Two sides of the same coin: the growing expectation on boards to address climate change as risks AND opportunities

Director Lens: Your ICD Member Communiqué

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Should corporate directors look at climate change as a risk or an opportunity? The news coming out of the U.S. underscores that it is not that simple.

Recently, officials urged nearly 1 million people to evacuate swaths of the mid-Atlantic coastline in anticipation of Hurricane Florence. Such “once-in-a-generation” storms seem to affect us almost every year now. The year 2017 featured Hurricanes Harvey, Irma and Maria among others, leading to a record breaking $202.6 billion in damages in the U.S. alone. Such extreme weather events - – record heat, wildfires, floods – now seem to be the new normal.

And businesses are being impacted. In 2017, 73 companies on the S&P500 publicly disclosed a material effect on earnings from weather events, and 90 percent felt it was negative. The average materiality on earnings for the companies that quantified this effect was a significant 6 percent.

On the other coast, at the Global Climate Action Summit, nearly 400 investors collectively

representing $32 trillion in assets committed to scale up their investments in climate change as a way to support the goals of the Paris Climate Agreement. This isn't about altruism. Ceres' recent report, "*In Sight of the Clean Trillion*" notes that the economic benefits of investments in climate change will average over $1 trillion per year and generate tens of trillions in investment opportunities through 2050. Investments in renewable energy remain resilient in the face of policy headwinds in the U.S. Zero emission and plug-in hybrid markets alone are estimated to be worth $1 trillion by 2030.

These seem like discordant narratives, but they are not. Investors have realized that risk and opportunity are two sides of the same coin, and companies that are likely to be most resilient in the face of climate change are those that are both proactively mitigating risk and taking advantage of opportunities.

This is one of the reasons that investors have doubled down on the importance of conducting scenario analysis to understand the impacts of climate change on corporate strategy. Heavyweights like Blackrock and Vanguard joined others in delivering historic majority votes in shareholder resolutions calling for such analysis at Occidental Petroleum, PPL Corp., ExxonMobil and Kinder Morgan. Additionally, in 2018, investors have started to call on companies to build on this analysis and rethink their strategies in an increasingly carbon-constrained world.

Given the complex nature of the impacts of climate change on businesses, we can expect investor calls for "climate-competent boards" to intensify. Board members need to be more than just aware of climate change. They need to be knowledgeable about the issue and actively involved in strategic decisions on what this issue means for risk management, capital investments, and indeed, the very business models of the companies that they oversee. Understanding the implications of climate change on the business is one thing. Knowing strategic options and how businesses can translate climate change risk into opportunities is another.

The question for boards then becomes, "How can we build this fluency for climate change into our systems and decision making?" A recent Ceres report gets to that point. "*Getting Climate Smart: A Primer for Corporate Directors in a Changing Environment*" presents a number of ways that directors can build climate competency into their board, and thus become more strategic when identifying risk and embracing opportunities. These initiatives include:

- **Formalizing climate change into the board structure**: Incorporating climate change into a board charter for instance will help ensure it is included in board agendas and considered in a strategic and systematic way. Citigroup and Ford Motor Company have already taken this initiative.
- **Recruiting climate-aware directors**: Committees should broaden their search during the nominating process so they can consider candidates with diverse backgrounds and the holistic knowledge needed to analyze climate risks and opportunities.
- **Educate the whole board on climate change**: Through formalized continuing education programs or focused training programs that bring in independent climate experts.
- **Integrate climate change into strategic planning and risk oversight**: Directors should ensure that management is taking the business impacts of climate change into account at every level of the company as a part of existing and new strategic planning and enterprise risk management frameworks.

- **Tie executive compensation to climate change**: Many companies are tying GHG emissions reductions goals to executive compensation, thereby creating meaningful incentives. Other options include setting targets for and rewarding the percentage of new low-carbon revenue growth.
- **Promote robust disclosure on climate change**: The TCFD framework provides guidance on disclosure that is intended to help markets price climate risk accurately and make informed investment recommendations.

The reality is that the business risks and opportunities of climate change are inextricably linked, and you'd be hard-pressed to find an investor who doesn't think of one without considering the other. This type of integrative thinking is needed on a company's board also. Climate competency at the board level would help get us there.

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