Climate Governance Initiative Australia

Australian Institute of Company Directors

Climate Governance Study

Risk and opportunity insights from Australian directors

Climate Governance Initiative Australia

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The AICD is the proud host of the Australian Chapter of the Climate Governance Initiative.

The Climate Governance Initiative (CGI) is an active global network of bodies that promote the World Economic Forum **Climate Governance Principles** for boards within their jurisdictions. The CGI network seeks to mobilise, educate and equip directors with the skills and knowledge necessary to address climate change at the board level. The CGI is active in 20 countries with 16 chapters and over 100,000 members.

Climate Governance Initiative Australia (CGI Australia) aims to bring together the expertise of organisational leaders to meaningfully contribute to the discourse on climate governance.

We aim to activate the director community through education on strategies for embedding climate considerations into Australian boardrooms' strategic decision making. As the long-term stewards of Australian organisations, the director community has a vital role in addressing the issue of climate change to ensure a sustainable future and a robust, competitive Australian economy.

Through CGI Australia, the AICD encourages non-executive directors to serve as advocates within their boards for the adoption of strategies that are aligned with the best-available recommendations of the scientific community, to achieve net-zero carbon emissions by 2050 or earlier, consistent with a global average temperature rise of no more than 1.5°C above pre-industrial levels.

CGI Australia is hosted by the AICD together with key partner organisations.

Contents

CEO Foreword

Climate change has long been seen by the director community as one of the key challenges facing Australia.

The focus has shifted from a policy challenge to incorporate governance dimensions, with corporate leaders tasked to take positive steps to address the risk and opportunities inherent in climate change in the absence of an underpinning and coherent national policy framework. Until now, what has been lacking is a broad picture of how non-executive directors are approaching climate governance within their own boardrooms. We have not had a clear understanding of what is motivating directors in their response, where the barriers are and, indeed, whether they see opportunity and not just risk. These topics have been explored in studies for the business sector generally but there is a dearth of information from the perspective of the non-executive director.

As part of the AICD's commitment to lift its focus on this key contemporary governance challenge, we surveyed our membership on the topic and supplemented this survey with interviews with senior directors to examine their practice. The results published in this report make interesting reading. Clearly, climate change is an issue that most directors grapple with, and they are alive to risk as well as opportunity. However, the scale of their concern about risk or enthusiasm around opportunity seems to have not yet been translated into concerted action in *all* boardrooms. Risk management appears underdeveloped from the survey responses and there is limited focus on skills and training. A substantial number of directors want to do more to address climate governance but do not know where to start.

The AICD's purpose is to strengthen society through world-class governance. One of the objectives of this study was to assess the current attitudes and practices of the director community on climate governance, in order to better assess what education and resources may be needed. This study confirms that there is considerable demand for more support, and directors are elevating their focus on this complex challenge. The AICD is committed to helping directors on this path towards a carbon neutral future for their organisations and the nation.

With this goal in mind, the AICD launched the Australian Chapter of the Climate Governance Initiative in August 2021 – connecting our director community with a global network of like-minded bodies championing the World Economic Forum principles for effective climate governance. This study is the first publication to be released by the Climate Governance Initiative in collaboration with the AICD.

We have recently published the ***Climate risk governance guide***, a plain-language resource which has already attracted over 3,000 unique downloads, highlighting strong member demand for accessible content. Throughout 2022, together with our Climate Governance Initiative partners, we will roll out further resources, content and events tailored to the director audience.

This study should provide a baseline for tracking how directors and boards are responding to climate change over time. We hope that through the efforts of the AICD, partner organisations, stakeholders and, in particular, our members, we can collectively contribute to a more sustainable future.

Angus Armour FAICD
Chief Executive Officer and Managing Director
Australian Institute of Company Directors

Executive summary

KEY FINDINGS

1 Australian directors are concerned about climate change risk to their organisations

- Most directors (77%) are concerned about climate change risk to their organisation, with nearly one quarter (22%) 'extremely' concerned
- Half (51%) also see opportunities from proactive responses to climate change

2 Directors want to do more – but face capacity and resource limitations

- Almost half (46%) of directors want their boards to increase attention to climate governance
- Almost half (46%) of directors want to do more, but 'don't know where to start'

3 Policy uncertainty and short-term market pressures are seen to constrain action

- Directors cite policy uncertainty and a short-term focus by investors as key barriers to successful climate risk governance

4 Climate change is on the agenda – but risk and governance maturity is low

- There is limited reporting to boards on climate footprint and sustainability, low use of climate risk metrics and limited evidence of board training and skills assessment
- Focus and confidence on climate risk governance varies considerably between sectors

Climate change is a key corporate governance challenge facing Australian boards.

There is limited research, both in Australia and internationally, exploring how directors and boards approach climate governance, risk and opportunity. For some time, the AICD's **Director Sentiment Index** has told us that directors regard climate change as a key risk and the highest policy priority for the Australian government, but there is little data on current governance practices.

To better explore director views on climate governance, the AICD conducted a member survey (2,074 respondents) as well as targeted interviews (14) with senior non-executive directors (see **Appendix B**).

The results are insightful and reflect the varying levels of focus and maturity of governance approaches across Australian boards. While there is broad concern about climate change risk, approximately half of all directors surveyed also saw opportunity, with a notable crossover of those who saw both risk and opportunity.

Both the survey and interviews showed that many boards were taking significant steps to address climate governance issues, primarily through a risk lens. Actions include embedding climate into risk management frameworks, and board reports on issues like climate footprint or sustainability metrics.

However, the results suggest that governance of climate risk varies significantly across organisations and sectors.

Although risk management frameworks are used extensively, climate does not feature in more than half of risk registers and three-quarters are not tracking climate risk with specific metrics. Most directors advised they do not receive reports on sustainability matters. Less than one in five directors have undertaken training on climate change issues.

Many directors would like to do more on climate change governance but are unsure of where to start. This highlights the need for education, guidance and support for this cohort, particularly for directors of not-for-profit (NFP) entities.

When examining the obstacles that were hindering directors who wanted to do more on climate governance, results showed that directors were not generally concerned about the effect on profit. Instead, directors cited uncertainties and other more pressing commitments. The lack of a clear and settled climate change policy at the national level was cited as the single largest barrier to effective climate governance by organisations.

Demographic factors tended to correlate with directors' attitudes towards climate challenges. Older directors were more likely to be confident in their board's abilities and less likely to feel the need to take action on climate governance. This trend is also true, although less pronounced, for men.

The findings serve as a useful basis point to examine how climate governance is evolving as an issue facing Australian directors and their boards. They suggest a rapidly maturing approach with varied performance, contrasting attitudes and high degrees of uncertainty on how to proceed.

Approaches differ across sectors, between industries and across different demographic groups. Given the general views on risk, opportunity and the common desire to do more, it is likely that boards will shift to more actively supervising climate risk issues in the near term. The AICD intends to conduct further research to track governance practice over time.

Climate risk governance guide: An introductory resource for directors on climate risk governance

The AICD, in collaboration with MinterEllison, has developed a resource guide to assist directors starting on their climate journey

The *Climate risk governance guide* provides a plain-language introduction to fundamental climate change concepts, and considers this issue in the context of the non-executive director's role and duties.

Specifically, the guide considers the following questions:

Part 1: What do I need to know about climate change?

An introduction to key climate change concepts and risks to develop your understanding.

Part 2: How do I start my board's climate change journey?

Key questions to ask yourself and your board when considering how to get climate change onto your board agenda and how to establish effective governance structures, consider strategy and risk, and report and disclose.

Part 3: What are the duties and expectations of me as a director?

Explores how your duties as a director might interact with climate change risk and opportunity, and the legal and strategic issues you and your organisation may need to consider.

Download the guide **here**.

KEY STATISTICS: WHAT DIRECTORS SAY

77%
are concerned about climate change risk to their organisation with 22% 'extremely' concerned

51%
see 'significant' or 'some' opportunity for their organisations from climate change

73%
of those concerned about climate risk also see opportunity in climate change

41%
select regulatory/political uncertainty and operational impacts as the main climate risks

46%
see the lack of a settled national climate change policy as a barrier to effective climate governance (the most common reason cited)

28%
do not believe their board has the knowledge and experience to adequately address climate governance issues

45%
have embedded climate change into their risk management frameworks

46%
believe their board should increase the attention it pays to climate governance but 'don't know where to start'

18%
have undertaken some form of climate training

Climate risk and opportunity

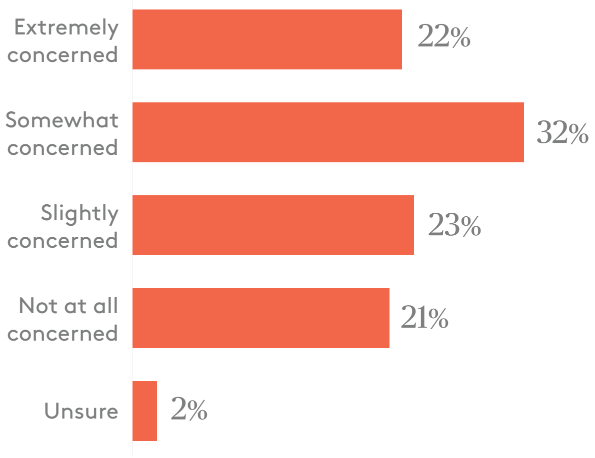
Both the survey and the interviews asked directors to reflect on climate change risk and opportunity and then consider how much priority those issues were receiving, or should receive, on their boards.

MAJORITY OF DIRECTORS ARE CONCERNED ABOUT CLIMATE RISK

More than three quarters of all directors surveyed (77%) said they were concerned about climate change risk to their organisation, with approximately one in five saying they were 'not at all' concerned.

CONCERN ABOUT CLIMATE RISKS

Q6. How concerned is your board about climate change risk to your organisation? (n=2,011)



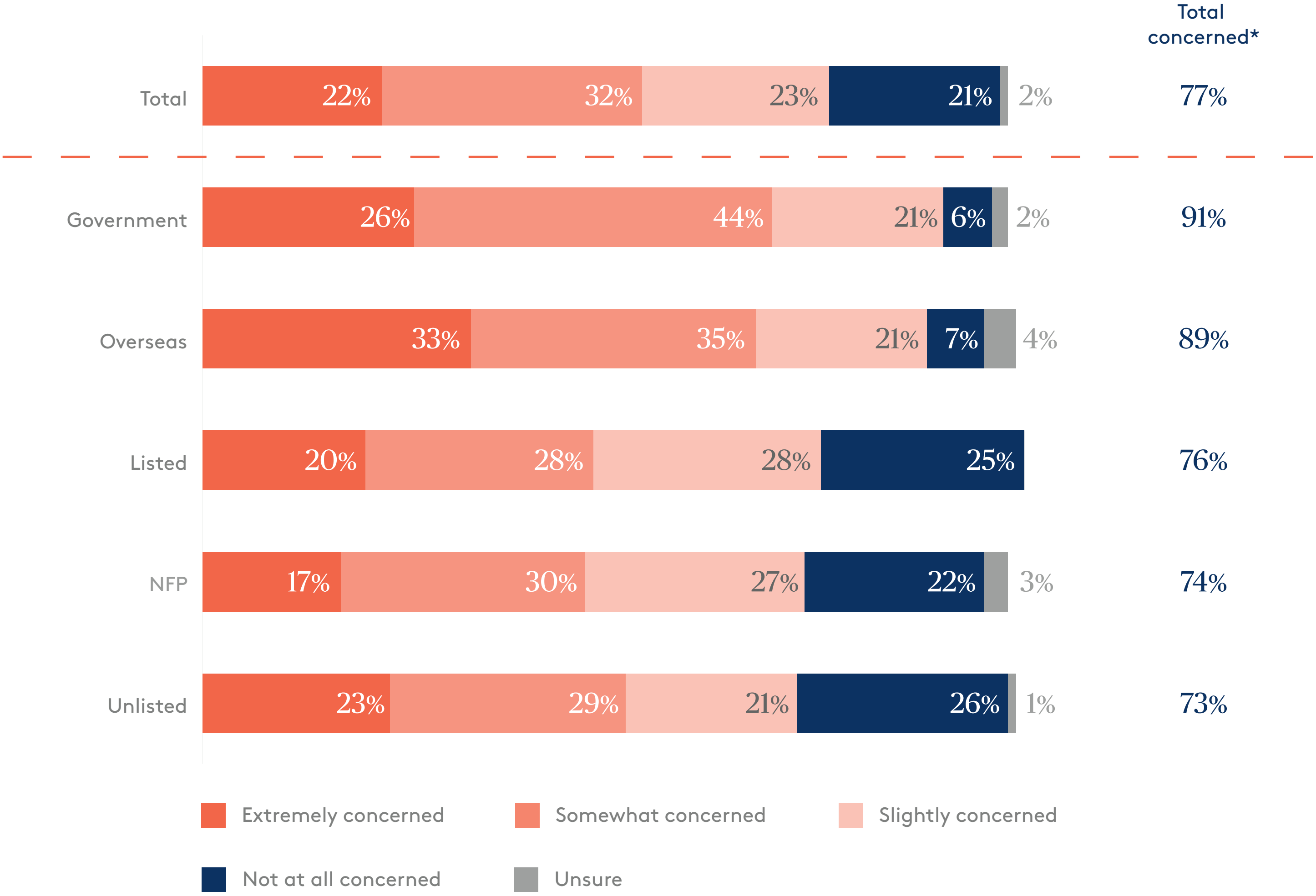
This level of concern is consistent with findings from the AICD's **Director Sentiment Index**. Throughout 2020-2021, at least half of all directors surveyed consistently reported that climate change was a 'material risk' for their organisations.

Interviewees, who were primarily senior experienced non-executive directors (see **Appendix B**), were universally concerned about climate risk. They noted that determining what risks and level of risk an organisation is prepared to take in pursuit of its objectives was a core role of directors. When discussing the role of the board, they felt that directors needed to incorporate climate analysis into their risk management frameworks.

The level of concern about climate risk was found to vary widely across sectors. Seven in ten directors from government/public sector boards said they were 'extremely' or 'somewhat' concerned about climate change risks, while only 48% of directors from the listed sector reported the same level of concern.

CONCERN ABOUT CLIMATE RISKS BY SECTOR

Q6. How concerned is your board about climate change risk to your organisation? (n=2,011)[1]



*Total concerned = extremely concerned + somewhat concerned + slightly concerned

The concern held by listed company directors is close to the average of all respondents, despite them arguably facing greater pressures including from investors and regulators as well as their additional reporting and disclosure obligations.

Approaches to climate risk also tended to vary based upon the demographics of the director and their industry. This is explored further in the **Demographic insights** and **Varied practice across high-risk sectors** sections of this study.

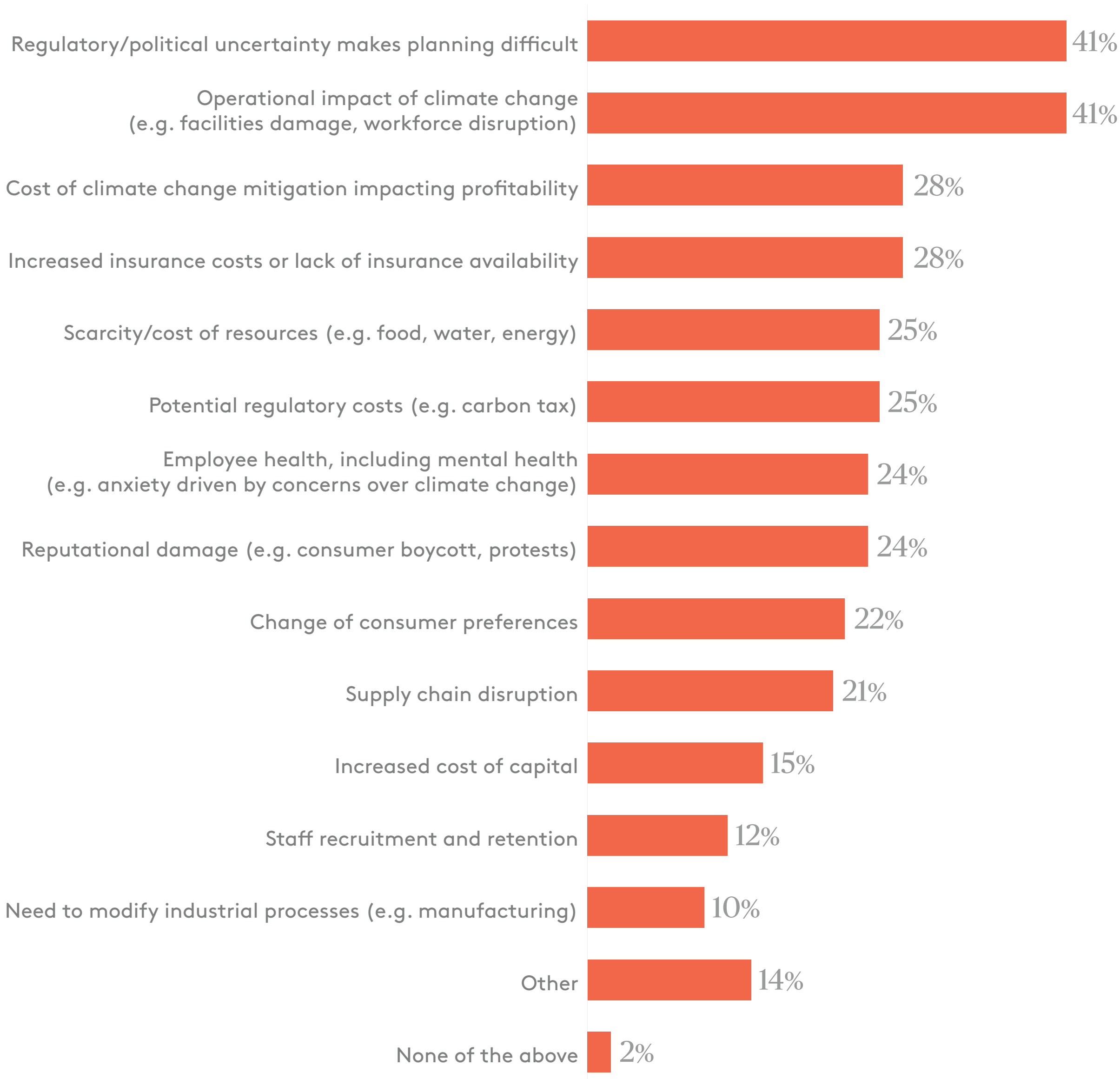
When asked about the specific climate risks that directors were facing, regulatory/political uncertainty and the operational effects of climate change were the two greatest concerns.[2]

1. Indicated sectors reflect in which type of entity each survey respondent advised their primary directorship was held: 'Government' = public sector/government body; 'Overseas' = overseas entity; 'Listed' = publicly listed Australian entity; 'NFP' = not-for-profit entity; 'Unlisted' = private/non-listed Australian entity.
2. The results for this question were broadly consistent with a C-suite **global survey** undertaken by Deloitte in early 2021.

SPECIFIC CLIMATE RISKS OF CONCERN

TYPES OF CLIMATE CHANGE RISK

Q7. What are the biggest environmental sustainability/climate change risks that you are concerned about for your organisation? (select up to 4) (n=1,481)



Not only did different sectors have varying levels of concern with climate risks, the types of climate risks that directors felt their sector faced were also quite different. Directors of listed entities, while still worried about operational risk, tended to be more concerned about increased regulatory costs such as a carbon tax, reputational damage, and increased cost of capital. Directors of NFPs were also more likely than those from other sectors to be concerned about employee health, including mental health.

A common risk identified by directors from all sectors was the regulatory/political uncertainty around the issue, which was nominated by two out of every five directors. This topic is explored further in the **Barriers to action** section of this study.

TOP 5 CLIMATE CHANGE RISKS BY SECTOR

Q7. What are the biggest environmental sustainability/climate change risks that you are concerned about for your organisation? (select up to 4) (n=1,481)[3]

	1	2	3	4	5
TOTAL	41%	41%	28%	28%	25%
LISTED	43%	30%	28%	27%	23%
UNLISTED	47%	36%	31%	29%	27%
GOVERNMENT	69%	34%	32%	29%	28%
NFP	44%	34%	30%	24%	18%
OVERSEAS	39%	31%	30%	23%	18%

TABLE KEY

Regulatory/political uncertainty makes planning difficult

Operational impact of climate change (e.g. facilities damage, workforce disruption)

Cost of climate change mitigation impacting profitability

Increased insurance costs or lack of insurance availability

Scarcity/cost of resources (e.g. food, water, energy)

3. Table represents how each sector rated the top 5 total risks. It does not necessarily list the top 5 risks identified by directors from that sector.

RISK MANAGEMENT FRAMEWORKS

There were conflicting views in interviews about the best risk management approach for considering climate risk. Some interviewees thought that assessment of climate risk was not materially different to other operational risks that directors have been trying to measure and manage for a long period of time. Others thought that climate change represented a high velocity strategic risk with significant ambiguity driven by external factors. They felt a board needed a mature skill set to be able to adequately perform that risk assessment.

Directors interviewed identified materiality assessment as a key area for board focus. Interviewees noted that this requires a dynamic approach given the evolving nature of climate risks. The board risk appetite statement and risk framework must consider defensive measures for risks to operations and strategic plans, and proactive measures to exploit opportunities where organisations have, or can develop, comparative advantage. This demands a high level of understanding and ongoing assessment of materiality, as climate risks emerge or intensify for organisations and sectors.

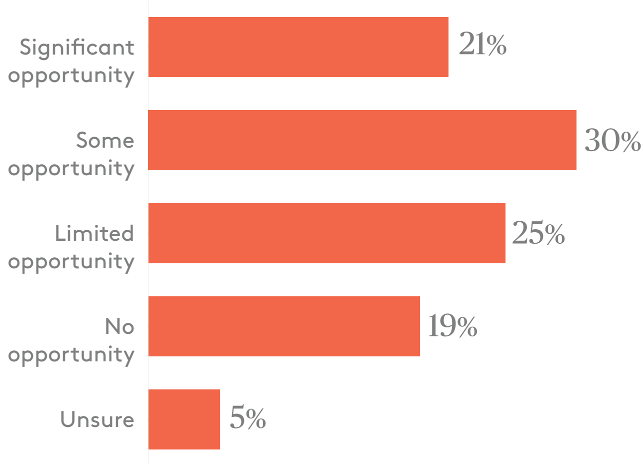
The survey indicated that less than half (45%) of respondents had embedded climate change into risk management frameworks, and only one in four (26%) were measuring it through metrics, which suggests that risk may not be adequately monitored at board level. Risk management was focused on issues such as undertaking business continuity planning in the event of extreme weather events (42%) and reviewing supply chain risk (30%).

HALF OF DIRECTORS SEE CLIMATE CHANGE AS AN OPPORTUNITY

Survey results showed that half of all directors (51%) saw either 'significant" or 'some' opportunity in climate change. One in five (19%) of all directors saw 'no opportunity' at all.

CLIMATE CHANGE OPPORTUNITY

Q8. To what extent does your board believe that climate change may provide opportunity for your organisation? (n=1,955)



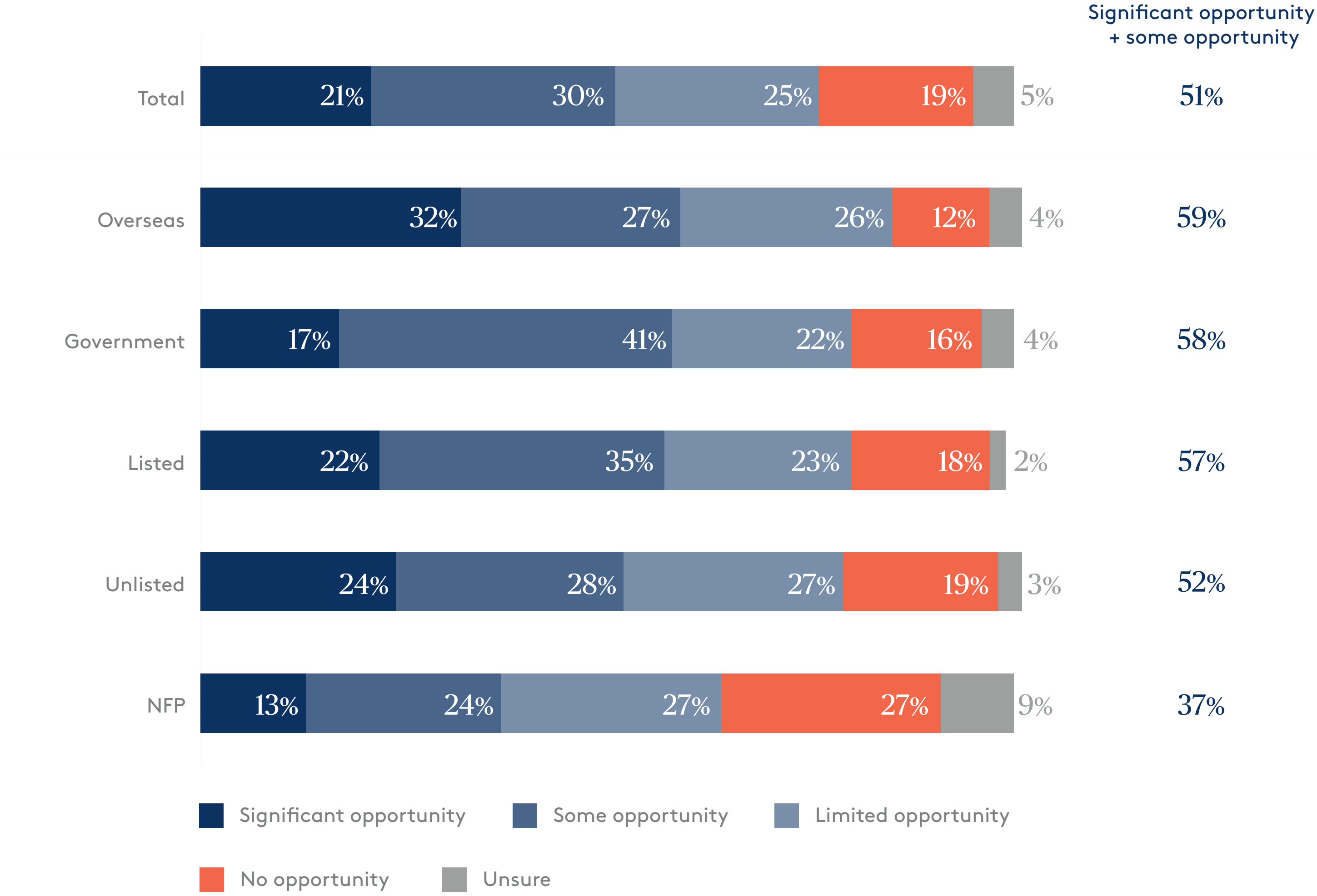
> "If it stacks up business-wise and it's friendly to the climate I think businesses would be mugs not to do it. There are plenty of customers and others out there who this means a hell of a lot to."

– Chris Wharton AM, Chair, Thriver Finance; Chair, Stealth Global Industries; Director, West Coast Eagles.

More than half of directors from all sectors said climate change provided 'significant' or 'some' opportunity for their organisations. The NFP sector was the only exception, where only 37% of NFP directors believed that climate change provided 'significant' or 'some' opportunity for their organisations.

CLIMATE CHANGE OPPORTUNITY BY SECTOR

Q8. To what extent does your board believe that climate change may provide opportunity for your organisation? (n=1,955)



Almost three quarters (73%) of directors that were 'extremely' or 'somewhat' concerned about climate risk also believed that climate change provided either 'some' or 'significant' opportunity. This suggests that directors most concerned with climate change sense both risk and opportunity.

> "Approach the challenge with a positive mindset; this is not just about risks but opportunities. Apply your usual governance processes to identify your company's risks and strategic opportunities in this area."
>
> –Teresa Handicott, Director, Downer EDI Limited.

Case Study – Downer EDI

Downer EDI provides integrated services across transport, utilities, asset management, and mining. The Downer board approached the issue of climate change through the lens of its existing governance processes and frameworks for strategy and risk management. This helped to demystify the task by using existing skills and processes, supported by external expertise as required, to tackle the subject as the board would any other opportunity or risk.

Once that lens was applied, directors formed the view that for Downer there were considerable opportunities that outweighed identified risks. This included the construction, operation and maintenance of solar, wind and potentially hydrogen facilities, assisting clients on their decarbonisation journey including upgrading infrastructure and providing low carbon solutions, and engaging in the circular economy through the roads business by investing in the use of recycled products such as glass and soft plastics in the production of bituminous products.

The importance of having both a risk and opportunity mindset was emphasised in interviews with directors. Interviewees felt there needed to be a shift in strategic thinking from boards around opportunity on climate change, from resistant to accepting to leading. In interviews, directors of climate-exposed entities said their board spent up to a quarter of their time talking about sustainability issues. In contrast, in the survey, directors from some of the same sectors were often less concerned and/or focused on climate issues than the general cohort.

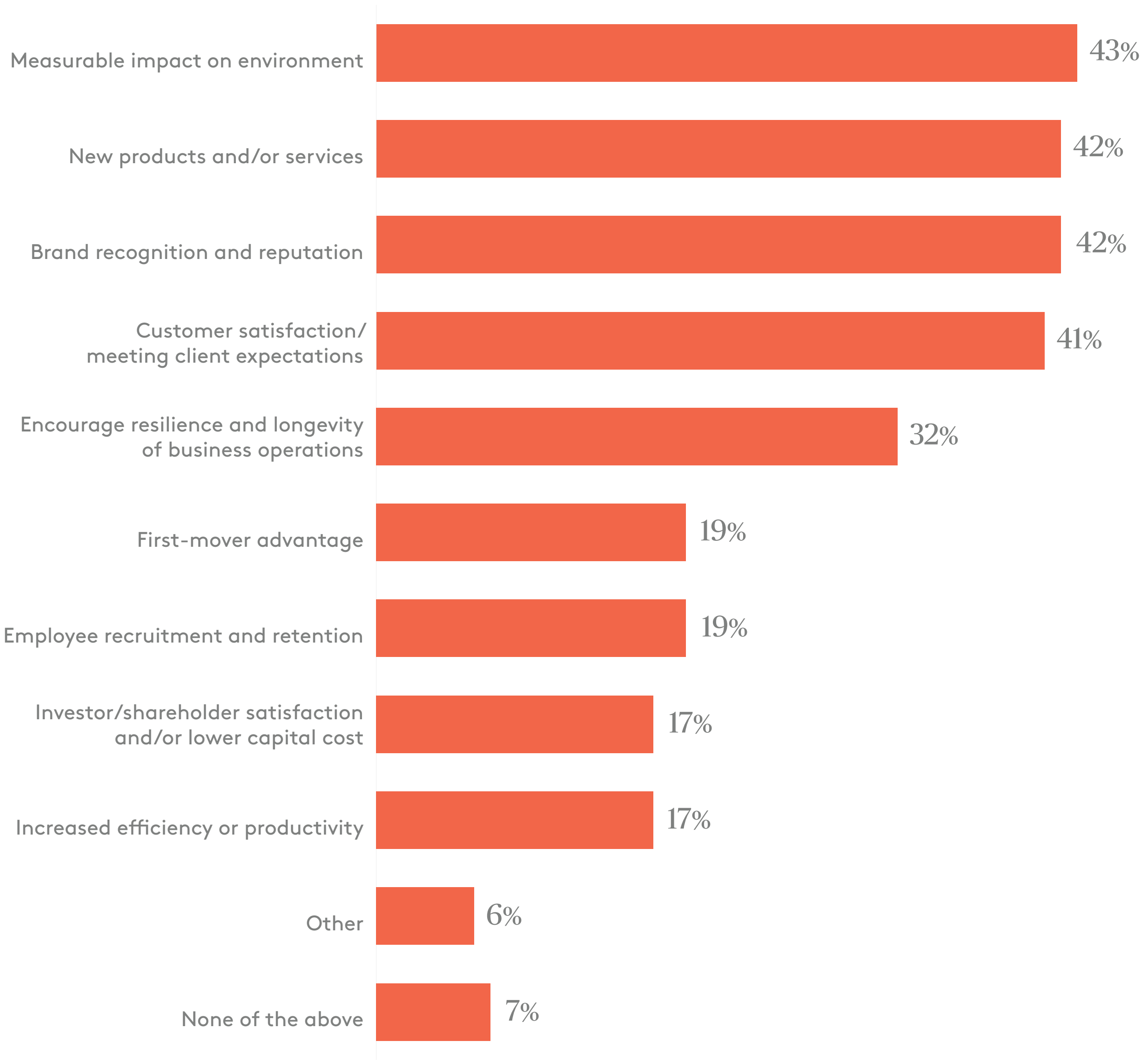
> "Boards should be focusing on both the growth opportunities as well as managing the risks of climate change. You need to think about the AND. Explore opportunities that deliver both net zero AND financial value. It is possible, achievable and prudent."
>
> – Sue O'Connor, Chair, Yarra Valley Water.

PERCEIVED BENEFITS FROM CLIMATE ACTION

When asked about specific opportunities that climate change had or might provide to an organisation, directors rated the measurable impact on the environment, new products and/or services, brand recognition and reputation, and customer satisfaction as the primary benefits.

TYPE OF CLIMATE CHANGE OPPORTUNITIES

Q9. What opportunity has/might climate change provide for your organisation? (select up to 4) (n=414)



Directors of government/public sector bodies saw the main opportunities as having a measurable impact on the environment, and improving the resilience and longevity of business operations. Listed and unlisted company directors were most interested in new products and/or services. Listed company directors also mentioned investor/shareholder satisfaction and unlisted directors first-mover advantage. NFP directors saw brand recognition as the positive opportunity in climate change.

TYPE OF CLIMATE CHANGE OPPORTUNITIES BY SECTOR

Q9. What opportunity has/might climate change provide for your organisation? (select up to 4) (n=1,414)

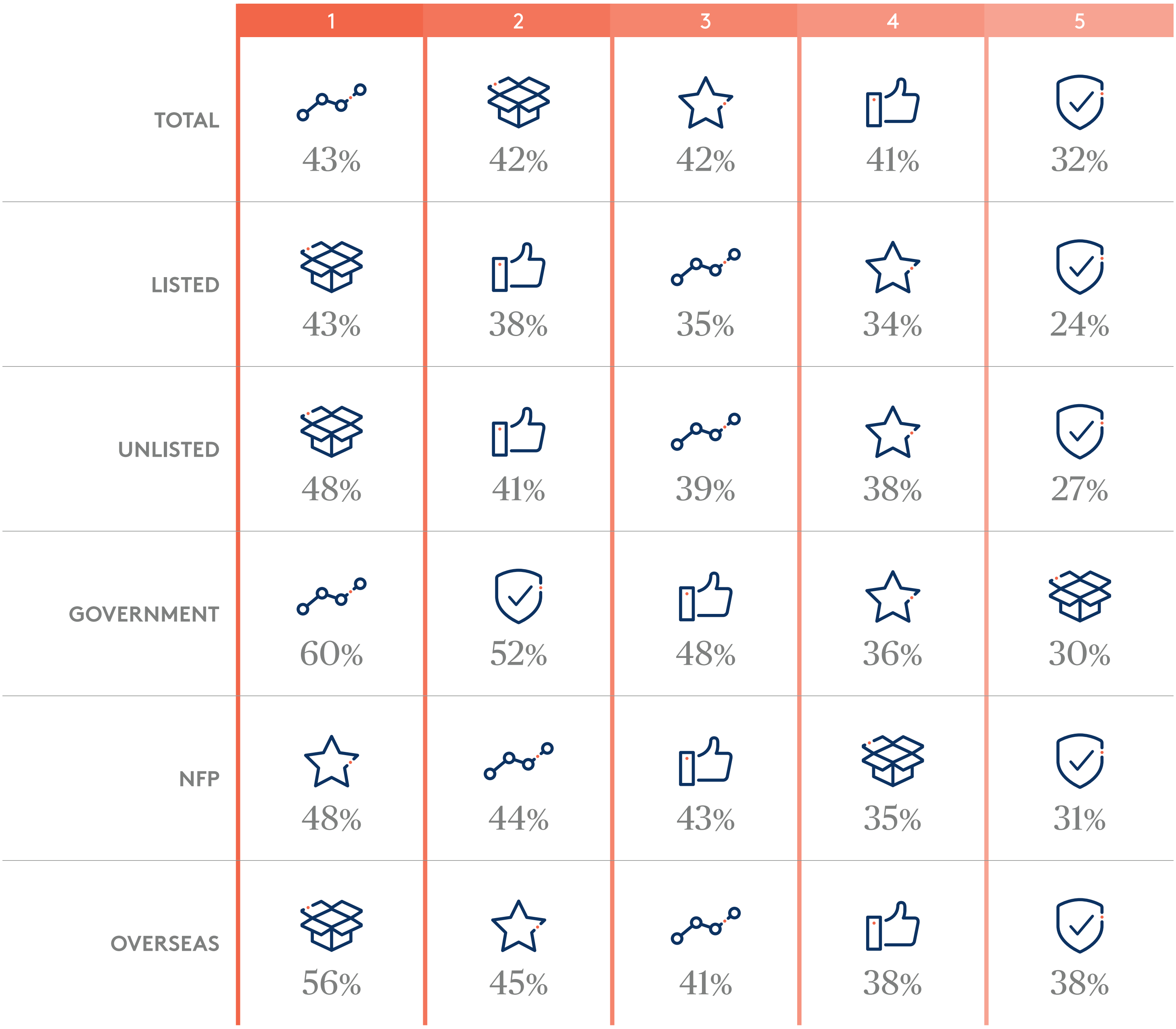


TABLE KEY

Measurable impact on the environment (e.g. reduced emissions)

New products and/or services

Brand recognition and reputation

Customer satisfaction/meeting client expectations

Encourage improved resilience and longevity of business operations

Interviewees thought that the range of opportunities for organisations may well depend on whether it had already seized some of the low hanging fruit such as energy efficiency projects with short-term paybacks. Boards may be asked to increasingly approve projects that might be harder to justify from an immediate profitability perspective and which may sit below the normal hurdle rates of return.

When commenting in the survey, directors provided a range of further feedback on opportunities in the space. For example, there were many comments about opportunity in the construction of new, decarbonised infrastructure.

Interviews with directors from financial services and superannuation funds all pointed to investment opportunities around climate change, which is clearly driving some investor decisions.

> "There is now a business case for investing in growth areas driven by climate considerations. And you have to consider the business case just like any other business case, looking at the financial aspects, operations and return on investment."

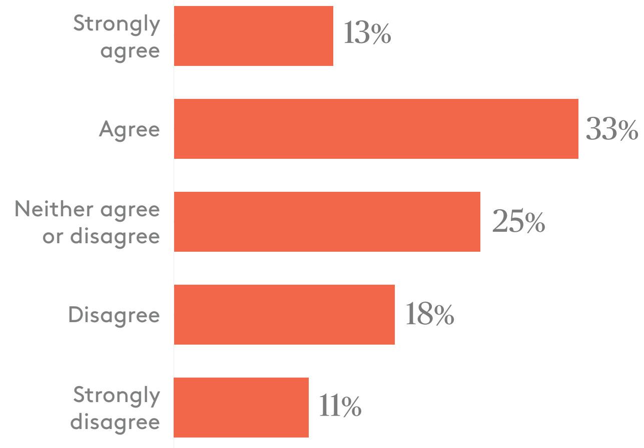
– Peter Warne, Chair, Macquarie Group Limited.

CALIBRATING THE BOARD'S FOCUS ON CLIMATE

Similar to the concerns around climate risk and opportunity, directors were divided on whether their board needed to increase the attention it paid to climate governance. Slightly less than half (46%) of all directors said their board should pay more attention, while 29% thought they were doing enough.

DESIRE TO INCREASE BOARD ATTENTION TO CLIMATE CHANGE GOVERNANCE

Q12 To what extent do you agree with the following statement: "In my opinion, my board should increase the attention it pays to climate change governance." (n=1,902)



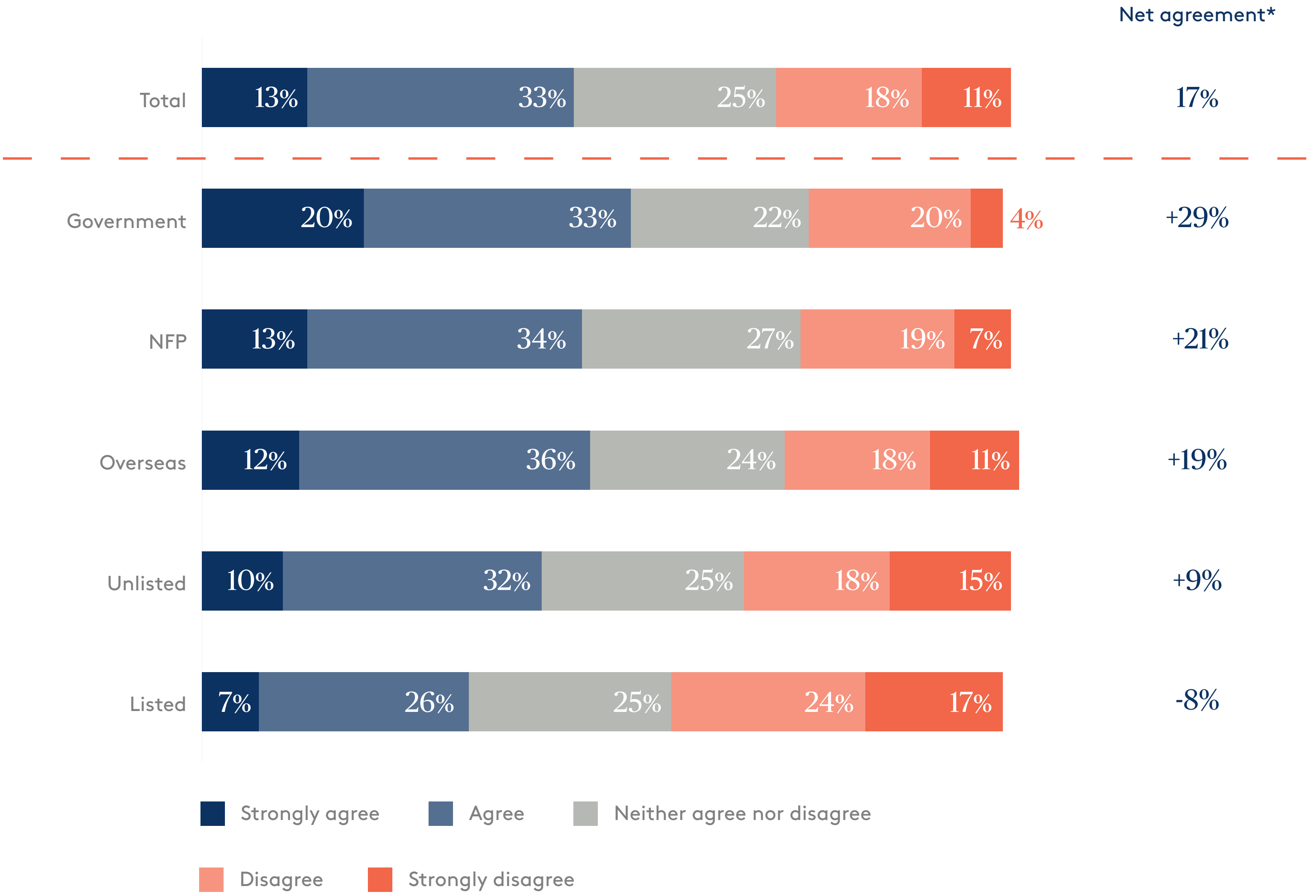
Further analysis reveals that those directors who stated they wanted their board to do more on climate change were also more likely to be concerned about climate risk.

Directors from the government and NFP sectors were more likely to agree that their boards should pay more attention to climate change governance.

Directors from listed and unlisted companies were less likely to agree that their boards should increase the attention paid to climate change governance. This may reflect the higher level of current board focus and greater confidence in board expertise, or it could also suggest a lower prioritisation of climate risk at board level. The latter sentiment was not reflected in AICD's interviews with senior directors.

DESIRE TO INCREASE ATTENTION TO CLIMATE CHANGE GOVERNANCE BY SECTOR

Q12 To what extent do you agree with the following statement:
"In my opinion, my board should increase the attention it pays to climate change governance. (n=1,902)



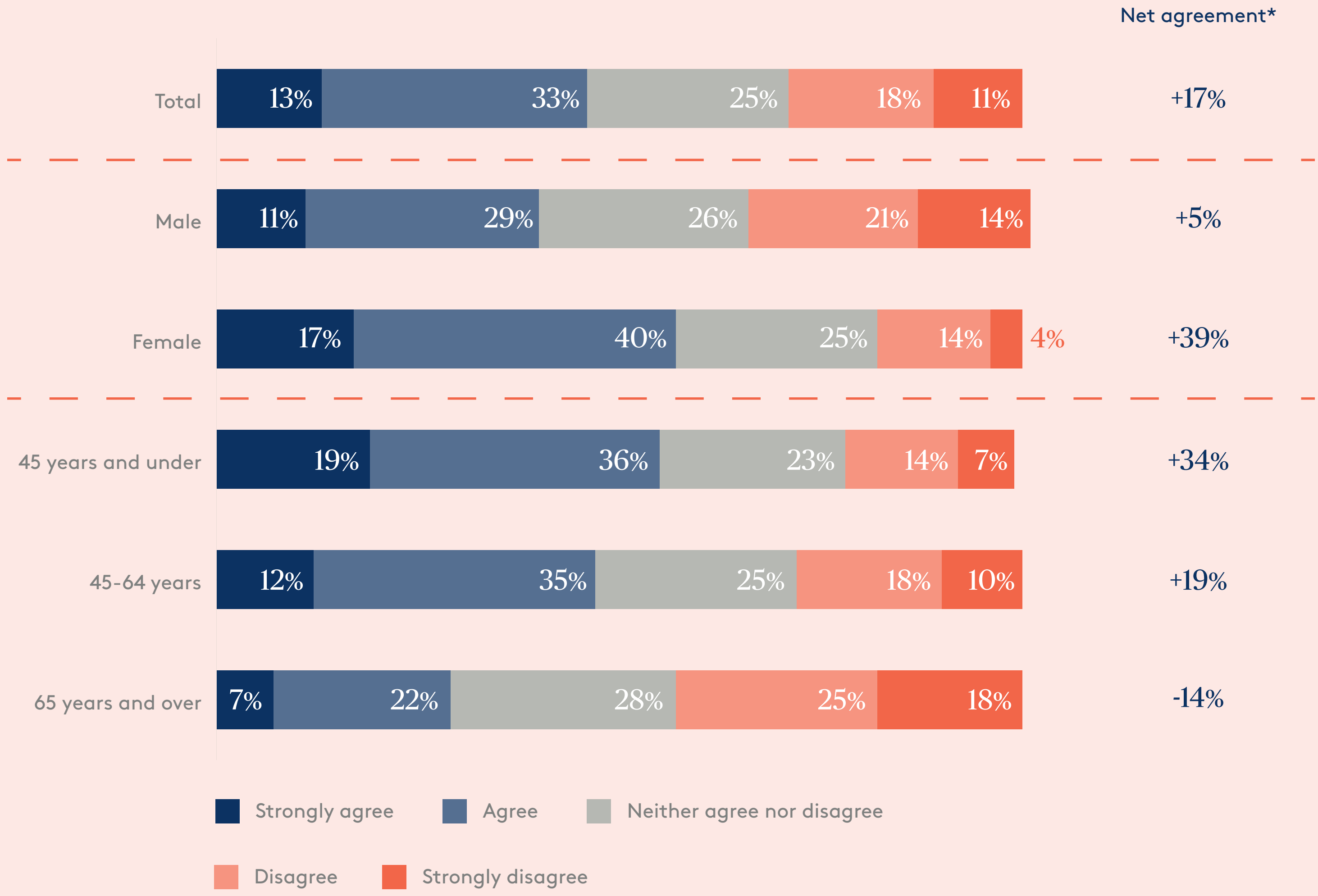
*Net agreement = (strongly agree + agree) minus (disagree + strongly disagree)

Demographic insights

The survey results suggest that demographic factors tended to help predict the attitudes of directors towards climate governance, risk and opportunity.

The graph below shows how directors reacted to the question of whether their board should 'increase the attention it pays to climate change governance,' by gender and age band. Female directors were more likely than male directors to want a greater focus on climate governance on their boards. The younger a director was, the more likely they felt more attention should be paid to the issue.

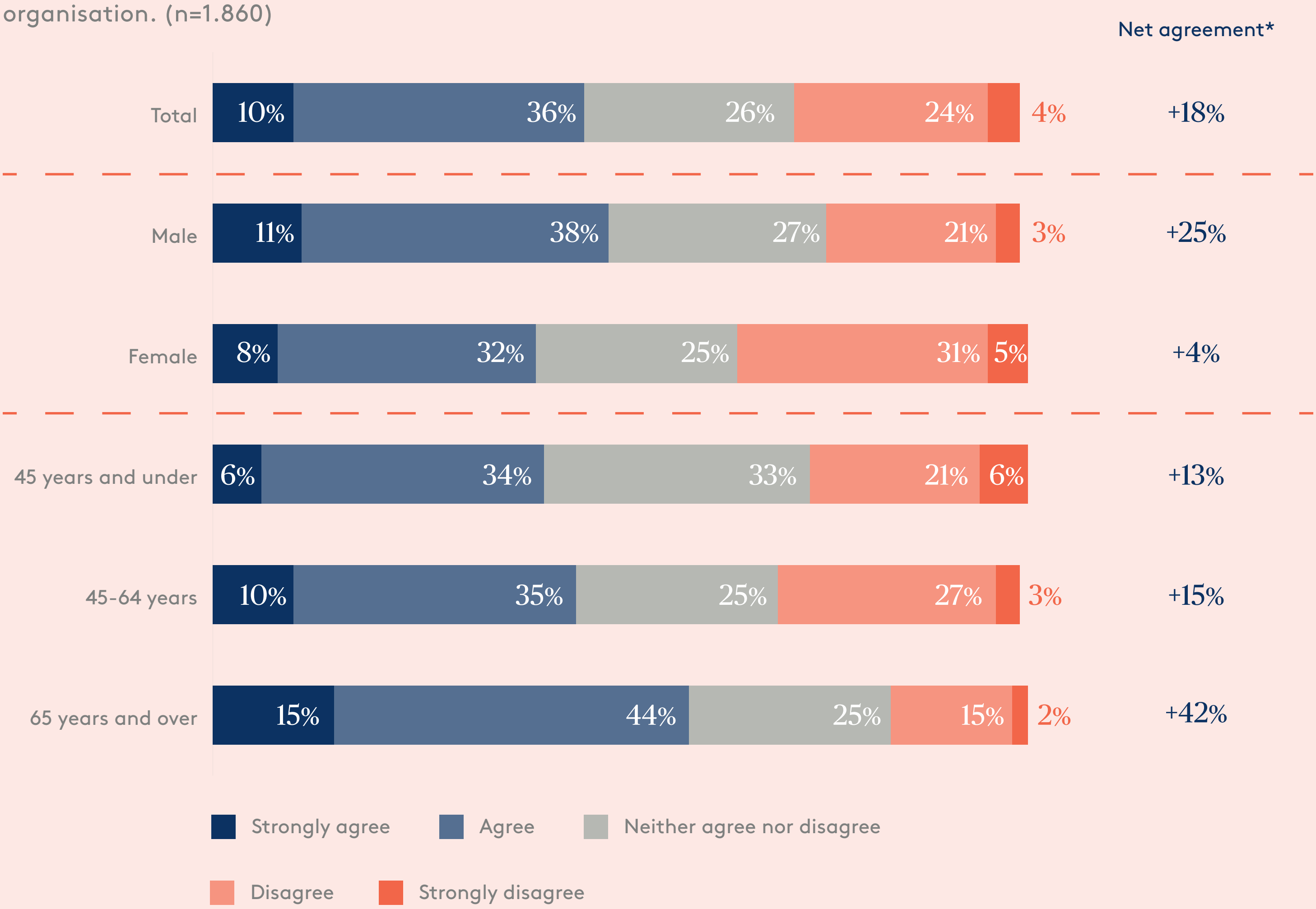
Q12 In my opinion, my board should increase the attention it pays to climate governance (n=1,902)



*Net agreement = (strongly agree + agree) minus (disagree + strongly disagree)

Similarly, both younger and female directors were also more likely to agree that they 'would like to do more on climate change governance on my board but I don't know where to start'. Female and younger directors also displayed less confidence in their board's knowledge and expertise in adequately addressing climate governance issues.

Q14 My board has the knowledge and experience to adequately address the climate governance issues facing our organisation. (n=1.860)



*Net agreement = (strongly agree + agree) minus (disagree + strongly disagree)

The patterns were less clear when it came to judgment of climate risk, with a broadly similar proportion of directors across age groups expressing concern. While women were less likely than men to report they were "not at all concerned" about climate risk, this remained a minority view across all demographic groups in the survey.

When it came to the type of climate change risk directors were most concerned about, men were generally less concerned about operational risks and resource scarcity than women and more concerned about potential regulatory costs.

Around half of survey respondents reported that they see opportunity for their organisations from action on climate change. Women directors were more likely than men to report seeing opportunity, while directors over the age of 65 were less likely to perceive opportunities. There were no real differences in perception of climate opportunities across demographic groups, although women were more likely to nominate having a measurable impact on the environment as an opportunity.

Generally, older directors were less likely to feel pressure to act on climate change from stakeholders.

Taken as a whole, these results suggest that women and younger directors appear to have higher risk perceptions on climate change, want more action and feel less confident in their board's ability to address climate change.

This finding is consistent with other general population **studies** that found women and younger Australians are most concerned about climate change.

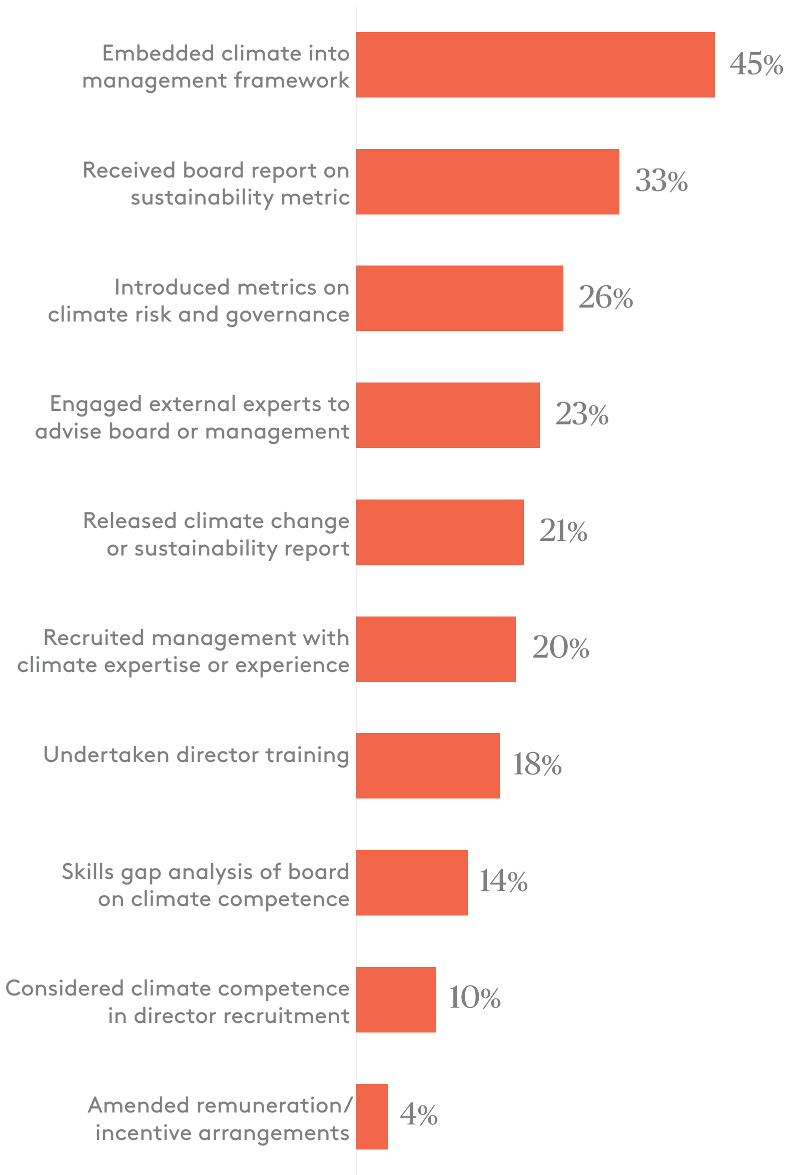
Climate governance and the board

CLIMATE CHANGE AND RISK MANAGEMENT

Directors were asked to identify what steps their board had taken to respond to climate governance, risk and opportunity. The two most common steps were that the board had embedded climate change into risk management frameworks (45%) and had received board reporting on climate footprint/ sustainability metrics (33%).

STEPS TAKEN BY BOARDS TO RESPOND TO CLIMATE CHANGE GOVERNANCE

Q15. What steps has your board taken to respond to climate governance, risk and opportunity? [select all applicable] (n=1,610)



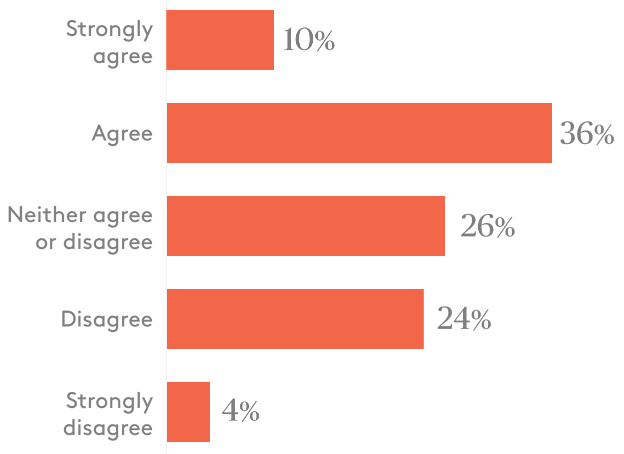
DIRECTORS MODERATELY CONFIDENT IN THEIR BOARD'S OVERSIGHT OF CLIMATE GOVERNANCE

A key responsibility of the board is to assess its own composition and determine whether it has the right mix of skills, experience and mindsets to meet the organisation's strategic purpose and goals.

When asked about board composition, directors were moderately confident that they were adequately prepared to address climate change issues, with 46% agreeing that their board had the knowledge and experience to adequately address the climate governance issues facing their organisation. However, at least a quarter (28%) of all directors surveyed did not express that confidence.

BOARD'S COMPETENCY IN DEALING WITH CLIMATE CHANGE GOVERNANCE

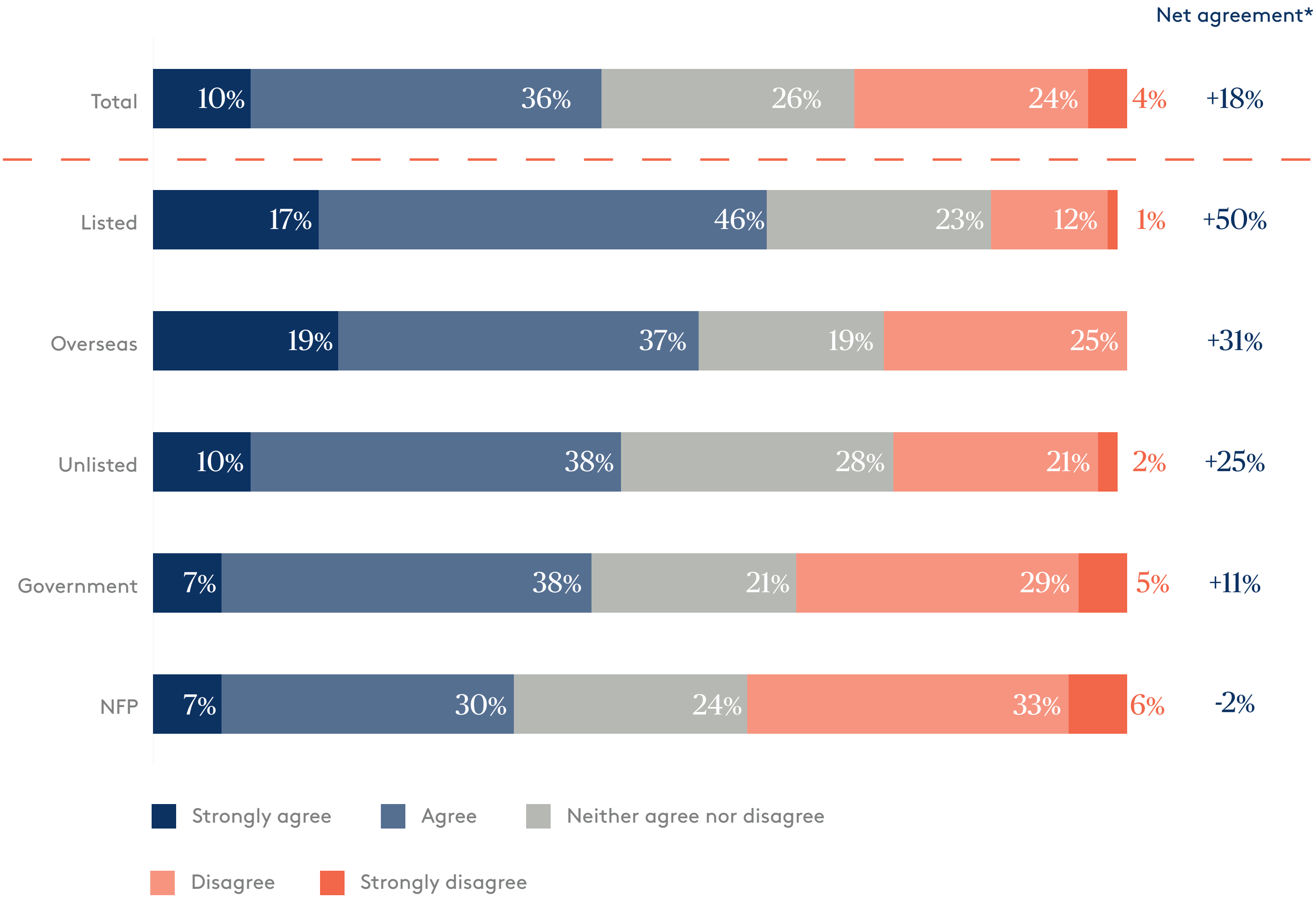
Q14. To what extent do you agree with the following statement: "My board has the knowledge and experience to adequately address the climate governance issues facing our organisation." (n=1,860)



Results by sector showed that listed company directors had the highest level of confidence in their board's ability to adequately address climate governance issues, which might explain the lower relative level of concern about climate risk. Conversely, directors on NFP boards overall lacked confidence (see **Appendix A**).

BOARD'S COMPETENCY IN DEALING WITH CLIMATE CHANGE GOVERNANCE BY SECTOR

Q14. To what extent do you agree with the following statement: "My board has the knowledge and experience to adequately address the climate governance issues facing our organisation." (n=1,860)



*Net agreement = (strongly agree + agree) minus (disagree + strongly disagree)

What steps might the board take to respond to climate risk?

Boards should consider the following steps when engaging with climate governance:

- Conduct a board readiness check
- Skills assessment of directors and review of board composition
- Consider upskilling or bringing in external assistance
- Embed into risk management and strategic oversight process
- Consider targets, metrics and reporting arrangements
- Review and seek continuous improvement.

For more information read ***Climate risk governance guide: An introductory resource for directors on climate risk governance***.

BOARDS NOT LOOKING FOR CLIMATE-SKILLED DIRECTORS

Boards often look for specific skills in the recruitment of directors, and where a board is exposed to climate risk or opportunity a board might look to recruit a director with expertise in the area. There is little evidence of this currently occurring, with 14% of survey respondents reporting their board had used climate competence as part of a skills gap analysis of the board. Similarly, only one in ten said that they had taken 'climate competence' into account in director recruitment.

> "Building 'climate competence' should be part and parcel of a director's job - increasingly, investors, proxy advisers and regulators are looking to see boards demonstrate this."
>
> – Graham Bradley AM FAICD, Chair, EnergyAustralia Holdings Limited.

Interviewees had mixed views about the utility of seeking specific climate skills on the board. In most cases the suggested approach was to have a diverse board that includes some members with industry specific experience along with seasoned directors with broad professional experience. However, some interviewees saw the case for hiring a director with specialist climate expertise where the board lacked it. It was also recognised that there should not be an over-reliance on any one director to provide climate expertise, and that it was the responsibility of all directors to appropriately inform themselves. Hiring a director with climate experience should also not be seen as a way of addressing skills gaps at an executive level.

Case Study - Newmont Corporation appoints corporate social responsibility expert as NED

Newmont Corporation is the largest gold producer in Australia and listed on the NYSE. In line with its corporate purpose "To create value and improve lives through sustainable and responsible mining," Newmont appointed **Jane Nelson** a corporate responsibility academic as a director in 2011. Ms Nelson is the founding director of the Harvard Kennedy School's Corporate Responsibility Initiative and serves on several advisory panels on sustainability leadership in the mining and metals sector. At Newmont, Ms Nelson chairs the safety and sustainability committee, which provides oversight over Newmont's operations to ensure it achieves its core value of sustainability.

LIMITED DIRECTOR EDUCATION ON CLIMATE GOVERNANCE

Ongoing training and development for the board on climate change is critical, especially where there are significant risks and opportunities.

Only one in five (18%) of directors indicated that their board has undertaken director training on climate governance issues with numbers slightly higher for listed (22%) and unlisted boards (21%) and much lower for government/public sector boards (10%). Given the challenges that climate change poses to risk and governance, this is a lower number than expected and suggests a potential need for greater focus in this area.

In response to the need for ongoing training and development, the AICD is elevating its focus on climate change governance. In August 2021 the AICD launched the **Climate Governance Initiative Australia** with local partners. The first major resource produced by the AICD is a **climate risk governance guide**, produced in conjunction with MinterEllison.

Interviewees agreed that a well-functioning board should have an induction process for new directors including briefings about climate change and sustainability issues, and how these issues inform the strategy of the organisation. Where specialist committees exist, such as a sustainability committee, new directors should be invited to attend to understand the scope of the committee's responsibilities and activities.

BOARD COMMITTEES VALUABLE BUT FULL BOARD MUST RETAIN OWNERSHIP

Boards may wish to form committees to consider climate change, environmental and sustainability issues in detail and provide recommendations to the full board. As always, boards need to be careful that the committee does not duplicate work that has been delegated to the CEO or management and that it does not operate as a board-within-the-board.

In interviews, directors considered there was no ideal model for a committee structure. Relevant factors to determine whether one was necessary included a materiality assessment of risk and opportunity, current board composition and existing structures and whether the board considered it needed the 'workhorse' of a committee. For example, if an organisation looked at climate change almost exclusively through a risk lens, then the board might choose to deal with it through their audit and/or risk committee. Where the board has established a sub-committee, the challenge of finding the requisite skills, might mean the board may wish to bring in some external experts to sit on it.

Notably, while committees can be important, interviewees were clear that the ultimate responsibility for strategy, decision making and addressing a material risk like climate change must sit with the full board. Critical decisions, like a commitment to net zero carbon emissions, should be approved by the full board.

Case Study – Lendlease sustainability committee tracks net zero commitments over time

Lendlease is a listed property group specialising in project management and construction, and has committed to reach zero carbon scope 1 emissions by 2025 and absolute zero by 2040. According to Nicola Wakefield Evans FAICD, the chair of the sustainability committee, the committee is tracking progress against these targets and regularly providing the full board with confidence that it will be able to reach these targets.

Organisations that have a material climate risk or opportunity exposure often have internal management-led committees. While these are strictly speaking not sub-committees of the board, they may report to a director, such as the chair of the sustainability or ESG committee, with the CEO's involvement. Such committees might also include relevant experts.

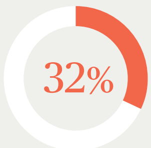
ASX 200: references to climate change and environment impact in governing documents

In mid-2021, the AICD commissioned Herbert Smith Freehills to analyse the incidence of sustainability/ ESG- focused board committees in the ASX 200, as well as the prevalence of those issues in the same cohort's board charters.

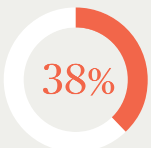
The analysis revealed that 31% of ASX 200 companies had a sustainability-focused board committee, slightly lower than the incidence amongst the ASX 50 (32%). However, it was much more common to see sustainability-related issues featuring in board charters, with 50% of ASX 50 companies referring to "environmental impact" or having regard to the "environment", with the number decreasing to 38% for the larger ASX 200 cohort. Looking at climate change specifically, 8% of the ASX 50 and 5% of the ASX 200 had board charters that directly referred to the topic.

In an interesting finding, references to climate change were more likely to appear in risk committee charters (13% of ASX 200 companies) than in their sustainability (11%) or audit (10%) equivalents. A similar picture emerges when looking at board committee charters referring to environmental impact (29% of risk committees vs 24% of audit committees vs 22% of sustainability committees). While this was influenced by the lower incidence of sustainability committees, it does provide insight into the ways in which climate change and environmental impact are currently being considered by boards across the ASX 200.

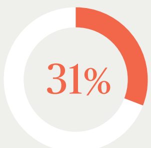
25 ASX 50
companies with environmental impact in board charters



16 ASX 50
companies with sustainability committees



76 ASX 200
companies with environmental impact in board charters



61 ASX 200
companies with sustainability committees

LOW LEVELS OF REPORTING TO THE BOARD ON CLIMATE FOOTPRINT

Each board must consider its own unique climate change exposure and determine how it should receive appropriate internal reporting.

Case Study – BlueScope Steel's new role to support climate focus

The BlueScope Steel board has appointed a Chief Executive Climate Change role that reports to the CEO. The job is focused on climate change strategy and a related program of work. As technology shifts, the person in this role is responsible for ensuring that BlueScope is an early adopter.

Interviewees thought that management could bring in independent external experts to assist with decision-making processes, and the board should be provided with this advice, as appropriate. Interviewees talked about circumstances where the board had felt the need to commission an external independent party to report directly to the board, allowing them to independently test management advice.

A third of directors (33%) stated they had received a board report on their climate footprint or sustainability issues, with boards of listed companies (47%) and government entities (45%) being much more likely to receive a report and boards of unlisted companies (26%) and NFP organisations (25%) much less likely.

METRICS AND TARGETS MUST BE ROBUST AND AVOID GREENWASHING

Some key metrics that organisations may track and report against include carbon emissions, energy consumption, water usage or waste and pollution. Interviewees felt these should be set in the usual way after a process of engagement with management – importantly, these should not be arbitrary targets set by the board.

Similarly, interviewees noted that targets to reach certain goals (for example, "net zero" commitments) should be accompanied by robust planning and resourcing. Significant damage to an organisation's standing (externally and internally) can be done where a credible pathway to those targets is missing, risking the accusation of "green-washing". There may also be legal liability risk associated with such an approach.

Interviewees stated that, when setting targets, directors needed to consider how they will interact with other metrics and not create perverse incentives. For example, a Return on Assets target might make management sweat an inefficient asset for longer, which might occur at the expense of increased pollution of greenhouse gas emissions and poor environmental outcomes.

Frequency of internal reporting to boards on relevant metrics will depend on the materiality of the issue. For some metrics, directors may receive only an occasional report. Where it is key data or a key metric, directors may need to ask for regular updates and receive them as part of a dashboard, similar to financial information.

Survey responses suggest that climate governance metrics are immature and require development. Approximately one in four (26%) of all directors indicated that their board had introduced metrics on climate change risk and governance. This seems low given the potential materiality of the risk to many organisations. Metrics were more likely to be utilised by boards of overseas (42%) and listed companies (34%), and less likely to be utilised by NFP entities (14%).

CLIMATE NOT FIGURING IN EXECUTIVE PAY

Both the survey and interviews showed that, generally, boards do not tie climate related metrics or targets to remuneration structures. Only 4% of all directors stated they had amended remuneration or incentive arrangements. In 2020, just eight ASX 100 companies included climate measures in short-term bonus calculations.[4]

Listed company approaches to climate change incentives

According to **research** conducted by Guerdon Associates and the GECN Group in October 2021, only three companies in ASX100 separated climate change metrics from other ESG metrics in their 2020 short term incentive plan.

Santos set 5% of the scorecard based on carbon emissions performance, Stockland set 5% based on their roadmap to achieve net zero by 2030 and BHP stated that approximately 4% of the scorecard was based on climate change metrics but did not disclose details.

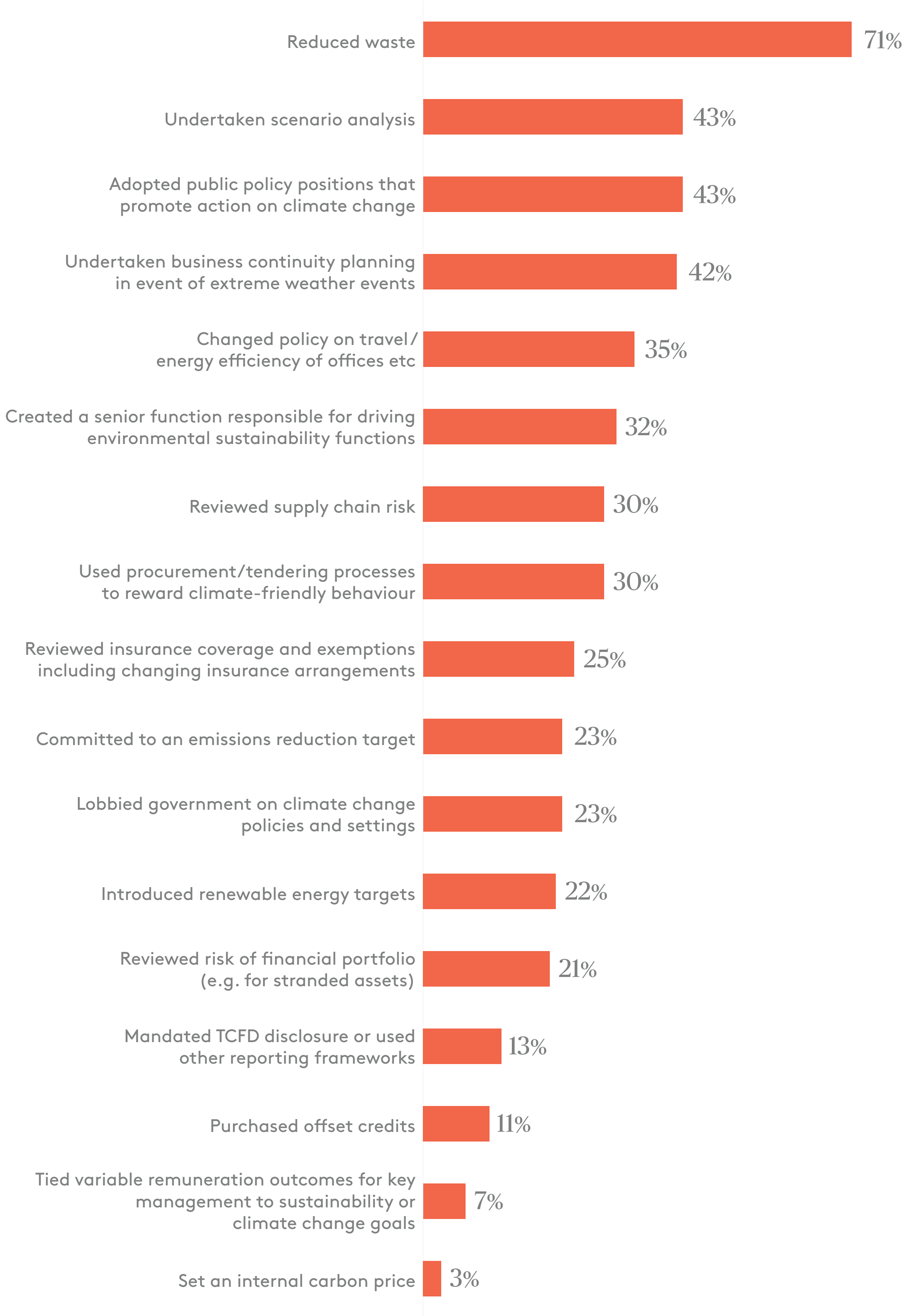
Eleven companies had climate measures built into their ESG scorecards. Standouts include BlueScope with a 45% scorecard weighting on their sustainability agenda including a reduction in emissions intensity and Downer EDI with a 30% scorecard weighting on 'Zero Harm' which includes GHG emission reductions.

The Climate Governance Initiative has released an **Executive Compensation Guidebook for Climate Transition** covering considerations for boards considering applying climate incentives.

4. Patten, S. "How to get the link between executive pay and climate right", *Australian Financial Review*, 15 July 2021. Available at: **https://www.afr.com/work-and-careers/leaders/how-to-get-the-link-between-executive-pay-and-climate-right-20210713-p589cf**, (accessed 9 November 2021)

ORGANISATIONAL CLIMATE CHANGE ACTION

Q16. What steps has your organisation taken to respond to climate risk and opportunity? (n=1,550)



SUSTAINABILITY REPORTING STILL LIMITED

Listed entities are required to report and disclose publicly and have additional obligations around narrative disclosure in their Operating and Financial Review, which require them to report on matters such as material business risks. For ASX-listed companies, Recommendation 7.4 of the Corporate Governance Principles and Recommendations asks an entity to disclose whether it has any material exposure to environmental or social risks and, if it does, how it manages or intends to manage those risks.

In interviews, directors reported that the process of commissioning and preparing external reports can lead to very useful information for boards. The information may be unexpected and may assist boards to reconsider their own assessment of strategy and risk. As sustainability reporting matures, interviewees expected it to deepen and better integrate with financial disclosures as the nexus to value creation is better understood and valued.

A particular challenge of climate reporting and disclosure for boards of listed companies is the need to widen the group of directors who are expected to engage with investors. Traditionally, the chair would speak to investors on behalf of the board. As more disclosures are made, investors may want to speak to, for example, the chair of the ESG or sustainability committee.

Many organisations that are not listed companies also choose to report on their sustainability outcomes voluntarily, either as part of general directors' reports or through a separate sustainability report. This enables organisations to demonstrate their oversight and accountability to stakeholders. There are many frameworks available that entities can report against (see the following breakout box).

Twenty-one per cent of all directors indicated they had released a climate change or sustainability report. As expected, that is much higher for listed companies with more than a third releasing a report (38%), and lower for unlisted companies (15%) and NFPs (9%).

Current non-financial frameworks and standard setting bodies

The IFRS Foundation, which sets the international accounting standards adopted by jurisdictions such as Australia, has announced its intention to create an **International Sustainability Standards Board (ISSB)**. The Australian government has yet to announce whether it would adopt the standards, including climate disclosure standards, released by the new ISSB. The first climate standard is scheduled for release in late 2022. The Climate Disclosure Standards Board and the Value Reporting Foundation (see below) will also be merged into the new ISSB. This means a merger of US and European -based independent reporting frameworks into the new body and suggests these existing frameworks will form the core of whatever standards are ultimately released by the ISSB.

The **Task Force on Climate-Related Financial Disclosures (TCFD)** is a multi-stakeholder taskforce established in 2015 by the Financial Stability Board to develop consistent and comparable climate-related financial risk disclosures. It has quickly been established globally as the recommended climate-related financial disclosures. In Australia it is referenced by regulators and standard setters and New Zealand, Japan and the UK have introduced or are introducing disclosure requirements for some companies around the TCFD.

The **Value Reporting Foundation** is a recently merged entity combining the former **International Integrated Reporting Council** and **the Sustainability Accounting Standards Board.** This is a US-based standard setter that provides assistance on disclosure of financially-material ESG information by companies to their investors. The standards are industry specific. Entities are then expected to apply the International Integrated Reporting Framework. Integrated reporting communicates how an organisation creates value across a broad base of capitals. It is mandatory for listed entities in South Africa and Japan and has been referenced by ASIC and the ASX Corporate Governance Principles in Australia.

The Global Reporting Initiative (GRI) is a European headquartered organisation responsible for the world's most widely used standards for sustainability reporting. The GRI standards help organisations understand and disclose their impacts in a consistent and credible way for multiple stakeholders. ▸

The Climate Disclosure Standards Board (CDSB) has a framework for reporting environmental information with the same rigour as financial information. Initially focused on climate, the framework has been expanded to cover natural capital more broadly including water and biodiversity. The CDSB is widely recognised by stock exchanges and the European Union non-financial reporting directive.

The Climate Disclosure Project (CDP) requests information from the world's largest companies on behalf of over 590 institutional investor signatories on climate, water and forestry. The companies can choose whether to respond. The CDP 'scores' companies' responses to encourage greater leadership in this space. ■

Interviewees noted that reporting is evolving rapidly. They felt there had been a real sea change around disclosure pressures since 2020, particularly from investors. Interviewees believed that investors and stakeholders more broadly are increasingly expecting detailed, quantitative disclosures on climate change impact.

TCFD VALUABLE BUT REQUIRES GENUINE COMMITMENT

The Task Force on Climate-Related Financial Disclosures (TCFD) framework has been embraced by a number of boards who find it a useful framework. Thirteen percent of all directors stated that they had mandated TCFD disclosure or used other reporting frameworks. Again, this was much higher for boards of listed companies (34%) and much lower for unlisted companies (8%) and NFPs (3%).

Interviewees from boards that have adopted the TCFD framework cautioned that, while they found it effective, full implementation of the framework is resource intensive and can take several years. This is particularly true for organisations undertaking scenario analysis and stress testing for the first time. This process asks an organisation to assess their exposure to climate risk along a range of scenarios, such as global temperatures rising in excess of 2°C or 4°C and an orderly transition to a low emissions economy versus a disorderly transition. APRA-regulated entities such as banks, insurers and superannuation funds are now required to undertake scenario planning and stress testing which means that it is likely to flow throughout the economy as those that they lend to, insure or invest in are required to provide them, in turn, with information on their exposures.

A surprising 43% of directors stated they had undertaken scenario analysis which most likely refers not to the TCFD process but to simpler scenario approaches, including less detailed business continuity planning for climate risk impacts.

In interviews, directors on boards that have undertaken scenario planning under the TCFD framework compared it to planning that already occurs in relation to other risks such as cyber-attack, major disruptions to services and significant reputational damage. These should already form part of the board's work and be conducted annually in more sophisticated organisations exposed to risk.

Scenario planning adds an additional layer of oversight as it involves a multitude of complex, contingent possibilities some of which are in the remote future and outside the normal planning range. Interviewees counselled that directors do not need to 'get into the weeds' when it comes to scenario analysis and stress testing. However, the board should involve itself in reviewing scenarios and their outputs and challenging them where necessary.

AUDIT AND ASSURANCE: THE LOOMING CHALLENGE FOR BOARDS

For organisations that set targets and produce sustainability reports, internal audit and external assurance processes play a critical role in verifying data and determining whether targets are achievable.

In interviews, most directors indicated that sustainability reports were partially assured by the company's external auditor. Directors expected pressure for full assurance of these reports to grow from stakeholders, which might include lenders and insurers. Where disclosures are made in the financial statements or relate to matters in the financial statements, interviewees emphasised the need for full assurance.

Audit and assurance on climate reporting and disclosure is an emerging area of practice that will need to be monitored in coming years, particularly as stakeholder expectations change.

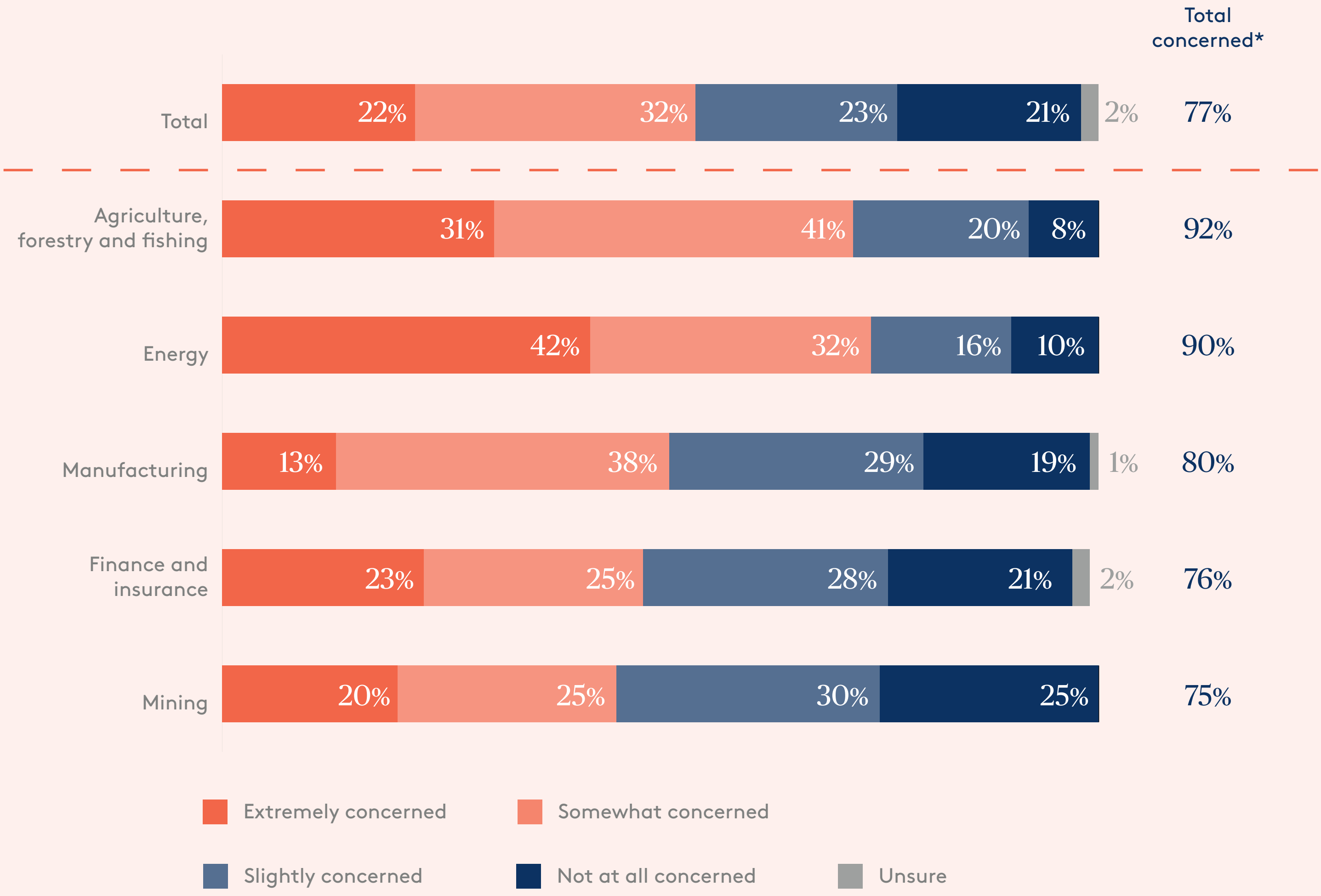
Varied practice across high-risk sectors

When looking at results across industries, the survey revealed mixed results among the industries recognised by the TCFD as at 'high risk' of material climate-related risk.[5]

Directors from the energy, and agriculture, forestry and fishing (AFF) industries tended to be more active than average on climate change issues, while those in mining were less so. Directors in the finance and insurance, and manufacturing industries tended to stick relatively close to the average of all respondents.[6]

5. The TCFD lists financial services, energy, transportation, materials and buildings (including metals and mining, and construction), and agriculture, food and forest products as among the 16 high-risk industrial sectors.
6. Results from other industries that are recognised as 'high-risk' by the TCFD such as construction and transport and storage industries are not reported in this study due to relatively smaller sample sizes.

For example, 73% of directors from energy and 72% from AFF were 'extremely' or 'somewhat' concerned about climate risk to their organisation, compared to directors from manufacturing (51%), finance and insurance (49%) and mining (45%).



*Total concerned = extremely concerned + somewhat concerned + slightly concerned

The striking figure from the graph above is that one in four directors responding to the survey from the mining sector, and one in five in the finance and insurance, and manufacturing sectors, were 'not at all concerned' about climate risk to their organisation. This result suggests more work should be done to understand underlying attitudes and approaches in these sectors.

STEPS TAKEN BY BOARDS TO RESPOND TO CLIMATE CHANGE GOVERNANCE BY INDUSTRY

Q15. What steps has your board taken to respond to climate governance, risk and opportunity? [select all applicable] (n=1,610)

While only 2% of directors in AFF strongly disagreed with the statement that their board should increase the attention it pays to climate change governance, 22% of directors in mining and 15% in manufacturing strongly disagreed, against an average for all directors of 11%.

Directors from energy, and mining were also much more likely to believe that their board had the knowledge and experience to adequately address climate change. They were followed by those in AFF, finance and insurance, and manufacturing, all of whom tended to have a greater level of confidence than the average survey respondent.

Overall, this paints a surprising picture in some high-risk sectors, particularly mining. Survey responses from these sectors show these directors are less likely to be seriously concerned about risk, are generally taking fewer steps to deal with it on their board and are less likely to want their boards to increase attention paid to climate governance, than respondents overall. This was coupled with a higher than average confidence in their board's ability to manage climate risk, despite a relatively low focus on board skills and training.

Conversely, survey responses from the energy and AFF sectors appeared more seriously concerned about climate risks and more likely to report active steps being taken on climate governance.

These results suggest further research is warranted to understand director attitudes and current practice in highly exposed sectors to see whether the expected shift in response to perceived climate risk is occurring.

Stakeholder relations

Interviewees reported that boards were facing mounting pressure from various stakeholders to act on climate change. Generally, interviewees, many of whom were from listed companies or on boards in financial services, thought that the strongest stakeholder concerns were coming from investors, employees and regulators.

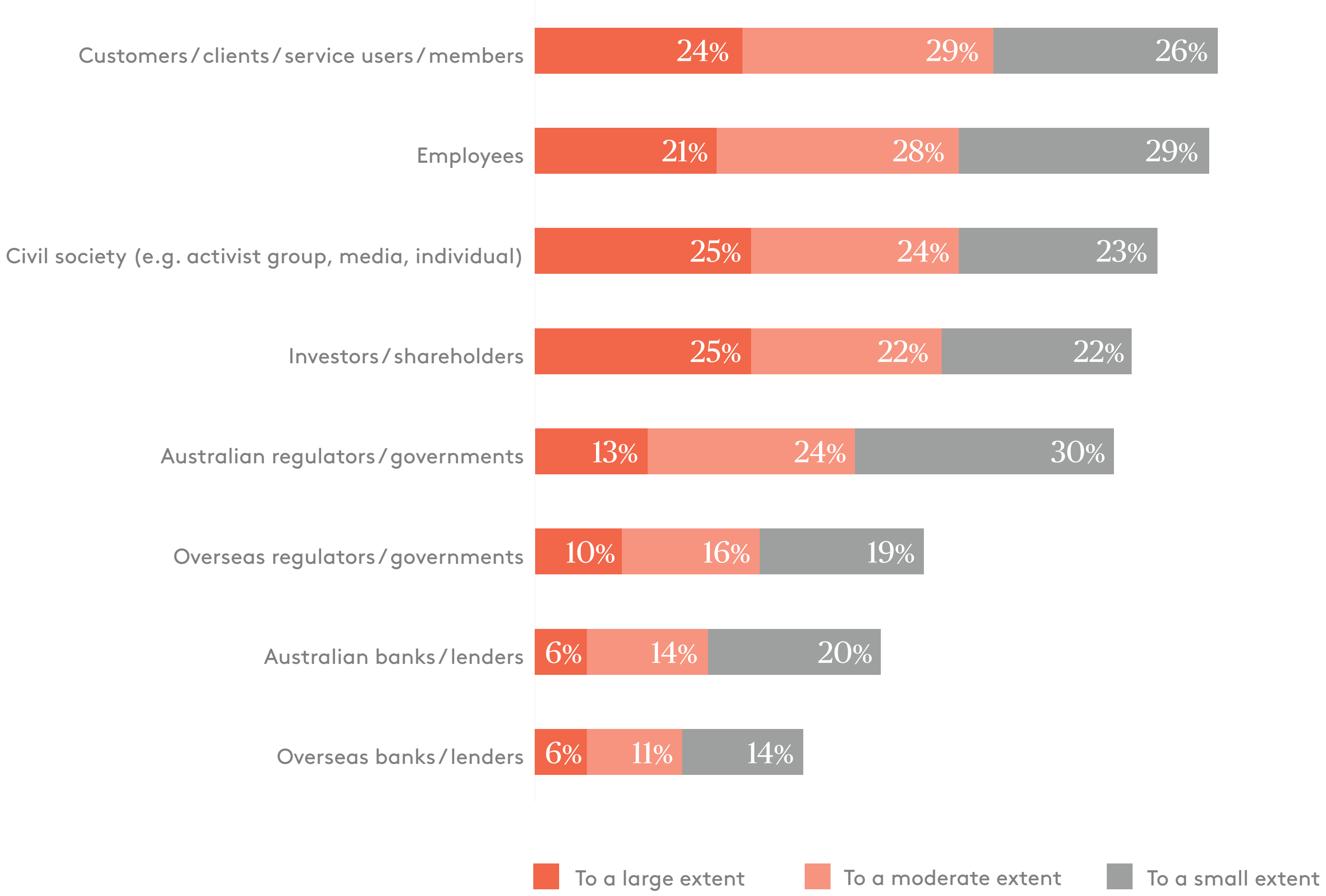
The survey produced slightly different results with directors citing pressure from clients, employees, and civil society. The following survey quote summarised this view:

> "Yes, it's imperative for boards to respond to climate change. Almost [all] of the community is concerned about climate change. Platitudes, window dressing and virtue signalling will increasingly be questioned by consumers who simply put will vote with their feet... customers support businesses that share their values. Time to act, simple really."
>
> – Survey respondent

In terms of engaging with stakeholders, interviewees were of the view that the approach should be the same for all stakeholders: a clearly stated position from the organisation setting out why actions are being taken, the logic behind it and why it was in the organisation's best interests. Engagement with stakeholders should be honest, recognising trade-offs, progress and setbacks, to keep earning trust. It is essential that any message is owned by both the board and management.

PRESSURE FROM STAKEHOLDERS

Q19. To what extent does your organisation feel pressure to act on climate change from the following stakeholders? (n=1,647)



PRESSURE FROM STAKEHOLDERS BY SECTOR

Q19. To what extent does your organisation feel pressure to act on climate change from the following stakeholders? (n=1,647)

	1	2	3	4	5
TOTAL*	Customers / clients / service users / members 54%	Employees 50%	Civil society 49%	Investors / shareholders 47%	Australian regulators / governments 38%
LISTED	Investors / shareholders 54%	Civil society 47%	Employees 45%	Customers / clients / service users / members 41%	Australian regulators / governments 37%
UNLISTED	Customers / clients / service users / members 52%	Employees 47%	Civil society 45%	Investors / shareholders 43%	Australian regulators / governments 34%
GOVERNMENT	Employees 71%	Customers / clients / service users / members 70%	Civil society 60%	Investors / shareholders 56%	Australian regulators / governments 55%
NFP	Customers / clients / service users / members 48%	Employees 46%	Civil society 42%	Investors / shareholders 37%	Australian regulators / governments 31%
OVERSEAS	Investors / shareholders 66%	Customers / clients / service users / members 65%	Civil society 63%	Employees 52%	Australian regulators / governments 34%

*TOTAL = to a large extent + to a moderate extent

TABLE KEY

- Customers / clients / service users / members
- Investors / shareholders
- Employees
- Australian regulators / governments
- Civil society (e.g. activist group, media, individual)

CUSTOMERS, CLIENTS, SERVICE USERS AND MEMBERS

Customers, clients, service users or members were the group most clearly driving pressure on boards to act on climate change. Likewise, interviewees noted that customers are looking for information in the form of sustainability reports, as well as products that help them reduce their carbon emissions.

> "There is no doubt there is a head-of-steam in the transition to a low carbon economy and renewables. It is escalating dramatically. Customers are driving this across lending, equity and development."
>
> – Peter Warne, Chair, Macquarie Group Limited.

CLIMATE ACTION IS A DRIVER OF EMPLOYEE ENGAGEMENT

Interviewees felt that positive engagement with climate change issues, and an organisational reputation that it took climate change seriously, were increasingly becoming important in attracting and retaining talent. Interviewees noted that it was essential in motivating an organisation's workforce, particularly younger workers.

Some interviewees noted that the impetus for change might actually come from staff who may identify opportunities missed by management. This was positive for the organisation and helped build employee engagement and alignment and identification with the business' mission.

CIVIL SOCIETY PRESSURE

Interviewees felt that, while there might be some short-term reputational gains in making climate-friendly announcements, boards should be wary of abandoning investments or businesses solely because of pressure from interest groups. Directors needed to assess what was in the best interest of the organisation over the long term.

While elements of civil society may be dissatisfied by an organisation's response, it was important to maintain dialogue and build mutual understanding where possible.

CLIMATE CHANGE NOW A BIGGER FOCUS THAN REMUNERATION FOR INVESTORS

Interviewees felt that interest in ESG issues from investors has increased considerably in recent times. Interviewees from listed company boards reported that questions from investors on ESG and climate change matters had now taken over from remuneration as the number one topic of conversation. These questions had also tended to dominate AGMs particularly in more climate-exposed sectors where activists are proposing climate related resolutions. The "Say on Climate" movement has also begun to feature in the most recent AGM season and is expected to only grow in prominence given global momentum and COP 26.

> "Investors today want more information about climate change-related risks. Companies need to be prepared to engage with investors on what they are doing to measure and mitigate environmental risks."
>
> – Graham Bradley, Chair, EnergyAustralia Holdings Limited.

Investor expectations of listed companies

In November 2021, the Investor Group on Climate Change (IGCC) released a report outlining their expectations of company boards and directors on climate risk. The report is based on an analysis of fifteen ASX listed companies facing material climate change exposure.

Based upon their review, the report states that "...many companies are not acting decisively on climate change. There are significant weaknesses in many companies' climate approaches, including the lack of credible strategy and targets that align with the goals of the Paris Agreement". The report concludes that there are deficiencies in how boards manage and disclose climate risk, including not having appropriately skilled directors and governance structures in place. ▸

The report sets out specific investor expectations with respect to climate governance. They include:

- Climate change being fully integrated into company strategy;
- Executive remuneration reflective of the company's climate change targets and for competing incentives to be removed;
- Independent assessment or audit of director skills;
- The board demonstrating it is receiving annual education about the relevant climate-related risks and opportunities for their business;
- The company undertaking robust climate change scenario analysis and disclosing capital investments, or assumptions, consistent with the Paris Agreement objective of limiting global warming to 1.5°C;
- Disclosure in accordance with the TCFD framework; and
- Putting a "say on climate" vote to shareholders at the company's AGM.

The full IGCC report can be accessed **here**. ■

REGULATORY PRESSURE NOT THE KEY DRIVER FOR CLIMATE ACTION

Regulator focus generally featured in interviews when discussing climate change governance. Undoubtedly, Australian regulators have been increasingly active in the space with climate risk being identified as a key focus by both ASIC and APRA. However, the pressure from regulators featured much lower in the survey, with directors from government/public sector bodies most likely to feel pressured and directors from unlisted companies and NFPs least likely to feel pressured. This suggests that the regulatory focus on climate governance has not, on the whole, been felt in boardrooms; contrary perhaps to the expectations of the regulators themselves.

BANKS AND INSURERS ARE PRICING IN CLIMATE RISK

Interviewees felt that lenders were starting to take a greater interest in the climate risk profile of their borrowers. Borrowers who actively managed climate risk may face a lower cost of capital, if not now then in the near future, placing them at an advantage against market competitors. Those on boards in sectors with high greenhouse gas emissions expressed concern about the rising cost of capital and noted that some banks may refuse to lend or impose more stringent conditions on 'high-risk' industries in the future.

Interviewees reported that climate risk is already being priced into insurance. This was supported by the survey finding, with one in four directors advising that their organisation had reviewed their insurance coverage and exemptions.

Interviewee claims about rising pressure from lenders was not as apparent in the survey, with 61% of directors saying their board felt no pressure to act on climate change from Australian banks and 68% for overseas banks. Directors of listed companies were more likely to feel pressure from both Australian and overseas banks and lenders than the average, although slightly less than half (46%) still felt no pressure from Australian banks.

The exception was for directors of overseas companies where there was a striking result with 55% of all directors of overseas companies experiencing either a 'large' or 'moderate' amount of pressure from overseas banks and only 31% feeling 'no pressure'. As these are the entities most likely to be exposed to overseas banks this suggests that these banks may be at a slightly more advanced stage on pricing climate risk into their lending structures and that Australian banks may soon follow.

Elevating stakeholder voices to the board

In 2021, the AICD released *Elevating stakeholder voices to the board: A guide to effective governance*, which supports directors to consider the interests of stakeholders in decision making.

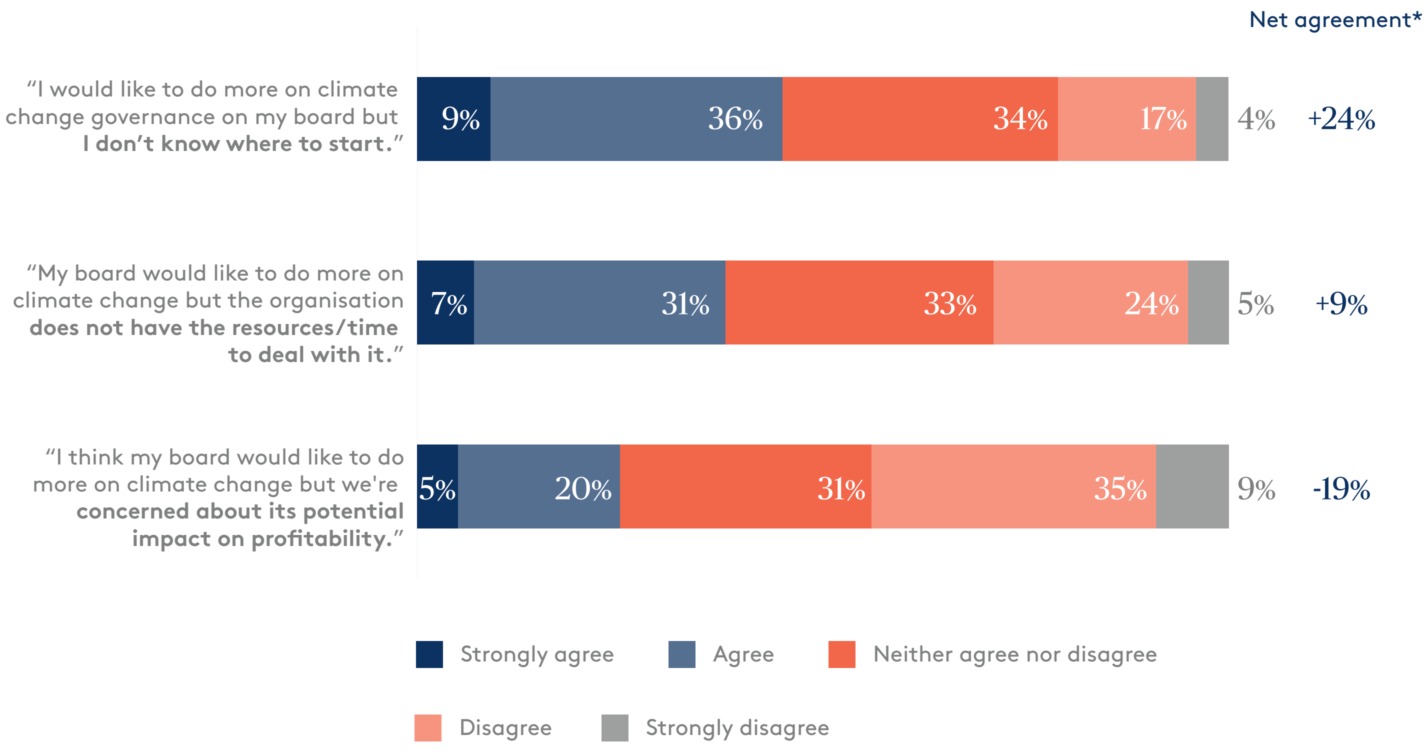
It can be used by directors of all organisations. Even the smallest organisation will have important stakeholder relationships and can benefit from applying the principles outlined in the guide.

Barriers to action

The survey sought to explore what might be preventing directors and boards from taking further action on climate change. Specifically, the survey asked whether directors and boards were not doing so because (a) they were uncertain where to start, (b) they lacked sufficient resources, or (c) if they were concerned about profitability.[7]

BARRIERS TO ACTION ON CLIMATE CHANGE

Q10, 11, 13. To what extent do you agree with the following statements... (n=1,308)



*Net agreement = (strongly agree + agree) minus (disagree + strongly disagree)

7. In this section of the report only those who 'strongly agreed', 'agreed' or 'neither agreed nor disagreed' with the statement 'In my opinion, my board should increase the attention it pays to climate change governance' were counted in the analysis to capture those who wished to take action but felt frustrated by a barrier.

MANY DIRECTORS DO NOT KNOW WHERE TO START

Results showed that the biggest obstacle to action was the difficulty directors faced in knowing where to start (45% of responses). Further support for this finding was found among the 23% of *all* respondents, who stated that the complexity of the topic makes risk and opportunity assessment difficult.

> "[The most common challenge I face is] 'lack of understanding', whether it relates to not understanding how the known acute and chronic risks affect an organisation, or lack of knowledge about what to act on and what not to, or lack of clarity about how to act, or all of these. The most common challenge I encounter is not lack of motivation but lack of understanding about how to act on climate in a way that is 1) impactful, 2) measurable, 3) authentic, and 4) aligned with culture, brand and business."
>
> – Survey respondent

NFP directors and those on government boards were much more likely to agree that not knowing where to start was a problem, while listed company directors were much more likely to disagree. This was confirmed in interviews with NFP directors (including those whose primary role was on listed company boards) This suggests a greater need for resources aimed at directors in the early stage of their consideration of the issue, with a particular emphasis on those on not-for-profit entities and public sector/government boards.

RESOURCE CONSTRAINTS HOLD BACK CLIMATE FOCUS, RATHER THAN PROFITABILITY CONCERNS

Approximately two in five directors (38%) said that despite wanting to do more, their organisation simply did not have the resources or time to deal with the issue. This was felt by directors from all sectors other than by those on listed company boards, with NFP directors expressing this view most strongly. This suggests there are many resource-constrained organisations where directors are unable to act on climate change governance challenges in the way that they would like.

Interestingly, almost half (45%) of the directors that wanted their board to do more on climate governance disagreed that their board was not taking action because of profitability concerns. This suggests that concerns about profitability are not the primary motivating factor in directors' attitude towards climate change.

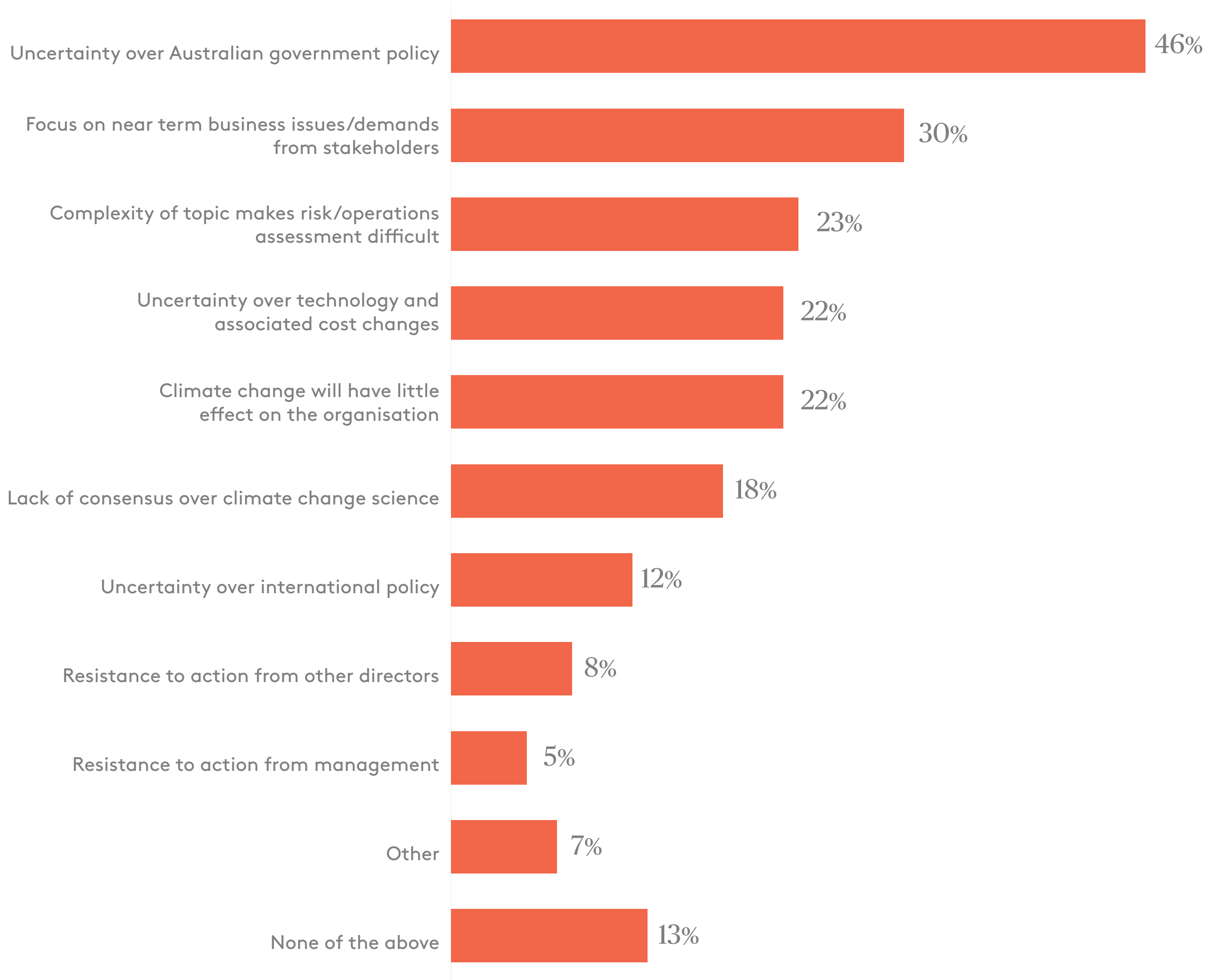
UNCERTAIN NATIONAL CLIMATE CHANGE POLICY IS BIGGEST BARRIER TO EFFECTIVE CLIMATE GOVERNANCE

The survey also asked directors to nominate up to three issues that they felt were a barrier to their board successfully governing for climate change. Uncertainty over Australian government policy was by far the most cited factor with 46% of all directors indicating this was a barrier.

Notably, 18% of respondents cited a lack of consensus over climate change science as an inhibitor to effective governance. This result was more pronounced for directors from commercial entities. Comments from survey respondents also suggested that there is small minority of directors who are sceptical of mainstream climate science.

BARRIERS TO GOVERNING CLIMATE CHANGE

Q20. To what extent do you feel the following issues are barriers to the board successfully governing climate change at your organisation? [select up to 3] (n=1,789)



Comparing across sectors, directors from listed companies were more likely to see 'focus on near term business issues,' as a barrier; those from NFPs were more likely to pick 'climate change will have little effect on the organisation'; and directors of government/public sector entities were more likely to pick 'complexity of topic makes risk and opportunity assessment too difficult'.

BARRIERS TO GOVERNING CLIMATE CHANGE BY SECTOR

Q20. To what extent do you feel the following issues are barriers to the board successfully governing climate change at your organisation? [select up to 3] (n=1,789)[8]

	1	2	3	4	5
TOTAL	46%	30%	23%	22%	22%
LISTED	43%	34%	20%	19%	19%
UNLISTED	49%	27%	26%	22%	18%
GOVERNMENT	52%	30%	27%	24%	8%
NFP	41%	32%	24%	24%	21%
OVERSEAS	45%	31%	24%	21%	11%

TABLE KEY

- Uncertainty over Australian government policy
- Uncertainty over technology and associated cost changes
- Focus on near term business issues/demands from investors/shareholders
- Climate change will have little effect on the organisation
- Complexity of topic makes risk and opportunity assessment too difficult

8. Table represents how each sector rated the top 5 total barriers. It does not necessarily list the top 5 barriers identified by directors from that sector.

APPENDIX A

Sector insights

A summary of views across the various sectors is contained in the following table:

	LISTED	UNLISTED	GOVERNMENT	NFP
Level of concern about climate risk	High	High	Very high	High
Desire to do more on climate governance	Low	Moderate	High	High
Confidence in board's knowledge/ experience to address climate issues	High	Moderate	Moderate	Low
Average number of steps taken to address climate risk and opportunity	High	Moderate	High	Low
Summary	High concern and high confidence. This may suggest an adequate management of the issue or potentially lack of focus.	High levels of concern, moderate confidence and action. May need to elevate focus.	Climate risk is a major concern for a sector that wishes to be much more active on the topic.	High concern and desire to do more with limited confidence on how to proceed. Sector that needs the most guidance.

LISTED COMPANIES GENERALLY CONFIDENT

The survey showed that listed companies have a similar view of climate risk to other directors, however, they tended to be more optimistic and taking more proactive steps.

There was a strong correlation between directors who saw both risk and opportunity from climate change. Listed company directors also viewed the possibility of investor or shareholder satisfaction and/or lower cost of capital as much greater opportunities from climate change action than overall respondents. Of interest, listed company directors strongly disagreed that profitability concerns were constraining their ability to act on climate risk governance.

Listed company directors tended to be much more confident in their current board composition and governance of climate risk. They were less likely than overall respondents to believe that their board should pay more attention to climate governance, and more confident in the knowledge and experience on their board.

Directors of listed companies were much more likely to have taken steps to respond to climate governance issues, including: receiving board reports on climate footprint/sustainability metrics; issuing sustainability reports; embedding climate change risks into risk management frameworks; and amending remuneration arrangements. However, there was limited focus on the board's composition, education or training, reflecting the results from the overall survey group.

Unsurprisingly, listed company directors were significantly more likely to report pressure from investors/shareholders and civil society for action on climate change. Less predictably, listed company directors were less likely to feel pressure from Australian and overseas banks.

NOT-FOR-PROFITS MOTIVATED TO ACT BUT NEED EDUCATIONAL SUPPORT

In interviews with directors, it became clear that most NFPs, while clearly aware of climate risk to their organisations, were not necessarily addressing climate-related issues as a priority. This was particularly the case for those struggling with the effects of COVID-19. However, that did not mean that NFPs were not dealing with issues that fell under the 'climate change' umbrella.

The survey results extracted throughout this report show how differently some NFPs are viewing issues around climate risk and opportunity.

> "A key issue is that the people we work with do have increased vulnerability to the impacts of increased high heat days and extreme weather events."
>
> – Kathleen Conlon, Director, The Benevolent Society.

Interviewees noted the issues that flow from climate change for NFPs, such as the impact on people that their organisation may be providing services to. They felt that climate change tended to be most obviously listed on the risk register because of the risks to the organisation's operations such as the impact of extreme weather events on their services, and on the most vulnerable.

Interviewees reported a significant level of concern about these issues and this was also evident in the comments to the survey.

However, interviewees noted that charities, especially those providing health and community services, needed to provide services irrespective of conditions. They cannot choose to exit a market when they are providing essential services. They might also be obligated to provide those services in particular geographic locations or comply with conditions attached to government funding or donations. This lack of discretion makes their considerations, particularly around opportunity, different to more commercially minded organisations. This was supported by the survey findings, for example directors in the health and community services industry was the industry most likely to see 'no opportunity' from climate change.

There are obvious steps that many NFPs can and have taken to deal with climate governance challenges such as minimising waste, reducing greenhouse gas emissions where possible and lowering electricity consumption. Interviewees noted these were good first steps that organisations should consider, however more complicated adaptations were harder to conceptualise.

What is clear from survey and interview responses is there is an acute need for further guidance regarding effective climate governance in the NFP sector.

SMES TAKING SMALL STEPS

SMEs will sometimes be owner operated with little to no distinction between the organisation's managers and directors. Accordingly, many of the corporate governance issues discussed in this paper which are aimed at non-executive directors, are probably of less relevance to the sector.

However, this does not mean some of the considerations around risk and opportunity assessment, and strategy will not continue to apply. Market opportunities clearly exist for SMEs and a strong focus on climate governance can be critical in attracting and retaining talented employees. SMEs may also find that their customers, who may be larger enterprises, are demanding information on their emissions given their role in the supply chain.

When it comes to engaging with issues around climate governance, interviewees reported that SMEs look to get quick, achievable results.

"Companies need to focus on their core business. Particularly for smaller businesses, if you want directors and managers to engage with climate change, the solutions have to be quick, easy and affordable."

– Christine Williams, Evalue8 Sustainability.

Interviewees noted that SMEs engaging with climate issues tend to follow a two-stage process. First, they achieve cost savings through measuring emissions and then finding ways to reduce energy use and decrease waste. This is low-hanging fruit and relatively easy to achieve. Second, there is a more difficult carbon reduction process which may involve short- to medium-term cost increases to achieve a long-term result. In an SME where cash and profits may be constrained, this can be a more difficult decision to make.

APPENDIX B

Research methodology and acknowledgements

The AICD conducted an online survey of 2,074 AICD members from 10 – 24 May 2021. Participation in the survey was based on self-selected volunteers (i.e. those who responded to the email). Results have been weighted to reflect the AICD's approximately 46,000 members by age, gender, and sector type. Survey results are therefore representative only of AICD membership and not the director community at large, noting that broad director population data does not exist.

The overall maximum margin of error is +/- 2.1% at a 95% confidence interval, with higher margin of errors with smaller sub-samples. Responses to individual questions average around the n=1,700 mark, with a margin of error at +/-2.3%.

The results of the survey are available **here** and can be freely downloaded for any reader who wishes to delve further into the data.

The AICD also conducted in-depth individual interviews with 14 senior non-executive directors operating in various sectors. Interviews lasted between 30 to 90 minutes. The discussion guide was framed by open-ended questions to explore the experience and perspectives of the interviewees. The semi-structured interview process was used flexibly in each of the interviews.

Interviewees were approached based on their knowledge of climate governance issues and/or senior governance expertise. In many cases, their responses represented the views of well-resourced organisations who were actively managing climate risk, supported by strong board oversight. Therefore, their insights are likely to represent the more advanced end of the governance practice spectrum.

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Bruce Brook MAICD, Director, CSL Limited, Newmont Corporation, Incitec Pivot Limited, Guide Dogs Victoria, Djerriwarrh Investments.

Ilea Buffier FAICD, Director, Evalue8 Sustainability, Corryong Health, Regional Development Australia ACT, Ninetwofive Interiors, Northside Community Service.

Kathleen Conlon FAICD, Chair, Lynas Corporation Limited. Director, Bluescope Steel Limited, Aristocrat Leisure Limited, REA Group, The Benevolent Society.

Ken Dean FAICD, Chair, Mission Australia. Director, Mission Australia Housing, Mission Australia Housing (Victoria), Reformed Theological College Limited.

Naomi Edwards FAICD, Chair, Spirit Super. Director, Tasmanian Development Board, Australian Institute of Company Directors, Propel Funeral Partners, Institute of Actuaries Australia.

Teresa Handicott FAICD, Chair, PWR Holdings Limited, Peak Services Holdings Pty Ltd. Director, Downer EDI Limited, Bangarra Dance Theatre.

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The Australian Institute of Company Directors is committed to strengthening society through world-class governance. We aim to be the independent and trusted voice of governance, building the capability of a community of leaders for the benefit of society. Our membership includes directors and senior leaders from business, government and the not-for-profit sectors.

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