OSLER

Climate Change – Why boards need to be proactive

MAY 17, 2017 5 MIN READ

Related Expertise

- Corporate Governance
- Energy
- Environmental
- Regulatory, Indigenous and Environmental

Authors: Andrew MacDougall, John M. Valley

Climate change and its potential impact are becoming increasingly relevant across the globe. In fact, the World Economic Forum's Global Risks Report for 2016 ranks "failure of climate-change mitigation and adaptation" as the greatest risk facing the world over the next 10 years.

The boardrooms of corporate Canada need to be attuned to this challenging reality, and must consider the potential long-term impact, risks and opportunities of climate change for the organizations they oversee.

We highlight below a few of the reasons why climate change needs to be a recurring topic on the board agenda.

Risk management: Managing the impact of 'extreme weather' events

From wildfires to flooding to heat waves, incidents of 'extreme weather' and natural catastrophes caused by climate change are reported with increasing frequency. Insurance companies are directly impacted and their boards of directors need to assess whether this elevated risk is being managed effectively. As part of their risk oversight function, boards of directors of all companies with operations at risk of exposure to extreme weather need to oversee how management proposes to mitigate or manage the risk of such events and crisis response preparations, to identify potential exposures that may affect the company before they occur and ensure that appropriate contingency plans are in place. Boards should also review the nature, extent and cost of the company's insurance to provide appropriate and cost-effective coverage for the impact of the event itself and any 'knock-on' effects for the business as it recovers, as well as potential implications of such events for the company's credit rating and cost of capital. A Standard & Poor's report from April 2015 indicated that since 2005, there have been at least 60 instances of corporate credit ratings being downgraded due in whole or in part to natural catastrophes.

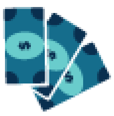
"... since 2005, there have been at least 60 instances of corporate credit ratings being downgraded due in whole or in part to natural catastrophes."

Stakeholder views: Demands for disclosure and divestment

Stakeholders, including consumers, affected communities and institutional shareholders, are increasingly demanding more information with respect to companies' climate change initiatives. Institutional investors in particular have expressed a view that they are not satisfied with the quality of existing disclosure. This concern is reflected in a significant number of shareholder proposals focussed on climate change and the environment and their implications for the company (approximately 8% of all shareholder proposals received in Canada over the past decade). Boards need to ensure that they are actively monitoring and encouraging management to respond appropriately to these issues to satisfy investor concerns and demands for information.

"Shareholder proposals focussed on climate change and the environment, especially on reporting on such matters, have accounted for 8% of shareholder proposals annually in Canada over the last 10 years."

Institutional investors themselves are facing heightened scrutiny from their stakeholders – these stakeholders are demanding that the institutional investor, when making investment decisions, consider the extent to which the potential investee business contributes to climate change, is reducing its carbon footprint, or is otherwise sensitive to the risks and opportunities presented by climate change. There is some evidence that this is having an effect: it has been reported that approximately 700 institutions in 76 countries have committed to divesting a total of $5 trillion from fossil fuel companies[1]. This pressure not only impacts investment policy on the boards of directors of institutional investors, but also has strategic implications for companies targeted for divestment which need to be considered by the boards of such companies.



"Approximately 700 institutions in 76 countries have committed to divesting a total of $5 trillion from fossil fuel companies."

Operations oversight: New challenges from increasing temperatures

Company responses to the effect of changing temperatures on company operations – and the capital cost that may be required to implement them – are key issues for board consideration. Take, for example, mining in the Northwest Territories. Currently, an ice road provides access to the Slave Geologic Province which is home to four operating diamond mines and several diamond prospects. However, warming temperatures have made the ice road's opening and closing unreliable, and that unreliability translates into potentially shorter seasons for the diamond mining companies – sometimes up to a third shorter. The potential material impact on company operations from changing temperatures is a reason why organizations are encouraged to consider, and report on, a 2° C scenario — i.e., when the global average temperature increases 2° C above pre-industrial levels. Boards of directors must monitor trends and ensure that management is 'scanning the horizon' to take into account potential operational issues that could arise from climate change.

"The potential material impact on company operations from changing temperatures is a reason why organizations are encouraged to consider, and report on, a 2° C scenario — i.e., when the global average temperature increases 2° C above pre-industrial levels."

Regulatory landscape: Emerging issues from policy changes

In the face of these issues, and particularly given the media coverage that accompanies them, governments are responding with new regulations. Understanding and anticipating these regulations and their impact on the company will be critical in developing an appropriate response strategy. While adapting to changing regulatory landscapes will be important across industries, for some the issue has been, and will continue to be, even more acute. For example, changes in government policy to phase out coal-fired power and to encourage the development of solar, wind and hydro power capacity — such as in Alberta — threaten the value and viability of some businesses.

Conclusion

Climate change has, and will continue to, present potential long-term risks and opportunities for organizations, and the scrutiny by the public, media and regulators of how companies and the boards of directors that oversee them respond is likely to increase. As a result, board oversight of the strategic, risk and disclosure implications of climate change for the business will also be increasingly important to ensure these risks and opportunities are identified and appropriately managed and communicated.

OSLER

[1] Measuring the Growth of the Global Fossil Fuel Divestment and Clean Energy Investment Movement, Arabella Advisors, September 2015, [PDF].