

Board Considerations when Implementing a Sustainability Strategy

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Introduction

Manmade Green House Gas (GHG) emissions continue to cause significant environmental problems, the financial effects of which will be profound. Consultancy firm McKinsey estimates that total global spending by governments, businesses and individuals on energy and land-use systems will need to rise by \$3.5 trillion a year, every year, if we are to have a chance of getting to net-zero in 2050¹. Organisations that recognised the significance have already begun to transition or have been encouraged to do so through macroeconomic, policy and legislative developments.

Sustainability and Environmental Social and Governance ('ESG') is broader than climate transition, it takes into account all stakeholders interests so a board needs to decide whether it will adopt a full suite sustainability strategy covering not only climate change and issues but also societal concerns such as human rights; employee protections; diversity and inclusion and more generally good governance standards (the S and G of "ESG").

The speed of change of not only specific definitions but also legislative developments in this space has created confusion and uncertainties for boards and directors and they require guidance and support to navigate this. This article offers an approach to implementing a sustainability strategy, derived from key Irish, EU and UK sources². References to climate in this article can be applied to other sustainability or ESG factor and risk references.

1. Governance

a. Climate Accountability: Leadership by Fostering a Culture of Sustainability

Accountability should include the long-term stewardship of an organisation. Directors "tone from the top" remain crucial in fostering a culture that addresses sustainability in an effective manner. Their role should be reinforced by rewarding collaboration and positive practices across the organisation.

Directors should also consider seeking partnerships with external stakeholders, including industry groups, to leverage collective expertise. By fostering a culture of sustainability and collaboration, directors can ensure that the company not only complies with regulatory requirements, but also drives innovation and resilience in the face of climate change.

b. Subject Command: Board Composition & Expertise

Boards should update board composition assessment processes to identify skills, experience and knowledge gaps created by these changed circumstances. This issue is particularly urgent for organisations in scope of the Corporate Sustainability Reporting Directive (CSRD)³ with the first wave of firms doing so for the financial year 2024 in 2025 but also a consideration for those in scope from 2026 on. Directors with relevant knowledge and / or experience are scarce given the short timeframe that this has been

a priority. Attracting and retaining the right board member will require a commitment to sustainability by the organisation.

c. Subject Command: Educate, Train & Upskill

Directors must upskill to effectively manage climate-related opportunities and risks. This involves gaining proficiency in recent scientific, macroeconomic, and policy developments. Boards should be familiar with frameworks such as the Task Force on Climate-related Financial Disclosures (TCFD) (now incorporated into the International Sustainability Standards Board (ISSB) standards) and the EU Green Deal, to guide their approach.

Climate Governance Initiatives' Chapter Zero Ireland is a valuable global non-profit resource for Non-Executive Directors to connect and network and share learning opportunities on boards experiences of climate actions and deliver effective climate governance content. One key recommended resource is the World Economic Forum's Principles for Effective Climate Governance (WEF Principles) on which to some extent this article is based⁴.

The Irish Government has also emphasised the need to educate industry on climate issues for Ireland to remain competitive. Initiatives such as Skillnet Ireland tasked with funding capacity building through subsidised training is a valuable resource. Boards and employees should examine the full range of courses and avail of this opportunity to fill any skills knowledge gaps. Compliance Institute members may be aware of its qualification offered with the Institute of Banking; the Professional Diploma in Sustainable Finance for Compliance Professionals.

d. Board Structure: Establish appropriate organisational structures

The board should determine who is tasked with responsibility for climate change or sustainability, depending on scope. The WEF Principles poses questions that may assist in guiding this decision, for example:

- Is there a specific director or a group of directors who will take responsibility?
- How will this responsibility be structured and reported?
- Should discussions occur at board level or be delegated to a Sustainability/ESG Committee?
- Is sustainability/climate risk sufficiently

material to the organisation to justify a sub-committee or if not is a different approach more appropriate?

- Will climate risk be a standing item on board agendas? If not, how will the board ensure it receives effective and sustained attention?
- Has the board considered appointing a climate risk expert, or creating an informal or ad-hoc climate advisory committee of internal and external experts?
- Will strategic advisors be engaged to assist with developing appropriate structures and processes?

2.Strategy

a. Strategic Integration: Integrate Sustainability into Strategic Planning

Climate considerations should be incorporated within existing strategic planning, business models, operations and organisational structure, financial planning and other decision-making processes. To be effective climate considerations should be integrated across an organisation's three lines of defence to help identify climate risks, allocate coordinated ownership and responsibility, and improve the quality of reporting to the board.

For those not subject to the complexities of CSRD, IBEC's Climate Action Toolkit for business developed in collaboration with Accenture provides a straightforward five step plan to develop a climate action strategy that also includes some sector specific perspectives⁵

b. Strategic Integration: Set Clear, Realistic and Achievable Strategic Goals

Sustainability is a multi-year project with cross functional impact and should have realistic short (12 month); medium- and long-term targets or goals. Clearly understanding the nature and scope of the 'value chain' which the European Sustainability Reporting Standards (ESRS) has defined (with more detailed guidance by EFRAG⁶) is important in order to set meaningful targets. In summary a value chain encompasses the activities, resources and relationships it uses and relies on to create its products or services from conception to delivery, consumption and end-of-life. The CSRD requires a 'double materiality' assessment that identifies both impact on people and the environment as well as impact on the organisation. The outcomes of the materiality assessment determine which components of the CSRD an organisation must



include in their reporting, ensuring relevance to both to the organisation and society at large. No matter what a company’s materiality assessment says, the CSRD establishes a baseline of reporting for all in scope entities. They include general disclosures on governance, strategy, impact, risks and opportunities and measurement and disclosure of the entities Scope I, II (direct) and III (indirect) emissions. Once this is clear the organisation can develop a roadmap to increase impact.

3. Risk Management:

a. Identify and Manage Sustainability Risks and Opportunities

Effective boards will ensure that the organisation’s risk management processes identify, assess, manage and report on climate-related risks and integrate them into the company’s risk management strategy. Guidance on the disclosure of clear, comparable and consistent information on financial risks and opportunities presented by climate change being the most urgent should be consulted e.g. the International Sustainability Standards Board’s (ISSB) IFRS S 2 (climate related disclosures) and the European Sustainability Reporting Standards (ESRS) E1 (climate change) which are now somewhat interoperable and more generally the Corporate Sustainability Reporting Directive (CSRD/the Directive).

Once identified, continuous management and monitoring is required.

Directors should also leverage opportunities from the transition to a low-carbon economy, such as green finance incentives and technology innovations on sustainable business practices or risk being outpaced by competition.

b. Material Risk & Opportunity Assessment:

The board should ensure that management assesses the short (12 month), medium, and long-term materiality of climate-related risks and opportunities on an ongoing basis. The board should ensure that the organisation’s actions and responses to climate are proportionate to the materiality of climate change to the company.⁷ The CSRD gives helpful guidance on materiality risk assessment processes and can be adapted to those that are not in scope for CSRD. The Directive aims to identify physical risks and transition risks that an organisation is exposed to over the short, medium, and long term for specific global warming scenarios.

Given the variable impact of climate change on business, materiality assessments should contain scenario analyses to understand potential risks and opportunities under different time horizons and climate outcomes. Scenario analyses can be similar to a recovery plan for



credit institutions or insurers; proportionate to the climate risk exposures of the organisation, of sufficiently high severity while also realistic and plausible. These materiality assessments and scenarios should be updated sufficiently frequently to be relevant.⁸

4. Metrics & Targets

a. Reporting & Disclosure: Voluntary Vs. Mandatory Disclosures

The Compliance Institute's Sustainability Reporting Assurance Readiness Webinar held on 26th June 2024 (available to watch on www.compliance.ie) set out the rules for in-scope CSRD entities, including compliance with ESRS. Even for organisations not subject to CSRD relevant stakeholders (employees, customers, suppliers and investors) will seek greater transparency on sustainability impact due to their stakeholder demands. Directors should familiarise themselves with Ireland's Climate Change Advisory Council (CCAC) and the Environmental Protection Agency (EPA) obligations to set emissions ceilings for various sectors or suffer carbon fines. Where disclosure obligations do not apply, directors should still consider publishing sustainability-related updates given increasing societal expectations. Incorporation of good practice disclosures within a strategic framework can safeguard against legal repercussions and support the goal of national and EU climate targets.

The Central Bank of Ireland (CBI) has stated that one of its supervisory priorities is ensuring that regulated entities "*improve their response to climate change and enhance their role in the transition to a Net Zero economy*"⁹. This includes firms' risk management practices for physical and transition risk and oversight of the part organisations play supporting sustainable finance. The CBI has committed to specific initiatives to better understand the materiality of the flood protection gap amongst other factors in Ireland. In addition, there is significant scrutiny on "greenwashing" in the promotion and sale of financial products to investors, both at national and EU level.

b. Incentivisation: Align remuneration with Sustainability Goals

Meaningful progress requires alignment of executive compensation with sustainability-related performance metrics. This can be achieved by incorporating sustainability-related Key Performance Indicators (KPIs) into executive remuneration policies. These KPIs should coincide with the company's interim milestones and long-term sustainability goals, ensuring that executives drive climate action.

Directors should establish clear, measurable, and achievable targets for emissions reductions and other sustainability outcomes. Linking compensation to targets, can motivate

senior leadership to bring sustainability into strategic decision-making and execution. This will ensure compliance with regulatory standards and demonstrate a commitment to long-term value creation.

Worthwhile questions to ask include:

- Which climate KPIs will be incorporated into the remuneration and rewards model?
- Are these the most important and most appropriate?
- Do these incentives align to expected corporate behaviours set out in the company Code of Conduct?
- How do these KPIs relate to other management incentives?
- Are there any inconsistencies or contradictions with other incentives?
- How can greenwashing be avoided?

c. Exchange: Engagement with Industry Groups & Transparent Climate Policy

Compliance with legal obligations should be a minimum expectation. Enhanced transparency and reporting builds trust and credibility and improves stakeholder relations with long term customer and employee loyalty and satisfied investors. Reporting transparency can be achieved using best practice frameworks already described. Directors should decide on the appropriate reporting framework and prioritise accurate and consistent reporting.

Best practice frameworks continue to evolve and should be followed closely.

Relevant questions to ask are:

- Does the organisation engage with the issue in an effective manner, e.g. industry thought leadership, or innovation?
- Does the organisation have oversight over thought leadership/collaboration or communicate with industry associations?
- Is the organisation engaging with the communities in which it operates, is it protecting its social “licence” to operate?
- How does the organisation stay up to date on best practice and peer comparisons?
- Will the organisation participate actively in public consultations and policy engagement?¹⁰

Conclusion

Climate risk has become a crucial and defining business leadership challenge. Young people also expect more from business than just profitability meaning a sustainable business model is required to survive. Sustainability is complex but can be addressed in a coordinated way. The frameworks referred to above will accelerate the process of creating a reliable, consistent and robust structure. Much can also be gained from engagement with peers and industry bodies but ultimately the greatest benefit will come from directors actively engaging with this opportunity and leading their boards.

The views expressed in this article are our own. We make no representation or warranty on the accuracy, adequacy or completeness of any information.

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2. WEF Climate Governance Principles (How to Set Up Effective Climate Governance on Corporate Boards); Taskforce on Climate Related Financial Disclosures (TCFD); EU Green Deal including Taxonomy Regulations; IBEC’s Climate Action Toolkit; Chapter Zero Ireland resources
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