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Boardroom climate competence

Advancing the board-management conversation

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Climate change in the board-management conversation

Shifts in the regulatory, political, competitive, and physical landscapes associated with climate change are leading to greater board engagement with management than we observed when we published our first paper in this series on boardroom climate competence in September 2021. The physical impacts on business operations are increasing as extreme and unusual weather proliferates, yet the challenges of adaptation and mitigation are burdened by economic and geopolitical realities. At the same time, a wealth of innovation in greener products and ways of doing business offer tremendous opportunities for value creation across a wide span of industries. These factors are driving the evolution in the board-management conversation, along with increasing stakeholder pressure for transparency, attacks on greenwashing, and a focus on data sourcing and verification in preparation for upcoming regulatory disclosure requirements.

Insights from the interviewees for this paper—as well as ongoing conversations with board members and business leaders—indicate that board members and management are engaging more frequently in discussions that factor in climate change and are seeking a broader array of perspectives from across the organization. This paper explores the shifts in the board-management conversation associated with climate change on the topics of value creation, risk, talent, and communication. As our interviewees made clear, the board's guidance and support of management are critical as companies work through green initiatives and strategies aligned with long-term imperatives.

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For the other papers in this series, see:

- Boardroom climate competence: Getting ahead of the curve
- Boardroom climate competence: Organizing for oversight

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The board-management conversation: Value creation

In a significant shift from the early days of climate change consideration, board directors no longer view climate issues as solely a matter of compliance or risk. Now, many also see the value creation opportunity for their companies: new markets and assets, alternative energy sources, resource efficiency, new products and services, and infrastructure and supply chain resilience.[1] Benefits may include immediate and longer-term revenue, employee and customer loyalty, and, ultimately, brand value. Such focus requires boards to drive an emphasis on innovation, and, "integrate climate considerations into business metrics," as one executive said. Board-management discussions are focusing on areas that include:

Operating efficiency. Climate-related initiatives often provide an impetus for companies to operate more efficiently and reduce costs over the long term. As one board director said, "Recycling as much as possible is helping us to reduce waste and water consumption, resulting in cost savings." And as a chief sustainability officer (CSO) said, companies that bake this mindset into their operations from the outset will see the benefit and avoid costs associated with having to change operations later on.

Government incentives. With the advent of the Inflation Reduction Act at the federal level, as well as numerous state and local programs, financial incentives are increasingly available in connection with electric vehicles; solar, wind, and other types of renewable energy; battery storage; green hydrogen; carbon capture; and other climate-focused initiatives.[2] Boards are asking management whether and how the company is taking sufficient advantage of these opportunities; management should be prepared to understand and leverage available incentives.

Evolving products and services. While climate may disrupt many existing lines of business, it also opens the door for new products and services. As we heard from our interviewees, products such as meat and dairy alternatives, electric tow trucks, and noncombustible exterior home siding, as well as expanding the availability of renewable electricity, may be significant value creators. As both a director and an executive from a building supply company commented, investments in climate-friendly products are frequently discussed between management and the board, filtered through the same lens as other forward-looking business investments.

"Where is the industry going, and how do we make sure that we're not bringing up the rear?"

[1] KPMG LLP, Climate risk and resilience, 2023.
[2] Bank of America Institute, IRA ripple effect: 10 areas of impact, August 2023.

Based on our conversations with board directors and business leaders, a few recommendations emerged. Not surprisingly, while the recommendations were specific to engaging with management on climate issues, they are a useful reminder of some keys to board effectiveness overall:

- **Understand the landscape.** The response of businesses to the implications of climate change is evolving, and boards, together with their management teams, need to keep pace. As a director of a retail company said, "Where is the industry going, and how do we make sure that we're not bringing up the rear?" Another director encourages continuing education that includes the board and management: "We seek out noncompetitive companies to meet with and have an exchange on climate leadership topics."
- **Engage across the enterprise.** In the past, boards frequently received their climate updates from the chief executive officer (CEO), supported by a CSO or head of risk. With climate considerations increasingly viewed as core to value creation and corporate strategy, boards should ensure they are accessing perspectives from across all relevant parts of the organization. Increasingly, that means going out into the field: "Visits to production sites and soliciting a range of views help us gather input so that when we discuss strategy, we are more prepared."

- **Align on the timeframe for investments.** Given the long-term nature of some climate-linked opportunities, expectations around timeframes for success can support or defeat a project. For some companies the issues are existential. When considering the climate aspirations of some failed early-stage companies, one director recalled: "Had they been patient, slow-growth companies, they might have been perfectly timed. However, the managers and investors wanted success in a couple of years, not a couple of decades." It is important that management and the board share an understanding of the expected timeframe for climate-related initiatives, and that they continue to communicate and calibrate as realities change.
- **Link climate-related value creation to the company's purpose.** Perhaps the most important way boards can influence their companies' approaches to climate issues is to convey to management the importance of linking to the company's purpose. Examples from industries as diverse as fintech, energy, and building materials are:

  "We're a mission-driven company that is only going to be successful if we have an ongoing relationship with our members. Our membership is our business, and therefore doing things that seem appropriate to our membership is always a good idea."

  "Our mission is to help people. Our climate-related action is business related. It's all about making money and advancing our mission."

  "Our mission is 'building a better future for all', meaning for all stakeholders. Not only for the shareholders, but also for the planet, for the employees, for our customers—for everybody, 360 degrees around us. We view environmental, social, and governance (ESG) investments like any other business investment. What does it bring in terms of hard benefits you can calculate, like reducing energy use, but also how does it advance who we want to be and how we want to be regarded?"

The board-management conversation: Risk

The risks of climate change are no longer hypothetical. The summer of 2023 offered a glimpse of what the future may hold in a warmer world, with devastating wildfires in Canada[3] and Hawaii,[4] floods in Norway[5] and China,[6] drought in the US Midwest threatening grain yields,[7] and severe heat and storms across a large part of the US leading to power outages. Not surprisingly, "directors are feeling a responsibility to understand how climate might impact their businesses:"

Physical risk. Boards need to assess the robustness of the company's crisis management processes. In the past, it might have been sufficient for management to undergo a tabletop planning exercise to prepare for a production halt in an individual facility due to natural disasters common to the area. While such an exercise is still important, the board should expect an expanded lens so that the company is also ready for extreme weather events that were previously rare or even unheard of in areas where company operations are located, as well as in the supply chain. In addition, given the increasing possibility that numerous facilities will be impacted simultaneously—perhaps one by wildfires, one by flooding, and another by damage and/or lengthy power outages in the aftermath of a storm—the scope of management's readiness for new and unexpected complexity should be examined.

In addition to assessing preparation for the immediate aftermath of an emergency, understanding management's scenario planning as a forward-looking means to build resilience into the supply chain is critical. As one director said, "Scenario planning is only as good as the scenario." Observation of a planning exercise provides an opportunity for board members to assess whether management has the right resources and processes in place to anticipate and address a sufficiently broad group of scenarios and to plan for contingencies. And climate change considerations lead to a long-term lens. One director said that plans for new facilities should take access to insurance coverage into account. As insurers withdraw from writing coverage for fire and flood for property and casualty policies in certain markets, decisions on allocating capital for new locations may raise the question, "Will the company be able to insure this facility over the next 25 years?"

[3] Ally J. Levine, Nia Williams, and Prinz Magtulis, Canadian wildfires burning land at record pace, Reuters, July 24, 2023.
[4] Marco Garcia, Maui fires: recovery to take years, Reuters, August 11, 2023.
[5] Terje Solsvik and Victoria Klesty, Norwegian river dam partly collapses, government expects more floods, Reuters, August 9, 2023.
[6] Simone McCarthy, Kathleen Magramo, and Berry Wang, China floods: More than a million displaced as Hebei region reels after record rains, CNN, August 5, 2023.
[7] According to the United States Department of Agriculture August 2023 Wheat Outlook, approximately 52% of US spring wheat production is within an area experiencing drought as of August 8, 2023, compared to only 18% as of the same time in 2022.

Transition risk. The policy, legal, technology, market, and reputation risks associated with transitioning to a lower-carbon economy,[8] known broadly as transition risk, is another critical area of increasing board-management engagement, both as a matter of opportunity and of managing risk. One director described the tension at an electric utility: "The consumer perspective is on both ends of the spectrum. Some want greener production, but all want low costs and high reliability. Our regulators would like to see us continue to rely on coal, but then we have customers who want all green energy and investors who want to see our climate footprint decrease." Because navigating these issues is highly challenging, political, and critical to company strategy, management frequently discusses the company's mix of wind, solar, natural gas, and legacy coal with the board in depth. While energy companies are front and center on climate transition risk, all companies are affected and need to plan their own path forward.

Global market access. As climate becomes a crucial topic of regulation around the world, compliance in all markets in which the company does business is becoming more complex and may affect the company's strategy enterprise-wide. While not yet issued as of the publication of this piece, the US Securities and Exchange Commission's (SEC) final rules on climate change disclosure are expected prior to the end of 2023. The EU is also phasing in regulations, both with respect to disclosure (the Corporate Sustainability Reporting Directive [CSRD]), and in the form of a tax applied to carbon-intensive products produced outside and imported into the EU (the Carbon Border Adjustment Mechanism [CBAM]).[9] As one director of a US-based company said, "In order to sell in the EU, we must comply with their standards. The fact that we have European operations is pushing us to go a little bit faster and further in the US as well."

Apart from compliance, companies with a customer base in industries that are sensitive to climate issues receive pressure from those customers. For example, as one manufacturing executive said, "Our major tech customers all have requirements for us to come in line over the next few years with climate objectives outside the US." Boards need to assess whether their management teams are keeping up with evolving expectations and requirements for access to relevant markets, while management needs to keep boards up to speed regarding these challenges and their plans to address them.

Polarization risk. An additional risk that is challenging boards' ability to engage on climate issues is the prospect that business conversations that incorporate climate-related topics will be sidetracked or completely derailed by politicization of the topic. As one director said, "What I'm seeing in some places is that because of the politics, some boards think 'Oh, I don't have to talk about this anymore.' Oh my gosh, no, you have to. There are so many things going on that impact every business and I see no data showing that it's going to slow down. I think as board members we need to be really strategic about how we're going to deal with it." The board and management can set the tone together. As one executive said, "It's not a political thing. It's a hard business case, tied to our values—being a company that people trust and want to buy products from and want to work for and want to invest in."

"It's not a political thing. It's a hard business case, tied to our values—being a company that people trust and want to buy products from, work for, and invest in."

[8] Task Force on Climate-related Financial Disclosures, Recommendations of the Task Force on Climate-related Financial Disclosures, June 2017, pp. 5–6.

[9] As part of the CSRD, impacted companies must report on an audited "double materiality" basis for their entire operations, including US and other non-EU businesses that meet certain thresholds for EU-based revenue. Both CSRD and CBAM are effective in 2023 but applicability will phase in over a number of years. For more, see KPMG Financial Reporting View on CSRD requirements for non-EU companies.

The board-management conversation: Talent

How does the board engage with management to assess whether the organization is prepared? The board-management conversation should focus on whether there is appropriate expertise and accountability at the senior levels, whether there is widespread organizational climate-related capability, and the sufficiency of the company's processes and incentives to create the conditions for success. Of course, leadership, starting with the CEO, pulls it all together. "I have had experiences with CEOs who were just talking the talk, and experience with those who truly believe. In order to put together a group of people and follow a mission that is cohesive, it really does take a believer," said one director:

Evolution of the CSO. Relevant climate-related expertise at a senior level can add value as the company broadly considers climate impacts as an input to strategy. "ESG was previously investor and risk focused. Moving me to the executive leadership team was key to showing that this is part of strategy and how we do business," said one CSO. Given the strategic importance of this role, it's not surprising that the number of companies with CSOs has risen, with demand for CSOs increasing globally by 228 percent over the last decade.[10] "You're looking for executives who are innovative, who can think differently. Climate is challenging, so you want executives who can think across industries, not just in their silo," said one director.

Climate capability across the organization. Sustainability is not only the job of the CSO. As one director said, "Is sustainability shared in the supply chain? Is it shared by the sustainability team? Is it shared by the management team? Is it shared by the product team, which is responsible for the packaging? Is it shared by the marketing team, which is responsible for global product management? All of these areas impact the climate." The issue this director highlights is echoed globally. According to a 2022 LinkedIn report, "The vast majority of green skills are being used in jobs that aren't traditionally thought of as green—such as fleet managers, data scientists or health workers."[11] Indeed, companies are challenged to recruit this talent. Some are taking creative measures. As one executive said, "At least one-third of our US employees are fully remote, and that's intentional. We're looking for the

"Climate is challenging, so you want executives who can think across industries, not just in their silo."

[10] Kate Birch, Charting the rise of the chief sustainability officer, Business Chief North America, June 4, 2021.
[11] LinkedIn Economic Graph, Global Green Skills Report 2022, 2022, p. 3.

best talent, not the best geography for the talent." In addition to recruiting for needed skills, companies are working to upskill existing talent through internal programs and external degrees and certifications.[12] "Education at the lower levels is important. It's got to become part of the DNA of the organization," said another executive.

Structure and process will be different for every company, depending on industry, where they are in the climate journey, and the organization's culture. Some examples of how other companies have established the conditions for success are:

"A matrixed effort is quarterbacked by the director of sustainability, who has a PhD in carbon-pricing economics. There's a heavy assist/dotted line to highly specialized accountants. There's a VP for 'grid of the future' focused on grid architecture. There's also an executive focused on reporting who serves on a subset of management's disclosure committee."

"I hired people out of the National Security Council because they really understand risk and could help with business continuity plans around tornadoes and other climate-related risks. We also brought in a consulting group to help design for sustainability—everybody says it, but how do you really do it?"

"We had a cross-functional feasibility task force to get deeper into the organization—engineering, plant, and procurement. And they convinced themselves the emissions and zero-waste goals are doable, and we'll actually save money on the way."

"Over the last few years, the ESG team was driving the boat and then they moved the accountability into the business. That's really helped to accelerate things."

Attracting talent. Climate can also be a value creator in terms of attracting talent. Boards should understand this dynamic and encourage management to communicate climate action as part of company culture and recruiting. For instance, one executive said its headquarters location helps draw top talent in a region that is particularly focused on the energy transition, given that its core product, batteries, is part of the solution. Even companies for whom climate is not a central focus can benefit from communicating their climate stance to their employees. According to one director, "Companies develop camaraderie and a sense of common mission through thinking about, talking about, and working on complex problems. So even if a company isn't particularly exposed to climate as a topic, recognizing the challenge is a healthy thing in today's world."

Maintaining a climate-competent board. Climate literacy and continuing education at the board level are critical for all boards, and some boards may also need directors with deeper climate expertise as board members. And as one director suggested, the analysis of what type of climate-related knowledge is needed at the board level has become more nuanced over time: "Boards should have someone who's very appreciative of the climate aspect, but there are so many aspects. There's technology, there's policy, there's finance, there's communications. We have an investment banker who is focused on how investors are looking at climate. It's not as science-driven or technology-driven as my background, but it's a really important perspective on climate."

[12] World Economic Forum, With green jobs booming, here's how to plug sustainability skills gap, January 9, 2023.

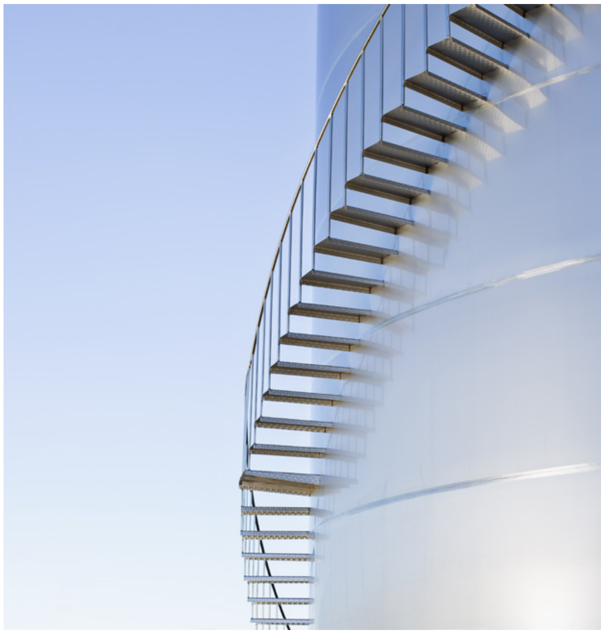
The board-management conversation: Climate-related communication

A web of reporting and regulatory disclosure frameworks dots the globe and makes consistent information and messaging is its own challenge. From pending SEC rules, the CSRD, the Greenhouse Gas Protocol, the International Sustainability Standards Board, the Task Force on Climate-related Disclosures, and the new California disclosure legislation,[13] companies are increasingly facing the task of managing voluminous and sometimes competing requests for information from multiple stakeholders.[14] Changes in both the regulatory landscape and investor expectations are driving enhanced board scrutiny and a focus on clear and consistent communication.

"With each of these [disclosure frameworks], there's more data and more qualitative assessments that the company has to do," said one director. "We have added staff and a data analyst just to prepare. And we're conducting a gap analysis. What do we have? What do we not have and what have we budgeted for? How are we going to bring it all together?" Another director put it more bluntly: "There's one rule: Don't lie. And as a board, we have to consider how the company is responding to investor questions. Are we getting ahead of it? We may be able to avoid contentious shareholder fights simply through better communication."

Oversight of disclosure as a matter of compliance. While voluntary sustainability reports may previously have received a light board or committee review, existing government scrutiny and upcoming mandatory disclosures in the US and the EU require a deeper level of oversight, comparable to oversight of financial disclosure. This begins with clarity as to who on the board or what committee has responsibility for oversight, and which communications that draw on the company's climate goals and metrics will be reviewed—earnings releases, quarterly and annual reports, proxy statements, investor presentations, promotional material, and more. "Is what we are currently disclosing precise enough to withstand SEC scrutiny?" asked one director. "The audit committee needs to know that the data is consistent and reportable."

"There's one rule: Don't lie."



[13] Coral Davenport, California Governor to Sign Landmark Climate Disclosure Bill, The New York Times, Sept. 18, 2023.

[14] See more on ESG reporting from KPMG Global.

Beyond compliance—moving toward alignment. Cutting through the noise across regulatory filings, sustainability reports, analyst days, marketing and advertising, and customer and employee relations, the company must communicate its approach on climate in a manner that is coordinated with strategy, verifiable by third parties, transparent to all stakeholders, and, above all, consistent. "Having the leader of the company driving the message makes all the difference," said one executive.

Boards should engage with management and ask the following questions:

- Is the company's message clear, concise, and consistent?
- Is company leadership, including the board, able to articulate how the company's strategy incorporates climate risk and opportunity?
- What is the nature of reported and disclosed climate data? How has it been validated, assured, or audited?
- Who is the company sharing information with (third parties, employees, customers) and is that information consistent with what is being shared publicly?
- How does the board organize itself to set the tone and review (as needed) climate-related communications?

Management's disclosure committee in the spotlight

Increasingly, whether as a result of regulation, litigation, or stakeholder expectations, climate-related disclosures are expected to be high quality. This presents an opportunity—if not an imperative—for audit committees to address the role of management's disclosure committee in maintaining disclosure controls and procedures, both for climate-related disclosures contained in SEC filings and for voluntary disclosures in sustainability reports, on websites, or elsewhere. For the board and audit committee, the KPMG Board Leadership Center suggests five areas of focus:

- The disclosure committee's role and responsibilities, including coordination with relevant cross-functional management team(s) or committee(s)
- Composition of management's disclosure committee
- Disclosure controls and procedures around voluntary climate-related disclosures
- Readiness for compliance with SEC and other relevant rules on climate-related disclosures once the rules are finalized and effective
- Expansion of management's subcertification process to support CEO and CFO quarterly certifications regarding design and operational effectiveness of disclosure controls (including internal controls) and procedures.

For more, read *ESG puts management's disclosure committee in the spotlight*.

Conclusion

How the board and management approach climate-related issues will vary from company to company, influenced by the company's specific issues and the culture of the organization and of the board. But as we've seen through our interviews, no matter how each company addresses it, the company benefits from this increased dialogue touching on matters of value creation, risk, talent, and communication.

As companies continue to move forward, final thoughts are best *summed up by our interviewees.*

The management perspective:

> *"The vulnerability of my board members to ask, 'what do we not know?' is something that I greatly value. Their curiosity has been inspiring to me, and keeps me motivated."*

The board perspective:

> *"As the board, we need to be thinking about climate because it's so strategic. There's no company that will not be affected by climate, for good or bad. You have to talk about it thoughtfully and it has to be completely tied to your business strategy. You can't ignore it—that's at your peril."*

About the KPMG Board Leadership Center

The KPMG Board Leadership Center (BLC) champions outstanding corporate governance to drive long-term value and enhance stakeholder confidence. Through an array of insights, perspectives, and programs, the BLC—which includes the KPMG Audit Committee Institute and close collaboration with other leading director organizations—promotes continuous education and improvement of public and private company governance. BLC engages with directors and business leaders on the critical issues driving board agendas—from strategy, risk, talent, and ESG, to data governance, audit quality, proxy trends, and more.

About Plan C Advisors

Plan C Advisors provides in-boardroom climate education and ongoing advisory services to advance board oversight of climate risks and opportunities. Our team consists of current board directors and seasoned top executives from iconic global brands who bring deep operating experience in climate and ESG across industry sectors. Our purpose is to equip business to play a pivotal role in accelerating action on climate, the most urgent and consequential concern of our times.

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The views and opinions expressed herein are those of the interviewees and do not necessarily represent the views and opinions of KPMG LLP.