Chapter Zero New Zealand
The Directors' Climate Forum

Hosted by

Institute of DIRECTORS NEW ZEALAND

Effective climate governance – Board structure and capability

How to structure your board and your conversations to deliver on climate goals

Thanks to Hobson Leavy (Foundation Partner of Chapter Zero New Zealand) for their involvement in this work

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This paper is one of a three-part suite of resources on how to promote effective climate governance through board structure and capability. See also the Board Structure Quick Guide and New Zealand Board Structure Case Studies.

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Effective climate governance structures

Getting your board structure and skill-set right is the first step but effective climate governance will also require constant learning and sharing of knowledge as the crisis develops and new solutions come into play.

Boards are expected to lead on reducing the impacts of climate change and in adapting organisations to a future zero-carbon economy.

This expectation is shared across a range of stakeholders from shareholders to staff, regulators to governments, investors to customers, and is contained in the fiduciary duty that directors (in most countries of the world) have to their companies in law.

To protect your organisation, you need a sustainable business model that takes into account the current and future impacts of climate change.

For boards, this presents practical challenges:

- The climate challenge is intensifying and we have little experience to draw on. Adapting will require directors to learn new things and synthesise them with existing knowledge.
- The future is unwritten and we can only take a best guess. That means getting expert advice on a range of potential scenarios and working out how they might impact your organisation.
- Adapting to climate change will cut to the very core of our societies' and our business' reliance on oil. Technological solutions are being developed and boards need to be across how that may change the way their organisations operate.
- Climate change impacts are already happening, from insurance premium hikes (or withdrawal of cover entirely) to new disclosure requirements and changing customer, supplier or buyer expectations. Boards need to be extraordinarily agile as they make real-time decisions in a fast-changing environment.

What do we know?

We know there will be challenges. Extreme weather and sea level rises are already here. Social disruption will occur, alongside business disruption. We don't know exactly when, how or where the climate emergency will manifest over the next few years.

We know directors have a duty – a legal and moral duty – to do what they can to meet the expectations that are increasingly being put upon them.

We know boards understand the problem is real. Our ***Climate Governance Pulse Survey 2023*** found 83% of respondents discussed climate in relation to organisational strategy.

We also know translating climate awareness into action is difficult. Just 50% of respondents to the *Survey* had taken the first step of measuring their emissions, with a slightly lesser 48% having set emissions reduction targets.

This is a common theme in governance around the world. Boards are taking first steps, watching and wondering what the climate emergency will mean for them and their organisations, and struggling to understand what to do about it.

Effective climate governance will require new ideas to meet a new challenge. It will mean considering climate across all aspects of your organisation's activities and assessing what the risks and opportunities might be today and in the future. It will be a movable feast as reporting requirements, regulation, community expectations and technology continue to develop alongside the potentially severe impacts of climate change.

For directors, that means learning, scanning the horizon and acting quickly in the face of new information when making decisions that will affect not only their businesses and organisations, but also our world.

Board structures – what does a good climate governance model look like?

Is there a board structure best suited to managing the difficulties associated with climate governance? No, what works best for your organisation may be quite different to what works best for another organisation.

International surveys have revealed a range of approaches by boards:

- Climate considerations are not formally embedded.
- It is the responsibility of the whole board.
- Climate is a standing item on the board agenda.
- A committee has been formed (often on broader ESG concerns).
- Climate questions are delegated to one or more existing committees.
- A non-executive director is appointed as a "climate champion".
- Climate knowledge and expertise is considered when appointing new directors.

How your board chooses to approach this will depend on the extent of in-house knowledge and expertise, the risks and opportunities identified and the potential impacts on the organisation.

The World Economic Forum has developed eight climate governance principles to support boards as they seek to improve their climate governance capabilities. Getting the structure right is just one.

This is a full-board job. As climate change is critical to a company's strategy, culture, stakeholder relationships, brand, reputation, competitive environment, and accountabilities, the full board needs to have critical oversight, even if aspects are delegated to a committee and/or it receives guidance/oversight from another committee or committees. The board must retain ultimate decision-making power and responsibility.

Principle 1: Climate accountability on boards – the board should take responsibility for ensuring the company's long-term resilience to climate risks.

Principle 2: Command of the subject – the board should be properly informed about climate-related risks and opportunities and be able to make relevant decisions.

Principle 3: Board structure – the board should implement the right board and committee structures to ensure climate risks and opportunities are understood, managed and reported.

Principle 4: Material risk and opportunity assessment – the board should ensure management fully identifies climate-related risks in the short, medium and long term, assess their materiality, and take appropriate action according to the seriousness of the risks.

Principle 5: Strategic integration – the board should ensure that climate systemically informs strategic investment planning and decision-making processes and is embedded into the management of risk and opportunities across the organisation.

Principle 6: Incentivisation – the board should align executives' incentives with the long-term success of the business. This may include climate-related targets in executive incentive schemes.

Principle 7: Reporting and disclosure – the board should ensure the company discloses its material climate-related risks, opportunities and strategic decisions to all stakeholders, especially investors and regulators. These disclosures should be included in financial reporting.

Principle 8: Exchange - the board should stay informed on current best practice in climate governance by maintaining dialogue with peers, policymakers, investors and others.

Effective climate governance structures – board capability

While board structure is a critical element in addressing climate change, a climate-literate board requires every director to have a minimum level of climate competence.

The Australasian Investor Group on Climate Change defines a climate-competent director as someone who “has expertise and experience of climate-related business threats and opportunities, including climate science, low carbon transition across the value chain and public policy”.

This is a new skill-set that will increasingly be required of all directors as the impacts of climate change grow stronger. Boards may have to lift their shared level of climate competence in order to start to tackle climate change issues.

The New Zealand Institute of Directors advocates using skills matrices during director recruitment to ensure boards have all the capabilities required to meet a range of challenges. Climate competency should be integrated into this mix.

In non-executive recruitment processes, boards typically remain focused on broad areas of contribution, alongside specific experiences such as contribution to audit and risk, health and safety, and remuneration committees.

In addition to a conventional suite of governance skills, boards may consider the role that scientists can play in the boardroom.

Climate-literate board candidates may have experience in a sustainability-focused organisation, or an organisation or sector that has already been highly impacted by climate-related challenges. They may have had exposure to sustainability-related activity from their executive experience, if addressing climate-related risks was a key metric of success.

Making appointments to boards and board committees

To progress board appointments and ensure increasing levels of climate competence on boards and board committees, boards (and chairs) could consider the following questions:

- How will you ensure and assess new director recruits are climate competent?
- How are these skills balanced against the need for other skills?
- Are you regularly reviewing your board to ensure climate competency is present?
- How will you preserve that capability, or refresh underperformance?
- Do you have a succession plan to ensure consistency and ongoing advocacy for the sustainability agenda around the board table?
- Have you considered including younger voices and the insights our next generation can offer?
- Are you considering the diversity of the board when making appointments?

After board appointments are made

Board appointments are only one part of ensuring boards and committees have relevant climate competence and literacy. Future considerations include:

- **Skills development:** Deliberate conversations with the board and chair ahead of a director recruitment process, regarding skills gaps and future needs regarding sustainability skills and experiences, should be undertaken. In parallel, criteria for appointing directors with climate capabilities should be developed, including which skillsets are prioritised and how new appointments are assessed. Inevitably, there will be trade-offs in any appointment, and a view around 'must have' vs 'nice to have' capabilities should be agreed. Without transparent messaging, organisations run the risk of criticism from interest groups and leave shareholders and stakeholders uncertain as to how directors are being appointed and why they are retained.
- **Succession planning, learning and development:** This ensures the board remains balanced and capability is preserved. It also triggers an urgent need to develop current and future executive leaders with the skills. What entities are offering training and development offerings in Aotearoa and internationally to acquire those skills, and how quickly can they scale? The need is now.
- **Diversity and inclusion:** When establishing committees, are you considering the diversity of voice and perspective? It is important to set a culture of inclusivity to ensure that the diversity of opinions, experiences, skills and perspectives are best utilised and incorporated within decision making.

Directors' capabilities – who do you need in your mix?

Recent research suggests diversity of thought is an important precursor to effective climate governance. Boards need to consider the characteristics and capability of directors appointed to board committees, as much as the board as a whole.

A 2019 study, *Corporate Social Responsibility, Board Structure and Gender Diversity: Evidence from Australia,* found boards with risk management and corporate social responsibility (CSR) committees were correlated with better CSR performance. Further, it found gender diversity on boards is correlated with better CSR performance.

A 2015 UK study, *Gender Diversity, Board Independence, Environmental Committee and Greenhouse Gas Disclosure*, found gender diversity on boards was an indicator of more fulsome greenhouse gas (GHG) reporting. Boards with more independent members also demonstrated a higher tendency to transparent GHG reporting.

These findings were echoed in *To Green or not to Green: the Influence of Board Characteristics on Carbon Emissions*, a 2023 study of companies from 46 countries that found boards with strong financial or industry-specific skills, or a higher share of women, tended to achieve higher reductions in GHG emissions. It also found a positive relationship between independent board members and GHG emissions reductions.

Questions to consider

- What is the board-level understanding of climate change?
- Do we have the right competence on our board and access to the right expertise?
- Have we included climate competence in our skills matrix?
- Do we have an education plan in place to enhance climate competency?
- Is the board size, composition and diversity meeting the company's evolving needs?
- Does management have sufficient resources to respond?
- Have we connected climate change with our strategy and culture?
- Are climate-related factors informing strategic decisions?
- Where does responsibility for climate change lie at a board level?
- Do we need to establish a specialised committee?
- Are we undertaking regular evaluations of the board and our committees?
- How is climate change integrated into wider risk-management processes?
- Where are the greatest risks and opportunities?

Additional resources – what the governance world is doing and thinking

There is a large amount of literature that can help boards understand current ideas in climate governance. You may find useful guidance in the experiences of others:

Australian Institute of Corporate Directors. (April 11, 2019). **Do board committee structures need a rethink?**

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KPMG. (September 2021). **Boardroom climate competence: Getting ahead of the curve.**

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KPMG (2022). **Governance challenges 2022: Climate governance.** NACD.

KPMG (December 6, 2021). **On the 2022 audit committee agenda.**

Kreuzer, C., & Priberny, C. (March 13, 2023). **To green or not to green: The influence of board characteristics on carbon emissions**. Finance Research Letters, Vol 64.

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About Chapter Zero New Zealand

The Institute of Directors New Zealand (IoD) is proud to be the host of Chapter Zero New Zealand, the national chapter of the Climate Governance Initiative (CGI). This global network seeks to mobilise, educate and equip directors with the skills and knowledge necessary to address climate change at board level.

Chapter Zero NZ is grateful for the support of our key partners who provide guidance and expertise to help us serve the director community.

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