

FRC Climate Thematic

Governance – How are boards taking account of climate-related challenges?

November 2020



Introduction

Throughout 2020, the Financial Reporting Council (FRC) has been undertaking a thematic review of climate-related considerations by boards, companies, auditors, investors and professional associations. This report forms part of that review and addresses the question ‘how are boards taking account of climate-related challenges?’.

Other aspects of the FRC’s findings can be found at the following links:

- The consolidated findings across corporate reporting and audit can be found [here](#).
- The detailed findings on corporate reporting can be found [here](#).
- The detailed findings on audit can be found [here](#).
- The detailed findings on professional oversight can be found [here](#).
- The detailed findings on investor reporting and better practice reporting under the Task Force on Climate-related Financial Disclosures can be found [here](#).

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We asked:

How are boards taking account of climate-related challenges?

Why is this important?

Climate change is a crisis affecting everyone and companies do not exist in isolation. Boards have a responsibility to consider both the impact the company has on the environment and how climate change might affect the success of the company, in both the short and longer term.

To govern successfully, boards cannot exclude climate change from their strategic decision making. They should be transparent with shareholders and other stakeholders by disclosing clear and relevant information.

What did we do?

We assessed a sample of 60 premium-listed companies' governance structures and references to climate-related considerations in the context of the [UK Corporate Governance Code](#).

We spoke to investors to re-test their views to see if, and how, they had developed since the publication of the FRC Lab's 2019 report on [climate-related corporate reporting](#) outlining investors' views on the state of reporting and what they wished to see.

What did we find?

It is the board's responsibility to consider climate-related issues, but there is little evidence that business models and company strategy are influenced by integrating climate considerations into governance frameworks.

Background

The challenges of climate change

The [Paris Agreement](#) aims to strengthen the response to climate change by: “Holding the increase in the global average temperature to well below 2°C above pre-industrial levels and pursuing efforts to limit the temperature increase to 1.5°C above preindustrial levels, recognising that this would significantly reduce the risks and impacts of climate change”, amongst other aims.

A serious reallocation of resources would be required to meet these goals, and therefore companies can be exposed to a wide range of risks and opportunities. Below is a high-level overview of some of the physical and transitional risks and opportunities companies will face. Climate change considerations are obviously relevant for entities across many industries and will therefore be relevant for their reporting and the audit of their financial statements.

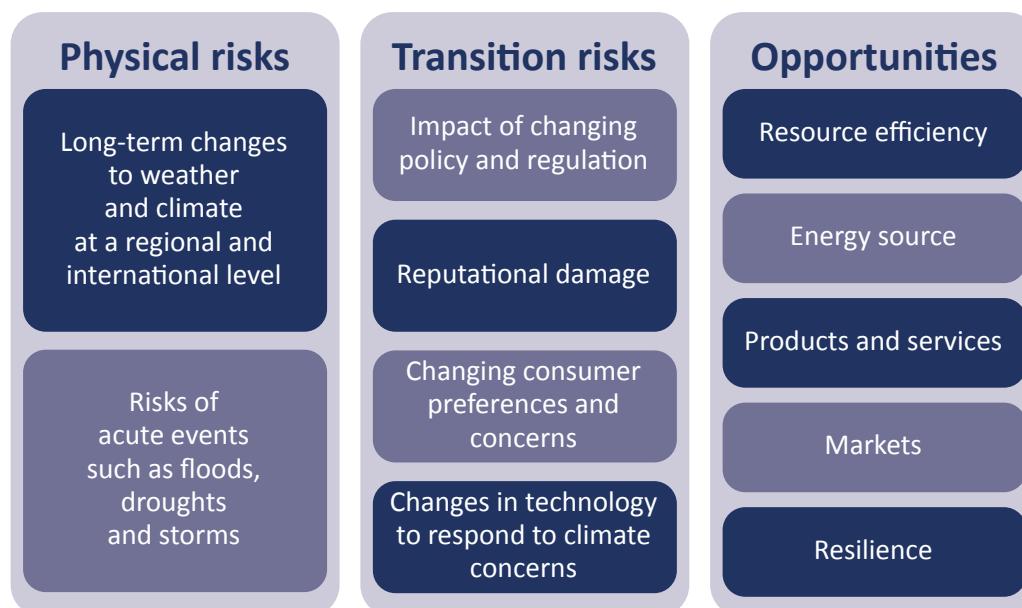


Figure 1: Possible physical risks, transitional risks and opportunities companies may face, as identified by the [Task Force on Climate-related Financial Disclosures](#) (TFCD).

FRC statement - Green Finance Strategy

In 2019, the FRC published a [joint statement](#) alongside the Financial Conduct Authority (FCA), the Prudential Regulation Authority (PRA) and The Pensions Regulator stating our view that the challenges associated with climate change, including both physical factors, such as extreme weather events, and transition risks that can arise for the process of adjustment to a carbon neutral economy, would challenge and change our society and the wider market.

At the time, the FRC also [stated](#) that:

The boards of UK companies have a responsibility to consider their impact on the environment and the likely consequences of any business decisions in the long-term. They should therefore address, and where relevant report on, the effects of climate change (both direct and indirect).

We are conscious that climate change is a multifaceted issue, presenting challenges for boards which must navigate an uncertain future to inform their decisions and develop strategy. In providing strategic assessment and direction boards should be taking into account the possible effects of climate change on their company and ensuring that the needs of users are met regarding the information disclosed.

UK Corporate Governance Code

The [UK Corporate Governance Code](#) (the Code) promotes good practice in governance and long-term sustainable success. Principle A states that:

A successful company is led by an effective and entrepreneurial board, whose role it is to promote the long-term sustainable success of the company, generating value for shareholders and contributing to wider society.

The Code does not include specific provision on environmental issues, but a number of the Code's principles cover matters relating to the environment, including the requirements to assess and manage the company's risks and the board's responsibility for narrative reporting and for engagement with wider stakeholders. Climate change cannot be excluded from these principles of good governance.

The Financial Reporting Lab report

The Financial Reporting Lab's 2019 [report](#) on climate-related disclosure outlined investors' views on the integration of climate-related considerations into company activity and reporting. This report found that investors were interested in climate-related reporting, and the investors we spoke to were supportive of the TCFD framework of 11 recommended disclosures across four core areas as a framework for companies to think through, and report on, their climate-related issues.

Climate change can be a new consideration for some, so in order to help companies consider the challenge and what they might report in the context of the TCFD recommendations, the Lab's report outlined a series of questions investors encourage companies to ask themselves in relation to governance, strategy, risk management and metrics and targets.

We spoke to a range of investors as part of the 2020 thematic. Investor expectations continue to develop and increase, but the areas of focus and consideration for investors remain similar to those identified within the Lab's report last year. Investors still seek to understand similar questions, so we encourage companies to continue to ask themselves the questions in the Lab's report.

The insights investors shared with us as part of the this thematic, and some examples of better practice disclosure, can be found in the report on investors [here](#).

The FRC has also released a statement encouraging public interest entities to report using the TCFD and the Sustainability Accounting Standards Board metrics relevant to their sector. The FRC's statement on non-financial reporting can be found [here](#).

The Task Force on Climate-related Financial Disclosures

The TCFD, established in 2015 by the Financial Stability Board, was tasked within reviewing how the financial sector could take account of climate-related issues. In 2017, the TCFD published a [report](#) which set out four core elements of recommended climate-related financial disclosures that apply to organisations across sectors and jurisdictions, as outlined below.

- Governance: The organisation's governance around climate-related risks and opportunities.
- Strategy: The actual and potential impacts of climate-related risks and opportunities on the organisation's businesses, strategy, and financial planning.
- Risk Management: The processes used by the organisation to identify, assess, and manage climate-related risks.
- Metrics and Targets: The metrics and targets used to assess and manage relevant climate-related risks and opportunities.

While reporting using the TCFD is not currently mandatory, as outlined through this report, a number of companies have begun to use this as a disclosure framework, and this additional disclosure is well supported by investors.

Governance	Strategy	Risk Management	Metrics and Targets
Disclose the organization's governance around climate-related risks and opportunities.	Disclose the actual and potential impacts of climate-related risks and opportunities on the organization's businesses, strategy, and financial planning where such information is material.	Disclose how the organization identifies, assesses, and manages climate-related risks.	Disclose the metrics and targets used to assess and manage relevant climate-related risks and opportunities where such information is material.
Recommended Disclosures	Recommended Disclosures	Recommended Disclosures	Recommended Disclosures
a) Describe the board's oversight of climate-related risks and opportunities.	a) Describe the climate-related risks and opportunities the organization has identified over the short, medium, and long term.	a) Describe the organization's processes for identifying and assessing climate-related risks.	a) Disclose the metrics used by the organization to assess climate-related risks and opportunities in line with its strategy and risk management process.
b) Describe management's role in assessing and managing climate-related risks and opportunities.	b) Describe the impact of climate-related risks and opportunities on the organization's businesses, strategy, and financial planning.	b) Describe the organization's processes for managing climate-related risks.	b) Disclose Scope 1, Scope 2, and, if appropriate, Scope 3 greenhouse gas (GHG) emissions, and the related risks.
	c) Describe the resilience of the organization's strategy, taking into consideration different climate-related scenarios, including a 2°C or lower scenario.	c) Describe how processes for identifying, assessing, and managing climate-related risks are integrated into the organization's overall risk management.	c) Describe the targets used by the organization to manage climate-related risks and opportunities and performance against targets.

Figure 2: [TCFD recommended disclosures](#)

Governance – headline finding:

It is the board's responsibility to consider climate-related issues, but there is little evidence that business models and company strategy are influenced by integrating climate considerations into governance frameworks.

Climate Governance

Code Reporting – FTSE350 companies

To consider the current state of governance practice and reporting, the FRC assessed the Code-related reporting of a random selection of 60 premium-listed companies. More information on the scope of this assessment can be found in the Appendix.

KEY FINDING: More companies are disclosing approaches to climate governance, but it is often unclear how consideration of climate-related issues informs key decisions or the business model or strategy. This consideration is even less obvious amongst smaller cap companies.

Reporting on climate governance

Many companies report that action on climate change is essential for their long-term success and are building climate-related issues into governance processes. Broadly, better reporting on climate governance was observed in the FTSE100 than the FTSE250.

In the FTSE100, the majority of companies reported on the governance and oversight of climate-related risks and opportunities, with approaches differing between companies. Some companies named a director responsible for climate-related issues, whilst others reported that climate risks are the responsibility of the whole board or relevant Committee.

Companies should choose the most appropriate way of achieving climate governance, but it is important that those involved have some understanding of how climate change will impact the company or have access to relevant expertise. Only with this knowledge will boards be able to make appropriate decisions on business plans and strategy.

“Boards need a strategy for dealing with the real business risks and opportunities. In an ideal world the baseline knowledge would be higher than it is” – Investor

Reporting on climate governance also varied within and between industries. FTSE100 companies in the insurance industry, for example, generally had more developed climate governance than insurers in the FTSE250. This is likely a reflection of the approach to disclosures in the market and the finding that larger insurers have further developed their TCFD disclosures.

In the Buildings and Construction industry, on the other hand, the difference between the two indices was not so large, and size appeared to be less of a factor. In this industry, the majority of companies in the FTSE350 sample reporting on their climate governance, including board oversight of climate related issues and the role of management.

Better practice included:

- A clear explanation of the company’s governance structure and oversight. The more developed reporters linked these insights to the TCFD framework.

Committee structure

Although many companies integrated climate governance within their general Sustainability or Social Responsibility Committees, others had taken a different approach. It was encouraging to see that many had set up Committees, internal taskforces or working groups specifically to help the board understand what climate change could mean for the business, the broader trends likely to impact the business and climate-related reporting requirements.

Some companies, particularly those currently more exposed to climate risks, had also set up independent environmental advisory Committees composed of academic experts and in-house expertise. Unfortunately, in many cases, the value of disclosure around climate-related working groups or committees was undermined where companies failed to go into any detail about the level of expertise, skills or training, if any, these bodies or individuals have on climate change. Moreover, a number of companies did not provide any explanation of the processes by which the board receives the relevant information from these committees.

Better practice included:

- Where such a group existed, the company reported on the selection process for the climate expert or body and/or any relevant training members had received.
- Explanations of the process by which the board received climate-related information.

“Board level understanding of climate risk and the need to transition has to improve. There are too many conversations where the board really doesn’t get it. We don’t necessarily need a climate expert in every boardroom – it should be that every board member is accountable for the company’s long-term strategy and the climate aspects of that. It’s concerning that too many boards seem comfortable with management dragging their feet” – Investor

“[Audit Committees are] such an important committee for where we are going in terms of climate and Sustainable Development Goals – we can’t have them constituted in the way they currently are” – Investor

Board and Committee monitoring of climate-related risks and opportunities

A significant number of companies are reporting on what basis climate-related considerations are monitored, how information relating to climate risks and opportunities is passed to the board and the number of times Committee or working group meetings were held during the year.

However, although many companies had clear governance structures in place for the identification and management of climate-related risk, it was often unclear whether climate considerations had been given sufficient attention on board agendas.

A number of companies, particularly in intense industries, noted the role of the board in reviewing the company’s ‘net zero’ strategy. This was usually carried out by the relevant Committee. However, many companies failed to explain how often or on what basis the delivery of ‘net zero’ and other environmental strategies are reviewed. The disclosure of this information would improve transparency significantly by ensuring shareholders and broader stakeholders that environmental matters remain in sight of the board and that the company is dedicating the time needed fully to comprehend and deliver their ‘net zero’ ambitions.

Few companies went into detail regarding key decisions that had been informed by considerations of the effect of climate change on the company or the steps taken to ensure the board understands the often-complex climate-related information and how this may impact business decisions.

Better practice included:

- Reporting on examples of specific climate-related issues discussed by relevant bodies, how those issues could impact the business and the reasoning behind any related decisions.

We were also pleased to find that some companies had reported on remuneration linked to the achievement of sustainability and climate change targets as key part of their governance.

“Consideration and disclosure [of climate change] by smaller issuers is a real issue... it’s really a challenge, even mid caps are a challenge” – Investor

Smaller cap companies and Code compliance

For the few small cap companies assessed, there was very little reporting on climate change governance. In some cases, the company disclosed the board’s oversight of the company’s annual submission to the [CDP](#) (formerly the Carbon Disclosure Project), but rarely was this linked specifically to the company’s operations or strategy.

Likewise, although a number of small cap companies dedicated an appreciable part of their Annual Report to environmental issues, reference to climate change was boilerplate, with no company going into any detail about the potential impact of climate change on the business.

It was unsurprising then that there was only one small cap company with a Committee whose remit specifically encompassed climate change. That company had also disclosed an example of a key climate-related decision, albeit in limited detail.

Although a number of companies in the small cap sample had Health, Safety and Environmental Committees, the responsibility of which is to monitor environmental risks, in the absence of any reporting on key decisions or outcomes, it was unclear how much attention environmental issues or climate change received, if any, on small cap agendas. This was a particularly disconcerting finding given our sample included some companies from resource intensive industries such as Mining and Consumer Products & Manufacturing where we would expect to see boards consider, at the very least, the potential impact climate-related issues could have on the long-term success of the business and their duty to take account of other specific environmental matters.

“This is about all industries, not just the ‘dirty’ ones. Is there a strategy for dealing with the challenges? Is there ambition? Yes or no. Have you considered what a carbon tax would do to your company? Where [the answer is] no, this can be a big issue. Even the least intense company is more intense than a set of individuals” – Investor

“If you’re thinking about it as a board a good starting point is either to go to the most carbon-intense areas or those with the most risk – with that understanding you can then think through materiality, but also then how it’s mitigated, or about opportunities” – Investor

FTSE 100 reporting practice

In its review of FTSE100 climate-related reporting earlier this year, Black Sun found that:

Challenges remain in embedding into strategy – 46% (from 32%) of FTSE 100 companies disclose climate issues among principal risks, but only 7% discuss the resilience of their strategy.

Greater integration into risk is required – 48% (from 26%) disclose board oversight of climate-related risks and opportunities, but only 24% (from 16%) describe how risk management processes for climate-related risks are being integrated into the organisation’s overall risk management.

Black Sun, [Accelerated action for climate resilience: status of climate reporting in the FTSE 100 against the TCFD framework – second annual research report](#), August 2020

Board oversight of climate change

Earlier this year, KPMG questioned more than 160 UK business leaders, representing a range of industries, on a set of environmental, social and governance questions. “When asked if climate change was a top priority, 82% said it was already being actively discussed, or on the boardroom agenda. However, when asked if they had a clear view of the risks ahead and how to tackle them, only 8% of businesses reported having a fully-fledged plan in place, with 89% in early stage discussions, and 3% not at all”.

KPMG, [COVID-19 accelerating ESG agenda, but majority of businesses yet to implement board-level change](#), 7 September 2020

Lab findings – investor views on governance

KEY FINDING: Investors continue to want companies to outline how the board considers and assesses climate change. Governance, and an understanding of the role of the board in relation to climate-related issues, is considered a key part of understanding the company's approach.

It was clear through the investor conversations that underpinned the Lab's 2019 [report](#) that the role of governance and oversight were considered key to a company's appropriate consideration of climate-related challenges.

The discussions undertaken as part of the thematic identified that one of the key questions investors seek to understand is how the board considers and assesses climate change. This is predominantly important in understanding how these issues are being overseen by the board, and how they are factoring into considerations of the strategy. Such reporting also gives investors insight into the role of governance, and whether the challenges of climate change are being taken seriously and integrated appropriately.

Whilst investors' views on climate-related issues continue to evolve, the conversations this year once again highlighted a great deal of investor support for the TCFD framework for a company's consideration, and disclosure, of climate-related issues.

Investors noted that they had seen more reporting on climate-related issues, particularly on governance oversight. This change was welcome, but investors noted that further development was still needed.

Governance and management questions

To help companies consider how best to report under the recommendations of the TCFD, and better to meet the needs of their investors, the Lab's 2019 report included an insight into what investors wanted to understand from the disclosures, and questions companies could ask themselves in order to provide, or build towards providing, the TCFD's recommended disclosures. Investors once again reiterated that these questions can be helpful for companies to consider as they develop their reporting, and they can be found to the right.

More detailed findings on investor reporting and better practice examples of reporting under the Task Force on Climate-related Financial Disclosures can be found in the FRC Lab's report [here](#).

Governance and management questions

- What arrangements does the board have in place for assessing and considering climate-related issues? What is the board's view of the climate change challenge, and what assumptions is it making?
- Who has responsibility for climate-related issues? How are the board and/or committees involved and how often are climate-related issues considered?
- What insight does the information give the company and how is it being integrated into strategic planning?
- What information helps the board understand the company's risk profile?
- What information and metrics do the board monitor in relation to climate-related issues? How does the board, establish, monitor and oversee, including modifying, climate-related goals and targets?
- Is the board preparing for different outcomes where there is uncertainty?
- How does the board get comfort over the metrics being used to monitor and manage the relevant issues?
- What arrangements does the Executive Committee, or other divisional levels, have in place for assessing and considering climate-related issues, and who has responsibility for them?
- Does the board consider the climate-related reporting to be fair, balanced and understandable?
- What competence and expertise does the board feel it needs, or needs access to, in order to consider and address the challenges climate-related issues pose?
- Has the board reviewed its public policy approach to climate-related issues for consistency?
- Is the organisation planning to report against the TCFD? If so, what can be shared about the progress made and what are the plans for disclosure?

Climate Financial Risk Forum

On 29 June 2020 the Climate Financial Risk Forum (CFRF) published its guide to climate-related financial risk management. The CFRF, co-chaired by the FCA and the PRA, builds capacity and shares best practice across financial regulators and industry to advance the financial sector's responses to the financial risks from climate change. Whilst focused on financial firms, the working groups of the CFRF addressed issues likely also to be of interest to the wider economy – Risk Management, Scenario Analysis, Disclosure and Innovation.

The Disclosure chapter outlines the important role of governance in the consideration of climate-related challenges. The information recommended for disclosure closely matches what we have heard investors would like to see and therefore may be of interest as companies, even those outside of the financial sector, consider their disclosures.

Climate Financial Risk Forum, [Climate Financial Risk Forum Guide 2020 – Disclosures Chapter](#), June 2020

Governance

Governance disclosures are useful to enable audiences to assess board oversight and management of climate-related risks and opportunities within the business.

As a starting point, financial institutions should describe the governance and operational arrangements in place. In particular, firms should disclose the board's role in overseeing climate-related issues. This should include:

- **Responsibility:** explaining where primary responsibility for climate issues sits at board level, for example: with the board as a whole' with nominated individual board members; or with particular board-level committees such as the risk committee or and investment sub-committee. If responsibility sits with particular individuals or committees, firms should disclose how climate issues are reported to the wider board.
- **Frequency:** the frequency with which the board and/or relevant committees are informed about and discuss climate-related issues, and whether it is a recurring agenda item. This may include whether and how frequently the board has received training on climate risk.
- **Integration:** how the board integrates climate-related financial issues into strategy-setting, risk management policies, budgeting and business planning, and whether there is a board-approved multi-year implementation plan in place.
- **Monitoring:** how the board oversees progress against climate-related metrics and targets.

Chapter Zero

1. Prioritising climate change

- Suggests strategies for getting climate change on your Board agenda.
- Highlights frameworks, external information sources and illustrations to help catalyse and drive the climate change journey with the right level of direction and energy.

2. Defining the strategy

- Includes frameworks to help the Board add substance and clarify their climate change strategy, ideally as part of the broader company strategy.
- Non-executive directors may contribute to the idea generation in a Board strategy day or they may simply review and discuss papers presented by the Executive Committee.

3. Ensuring action

- Describes observed best practices, Board discussion topics and questions for NEDs to help ensure action is taken to deliver on your climate change strategy.

Chapter Zero is the UK chapter of the World Economic Forum's Climate Governance Initiative. It aims to build a community of non-executive directors who understand and can position the climate challenge with their board colleagues. Chapter Zero, with a range of partners, has developed checklists, toolkits and other resources for Non-Executive Directors interested in climate change issues and how these can be better integrated into a company's strategy and approach.

For example, Chapter Zero and Eden McCallum have created a toolkit to help non-executive directors educate themselves on the business implications of climate change and provide a resource that they, their boards and executives can use to help design and implement a response. The three areas covered are: Prioritising climate change; Defining the strategy; and Ensuring action. Other resources include a Directors' climate journey and a primer on physical risk considerations.

[Chapter Zero - climate change management toolkit](#)

Appendix – Scope

Corporate Governance and Stewardship

The latest version of the [Code](#) applies to companies with a premium listing on the London Stock Exchange and for accounting periods beginning on or after 1 January 2019. The Code focuses on the application of its Principles. The Listing Rules require companies to make a statement of how they have applied the Principles, in a manner that would enable shareholders to evaluate how the Principles have been applied. The ability of investors to evaluate the approach to governance is important. Reporting should cover the application of the Principles in the context of the particular circumstances of the company and how the board has set the company's purpose and strategy, met objectives and achieved outcomes through the decisions it has taken.

We assessed reporting against the Code by 60 premium-listed companies to understand their' governance structures and whether, and if so how, climate-related considerations have been taken into account in their governance and in the board's requirements within the context of the Code.

The Lab

Over the course of 2019 The Lab held discussions with 20 investors and investor groups to get their views on what they wanted to see from the integration of climate-related issues into corporate reporting and audit. Investors were asked about their views on the developing reporting and audit, and whether the views shared in the Lab's 2019 report on this topic – [Climate-related corporate reporting – Where to next?](#) held true or had developed further. We thank the investors who participated in this thematic for giving up their time.



Information about the Financial Reporting Council can be found at:

<https://www.frc.org.uk>

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