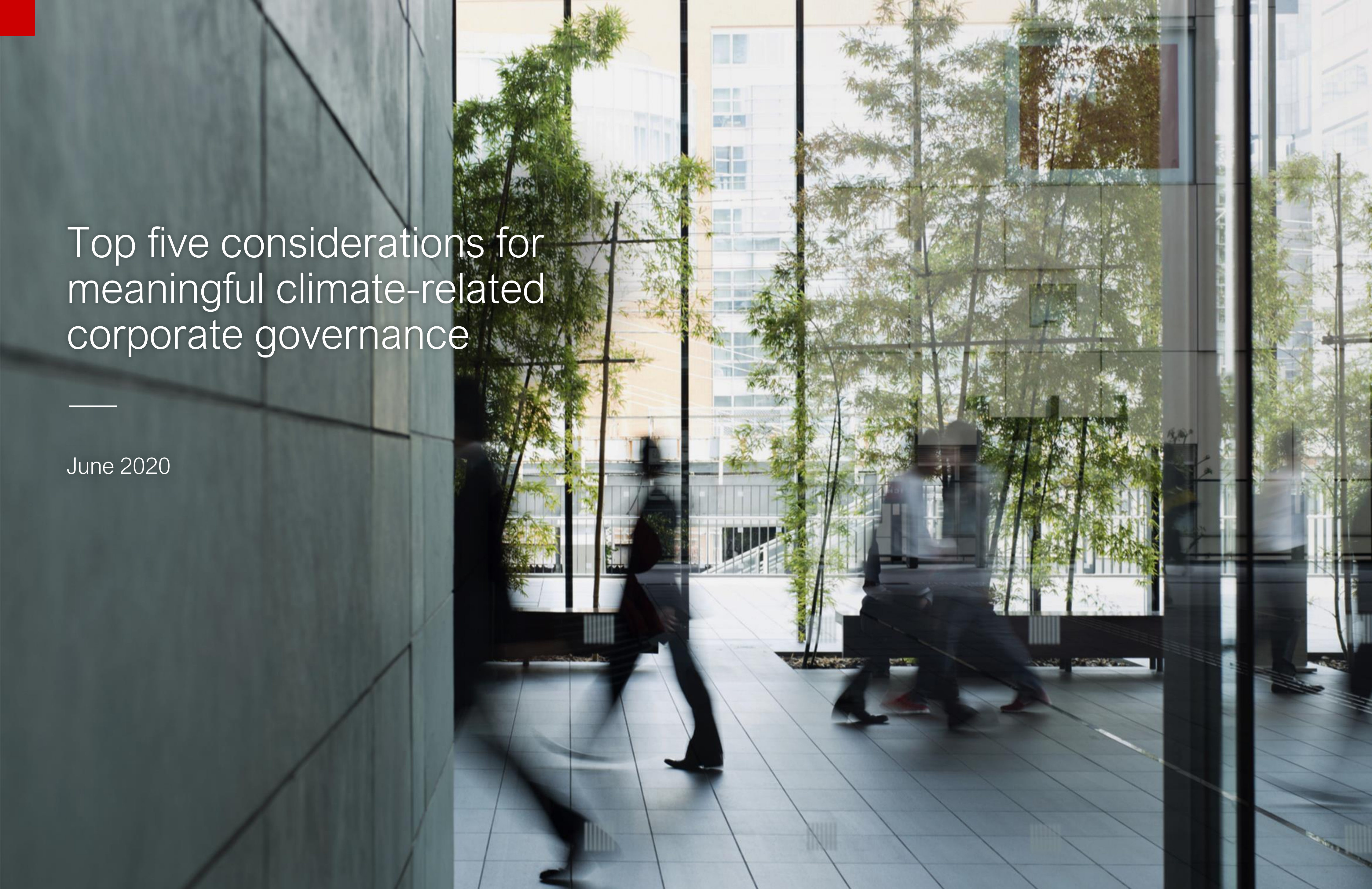


Top five considerations for meaningful climate-related corporate governance

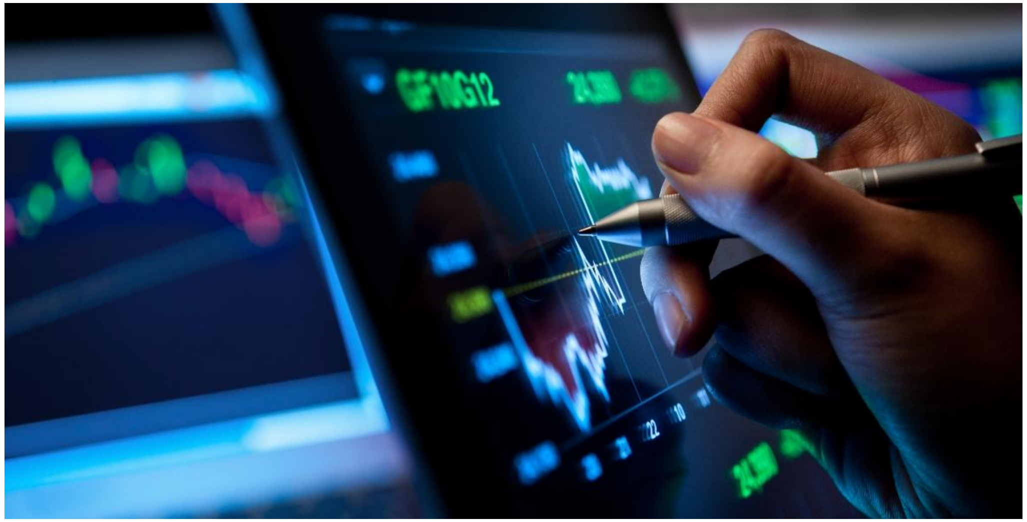
June 2020

Top five considerations for meaningful climate-related corporate governance

Investor and regulatory expectations on corporate governance of climate-related risk continue to intensify. Our team considers key questions to help guide your assurance and disclosure process in the FY20 reporting season.

With reporting season looming large, Australian directors have begun to broaden their focus beyond immediate COVID-19 concerns to assurance and reporting. One key area of focus – in which regulatory and investor expectations have continued to progress in FY20 – is climate change risk governance, assessment and disclosure.

Our analysis of FY19 annual reports indicates that only 21 (7%) of ASX300 companies had 'meaningful' climate change risk disclosures, compared with 137 (45.5%) of reports containing little or none.



These relativities do not bode well for many listed companies in light of ASIC's recent announcement that it will prioritise surveillance of the climate change risk disclosures in FY20 annual reports.

So how do boards assure themselves that they are in the former category, and not the latter?

To assist, we have set out below our top 5 climate change-related governance issues for directors, and the company secretaries and general counsel on which they rely, to consider this reporting season.

1. Narrative disclosures – TCFD and stress-testing move from gold standard to base expectation

An increasing proportion of mainstream institutional investors (including the world's largest investor, BlackRock, and members of the US$40trillion Climate Action 100+) now expect investee companies to apply the governance, strategy, risk metrics and disclosure framework set out in the 2017 Recommendations of the Bloomberg Taskforce on Climate-related Financial Disclosures (TCFD). One of the key TCFD Recommendations relates to stress-testing and scenario planning of business strategies against a plausible range of climate futures. Investor demands are now underwritten by regulatory imperative, with ASIC updating its Regulatory Guidance on Operating & Financial Reviews, RG247, to include information on the impact of climate change on financial performance, position and prospects.

Consider:

- Have we made credible inroads on the journey towards compliance with the Recommendations of the TCFD in FY20?
- Have we fulfilled intentions and specific steps previously signalled to the market?
- On what basis are we assured that our position on climate risk governance, strategy and risk management is appropriately reflected in our 2020 Operating and Financial Review in accordance with RG247?

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2. 'Net zero' emissions transition…

COVID-19 has done little to dampen the corporate trend towards embracing commitments to transition to net zero emissions by (or before) 2050 in accordance with Paris Agreement or 'science-based' targets. Many of these net zero pledges – across sectors as diverse as manufacturing, pharmaceuticals, information technology, apparel, retail, mining, and oil and gas – now include 'scope 3' emissions from downstream consumption. Mainstream investors and large proxy advisors (such as ISS and Glass Lewis) are increasingly voting in favour of activist shareholder resolutions that seek corporate disclosure of net zero emissions strategies – often against the recommendation of management.

Consider:

- How do we envisage our business will continue to thrive in a 'net zero' economy, and what is our own strategy for transitioning our business?
- Have we committed to an emissions reduction trajectory that is consistent with Paris Agreement targets, across both direct and indirect emission scopes?
- If not, what is our timeline for considering this issue?

3. …and a roadmap for achieving Paris Agreement goals

As the urgency to transition the global economy to a low-carbon trajectory accelerates, investors are increasingly dissatisfied with bare pledges of 'support for Paris Agreement goals' that are not backed by credible corporate strategies. In FY20, investors are looking for a road-map of short- and medium-term targets against which to assess a corporation's net zero transition commitment, and evidence of credible progress on that journey. In addition to the well-publicised votes at a number of Australian and European oil and gas producers, this was evident in several bank proxy battles in the recent northern hemisphere reporting season. These included JP Morgan, where a pledge to commit US$200 billion to sustainable lending was insufficient to secure withdrawal of a resolution calling for publication of a Paris-aligned portfolio decarbonisation pathway, which received 48.6% shareholder support. Similarly, at Barclays, a resolution calling for a plan to phase out lending to 'non-Paris aligned' fossil fuels and utility companies received 24% support, despite a 'counter proposal' in which Barclays pledged its ambition to become a net zero bank by 2050 (which itself secured 99.9% shareholder support).

Consider:

- Have we progressed with plans to achieve our emissions reduction commitments (short- and medium-term targets to progress towards a longer-term net zero goal)?
- What is our strategy for achieving these goals, and how has it been integrated into our business plans and risk management frameworks?

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4. Valuation and impairment – relevance of climate change-related assumptions to financial reporting and audit

The reasonableness, and consistent application, of material climate change-related assumptions is squarely relevant to financial reporting and audit in FY20. In April 2019, the Australian Accounting Standards Board and Auditing and Assurance Standards Board issued joint guidance 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. ASIC followed with its own guidance in August 2019, updating INFO 203: Impairment of non-financial assets: Materials for directors to highlight climate change and other risks that may be relevant in determining key assumptions that underly impairment calculations. The potential impacts are far from theoretical, with a number of large corporations – including Repsol and BP – recently announcing multi-billion dollar asset write-downs necessitated by a 're-basing' of their climate-related valuation assumptions.

Consider:

- What consideration has been given to the climate-related variables that may materially impact on our accounting estimates (financial position) and prospects?
- What range of assumptions are reasonable, and what is our central case?
- Have we undertaken scenario analysis against a range of stressed scenarios – including a disorderly transition to a net zero economy?
- How have these variables been integrated into our accounting estimates, project feasibility models and financial statements disclosures?
- How have these variables and uncertainties been dealt with in the audit process?

5. Governance, executive remuneration and their relationship with climate change strategy

Finally, activist shareholders often seize on executive remuneration as a core driver of (or barrier to) a company's strategic alignment with climate change goals. To guard against proxy challenge on point, companies should benchmark their governance of climate change strategy and risk management against the Recommendations of the TCFD (including board-level oversight of, and senior executive accountability on, climate-related strategy), and ensure that a portion of the discretionary remuneration of relevant senior officers is linked to progress against the business' climate targets.

Consider:

- Are our governance structures benchmarked against the TCFD?
- Are remuneration structures assessed to ensure that no perverse incentives exist that may undermine policies or progress?
- Are remuneration policies revised to reflect progress against climate-related business objectives?

As reporting season begins, these considerations should be front of mind for directors, general counsel and corporate secretariats. Our team can help you navigate the heightened risk assurance and disclosure landscape. Please contact us for more information.

How Minter Ellison's Climate Risk Governance team can help

Minter Ellison's Climate Risk Governance team is an integral part of our Responsible Business practice. We lead the market in advising on climate change through a corporate law lens.

Our unique multi-disciplinary team of lawyers and auditors works closely with scientists, economists, financiers and international regulators to ensure that our clients have the benefit of global thought leadership in this dynamic risk area. Our subject matter expertise is combined with deep sectoral experience to provide an unrivalled commercial lens across climate-related risk, governance and disclosure law issues.

We would be pleased to share our expertise with you in the 2020 reporting season, including:

- Capacity-building on climate-related financial risks boards, finance and governance teams
- Board oversight: due care and diligence assurance and advisory
- Transition strategy, governance and risk management advisory
- Annual reports: disclosure assurance and advisory – alignment with TCFD and updated ASIC RG247, benchmarking to peer- and global-best practice
- Investor relations, AGM and executive remuneration advisory
- Climate risk litigation advisory and defence
- Project, transactional and finance due diligence - specialist modules on climate-related risk issues
- Material contract reviews – advice on identification, risk allocation and efficiently pricing of climate risk exposures

We create lasting impacts.

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