which understand the risks and opportunities to their company pertaining to climate change. A climate competent board, rooted in strong corporate governance, must focus on long-term strategic direction and bottom-up technical implementation in order to ensure long-term value for all stakeholders.

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FOR MORE INFORMATION

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18. "What would it take to limit climate change to 1.5 degrees Celsius?" International Institute for Applied Systems Analysis (21 May 2015), *available at* http://www.iiasa.ac.at/web/home/about/news/150521-15-scenarios.html; See also "1.5 Degrees C temperature limit – key facts," Climate Analytics available at http://climateanalytics.org/hot-topics/1-5c-key-facts.html (accessed on 30 October 2016). The IPCC is anticipated to release a Special Report in 2018 on the impacts of global warming of 1.5 degrees Celsius above pre-industrial levels—highlighting the threat of climate change to sustainable development and poverty eradication. "Special Report on the impacts of global warming of 1.5 degree Celsius above pre-industrial levels and related global greenhouse gas emission pathways: Pre-scoping, Scoping, Timeline, Relevant Links," IPPC: INTERGOVERNMENTAL PANEL ON CLIMATE CHANGE, *available at* http://www.ipcc.ch/report/sr15/ (accessed on 15 October 2016).

19. The views expressed in this paper are those of The B Team alone and do not necessarily reflect those of the contributors.