# Building the right board to respond to the climate challenge

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This research paper seeks to answer the question 'what board characteristics are driving the climate change response of firms in the financial sector?'. To answer this question, a review of relevant academic and practitioner literature was undertaken followed by a survey and semi-structured interviews to collect insight from primary data.

Under its fiduciary duty, the board is responsible for overseeing and ensuring the long-term success and strategic direction of the firm and is therefore in a crucial position to impact a firm's climate response. Three overarching themes emerged from the literature review on board characteristics driving a firm's climate response: board structure; board diversity and mindset; and board processes. These themes were investigated for underpinning characteristics, to respond to the research question.

The literature review revealed that drivers of climate response are not well defined, which provides challenges for establishing causation between board characteristics and financial firms' climate response. Board structure appeared to be of low importance, with separation of CEO and chair roles the only characteristic found to positively influence climate response. Board processes are necessary to enable boards to meet their fiduciary duty, but there was no consensus on characteristics necessary to achieve this. However, both the literature review and the primary research provided evidence that board diversity, including gender, age, and expertise, positively contributes to a firm's climate response, as does a sustainability mindset. Furthermore, our primary research found that aspects of diversity such as gender and age are associated with a sustainability mindset.

Our research also highlights the importance of the chair in driving the firm's climate response. When the chair possesses a sustainability mindset, this has an impact on whether climate is included on the board agenda and ultimately in the firm's climate response. However, even a climate-literate chair with a sustainability mindset still needs to bring other directors along on the journey. These findings make a useful contribution to the existing knowledge regarding board characteristics positively impacting climate response.

The implications of our findings could be relevant to nominations committees when seeking to recruit board directors, and climate should be included in both board and director skills

evaluation. Findings from the interviews highlighted that there is an opportunity to educate board recruitment firms on the importance of sustainability mindset as an attribute for board appointees. Although the definition of sustainability mindset is subjective, literature includes dimensions such as creative thinking, inclusive thinking, connection with nature and partnering as well as a good level of climate knowledge; these features can be targeted in the recruitment process.

The relative immaturity of climate as a systematically integrated board topic opens research opportunities into how a sustainability mindset can be fostered at board level. We recommend it be pursued through education and awareness, targeted recruitment, or by enhancing the gender and age diversity of the board. Given the board's fiduciary duty to the stewardship of the firm and that regulators have indicated that financial firms' climate-related disclosures will continue to increase, we recommend further research on the connection between sustainability mindset, board diversity and climate response to contribute to the body of knowledge on effective climate governance and management in financial firms.

## Board structure

Interviewees and survey respondents were asked about the inclusion of climate on board committees. The majority of survey respondents indicated that climate should be integrated into all board decision-making. Some interviewees suggested that risk and audit committees or sustainability committees should have primary responsibility but that the full board ultimately has accountability. When asked specifically in which committee climate should be considered, survey respondents expressed preference for the risk committee, followed by the remuneration and audit committees, but also a clear majority saw the need for a separate climate advisory committee. In the interviews however, sustainability committees were generally not considered necessary at board level but seen as useful at the executive level , as long as climate response is integrated into board committees. Interviewees and survey respondents agreed that a dedicated group at either board or executive level needs to be responsible for driving climate response and many interviewees noted that the maturity of an organisation's processes influences where in its structure the board considers the issue.

Participant responses reflected the lack of consensus in the literature. While best practice recommendations have highlighted the benefits of a dedicated climate committee, the literature indicated that responsibility for sustainability can be allocated to dedicated committees, other established committees (such as risk), and board itself. The diversity in approaches is also reflected by this study's participant responses. Furthermore, the literature provides mixed results for the impact of dedicated committees in driving climate response. Interview and survey respondents stressed the requirement that climate receives focus at the board level, but that it can be integrated in various ways. This leads to the conclusion that specialised climate committees are not appropriate for all firms but should be considered within the firm’s specific context.

Interviewees and survey respondents were asked about the significance of board independence, CEO duality, tiering and size. When asked about board independence, only half the survey participants considered it important but also articulated that the skills map is just as important as independence. One noted that shared values are more important than independence, while another mentioned that board independence potentially creates faster decision making which could be important when addressing climate response.

In regard to CEO duality, an interviewee suggested that keeping chair and CEO as separate individuals is deemed best practice, as it reduces over-dominance of one personality and allows independent directors greater influence if the CEO is on the board but has misaligned values. Generally, survey respondents did not articulate a clear preference, nor did they collectively connect CEO duality to a better or worse climate response. One survey comment agreed that separation of roles may become more important in times of crisis.

One interviewee stated that a unitary board is preferable to a two-tier structure to ensure there is only one conversation. About half of the survey respondents agreed with this statement, the other half being unsure. Survey participants referenced corporate values and leadership as more important than structure and one interviewee pointed out that having board directors who are or have been CEOs (of other firms) is ideal as they tend to have a systems view and are used to focusing on multiple issues at once.

Board size appeared to be of little importance to survey respondents. Most believe that ‘it depends’ on the organisation. Notably, comments relating to board structure within the survey often alluded to the significance of leadership; one respondent said ‘climate governance extends to conviction of its leaders’ rather than the size of the board. When asked about tiering, two respondents referenced values and leadership as more important than structure and when asked about the separation of the board and the CEO, it was pointed out that the ‘CEO sets the mindset and internal attitude towards climate governance’.

Participant responses portrayed a lack of consensus as to the relationship between climate response and board independence, tiering and size. This reflects the literature which also demonstrated mixed results. While the literature indicates separating the role of CEO and chair positively drives climate response, participants, except for one interviewee and one survey respondent, did not believe it was significant. This could reflect the fact that CEO duality and board tiering do not feature in the jurisdictions covered in our primary data. While specific structures did not appear to be important to respondents, a theme of leadership and mindset arose, an area explored further below.

Within board structure, there appears to be no one optimal approach for driving climate response, suggesting the importance of firm-specific characteristics. The lack of consensus on structure may also indicate that climate is of such significance that it should permeate all board committees and not be allocated to specific structures. One implication of this finding is that addressing only structural aspects of the board will not be sufficient to drive climate response.

## Board diversity and mindset

Interview participants and survey respondents were asked about the significance of board diversity and mindset to their firm's climate response. In the interviews, many articulated that diversity of thinking could be increased through addressing the lack of women on boards, highlighting the role of gender diversity in broadening perspectives. 'Boards should put in place structures that ensure they continue to map the skills and attributes to maintain diversity'. Cultural, gender, local and international diversity are all important in providing a range of perspectives. Including younger directors was also seen as important as knowledge of sustainability and climate change tends to rest with younger people; 'older people are risk averse but, by ignoring climate change, are ironically creating more risk'. 'Broader diversity ensures greater likelihood of understanding what information should be received by management'. Survey respondents did not feel strongly about gender diversity *per se* but articulated the importance of 'thought' diversity (the avoidance of groupthink) for a firm's climate response. Diversity of thinking was mentioned as important by interviewees and the importance of mindset was highlighted, with 'sustainability mindset', 'stewardship mindset', 'national and international mindset' all referred to. 'Forward-thinking people with a positive mindset' are needed to take account of opportunities as well as risks of climate change. Several participants thus confirmed the link between diversity and sustainability mindset.

With regard to leadership, interviewees and survey respondents viewed both the chair and the CEO as crucial in influencing a firm's climate response. The chair holds the pivotal role as either promoter or blocker of climate response. Interviewees considered it necessary to have the chair and at least one other director supporting climate response and stated that if the chair and one other director are climate change deniers, it doesn't matter if you have several directors who want to promote the issue, it won't get on the agenda. In contrast, one chair described bringing other directors on the journey, describing himself as 'a mole' within the board, 'chipping away at their insecurities' and warning that even as chair, 'you have to temper how strident you are or you will lose credibility'. This was echoed by another chair who warned of the risk of non-believing directors 'digging in', becoming more entrenched in their view if you try to move them on too quickly.

The personality of the chair was viewed as important, regardless of whether or not they are a promoter of climate response, with one respondent noting that their chair, despite being a believer, 'is a control freak who is threatened by the expert director' that was brought in specifically to assist with climate response. Another respondent: ‘it doesn’t matter what we think as long as we understand what (the chair) wants us to achieve’. The need for balance within the board was also noted. The CEO also has an important role, with some saying that the process should be driven by management but with the tone set by the chair in addition to the CEO. One interviewee noted that the chair and CEO must set the tone but build expertise on the board. In the survey, all respondents felt that corporate values need to be aligned to climate response, voicing that it should be portrayed as a priority internally and externally. Interestingly, respondents had different reasons for this assertion, ranging from ‘it has an impact on everyone; critical topic for the world’ to ‘should be integrated in business decisions...not corporate values’. One respondent noted that climate response is simply part of ‘rational business’.

The importance of diversity in driving climate response was clear, but there appeared above all a focus on diversity of mindset. For gender diversity, the literature confirms it improves climate response and interviewees supported this conclusion, although consensus was lacking in the survey. Findings in the literature on the relevance of age diversity were mixed but highlighted the generational divide on climate issues. This theme emerged in participant responses, supporting the view that age diversity can improve climate response. Literature also highlights that diversity helps to introduce different mindsets, driving firms’ climate response and several respondents identified this connection. The mindset of specific leadership roles has only been partially acknowledged within literature, while responses of interviewees indicated its importance. Although not explicitly asked, some survey respondents noted the important role of leadership in driving climate response. The chair’s mindset (and the CEO’s to a lesser extent), was deemed to be pivotal because it ensures climate is considered within the board’s agenda (and corporate values are aligned), although participants noted that if people in these roles are alone in their views, it can be difficult to drive climate response.

Interviewees and survey respondents were asked about the importance of climate education and knowledge on the board. Most survey respondents felt there should be an expert on the board. The majority responded that everyone on the board should have the same level of expertise (through training) and over half believed that expertise should be brought in via external advisors or through recruiting an external expert to join the board. Many interviewees mentioned the use of both internal and external experts, but there was a concern the use of experts could be a box-ticking exercise rather than a sign of better climate governance – ‘there is no bandwagon un-jumped upon!’, which can sometimes be ‘unhelpful and expensive’. In terms of internal efforts, annual training programmes, site visits and expert presentations were mentioned. One interviewee firmly believed it is management’s job to bring in this expertise and another reinforced this, saying ‘if it hadn’t been pushed up the organisation it wouldn’t have been discussed at all (at board level)’.

Climate capability was not viewed as an explicit skill for directors; ‘a sustainability mindset is what is needed’, although, according to one chair, ‘I don’t recall ever having mindset or anything capturing mindset on the criteria list for nominations even though this is what is important rather than (other forms of) diversity’. Some interviewees stated climate capability should be only one of many skills a director might have rather than the predominant one, but one interviewee stated that it is necessary to have at least one expert – although this is dependent on whether the firm ‘is impacted by’ climate change – and to disclose who this person is. The role of the nominations committee in succession planning and assessing skills gaps and the low standard of board recruitment consultants was also noted. Other external entities engaged with by boards include climate scientists, non-governmental organisations (NGOs), insurers, industry bodies and regulators, peers and shareholders.

Climate expertise was found to be an important consideration in addressing climate response among participants, whether from external experts or improving knowledge internally. The literature supports this conclusion, indicating that board expertise and climate response are linked. Furthermore, participant responses highlighted the lack of emphasis placed on directors’ climate expertise and mindset. Recruitment of climate-literate board members is a theme underexplored by existing literature.

In conclusion, board diversity goes beyond traditional measures of diversity (such as gender), to encompass factors such as expertise and mindset. Mindset, particularly for chair and CEO roles, appears to be a pivotal factor driving climate response within the finance sector.

## Board processes

It was generally observed by interviewees that the board, as a collective, has a fiduciary duty for the short and long-term outlook for the firm, that negative externalities are minimised (IR #3) and that boards are accountable for ensuring they have a robust process in place to show they have considered climate: ‘the board should be aware of the readiness of the organisation to implement regulatory requirements and other commitments’. Climate response was considered the joint responsibility of the entire board by many interviewees as well as most survey respondents. However, a third of survey respondents felt it is important that the chair of the board was individually responsible. One interviewee noted that CDP signatories are required to make it the responsibility of the entire board, but this collective ownership can mean that accountability rests with ‘everyone and no-one’.

There were contrasting views as to whom the fiduciary duty is extended, with one perspective being that boards have accountability to the environment as well as stakeholders. Similarly, that disclosures of true and fair representation of the firm’s performance do not currently include social and environmental impacts in addition to financial. A contrasting view was that there is a point at which fossil fuel lending or investing becomes so attractive that ‘you cannot, given your fiduciary responsibility, exclude it from your portfolio’.

In overseeing climate response, some interviewees made a distinction between the responsibility of the board for crafting the climate response and the responsibility of management for strategy execution. In the survey, almost all respondents agreed with this distinction and believe there should be a strong interaction between the executive and the board, preferably via the CEO.

While the board may ultimately be accountable for climate response, one interviewee emphasised the need for systematic processes for informing the board about climate, and that the adoption of the TCFD will mean that boards become better informed about climate risks faced by their organisation. However, one director observed that the executive management determines which papers the board gets to see, and they did not recall having seen the firm's TCFD scenario analysis. This was not unusual amongst respondents; if robust processes are in place for informing the board, there is a higher likelihood of climate becoming embedded, while the board is also responsible for continually assessing implementation of strategy. Opinion on board access to information on climate varied amongst interviewees, and was generally regarded as weak, although at one organisation the chair is also the head of the sustainability committee, so they are directly informing strategy through their role on this committee.

The literature emphasises the board's role in designing strategy and supervising its implementation. This reflects participant views that responsibility for overseeing climate response sits with the board, although some survey participants singled out the role of the chair. Furthermore, many interviewees identified the board's responsibility for climate strategy as a fiduciary duty, but there was a clear contrast in how participants interpret this. Some interviewees also noted management's duty to execute climate response, but the explicit meaning of fiduciary duty of a board for climate response is not specified in the literature. Where the board's responsibility ends, and management's responsibility starts is unclear. The board's monitoring of execution is determined by the processes in place, including access to climate information which was generally considered weak by respondents. Practitioner literature has begun to recognise the lack of processes to help the board oversee climate response in the finance sector.

Almost all survey respondents felt that climate change should be addressed in board meetings more than once a year. Just under half of participants believed it should take place in focused sessions, while more than a third thought climate change should be considered at every meeting. If climate change is considered within existing committees, such as the audit committee, as suggested by survey participants and one interviewee, it would imply a regular review. However, frequency of meetings did not arise explicitly as a success factor in driving climate response within interviews. The literature, surveys and interviews are each inconclusive on the importance of meeting frequency.

Therefore, the importance of board processes in driving climate response in the finance sector derives from the fiduciary duty of the board to oversee the long-term performance of the firm. Climate response should be developed explicitly as part of this fiduciary duty and therefore the board needs access to structured climate information to facilitate oversight.

Summarising the results overall, our research found that specific board structures do not seem to be pivotal for driving a financial firm's climate response. In terms of board processes, fiduciary duty is deemed important, but there is no consensus on the processes necessary to meet this duty. It is diversity, and in particular the mindset of the chair and CEO, that are key in driving climate response at financial firms.

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