Intended for professional clients only
Not to be distributed to retail clients

A guide to climate governance: Changing of the guard or guardians of change?

Why company boards are key to steering companies towards a low-carbon economy.

Climate change has far-reaching implications for companies. Extreme weather can disrupt operations and supply chains, while new climate policies, clean technologies and changing consumer attitudes stand to challenge established business models.

Following the Paris Agreement on climate change, companies are expected to reach zero carbon emissions on a net basis. Achieving this extensive overhaul over relatively few business cycles presents significant risks. But importantly, this also brings opportunities.

Options for companies

low-carbon innovation	or	business as usual?
More efficient operations		Higher costs
Lower regulatory burden		Risk of fines and litigation
Opportunities from low-carbon products		Lost demand for goods and services
Access to talent		Barriers to recruitment
Resilience to climate change		Disruption to operations and supply chain

Having the right debate

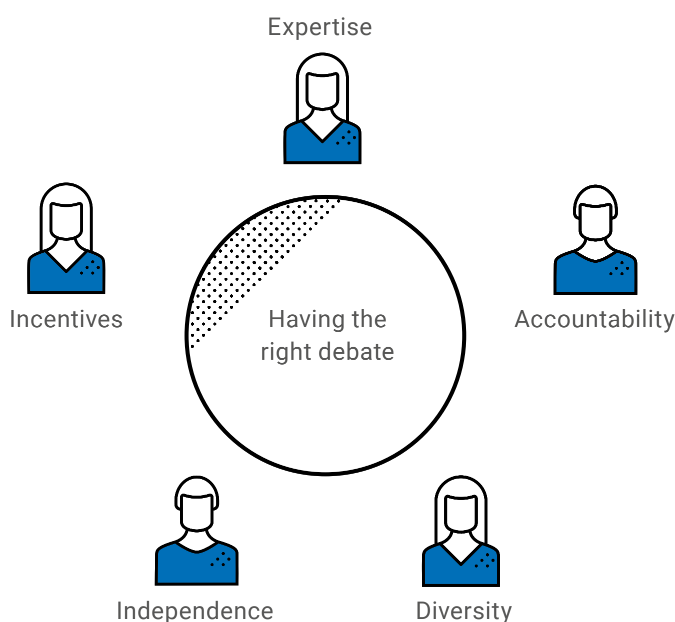
Under existing mandatory reporting requirements in jurisdictions including the UK and the US, companies should disclose in detail the business impact of material issues such as climate change.

For this to be an informed assessment, boards should ensure the proper governance of climate change. In practice, this means that:

- The board should have the levels of independence and diversity of skills, gender, and experience needed for the robust oversight of the company. The nomination, remuneration and audit committees play a key role in ensuring that board appointments, pay practices and procedures promote long-term success
- Climate change should have a clear and formal place on the board's agenda
- Accountability for material climate issues should be held at the most senior executive level

Legal & General
INVESTMENT MANAGEMENT

- The board must be aware of key trends in regulation, technology and consumer attitudes which could materialise faster than expected
- Boards should seek out the expertise needed to understand the likely climate impacts given the company's operations and geographical footprint. This might require external advice, but companies may already have significant internal knowledge and appetite to drive the implementation of climate-related projects



Taking action

Companies should ensure that climate is linked to business planning as a core strategic issue, which requires an evaluation of materiality. On the risk side, the results can be captured in the form of a risk register. On the opportunity side, the assessment can illuminate areas of opportunity in developing new products and services. Companies should ensure that they are engaging with their customer base to understand where they might be able to offer novel solutions or innovations, filling a business need which in turn helps customers address their own exposure to climate change.

The end objective is to help the company in adopting commitments and targets in support of the Paris Agreement. Companies should also review any pay incentives which may work counter to their efforts on climate change. A growing area of focus for investors, boards should also closely scrutinise the lobbying activity undertaken by the company, either directly or through trade bodies, to ensure it is aligned with public stance on climate change.

Disclosing decision-useful information

By omitting financially material climate risks from their annual reports, we believe companies are not fulfilling their legal reporting obligations. Without this information and an understanding of the company's prospects over adequate time horizons, investors cannot make fully informed investment decisions. Disclosures should be sufficiently granular and comprehensive. The impact of climate to both suppliers and customers, as well as the emissions embedded in supply chains and associated with customers' use of products and services must be considered.

Climate disclosure: Best practice

Companies should:

- Disclose climate-related risks as narrative reporting in their annual reports and accounts
- Report in line with the recommendations from the Task Force on Climate-related Financial Disclosures, ensuring the availability of relevant data and analysis necessary to report comprehensively and meaningfully
- Disclose 'green' revenue streams, R&D spending allocated to sustainability initiatives and other positive efforts, which can be captured as data points and used by investors seeking to allocate capital to companies beneficial to the low-carbon transition

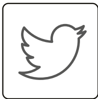
Preparing for a low-carbon future

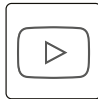
Bolstered by improved climate disclosures, a growing number of investors are increasing their investments into funds with environmental, social and governance criteria. Thus, companies which can demonstrate a credible climate strategy are likely to gain easier access to capital and talent and markets. Conversely, the global direction of travel with regards to regulation and technological development, set against the pressure from rising temperatures, mean that companies ignoring the imperative of climate resilience are likely to face sustained headwinds.

This is why discussions on climate change must be held at the most senior levels, in order to build resilient and successful business strategies as the world transitions to a low-carbon economy.

Contact us

For further information about LGIM, please visit lgim.com or contact your usual LGIM sales representative





Important notice

Investment Management Limited or contributors as a result of information contained in this publication. Specific advice should be taken when dealing with specific situations. The views expressed here are not necessarily those of Legal & General Investment Management Limited and Legal & General Investment Management Limited may or may not have acted upon them. This document may not be used for the purposes of an offer or solicitation to anyone in any jurisdiction in which such offer or solicitation is not authorised or to any person to whom it is unlawful to make such offer or solicitation.

As required under applicable laws Legal & General will record all telephone and electronic communications and conversations with you that result or may result in the undertaking of transactions in financial instruments on your behalf. Such records will be kept for a period of five years (or up to seven years upon request from the Financial Conduct Authority (or such successor from time to time)) and will be provided to you upon request.

© 2020 Legal & General Investment Management Limited. All rights reserved. No part of this publication may be reproduced or transmitted in any form or by any means, including photocopying and recording, without the written permission of the publishers.

Legal & General Investment Management Ltd, One Coleman Street, London, EC2R 5AA

Authorised and regulated by the Financial Conduct Authority.

M1949 GM

Legal & General
INVESTMENT MANAGEMENT