

Climate Risk Governance Guide

An introductory resource for directors
on climate risk governance



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Purpose and scope of this guide

This guide is an introductory resource for directors on climate change risk governance.

It provides a plain-language introduction to fundamental climate change concepts, and considers this issue in the context of the non-executive directors' role and duties. This guide is general – it does not go into detail nor comment on specific duties that may apply in any given circumstance.

This guide considers the following questions from the perspective of a non-executive director:



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

- 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 about how to get climate change onto your agenda, establish good governance structures, consider strategy and risk, and report and disclose.



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

- 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.

Directors starting on their climate change journey might want to think about some of the questions posed in the practical guidance in Part 2 and then use Parts 1 and 3 to build their understanding of this issue.

Climate Governance Initiative Australia

The AICD is the host of the Climate Governance Initiative Australia which assists in supporting our members in meeting the challenges and opportunities of governing climate change risk. As host of the Australian Chapter of the Climate Governance Initiative, our members have access to a global network of experts in risk and resilience and to non-executive directors who are leading their organisations' governance response to climate change.

The Climate Governance Initiative (CGI) is an active and rapidly expanding network of over 20 bodies globally, whose Chapters promote the World Economic Forum Climate Governance Principles for boards and effective climate governance within their jurisdictions. The principles are set out in **Appendix 2** of this guide.

The principles support directors to gain awareness, embed climate considerations into board decision making, and understand and act upon the risks and opportunities that climate change poses to their organisations.

CGI chapters have already been established in many comparable countries, including the UK, US (hosted by the National Association of Corporate Directors), Canada (hosted by the Institute of Corporate Directors) and France.

How do I use this guide to start my board's climate journey?



GET CLIMATE CHANGE ON THE AGENDA

This will enable the board to discuss climate-related risks or opportunities which are not being addressed in order to have a deeper conversation

READ

-  Part 1: What is climate change?
-  Appendix 1: Glossary of key climate terms and leading frameworks

CONSIDER

-  Part 2: Where are we now?
-  Appendix 3: The Board Readiness Check tool



EXAMINE GOVERNANCE STRUCTURES, STAKEHOLDERS AND REPORTING

To ensure your organisation is prepared to address the issue and understand stakeholder sentiment and reporting expectations

READ

-  Part 3: Heightened regulatory and stakeholder expectations
-  Part 3: Climate change and misleading disclosure

CONSIDER

-  Part 2: Governance - embedding sound foundations, processes and structures
-  Part 2: Reporting



ASSESS RISK

To ensure your organisation is prepared for the impact of climate change on your organisation

READ

-  Part 1: Why is climate change an issue for organisations and boards?
-  Part 3: Directors' duties

CONSIDER

-  Part 2: The board in action - strategic planning and risk oversight



ASSESS OPPORTUNITY

To ensure your organisation is in a position to benefit from the opportunities that climate change presents (e.g. transition to a low-carbon economy)

READ

-  Part 3: Directors' duties

CONSIDER

-  Part 2: The board in action - strategic planning and risk oversight



TAKE ACTION

Once your board has taken these steps, take action and focus on continuous improvement

How? Agree an action plan, convey to management, implement, monitor and review

Monitor AICD for updates and more guides and assistance



PART 1:

What do I need to know about climate change?

WHAT IS CLIMATE CHANGE?

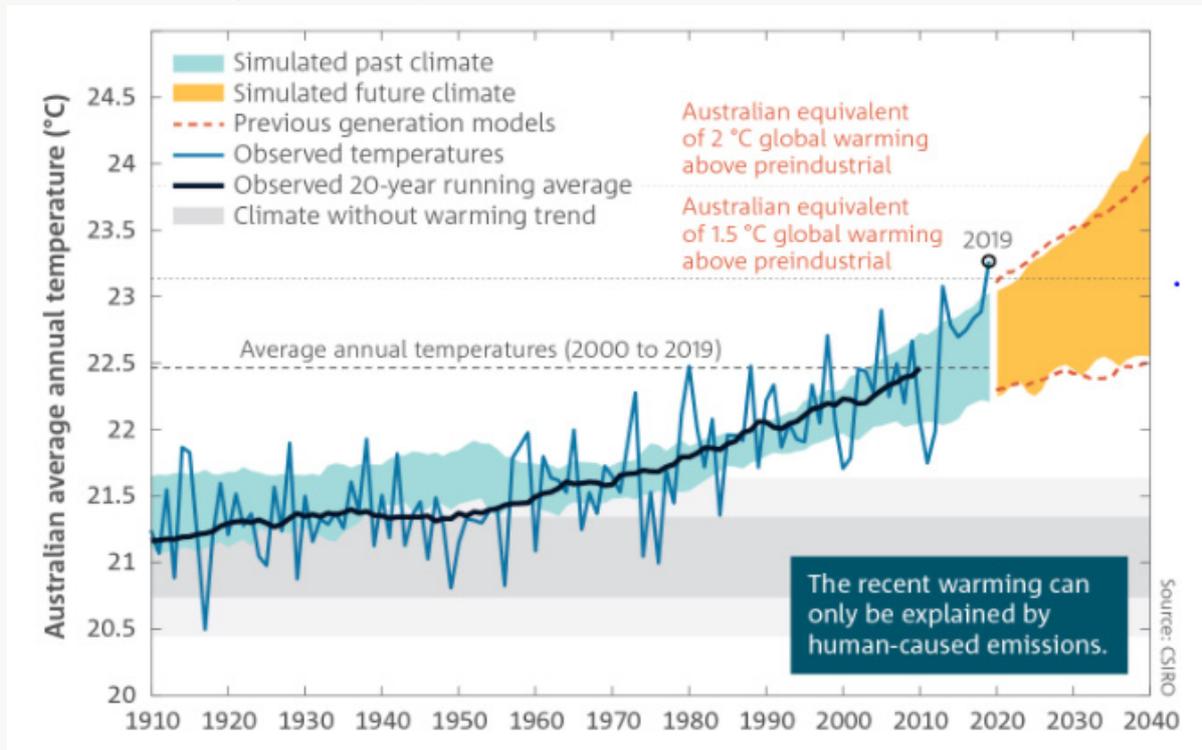
Climate change is a phenomenon that occurs from the accumulation of greenhouse gases (including carbon dioxide, nitrous oxide and methane) in the atmosphere.

Scientists have been in broad consensus about the human contribution to climate change, for a number of decades. Human industrial activity has resulted in volumes of greenhouse gas emissions significantly higher than the natural baseline. These activities include (for example) the combustion of hydrocarbon-based fossil fuels (such as coal, oil and gas) for both stationary energy and transport, the release of methane from livestock and nitrogen in agricultural fertilisers, and the clearing of nature's gas 'sinks' (such as forests and peats).

The additional volume of emissions has caused the layer of greenhouse gas to thicken. As it thickens, it traps more and more heat within the Earth's atmosphere. Global average temperatures now exceed 1.1°C above those of pre-industrial times, and more than 1.4°C above pre-industrial averages over Australia. Scientists have warned that current emissions trajectories may result in catastrophic warming in excess of 4°C by the end of this century.

In response, 196 countries have signed the Paris Agreement, under which governments have committed to reducing economic emissions to a level consistent with limiting global warming to well below 2°C above pre-industrial averages, and to pursue efforts to limit warming to 1.5°C. This commitment, in turn, will require the global economy to transform to a 'net zero emissions' norm (that is, one in which the volume of greenhouse gas emissions produced is balanced with the volume of emissions taken out of the atmosphere) before 2050, and to halve its emissions footprint by 2030.

Figure 1: Australian average annual temperatures – observed and simulated to 2040



Source: Bureau of Meteorology, *State of the Climate 2020*, <http://www.bom.gov.au/state-of-the-climate/future-climate.shtml>.

WHY IS CLIMATE CHANGE AN ISSUE FOR ORGANISATIONS AND BOARDS?

Climate change has rapidly evolved from one seen as an ethical and environmental issue to one that presents material financial risks and opportunities for organisations – across short, medium and long terms. This evolution has been driven by developments in the climate science, and a stark shift in institutional investor, debt finance, regulator, market and community expectations. Today, many employees also see their organisation's environmental impact as an important factor impacting their choice of employer.

Climate change creates two primary financial risks: the **physical impacts** of a changing climate; and risks in the **transition to a net zero emissions economy**.

A failure to manage these risks can, in turn, give rise to significant risks to a company's reputation and 'social licence to operate' and, ultimately, exposure to **litigation risks**.

These risks are discussed in turn below:

- **Physical risks**¹ – to the natural and built environment. These include both acute risks associated with an increase in the frequency and intensity of extreme weather events, such as coastal and inland floods, extreme winds and precipitation, soil contraction,

heatwaves and drought, and gradual onset impacts such as rising sea levels, increasing average temperatures and rainfall variation. These, in turn, have significant consequences for ecosystem loss, human health, the integrity of the built environment and supply chains. Consequences for organisations may include:

- **Damage to assets and project delays** – Increasing frequency of extreme weather events can heighten the risk of physical damage and associated costs to projects, plant and equipment.
- **Uninsurability of projects and assets** – Climate change can impact on insurance coverage and uninsured loss implications, together with additional capital expenditure requirements.
- **Supply chain disruptions** – Severe weather events (such as extreme precipitation leading to inland flooding) may disrupt operations and/or supply chains, which can impact revenue.

Physical risks compound over time and become significantly worse under high emissions scenarios. However, scientists have made clear that even under 'low emissions' scenarios, where emissions are significantly reduced to a level that limits warming to 1.5°C above pre-industrial averages, both physical risks are now (and will continue to be) significantly elevated versus historical experience.

1. Refer to the following key physical risk resources: Intergovernmental Panel on Climate Change (IPCC), *Climate Change 2021: The Physical Science Basis, Summary for Policy Makers*, August 2021, https://www.ipcc.ch/report/ar6/wg1/downloads/report/IPCC_AR6_WGI_SPM.pdf; Regional fact sheet - Australasia, https://www.ipcc.ch/report/ar6/wg1/downloads/factsheets/IPCC_AR6_WGI_Regional_Fact_Sheet_Australasia.pdf; and Interactive Atlas, <https://www.ipcc.ch/report/ar6/wg1/#InteractiveAtlas>. See further Appendix 1 Glossary of key climate terms and leading frameworks and Appendix 4 Resources library.

- **Economic transition risks²** – as governments, capital markets and the real economy shift in pursuit of low-emissions targets. Transition risks include policy and regulatory responses (such as emissions reduction laws, trade laws and tariffs, prudential regulation and heightened planning and building codes), technological developments (in areas such as renewable energy and electric vehicles) and shifts in stakeholder preferences (including of investors, insurers, customers and the community).

- **Litigation transition risks** – arise from a failure to manage or disclose the physical or economic transition risks. This includes areas such as directors’ duties, misleading disclosure (in annual reports, fund raising documents and contracts), contractual disputes (in areas from force majeure to pricing pass-throughs) and nuisance/negligence (where third parties suffer damage due to a failure of an asset owner to adapt their assets to foreseeable climate-related risks). Further examples of these risks are set out in Part 3 of this guide.

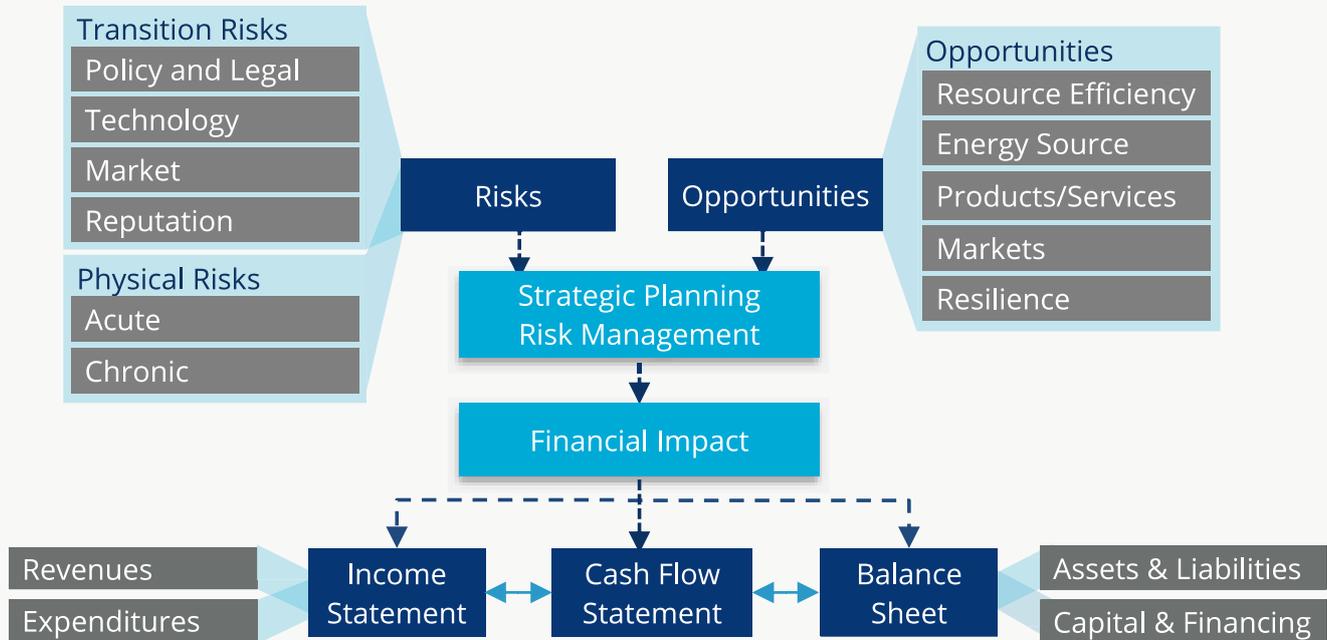
In 2021, even despite the global COVID-19 pandemic, the World Economic Forum’s Global Risks Report identified a failure of climate change action as the greatest risk to the global economy, and climate-related issues as five of the top six greatest risks.³

The risks and opportunities associated with climate change, and their potential financial impacts, is summarised by the Taskforce on Climate-related Financial Disclosures below.

The attention of governments, regulators and investors has recently shifted to achieving the ‘stretch’ target under the Paris Agreement, of limiting global warming to 1.5°C above pre-industrial averages, in an effort to limit the worst physical impacts associated with climate change. Achieving that target would require a significant transformation in the global economy – which in turn implies the potential for heightened economic transition risks (and opportunities) over short, medium and long term time horizons.

Already, governments representing more than 70% of the global economy have announced policies to transition their economies to ‘net zero’ by 2050 (including every Australian State and Territory) – in many cases with commitments to halve emissions by 2030 as they work towards the longer-term target. These global emissions reduction commitments are increasingly being applied across adjacent areas of regulation – including tariffs and trade, and capital regulatory requirements.

Figure 2: Climate-related risks, opportunities and financial impacts



Source: Taskforce on Climate-related Financial Disclosures, 2017, *Implementing the Recommendations of the TCFD*, June, p 5.

2. Refer to the following key economic transition risk resources: Task force on Climate-related Financial Disclosures, *Recommendations of the Task Force on Climate-related Financial Disclosures*, June 2017, <https://assets.bbhub.io/company/sites/60/2020/10/FINAL-2017-TCFD-Report-11052018.pdf>.; Sustainability Accounting Standards Board, *Climate Risk: Technical Bulletin*, April 2021, <https://www.sasb.org/knowledge-hub/climate-risk-technical-bulletin/>. See further Appendix 1 Glossary of key climate terms and leading frameworks and Appendix 4 Resource library.

3. World Economic Forum, 2021, *The Global Risks Report 2021*, 19 January, <https://www.weforum.org/reports/the-global-risks-report-2021>, (accessed 15 August 2021).

WHICH INDUSTRIES ARE IMPACTED BY CLIMATE CHANGE?

Climate change risks and opportunities permeate most economic sectors and industries. Analysis by the Sustainability Accounting Standards Board (SASB) concludes that 68 out of 77 industry sectors across the economy are subject to material climate-related risks.⁴ Although climate risk cuts across almost every sector, its impacts are differentiated depending on factors such as the relevant market and geography.

The influential Taskforce on Climate-related Financial Disclosures (TCFD) has recognised 16 industrial sectors that are at 'high risk' of material climate-related risk. These sectors traverse the vast majority of the Australian economy, including:

- financial services – banks, insurance companies, asset owners (including superannuation funds) and asset managers;
- energy – oil and gas, coal, electric utilities;
- transportation – air freight and passenger transport, maritime, rail, trucking, automotive and components;
- materials and buildings – metals and mining, components, construction materials, capital materials, real estate management and development; and
- agriculture, food and forest products – beverages, agriculture, packaged foods and meats, paper and forest products.

In addition, the health implications of climate change are widely recognised as being material to organisations involved in health and human services.

CLIMATE CHANGE KEY CONCEPTS

Appendix 1 of this Guide includes a glossary of key climate terms and leading frameworks to help you understand the relevant foundational concepts. It covers commonly used climate terms such as:

- Emissions – scopes 1, 2 and 3;
- 'Net zero' emissions;
- The Paris Agreement;
- Stress testing and scenario analysis.

It provides an overview of two current leading frameworks:

- Taskforce on Climate-related Financial Disclosures (TCFD)
- Sustainability Accounting Standards Board (SASB)

It also references the leading international authority on climate science, greenhouse gas emissions and the impacts of climate change:

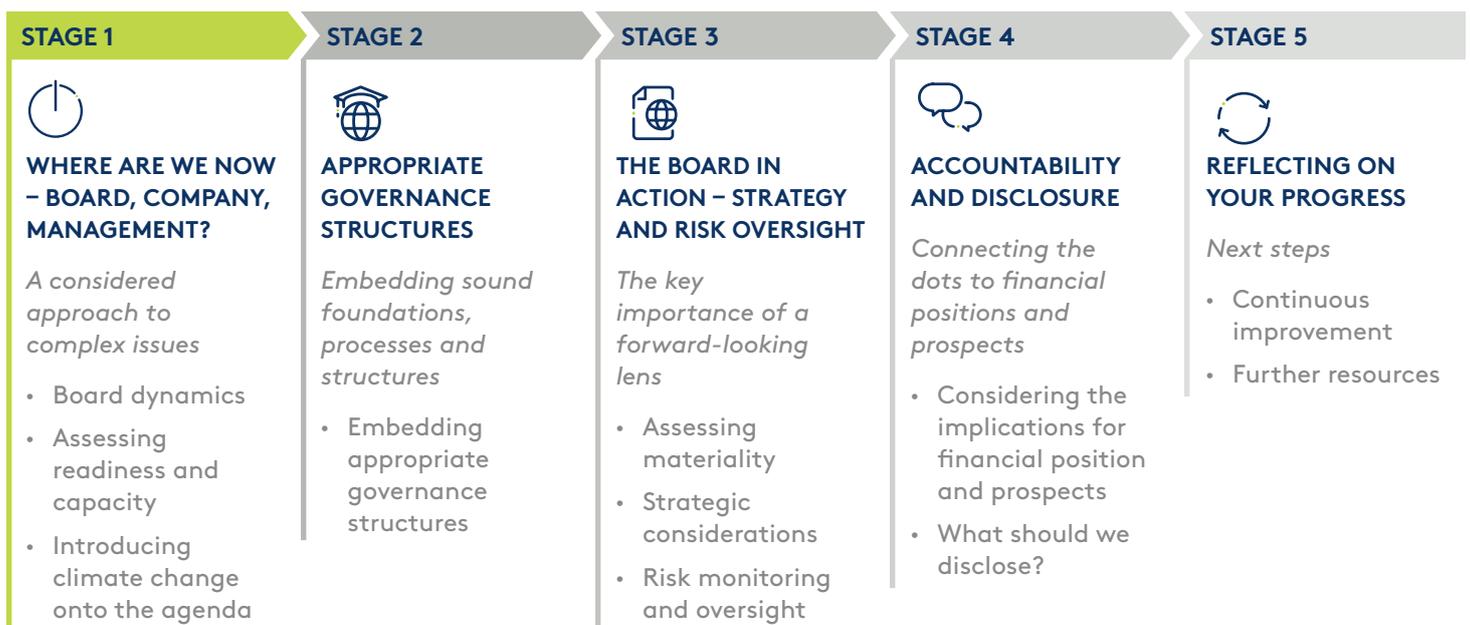
- The 6th Assessment Report of the United Nations Intergovernmental Panel on Climate Change (IPCC).

4. Sustainability Accounting Standards Board, 2021, *Climate Risk Technical Bulletin*, <https://www.sasb.org/wp-content/uploads/2021/05/Climate-Risk-Technical-Bulletin2021-042821.pdf>, (accessed 15 August 2021).

PART 2:

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

This Part of the guide provides a practical guide to assist directors of organisations near the beginning of their climate change governance journey. It should not be taken as a checklist of initiatives to guarantee due care and diligence in the context of your particular board and organisation. However, it is a useful 'ready reckoner' to help you take a constructive governance approach, and to assist in building organisational capacity to consider climate change.



WHERE ARE WE NOW?

Climate change is an evolving and complex issue with the potential to significantly impact on organisational risk, opportunity and strategy. As with any dynamic issue, consideration may require your organisation to embark upon a course of reflection and change. In beginning your climate governance journey, it is important to take a constructive approach that is sensitive to the varying levels of understanding around the board table.

CLIMATE CHANGE IN OUR ORGANISATIONAL CONTEXT — BOARD DYNAMICS

- Why is it important that the board considers climate change, now? What are the evolving dynamics (in regulation, in markets and in key stakeholder preferences) that objectively elevate its significance to the organisation, its risk, opportunities and strategy?

You can use **Part 1** of this guide to help you consider the relevant issues through a financial, reputational and liability lens – from potential impacts on your business operations and supply chains, to resource costs and availability, shifts in policy and regulation, to technological developments, and shifts in the preferences of key stakeholders (investors, insurers, customers, employees and the community).

- How should climate change be considered in the context of the best interests of our organisation, its purpose and values? What are the views of our key stakeholders?
- Does the board have an appropriate level understanding of climate change, its causes, its dynamics, and potential risks (and opportunities) for our organisation? What additional capacity-building may be required?

All board members should have an appropriate level of understanding of key climate change concepts such as those in **Part 1** of this guide. The greater the level of potential impacts on your organisation, the greater the level of understanding that will be necessary to allow you to undertake informed inquiry and oversight.

You can also refer to the additional resources set out in **Appendix 4** of this guide. Depending on the size and nature of your organisation, it may be appropriate to arrange specific briefings for the board and executive on current climate-related issues and relevant impacts.

- What should be done to introduce climate change on the board agenda? What reports or other inputs do we require from management? Do we need external advice or assistance?
- Can we have an effective and constructive conversation about climate change and its dynamics around the board table? Do we need to consider how we work together to build consensus? What will be the effect on board dynamics? Should we bring an external party in to assist us with this process?

ASSESSING READINESS AND CAPACITY — ENSURING YOUR BOARD IS PREPARED

- Would the Board Readiness Check assist my board in getting ready to discuss this topic?

The Board Readiness Check has been developed by Chapter Zero in the UK with the support of the Berkeley Partnership and Hughes Hall Centre for Climate Engagement. It is a useful self-assessment tool for boards to gauge their current level of readiness as an organisation and as a collective. It has been designed to enable boards to self-assess their 'Current' state, understand its implications and, based on this, specify their intended 'Target' state regarding climate change.

The Board Readiness Check is available [here](#). A summary of how the Board Readiness Check tool works is set out in **Appendix 3** of this guide.

GOVERNANCE — EMBEDDING SOUND FOUNDATIONS, PROCESSES AND STRUCTURES

- How are issues associated with climate change integrated into our board governance (strategic and oversight) responsibilities? Is this issue receiving adequate time and focus within the board/committee agenda?

Should this be a matter for the full board, included within the remit of a sub-committee (for example, audit & risk) or, for your organisation, does it warrant a specific sustainability sub-committee?

- What is our organisational policy on climate change? Do we need a specific policy document?
- In what part(s) of the organisation does operational responsibility for climate-related issues (identification, assessment, management and monitoring) reside? Who is responsible and accountable for this issue within management? Are we satisfied that relevant staff (or the experts that they consult) have the appropriate competence and resources?

Appropriate responsibilities and resourcing will depend on the nature of your organisation and its climate-related issues.

- What reports should be made to the board or its committees, and how often?
- How do we as a board, and senior management (including legal, governance, finance and risk teams), ensure that we are staying up to date in this dynamic area?

What resources do we require to do so? What information and updates are made available by relevant regulators and industry bodies? Do we need specialist advice?

- Are our remuneration structures aligned with our strategic approach to climate change, or do they create perverse incentives (for example that may favour investment in assets at risk of being stranded in the transition to a low-carbon economy)?

THE BOARD IN ACTION — STRATEGIC PLANNING AND RISK OVERSIGHT

- What are the relevant risks and opportunities for our organisation – across the short, medium and long term?

At its core, climate change disrupts 'business as usual'. This can present both risks and opportunities. Consider issues such as:

- Have we considered how the changing climate may impact on our operations and supply chain?
- Are there emerging regulatory or policy developments that may signal future market directions?
- What are our competitors doing – and planning to do?
- What are emerging customer trends and pressures, and what feedback can we gather?
- What opportunities may this bring for new product or service development?
- What do our employees think?
- How can a proactive approach help in building our reputation and brand, and assist us to access competitive capital and insurance? What are the consequences if we do not progress?
- How do we balance competing commercial or resourcing considerations, and short vs long-term interests?

- What are the relevant risk metrics and benchmarks?

What guidance is available from leading frameworks such as the **Taskforce on Climate-related Financial Disclosures** and **Sustainability Accounting Standards Board**? Are there any industry-specific benchmarks and guides? See **Appendix 1** for an overview of these leading frameworks.

- How should we consider both climate risk and opportunity in our normal strategic planning process? Do we understand the role of stress testing and scenario analysis to assist in strategic planning?

Stress testing and scenario analysis (as set out in the Recommendations of the TCFD) have emerged as key tools to help organisations consider climate risks and opportunities across the broad range of potential futures. For some organisations, this will be a complex exercise involving detailed economic modelling. For others, it will be a more qualitative and intuitive process to help you consider how climate change may impact on 'business as usual', and to sense check your strategy across the range of potential risks.

See **Appendix 1** for more detail on stress testing and scenario analysis.

- How should climate change be integrated into our existing risk management framework? Is this framework appropriate to adequately evaluate and manage identified climate risks?
- How do we determine which climate-related risks present a *material* exposure to our strategy or operations (in both absolute and relative terms), over what relevant timeframes? On what basis is the threshold of 'materiality' set?
- Is the risk acceptable: that is, within our risk appetite and tolerance? What actions can we develop to mitigate the risk consequences to bring it within tolerances?
- How do climate-related risks and opportunities impact on other risks and opportunities identified by the organisation? How should we manage it in relation to those other risk and opportunities?
- How does management determine the order of priority of each relevant climate-related risk/opportunity?
- Should we introduce specific targets to reduce our own greenhouse gas emissions? Should this include a pathway to 'net zero' emissions? Over what timeframes? Should these be aspirational or firm commitments? Have we considered the strategic and resourcing implications of those targets, and have a credible plan (or, at a minimum, a genuine, demonstrable intention to work towards that target) to achieve them? What are the reputation and competitive implications if we do not set and pursue such targets?
- How is management held accountable for implementing the climate-related policies and strategies set by the board?
- Do we have the right leadership for the strategic direction that we want the organisation to take? Do we need to recruit management with differing skills, experience or mindset?

REPORTING

- Where we have assessed climate change as a material issue, how have we assessed its potential impact on our financial position and prospects?
- For reporting entities, what are the appropriate disclosures that should be made in our directors' report (including the Operating and Financial Review where relevant). Have we had regard to the Recommendations of the TCFD – and if not, why?

Directors should refer to guidance issued by ASIC (**Regulatory Guide RG247 (Effective Disclosure in an Operating & Financial Review)**) and the AASB and AUASB (**Joint Guidance on Climate-related and other emerging risk disclosures (April 2019)**).

- Have we put specific questions to the CFO (where applicable) about the impact of material climate assumptions on asset useful lives, valuation and impairment, liability provisions, revenues, expenditures and cash flows? What are the key assumptions made, and metrics or statements requiring the most judgment? Has there been adequate disclosure in the financial statements? Are we satisfied with the effectiveness of our systems of internal control and risk management that sit behind this assessment?
- Has our reporting been subject to external audit or assurance?⁵ How was that decision reached?

REFLECTING ON YOUR PROGRESS — NEXT STEPS

Once your board has these strong governance foundations in place, it is important to approach climate change governance through the lens of continuous improvement. This is particularly important for this issue, due to its fluidity.

We have set out some more advanced resources in **Appendix 4** of this guide that can support you in taking the next step to embed climate change governance maturity in your organisation.

5. Not all reporting will be subject to audit, many NFP entities are not required to have their accounts audited. Where a board is obtaining information from management, and resources permit, they may want external assurance over that information.



PART 3:

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

DIRECTORS' DUTIES

This Part of the guide considers the relevance of climate change in the context of non-executive directors' core duties. While this guide focuses on duties that apply to company directors incorporated under the *Corporations Act 2001* (Cth) (*Corporations Act*), the directors or their equivalents (for example, management committee members/officers) of most not-for-profit organisations (NFPs) and government business entities (GBEs) have similar duties under common law and specific legislation (such as applicable state and territory incorporated associations laws, and public entity governance laws).

Refer [here](#) for the AICD's tool on directors' duties for further information.

Where climate change is a material and foreseeable risk to an organisation, directors will have obligations to seek to address it as part of their risk oversight role. To enliven directors' duties, the risk (or opportunity) will need to be both *foreseeable* and *material*. The bar for foreseeability is relatively low and means 'not far-fetched or fanciful'. Whether a climate change risk (or opportunity) is material, will require consideration of the organisation's strategy, financial position and prospects in the unique context of that organisation.

This does not mean that climate change necessarily needs to be prioritised by directors over any other foreseeable risk. But it does mean that directors should inform themselves of the impact of climate change risks and/or opportunities to their organisation. If they determine such risks and/or opportunities are material, directors must appropriately consider these in their governance of strategy and risk oversight – in the same manner as they would any other foreseeable financial risk or opportunity.

In particular, climate change may be relevant to a director's duty to act in the best interests of the company and their duty of care and diligence.

CLIMATE CHANGE AND THE BEST INTERESTS OF THE COMPANY

Section 181 of the Corporations Act requires directors to act in good faith, for a proper purpose, and to act in the best interests of the company. There has been a long-standing debate on the extent to which directors can or should have regard to the interests of external stakeholders in discharging their duty to pursue the ‘best interests’ of their organisation. Historically, ‘climate change’ was often considered a ‘stakeholder issue’ - a purely environmental, ‘non-financial, ethical’ issue, and its consistency with the ‘best interests’ of the organisation questioned.

The stakeholder debate has moved on however, with recognition that consideration of stakeholders such as customers, employees, the environment and the community is often consistent with organisational long-term interests. Put more bluntly, a failure to appropriately manage those stakeholder interests often risks the best interests – including financial interests – of the company and its shareholders/members.

Former Australian High Court judge and financial services royal commissioner Hon Kenneth Hayne, has gone further in publicly stating that: ‘a director acting in the best interests of the company must take account of, and the board must report publicly on, climate-related risks and issues relevant to the entity’.⁶

Whether the foreseeable risks associated with climate change have a material impact on a corporation’s strategy, financial position or prospects, the magnitude of that impact and the appropriate organisational response, are matters that can only be determined in the unique context in which an organisation operates.

DUTY OF DUE CARE AND DILIGENCE AND TAKING A PROACTIVE APPROACH TO CLIMATE GOVERNANCE

Section 180 of the Corporations Act imposes a duty of due care and diligence upon company directors. This duty of care and diligence has both subjective and objective features. Directors are held to the objective standard of conduct – that of a reasonable person – in the subjective circumstances faced by that director, in that company.⁷

The duty of care is an obligation of robust process, rather than one that dictates any substantive outcomes.

It requires directors to take a proactive and robust approach to interrogation of foreseeable risks, and potential material impacts, for corporate strategy and risk management.

This requires directors to exercise independent judgment when evaluating contemporary climate change information and anticipated impacts on their organisation. Directors have a positive obligation to apply an inquiring mind to their role, bringing to bear knowledge that they ought reasonably have known about the entity, its functions and operational context.

Directors should take a proactive approach to considering how climate-related risks can be managed and opportunities seized – particularly in those sectors with significant climate-related exposures (such as financial services, resources, energy, infrastructure, materials and manufacturing, transportation, agribusiness and real estate, amongst others). This requires directors to form their own assessment and make their own decisions as to what action, if any, is to be taken. The questions in Part 2 of this guide aim to support directors in this work.

The greater the materiality of the potential risks, the greater the degree of interrogation and assurance, supported by advice from management and/or independent expert advice, that may be warranted.

Hutley opinions on directors’ duties and climate change

A series of high-profile opinions by Noel Hutley SC and Sebastian Hartford-Davis of Counsel in 2016, 2019 and 2021 (known as ‘the Hutley Opinions’) are useful reading for directors embarking on their climate governance journey. Refer [here](#), and [here](#), for an overview and links.

6. K Hayne, 2019, “What Kenneth Hayne says about climate change”, *Financial Review*, 9 December, <https://www.afr.com/politics/federal/what-kenneth-hayne-says-about-climate-change-20191206-p53hiw>, (accessed 15 August 2021); J Fernyhough, 2019, “Hayne rebukes directors on climate risk failure”, *Financial Review*, 9 December, <https://www.afr.com/policy/energy-and-climate/hayne-rebukes-directors-on-climate-risk-failure-20191206-p53hnd>, (accessed 15 August 2021).

7. *ASIC v Adler (No 1)* (2002) 168 FLR 253 at [372] (4) per Santow J; *ASIC v Rich* (2009) 75 ACSR 1 at 623 [7242] per Austin J.

CLIMATE CHANGE AND MISLEADING DISCLOSURE

Where climate change presents material risks to the best interests of an organisation, including for its financial position and prospects, directors should also consider how adequately the risks have been disclosed.

Misleading disclosure occurs where a reasonable person in the audience would be led into error by the overall impression that is conveyed. Silence or omission may give rise to a misleading impression.

Directors must exercise due care and diligence in ensuring that their organisation does not mislead the market on the impacts of climate change and the response to that risk – in the same way as for any other financial risk issue.

Misleading disclosure is most likely to apply to listed companies (and other reporting entities) that produce public reports for shareholders. Climate-related misleading disclosure risks are particularly acute in relation to annual reports, for which directors are required to attest that a ‘true and fair view’ is presented of a company’s financial position and performance, and to approve a directors’ report that (amongst other things) outlines material risks to a company’s prospects.⁸ Heightened regulatory and investor expectations on the kinds of climate-related information required to present a ‘true and fair view’ of corporate position and prospects, and litigation trends in this area, are discussed below.

However, misleading disclosure should be considered by all types of entities, including private companies and NFPs. This is because misleading disclosure risks can arise in other kinds of public statement or external representation – from contracts, to statements made to donors, to advertising in trade or commerce. This includes misleading or deceptive conduct under the Australian Consumer Law (and equivalent State fair trading legislation), which governs the way in which organisations seek to promote the ‘green credentials’ of their organisation, or a specific product or service.

One high-profile misleading disclosure risk associated with climate change is known as ‘greenwashing’. In general terms, greenwashing is conduct or representations that under-states the impact of climate change risks to a company, over-states the robustness of a company’s response to those risks, or otherwise over-emphasises its environmental credentials. ASIC has stated that greenwashing is an area of its enforcement focus.

HEIGHTENED REGULATORY AND STAKEHOLDER EXPECTATIONS

The regulatory environment in Australia has changed significantly in the last five years. Australian regulators acknowledge the foreseeability of climate-related financial risks and are largely aligned on the economic/financial significance of climate-related risk.

Compliance with the governance, strategy, risk metrics and disclosure framework set out in the TCFD Recommendations has evolved from ‘gold standard’ to ‘base expectation’ for listed companies in many jurisdictions. One of the key TCFD Recommendations relates to stress-testing and scenario planning of business strategies against a plausible range of climate futures.

REGULATORY EXPECTATIONS

- ASIC
 - Regards climate change as a ‘systemic risk that could have a material impact on the future financial position, performance or prospects of entities’.⁹
 - ‘Reminds’ listed companies to consider both physical and transitional climate risk, develop and maintain strong and effective corporate governance, which supports prudential risk management and where climate risk is material, to consider the TCFD recommendation when reporting.¹⁰
 - ‘Greenwashing’ is an area of focus for ASIC. ASIC Commissioner Cathie Armour has encouraged boards to ‘look out for greenwashing and to ask whether their company’s disclosure around environmental risks and opportunities... accurately reflects their practices in this area’.¹¹
- APRA
 - Expects regulated entities to understand and manage climate-related financial risks through stress testing and scenario analysis and disclose decision useful information to the market.
 - Development of a draft Prudential Practice Guide¹² is underway and APRA will incorporate climate vulnerability assessments into its stress testing of the financial system (starting with Australia’s largest banks this year).

8. *Corporations Act 2001* (Cth) sections 295–297.

9. The regulator has updated its regulatory guidance on climate-related financial disclosures made in both offer documents (RG228) and Annual Report Operating and Financial Reviews (RG247) to refer to the kinds of climate risks described by the TCFD.

10. ASIC, 2021, *Corporate Finance Update – Issue 4*, March, <https://asic.gov.au/about-asic/corporate-publications/newsletters/asic-corporate-finance-update/corporate-finance-update-issue-4/>, (accessed 15 August 2021).

11. C Armour, 2021, “Green clean”, *Company Director*, 1 July, <https://aicd.companymagazine.com.au/membership/company-director-magazine/2021-back-editions/july/the-regulator>, (accessed 17 August 2021).

12. APRA, 2021, *Prudential Practice Guide: Draft CPG 229 Climate Change Financial Risks*, April, https://www.apra.gov.au/sites/default/files/2021-04/Draft%20CPG%20229%20Climate%20Change%20Financial%20Risks_1.pdf, (accessed 15 August 2021).

- RBA
 - Deputy Governor acknowledged that the physical and transition risks associated with climate change as 'likely to have first-order economic effects.'¹³
- Australian Accounting Standards Board and Auditing and Assurance Standards Board
 - Released a joint bulletin stating that climate change-related assumptions have the potential to be a material accounting estimation variable, impacting on asset useful lives, fair valuation, impairments and provisions for bad and doubtful debts. Although the guidance is 'voluntary', the standard setters made clear that they 'expect' it will be applied by report preparers and auditors.¹⁴
 - The Australian position on integration of material climate-related assumptions into financial statement accounting estimates has now been echoed in guidance by the body responsible for international accounting standards, IFRS.¹⁵

INVESTOR EXPECTATIONS

An increasing proportion of mainstream institutional investors (including the world's largest investor, BlackRock, members of the US\$52 trillion Climate Action 100+, IIGCC, PRI, and Net Zero Asset Managers' Initiative) have intensified commitments to engaging with investee companies on climate-related financial risk and disclosure, and set out accelerated expectations in relation to disclosures. More recently, focus has centred on how investees plan to transition to 'net zero' in line with Paris Agreement goals.

OTHER STAKEHOLDERS

Stakeholders also have increasingly heightened expectations in relation to how an organisation considers and addresses climate change. These include:

- **Customers** – both consumers and business customers increasingly expect their suppliers to demonstrate environmental sustainability in a transparent way. A failure to meet customer expectations can result in significant reputational damage, and ultimately lead to a decline in demand, revenue, competitiveness and profitability.
- **Employees** – employees are placing increased importance on alignment between their personal values and those of their employer. Environmental sustainability, and climate change in particular, have emerged as key issues for staff in choosing, and remaining with, an employer. Organisations with poor climate credentials may find it increasingly difficult to attract, and retain, top talent.
- **Community** – changing and increasingly demanding environmental and social standards from communities across Australia. Heightened community pressure may lead to adverse publicity and scrutiny of strategy and decisions.

NFPs may need to consider the perspectives of important stakeholders like members, volunteers, donors, funders and the general public. For example, a sporting club may need to consider the expectations of its sponsors on the issue of climate change or have in place an extreme heat policy. Government funding grants may also include expectations around climate change action.

13. G Debelle, 2021, *Climate Change and the Economy with the RBA's Guy Debelle*, Public Forum, Centre for Policy Development, 17 August, <https://cpd.org.au/2019/03/climate-change-economy-rbas-guy-debelle-public-forum-march-2019-2/>, (accessed 17 August 2021).

14. Australian Accounting Standards Board and Australian Auditing and Assurance Standards Board, 2019, *Climate-related and other emerging risks disclosures: assessing financial statement materiality using AASB/IASB Practice Statement 2*, April, https://www.aasb.gov.au/admin/file/content102/c3/AASB_AUASB_Joint_Bulletin_Finished.pdf, (accessed 15 August 2021).

15. IFRS Foundation, 2020, *Effects of climate-related matters on financial statements*, November, <https://www.ifrs.org/content/dam/ifrs/supporting-implementation/documents/effects-of-climate-related-matters-on-financial-statements.pdf>, (accessed 15 August 2021).

LITIGATION RISKS

Climate-related litigation has increased over recent years with a number of cases, both in Australia and globally, testing the bounds of government and corporations' obligations. Some of the most significant recent actions, in both Australia and internationally, are set out below. Whilst not all set a binding formal precedent for Australian organisations, they illustrate the increasing proactivity of strategic litigants in this space, and may influence the development of the law in our own jurisdiction.

Recent examples include:

- **Emissions reduction targets and credibility of strategy.** In May 2021, the Dutch District Court found that Shell's failure to reduce emissions on a trajectory consistent with the Paris Agreement was a breach of its duty of care to, and human rights of, Dutch citizens, and ordered it to increase its emissions reduction policy to 45% by 2030 (against a 2019 baseline). The Court was critical of Shell's prevailing emissions reduction policy, finding that it was 'not concrete, has many caveats and is based on monitoring social developments rather than the company's own responsibility for achieving a CO2 reduction.'
- **Duty of due care and diligence – investing on behalf of superannuation beneficiaries.** In July 2018, an Australian superannuation fund member sued the corporate trustee of his superannuation fund REST alleging a breach of its duty of care on the basis that it had failed to integrate climate change considerations into its investment strategy. The matter settled in November 2020. REST agreed to take further steps to ensure its investment managers actively consider, measure, manage and report back on the financial risks posed by climate change, to commit to a target of net zero carbon footprint for the fund by 2050, and to report on portfolio holdings, risk management processes and decarbonisation progress in line with the Recommendations of the TCFD.¹⁶
- **Financial risk disclosures – misleading disclosure and due care and diligence.** In July 2020, a claim was filed in the Federal Court against the Commonwealth alleging that the investor information statements issued in relation to Commonwealth bonds were misleading or deceptive contrary to section 12DA(1) of the ASIC Act. This was alleged on the basis that the disclosures did not contain adequate information about the economic and fiscal risks associated with climate change, and associated credit risks. The claim further alleges that, in approving the disclosure documents, the Secretary to the Department of Treasury and the CEO of the Australian Office of Financial Management failed to discharge their statutory obligation to exercise due care and diligence under section 25(1) of the Public Governance, Performance and Accountability Act 2013. The claim remains on foot, and is unlikely to be heard until 2022.
- **Negligence – failure to take reasonable precautions against the reasonably foreseeable risks associated with climate change.** In January 2019, the South Australian Royal Commission into the Murray-Darling Basin Plan published a report concluding that the Murray Darling Basin Authority (Authority) had acted with gross negligence and maladministration in the manner in which it had (or, more particularly, had not) taken climate-related issues into account in discharging its obligation to implement and manage the Murray-Darling Basin Plan. The Commissioner pointed to failures including the Authority's (a) reliance on historical data, rather than climate change-adjusted forecasts, as the primary source of authority, (b) treatment of the best available science as an 'inconvenience to be worked around' rather than as a key input to decision-making, and (c) its deferral of consideration of climate change until future strategic cycles.
- **Misleading advertising.** In February 2020, BP was forced to withdraw its *Advancing Possibilities – We're Working to Make Energy Cleaner* marketing campaign following a complaint filed by public interest law firm ClientEarth, alleging that the ads conveyed a misleading impression of BP's focus on low-carbon energy when its investment in renewable activities represented less than 4% of its exploration and development spend.

16. *McVeigh v REST* NSD1333/2018, Federal Court of Australia, <http://climatecasechart.com/climate-change-litigation/non-us-case/mcveigh-v-retail-employees-superannuation-trust/>, (accessed 15 August 2021).



APPENDIX 1:

Glossary of key climate terms and leading frameworks

KEY CLIMATE TERMS

• Emissions 'scopes' – 1, 2 and 3

To mitigate the effects of climate change, a wide-scale transition to a low carbon economy is required. In order for an entity to set a credible emissions reductions strategy the organisation's emissions profile must first be understood. An effective emissions reduction strategy covers emissions across an organisation's full value chain, which includes Scope 3 emissions.

The Greenhouse Gas Protocol categorises greenhouse gas emissions by 'Scopes':

- Scope 1 – direct emissions from entity owned or controlled sources.
- Scope 2 – indirect emissions from the generation of purchased electricity, steam, heating and cooling consumed by the entity.
- Scope 3 – includes all other indirect emissions that occur in an entity's value chain.

Scope 3 emissions are often the largest part of an entity's emissions portfolio and also the hardest to measure.

• 'Net zero' emissions

Net zero emissions refers to achieving a balance between greenhouse gas emissions produced by humans and greenhouse gases removed from the atmosphere. In 2018, the United Nations' Intergovernmental Panel on Climate Change *Special Report Global Warming of 1.5°C* made clear the imperative of reaching net zero global emissions by 2050 in order to mitigate the effects of global warming. In order to reach net zero by 2050, global emissions must be halved by 2030.

As outlined above, countries around the world with economies representing more than 70% of greenhouse gas emissions have announced 'net zero emissions' economic targets – including the EU, the UK, South Korea, Japan and China. In Australia, all States and Territories have announced net zero by 2050 targets, with a number (including Victoria) having incorporated these into law. As at the date of publication, the Commonwealth Government has not formally committed to a net zero by 2050 target although it has said that it would like to achieve that goal as soon as possible and preferably by 2050. These emissions reduction commitments are increasingly being applied across adjacent areas of regulation – including tariffs and trade, and capital regulatory requirements.

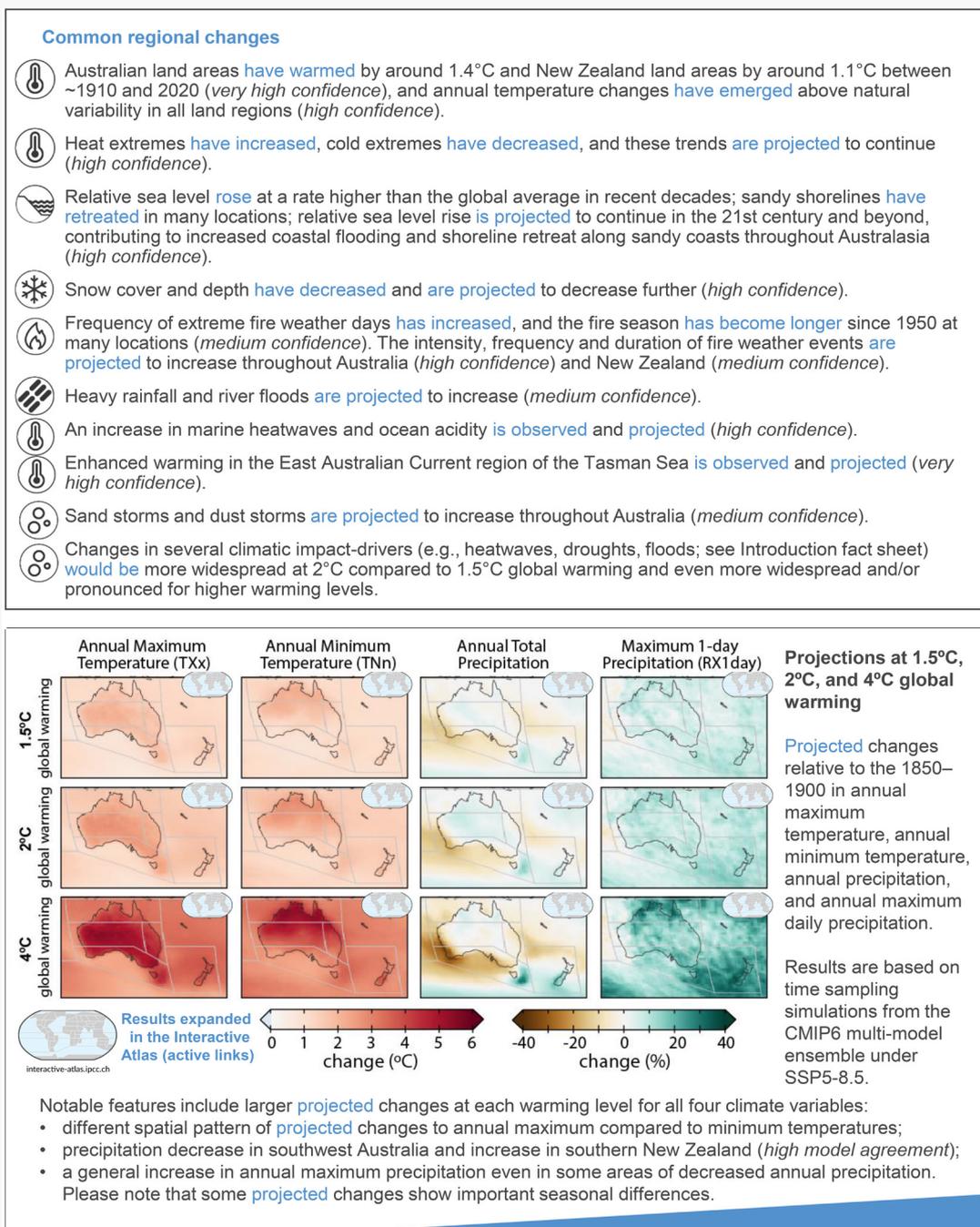
• IPCC and AR6

The Intergovernmental Panel on Climate Change (IPCC) is a United Nations body that assesses the state of science relation to climate change. In August 2021 the IPCC published its 6th Assessment Report *Climate Change 2021: The Physical Science Basis* (AR6). The report is a product of peer review of more than 14,000 individual studies (themselves all peer-reviewed), by scientists from 66 countries. It is considered the ‘gold standard’ of climate science.

AR6 concludes that human-induced climate change is already affecting every region across the globe. The **Australasia regional fact sheet** (refer to Figure 3 below) details regional changes that include average warming of 1.4°C, an increase in heat extremes and extreme bushfire danger days, decrease in cold extremes, sea level rise contributing to increased coastal flooding and shoreline retreat, and projected increases in heavy precipitation and inland flooding.

AR6 includes an online tool, the **Interactive Atlas**, that allows users to explore specific impacts on their region under different warming scenarios, across different timeframes.

Figure 3: Regional fact sheet - Australasia



Source: IPCC, 2021, “Regional fact sheet – Australasia”, *Sixth Assessment Report*, p 1.

- **Paris Agreement**

In December 2015, 196 countries signed the Paris Agreement, under which governments have committed to reducing economic emissions to a level consistent with limiting global warming to well below 2°C above pre-industrial averages, and to pursue efforts to limit warming to 1.5°C. This commitment, in turn, will require the global economy to transform to a net zero emissions norm before 2050.

Under the Paris Agreement, countries must submit their own emissions reductions targets, referred to as Nationally Determined Contributions (NDC). Australia submitted its first NDC in 2015 (and reaffirmed this in 2020), with a target to reduce greenhouse gas emissions by 26% to 28% below 2005 levels by 2030. Every five years, countries are required to submit more ambitious NDC targets under the review and ratchet mechanism of the Paris Agreement. Australia has not yet committed to increasing its emissions reduction targets.

- **Stress testing and scenario analysis**

Climate change has catalysed a 'new normal' for risk – one in which historical experience alone no longer provides a proxy for the present or future. However, the range of plausible climate futures presented by the changing climate remains radically uncertain. Stress testing and scenario analysis over a plausible range of climate-futures has emerged as a critical risk management and strategic planning tool for an organisation in the face of such uncertainty.

Scenario analysis is a process for identifying and assessing the potential implications of a range of plausible future states, and provides a tool for organisations to consider how the future might look if certain trends continue or certain conditions are met. The necessity to apply a forward-looking lens has been reinforced by stakeholders across the board (including investors, regulators and credit ratings agencies).

For some organisations, stress testing and scenario planning will be a complex exercise involving detailed economic modelling. For others, it will be a more qualitative and intuitive process to help you consider how climate change may impact on 'business as usual', and to sense check your strategy across the range of potential risks. Either way, at its core, it is a risk management tool to allow organisations to consider the spectrum of climate-related risks in the face of uncertainty. At one end of the spectrum – what if there is a swift and disorderly transition to a net zero economy? What does that mean for our organisational strategy and business plan? What would we need to do to thrive in that transition? At the other extreme – how would we be impacted if the climate tips into a high warming scenario? How are we placed to manage the relevant physical risk impacts to our business and supply chains? What risk management and adaptation strategies can we sensibly consider, now?

Key guidance on stress testing and scenario analysis is found in the **Recommendations of the TCFD**.

GOVERNANCE, MANAGEMENT & DISCLOSURE – CURRENT LEADING FRAMEWORKS

Mainstream investors now identify climate change-related disclosures as decision-useful, particularly in high-risk sectors (such as energy, infrastructure, transport and agriculture). Both the physical and economic transition risks associated with climate change are characterised by uncertainty. However, the one thing that is certain about climate change is that the physical and market landscape of the future will look very different.

Tools to assist corporate risk management in the face of such uncertainty, such as stress testing and scenario analysis, have emerged as critical inputs for diligent governance and strategic planning. Two of the current leading frameworks are the **Taskforce on Climate-related Financial Disclosures (TCFD)** recommendations, and the **Sustainability Accounting Standards Board (SASB)** reporting standards.

TASKFORCE ON CLIMATE-RELATED FINANCIAL DISCLOSURES

The recommendations of the G20 Financial Stability Board's *Taskforce on Climate-related Financial Disclosures* are a recognised key benchmark against which to assess the strategic approach of corporations to managing climate change risk. The TCFD recommendations:

- provide a framework for the kind of information that must be analysed and disclosed in order to truly and fairly represent (and enable assessment of) the impact of climate-related risks on financial positions and prospects;
- call for information to be disclosed in a comparable and consistent form that is decision-useful for investors, lenders, and insurance underwriters; and
- contemplate not only the disclosures themselves, but the metrics and targets, strategy and governance processes within which climate risk issues are managed.

A central requirement of the TCFD is forward-looking stress testing and scenario analysis across the plausible range of climate futures, including a 'well below' 2°C emissions pathway consistent with Paris Agreement targets. Since the publication of the TCFD Recommendations in 2017, market expectations have continued to focus on the Paris Agreement 'stretch' target of 1.5°C.

The TCFD highlights governance as a foundational building block of effective climate-related risk and opportunity management. Without effective climate-related governance structures in place, a company will not be able to make informed strategic decision or appropriately manage the risks.

Investors, regulators and other stakeholders increasingly expect the TCFD recommendations to be used to navigate the physical, economic transition and liability risk exposures relevant to their organisation. In addition, disclosure in accordance with the TCFD recommendations could in fact be used as a strategy to publicly demonstrate compliance with directors' duties and disclosure obligations.

Figure 4: The TCFD recommendations and supporting recommended disclosures

Governance	Strategy	Risk management	Metrics and targets
Disclose the organisation's governance around climate-related risks and opportunities	Disclose the actual and potential impacts of climate-related risks and opportunities on the organisation's businesses, strategy, and financial planning where such information is material.	Disclose how the organisation 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 organisation has identified over the short, medium, and long term	a) Describe the organisation's processes for identifying and assessing climate-related risks.	a) Disclose the metrics used by the organisation 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 organisation's businesses, strategy, and financial planning.	b) Describe the organisation'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 organisation'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 organisation's overall risk management.	c) Describe the targets used by the organisation to manage climate-related risks and opportunities and performance against targets.

Source: TCFD, 2017, *Final Report: Recommendations of the Task Force on Climate-related Financial Disclosures*, June, p 14.

SUSTAINABILITY ACCOUNTING STANDARDS BOARD

The Sustainability Accounting Standards Board (SASB) publishes sustainability reporting standards in relation to ESG issues that are material to investors, including climate-related issues. Resources include a Conceptual Framework and Application Guidance, and 77 industry-based Sustainability Disclosure Standards across 11 sectors (consumer goods, extractives and minerals processing, financials, food and beverage, health care, infrastructure, renewable resources and alternative energy, resource transformation, services, technology and communications and transportation).

In April, SASB released its 2021 edition of the *Climate Risk Technical Bulletin* (Bulletin). The Bulletin provides recommendations on how industry-specific climate risk can be more effectively measured, managed and, disclosed thereby ensuring markets have the information they need to price climate-related risks (and opportunities). The Bulletin finds that climate risk is likely to materially affect almost every one of the 77 industries covered by SASB's materiality map, although the nature of those risks, and likely impact on the organisation varies across different sectors.¹⁷

The Bulletin identifies the categories of climate-related risk that are most likely to be material for an organisation in each sector (classified across physical, transition and regulation risks), and the risk metrics (both quantitative and qualitative) that are likely to provide decision-useful information to investors in relation to each risk. Each sector-specific Standard contains additional detail on the relevant sustainability issues faced by organisations in the sector, and further commentary on the risk metrics recommended for disclosure.

The SASB Standards are voluntary but are favoured by many investors.

SASB recently merged with the International Integrated Reporting Council (IIRC) to form the Value Reporting Framework. This merged entity intends to harmonise the SASB Standards with another leading 'integrated reporting' framework, the IIRC's Integrated Reporting Framework.

INTERNATIONAL SUSTAINABILITY STANDARDS BOARD

The IFRS Foundation, which is responsible for the International Accounting Standards that form the basis of Australian Accounting Standards, is establishing an International Sustainability Standards Board. This will set standards for reporting on an entity's performance on material sustainability issues. It has announced its intention to release its first standard, on climate-related reporting, in mid-2022. If incorporated into Australian standards, this may further change how Australian entities report on climate matters.

17. SASB, 2021, *Climate Risk – Technical Bulletin*, 12 April, <https://www.sasb.org/knowledge-hub/climate-risk-technical-bulletin/>, (accessed 15 August 2021).



APPENDIX 2:

World Economic Forum principles

1. **Climate accountability on boards** - The board is ultimately accountable to shareholders for the long-term stewardship of the company. Accordingly, the board should be accountable for the company's long-term resilience with respect to potential shifts in the business landscape that may result from climate change. Failure to do so may constitute a breach of directors' duties.
2. **Command of the (climate) subject** - The board should ensure that its composition is sufficiently diverse in knowledge, skills, experience and background to effectively debate and take decisions informed by an awareness and understanding of climate-related threats and opportunities.
3. **Board structure** - As the stewards for long-term performance and resilience, the board should determine the most effective way to integrate climate considerations into its structure and committees.
4. **Material risk and opportunity assessment** - The board should ensure that management assesses the short-, medium- and long-term materiality of climate-related risks and opportunities for the company on an ongoing basis. The board should further ensure that the organisation's actions and responses to climate are proportionate to the materiality of climate to the company.
5. **Strategic and organisational integration** - The board should ensure that climate systemically informs strategic investment planning and decision-making processes and is embedded into the management of risk and opportunities across the organisation.
6. **Incentivisation** - The board should ensure that executive incentives are aligned to promote the long-term prosperity of the company. The board may want to consider including climate-related targets and indicators in their executive incentive schemes, where appropriate. In markets where it is commonplace to extend variable incentives to non-executive directors, a similar approach can be considered.
7. **Reporting and disclosure** - The board should ensure that material climate-related risks, opportunities and strategic decisions are consistently and transparently disclosed to all stakeholders – particularly to investors and, where required, regulators. Such disclosures should be made in financial filings, such as annual reports and accounts, and be subject to the same disclosure governance as financial reporting.
8. **Exchange** - The board should maintain regular exchanges and dialogues with peers, policy makers, investors and other stakeholders to encourage the sharing of methodologies and to stay informed about the latest climate-relevant risks, regulatory requirements, etc.



APPENDIX 3:

How the Board Readiness Check works

The **Board Readiness Check**¹⁸ has been developed to enable boards to self-assess their current state, understand its implications and, based on this, specify their intended target state and establish their need for change.

The following outline is adapted from the **Chapter Zero: A climate change boardroom toolkit** (pp 15-20), with Chapter Zero's permission (a member of the Climate Governance Initiative network).

4 KEY LEVELS OF ATTAINMENT

Within the tool, there are a number of questions. Each question has a set of four sample answers each representing a stage on the continuum of Climate Change Action from '1. Unprepared' to '4. Leading'.

For each question, the user is asked which answer best represents 'Current' state and intended 'Target' state.

In broad terms, the four stages on the continuum are characterised as follows:

CLIMATE CHANGE ACTION LEVEL

1. UNPREPARED

Not sufficiently prepared to mitigate or adapt to the risks of climate change – or realise the opportunities of transitioning to the low-carbon economy.

2. COMPLIANT

Aware of and taking action to meet current rules and regulations – but typically not going beyond legal obligations to address bigger and broader risks and opportunities.

3. PROACTIVE

Aware of the risks of climate change and the opportunities presented by being a low-carbon business. Proactively taking action to address these which goes beyond regulations – but is typically focused within their business and is perhaps behind others in their sector in level of ambition.

4. LEADING

As for '3. Proactive', but the action they are taking is ahead of others in their sector in level of ambition and achievement – and extends across their end-to-end value chain in partnership with suppliers, consumers, producers of complementary products, etc. Typically, they are also leveraging their low carbon stance as a source of commercial and competitive advantage.

18. Chapter Zero: The Directors' Climate Forum, *Board Readiness Check*, <https://www.chapterzero.org.uk/board-readiness-check/>, (accessed 26 August 2021).

5 AREAS OF ASSESSMENT

The questions asked are divided into the following 5 areas of assessment:



A. FOOTPRINT: Understanding and improving your carbon footprint

Covers knowing what your carbon footprint is and its key drivers and taking measurable action to reduce it.



B. COMPLIANCE: Adhering to the rules on climate change

Covers being clear on duties and obligations under current climate change and emissions rules and regulations and being sighted on and prepared for policy/regulatory change.



C. SENTIMENT: Ensuring your business is in tune with stakeholder sentiment on climate change

Covers being clear on and aligned/in tune with stakeholder sentiment on climate change. Stakeholder groups include investors, customers (B2B), consumers, and current/prospective employees.



D. RISK: Ensuring you're prepared for the impact of climate change on your business

Covers being clear on how the business and operations will be impacted by climate change in future and having governance, disclosures, plans and resources in place to mitigate any physical and transition risks (e.g. with regards to supply chain, asset values, financial/cost base, customer base, compensation claims, etc.).



E. OPPORTUNITIES: Ensuring your business benefits from the transition to a low-carbon economy

Covers being clear on and acting to realise opportunities to deliver enhanced business performance through the transition to a low carbon economy (e.g. reducing operational cost (resource efficiency), gaining access to government incentives, leveraging positive impact on brand and reputation to achieve competitive advantage, etc.).

WHAT ARE THE OUTPUTS PROVIDED BY THE SELF-ASSESSMENT – AND HOW TO USE THEM

The tool surfaces 'current' vs 'target' comparisons for each question, to help the user understand where and to what extent the business will need to change to achieve its intended 'target'.

UNPREPARED

No. We get the concept of a carbon footprint in general terms, but we are not clear in specific terms what it is or how you measure it.

COMPLIANT

We know in measurable terms, but only in the sectors and facilities which are subject to emissions regulations such as European ETS.

PROACTIVE

We know in measurable terms for all aspects of our in-house operations – but we still struggle with end-to-end value chain.

LEADING

We have a clear, measurable view for all aspects of our end-to-end value chain, both internally and externally.

Based on the answers selected for each question, the Board Readiness Check returns **illustrative implications** to provide guidance on how the 'current' and 'target' selections made might impact the business.

The contrast in 'current' vs. 'target' risk/performance may prompt the user to adjust their answers for 'target' state ambition.

WHEN AND HOW TO USE THE BOARD READINESS CHECK

The Board Readiness Check can be used in a wide variety of different scenarios. For example:

1. This is the first time you're discussing climate action as a board and want to establish your current state and its implications – and define a target state ambition as a precursor to determining and planning the change required to achieve your agreed 'target'.
2. You're not sure if or why climate action is relevant to your business – and want to find out more about the subject and the relative current state of your business in order to take an informed view.
3. You're already on the journey and want to do a quick 'litmus test' of the progress you're making – and what areas for development remain.
4. You think you've already done everything that needs to be done with respect to climate action – but want to undertake a high-level review to make sure.

As a whole-of-board exercise, it may be useful to use a facilitator to manage the process.

STEP 1

Get each board member to fill in the Self-Assessment in the Board Readiness Check, based on their own personal understanding and views – prior to getting them together as a group to discuss it.

Doing this has the following benefits:

- i. By using the Self-Assessment they'll get familiar with the issues and potential implications of different choices.
- ii. You'll get to see any key disparities in understanding of 'current' state and intended 'target' state.
- iii. You'll know in advance where to prompt for evidence to back up claims (e.g. if someone has said they think they are '4. Leading' on 'A. Understanding and improving your carbon footprint' – and everyone else has said '1. Unprepared').

STEP 2

Summarise what the aggregated results tell you.

- i. Where is the board aligned on 'current' state and where is it not?
- ii. What are the implications of 'current' state in terms of business performance and risk? (that is, the need for action).
- iii. Where is the board aligned on 'target' state and where is it not?

STEP 3

Bring the board together to review.

- i. Discuss the aggregate results above – and to align on (a) 'current' state, (b) implications of 'current' state and consequent need for action/change, and (c) intended 'target' state.
- ii. Agree on action plan to undertake more detailed analysis and planning to identify specific improvements.
- iii. Agree how to factor climate action into board level governance on an ongoing basis and monitor and report back on progress and achievement to the board.



APPENDIX 4:

Resource library



GENERAL OVERVIEW OF CLIMATE CHANGE-RELATED FINANCIAL RISKS

PHYSICAL RISKS

1. IPCC, **Climate Change 2021: The Physical Science Basis, Summary for Policymakers**, August 2021
2. IPCC, **Climate Change 2021: The Physical Science Basis, Australasia Regional Fact Sheet**, August 2021
3. Climate Governance Initiative/ Chapter Zero, **Primer on physical climate risk**, July 2020
4. World Economic Forum, **Global Risks Report 16th edn**, January 2021
5. IAG and US National Center for Atmospheric Research, **Severe Weather in a Changing Climate (Insurance)**, v2 September 2020
6. Bureau of Meteorology and CSIRO, **State of the Climate 2020**, November 2020

ECONOMIC TRANSITION RISKS

7. International Energy Agency, **Net Zero by 2050 – A roadmap for the global energy sector**, May 2021
8. BlackRock, **Larry Fink’s 2021 Annual letter to clients and CEOs**
9. Guy Debelle, Deputy Governor of the Reserve Bank of Australia, **Speech: Climate Change and the Economy**, March 2019 and **Financial Stability Review in October 2019**
10. Deloitte, **A new choice: Australia’s climate for growth**, November 2020



UNITED NATIONS, SCIENCE AND THE PARIS AGREEMENT

11. UNFCCC, **Paris Agreement and Nationally-Determined Contributions (overview)**
12. IPCC, **Climate Change 2021: The Physical Science Basis, Summary for Policymakers**, August 2021
13. United Nations, **Sustainable Development Goals**

**LITIGATION RISK AND DISCLOSURE****CORPORATE GOVERNANCE AND DIRECTORS' DUTIES****POOR ESG GOVERNANCE AND UNDERPERFORMANCE**

14. Climate Governance Initiative and Commonwealth Climate and Law Initiative, **Primer on Climate Change: Directors' Duties and Disclosure Obligations – In support of the Principles for Effective Climate Governance**, June 2021
15. Sustainability Accounting Standards Board, **Climate Risk Technical Bulletin**, April 2021
16. AASB, **Climate-related and other emerging risks disclosures: assessing financial statement materiality using AASB Practice Statement 2**, April 2019
17. Deloitte, **TCFD reporting requirements and assurance considerations: A guide for audit committees**, 2021
18. ASIC, **What is 'greenwashing' and what are its potential threats?** July 2021
19. ASIC – **RG247 (OFRs) and 228 (prospectuses)**
20. MinterEllison, **Misleading climate-related disclosure: are your verification and disclosure processes defensible?** July 2020
21. Noel Hutley's **2016 Legal Opinion on Climate Risks and Directors' Duties**, the 2019 Update and the 2021 Update
22. Climate Governance Initiative and Commonwealth Climate and Law Initiative, **Primer on Climate Change: Directors' Duties and Disclosure Obligations – In support of the Principles for Effective Climate Governance**, June 2021
23. Climate Governance Initiative / Chapter Zero, **Acclimatise and MinterEllison, Questions to assist non-executive director oversight of physical climate risk management**, July 2020
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About the author

MinterEllison is the Asia-Pacific's largest commercial law firm, with offices across Australia, New Zealand, mainland China and Hong Kong, Mongolia, and the United Kingdom. The firm's dedicated Climate Change & Sustainability Risk Governance team is an integral part of its leading Environmental, Social and Governance practice.

Sarah Barker is a Partner, and Head of Climate Change & Sustainability Risk Governance at MinterEllison. She has more than two decades' experience as a corporate lawyer, and is regarded as one of the world's foremost experts on climate change risk assessment, strategy and liability. She brings a unique practical lens as a director of one of Australia's largest super funds, the \$30 billion Emergency Services & State Super. Sarah is a faculty member of the Cambridge University's Institute for Sustainability Leadership's Earth on Board programme, and has been a facilitator of the AICD's flagship Company Directors' Course for more than 15 years. She was the instructing solicitor on a brief to Mr Noel Hutley SC widely cited as authority on directors' duties and climate change.

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