KPMG

Boardroom climate competence: Getting Ahead of the Curve

Board Leadership Committee
November 2021

Six Climate-related Areas

The clamor for attention to climate change as a financial risk has become more urgent and boards of all companies, irrespective of size of industry, need to take note.

We will discuss the six climate-related areas that are critical to board oversight. The framework for board oversight will be shared to provide guidance in framing the climate-associated issues.

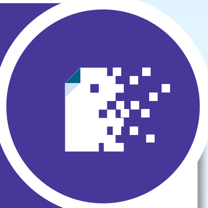
- Level Setting
- Risk Assessment
- Opportunity Assessment
- Integration
- Board Governance
- Communication

Level Setting: Net Zero

FOCUS THE DISCUSSION:
Observed increase in well-mixed greenhouse gas concentration

The term “net zero” refers to balancing the amount of greenhouse gas (GHG) emitted with that removed from the atmosphere. Carbon Dioxide is one of the GHGs targeted because it is a substantial factor in climate change. Business can strive to reach net zero by identifying, mitigating and monitoring three types of GHG emissions

Scope 1



- Direct company-owned or – controlled emissions occurring at the source, including facilities and manufacturing operations

Scope 2

- Emissions associated with the production of energy consumed by a company, for instance electricity generation

Scope 3

- Indirect emissions associated with company activities from sources not owned or controlled by a company, including the supply chain

Stakeholders are increasingly demanding net zero plans from companies, The plans must be understood and endorsed by the board, have actionable interim targets and be regularly tracked and reported on.

Risk Assessment

TAKE A COMPREHENSIVE LOOK AT CLIMATE RISKS FOR YOUR BUSINESS:

1. **Short-term considerations: crisis planning for operational resilience in the event of disruption due to the damage from extreme weather**
2. **Long-term planning: a strategic look at the company future supply chain vulnerabilities in the event of varying degrees of global warning**

Assessing management's climate-related risk processes

Who in the organization is responsible for the assessment?

Does the assessment process include involvement by key business leaders and sustainability experts?

How were stakeholder perspectives factored into the assessment?

Which stakeholders were considered and are any important stakeholders are missing?

Were the risks assessed based in scenarios consistent with global warming at 1.5"C and higher?

Were the timelines considered in the assessment consistent with the company's business and capital investment time horizons?

Can company leadership clearly articulate how the risk assessment and business strategy are integrated?

Transition Risk faced by the Board oversight

"Risks associated with the transition to a lower-carbon economy, the most common of which related to policy, tax, and legal actions, technology changes, market responses and reputational considerations"

Talent-related transition risk

"Employee tend to want to be in the parts of the company working on newer, cleaner technologies."

Risk Assessment

The board and management should also consider rising costs of capital and even potential loss of access to the capital markets due to the company's stance on climate and climate-related targets.

Financial institutions are having more pressure to the sustainability of their debt and equity portfolio and major lenders are focusing more on physical and transition risks embedded in their loan portfolios.

As part of a comprehensive look at climate-related risk, boards should :

1. **Encourage management to understand and incorporate stakeholder demands, transition risk and climate-related physical risk into the company's ERM program or other applicable risk assessment**
2. **Determine whether the company's scenario planning is sufficiently robust to identify climate-related business impacts that have a longer timeframe than typical ERM assessments**
3. **Support a culture of readiness across the enterprise to promote early detection and management of climate impacts**

Opportunity Assessment

Reevaluate your strategies in light of climate change to identify opportunities for growth and transformation

Actions that boards should consider to realign strategy with climate realities

Examine company values, mission and key assets

Conduct a “climate foresight” exercise to explore how climate may impact your company in the short term, medium term and long term (at least 5 – 10 years)

Reevaluate products, services, and operations based on climate, highlighting core assets and points of differentiation

Consider a balance need to maintain/enhance firm value today without compromising the ability to create value in the future

Climate-related trends should be examined as external forces that mzy enable or disrupt the company’s business model. Confronting the implications in strategic discussions will help the boards in guiding the companies in mitigating risk but to open new opportunities.

Long-term scenario planning helps to anticipate and embed resilience into company strategy. Considering investment discussion through the lens of potential climate scenarios can position the company well.

Climate considerations may require strategic trade-offs which the board can help to guide.

Integration

Encourage engagement across the entire enterprise

A broad-ranging climate-related goal is unlikely to succeed without organizational alignment on the goals, processes and incentives that will enable success.

Boards should consider whether the company structure and processes are optimized to enable integration.

An organization-wide effort should be paid to drive climate-focused employee engagement through a social media platform for crowd-sourcing employee ideas and several other cross-company initiatives

Boards should assess how the company is engaging with others to drive synergies.

Ways to encourage integration of climate action

View climate holistically, as more than the E in ESG

Guide management to develop an enterprise stance on climate action based on science, company capability and interests of external and internal stakeholders

Encourage climate education, consistent language and collaboration on goals setting and implementation across the organization

Consider the appropriate metrics and incentives in connection with executive compensation and compensation philosophy for the organization as a whole

Consider management’s external outreach efforts, including consumers, business consortiums and public/ private partnerships

Board Governance

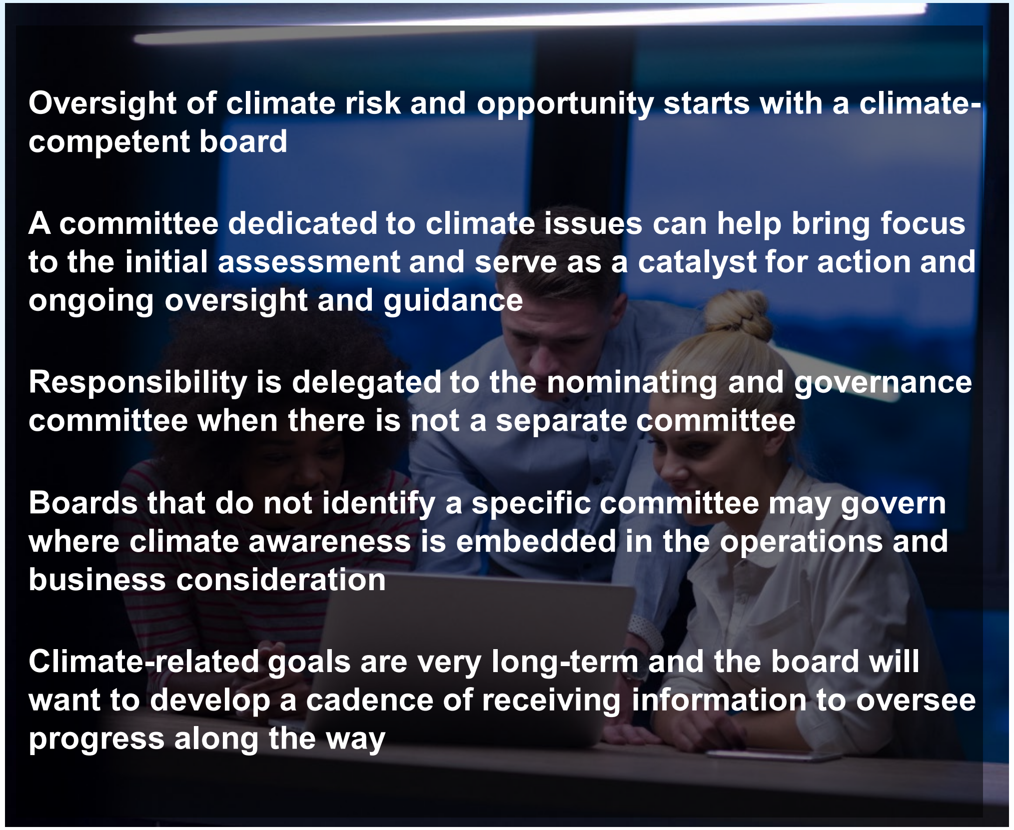
Ensure that climate-related oversight is built into the board composition, structure and process

Ways to find the right balance between long-term and short-term goals

Ensure the board it self is fit for purpose with respect to climate issues. As part of the board evaluation, assess whether the board has the right mix of skill sets and whether directors pursue ongoing education sufficient to enable informed assessment and discussion of the issues

Assess and continuously improve the board's committee structure and agendas to address the critical issues to oversight of climate-related risks, opportunity and enterprise-wide integration

Consider how management will report to the board and be held accountable for climate-related commitments



Oversight of climate risk and opportunity starts with a climate-competent board

A committee dedicated to climate issues can help bring focus to the initial assessment and serve as a catalyst for action and ongoing oversight and guidance

Responsibility is delegated to the nominating and governance committee when there is not a separate committee

Boards that do not identify a specific committee may govern where climate awareness is embedded in the operations and business consideration

Climate-related goals are very long-term and the board will want to develop a cadence of receiving information to oversee progress along the way

Communication

Set the tone for disclosure and stakeholder engagement

Investors are requesting specific disclosures related to company plans to achieve net zero emissions. The challenges surrounding disclosure encompasses three broad areas of focus:

1. **Are the company’s discourses that are filed with the relevant regulators accurate and appropriate under the rules?**
2. **Does the company have in place a process to mitigate risk of litigation and reputation risk from its overall climate-related public communications?**
3. **Is management sufficiently tracking and ready to respond as relevant regulators proceed towards rulemaking with climate disclosure?**

The company’s story should be consistent, whether communicated directly by a board director to an institutional shareholder, by the CEO if a client or in a sustainability report or regulatory disclosure

Ways to stay on top of communication, engagement and disclosure

Have working knowledge of the frameworks and ratings most relevant to the company and how the company is currently tracking

Be able to articulate the company’s leading climate issues and how they are linked to strategy. Investors now expect this of directors

Evaluate the processes and controls for the collection and communication of climate-related data

Insist on a process that avoids disconnects between the company’s statements and conduct

Contact us

Alva Lee
Partner
Tel: +852 2143 8764
alva.lee@kpmg.com

Jia Ning Song
Partner
Tel: +852 2978 8101
jianing.n.song@kpmg.com

Jeffrey Hau
Partner
Tel: +852 2685 7780
jeffrey.hau@kpmg.com

Edna Wong
Partner
Tel: +852 2143 8693
edna.wong@kpmg.com

David Lonergan
Partner
Tel: +852 2826 7195
david.lonergan@kpmg.com

Jens Kessler
Director
Tel: +852 2143 8584
jens.kessler@kpmg.com

Paul Cheng
Director
Tel: +852 2847 5075
paul.cheng@kpmg.com

Claudia Yu
Director
Tel: +852 2685 7898
claudia.yu@kpmg.com

Safa Sadigh-Mostowfi
Director
Tel: +852 2826 7263
safa.mostowfi@kpmg.com

Gianfran Liu
Director
Tel: +852 2847 5164
gianfran.liu@kpmg.com