Climate change issues- what the board of directors need to do

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Climate change - a global concern

According to the United NationsClimate Change Annual Report 2019,the world is 1.1°C warmer than pre-industrial times.India's average temperature has risen by around 0.7°C during 1901-2018 .The rising temperature has led to a fall in monsoon precipitation, rise in extreme temperature and rainfall, droughts, sea level rise, extreme weather events and particularly an increase in the intensity of cyclones.The average temperature in India is set to rise by 4.4°C by the end of 2100 relative to the average temperature over 1976–2005 and as per Global Climate Risk Index 2021 India is the seventh most vulnerable of 180 countries.The Reserve Bank of India (RBI), noted in its annual report for 2019-2020 that the number of dry days as well as days with extremely high levels of rainfall have increased in India, droughts have become more intense and water tables have depleted at an alarming rate.This has had a direct impact on agriculture with a marked increase in the extent of crop area damaged due to unseasonal rains and heavy floods. There was also a notable deceleration in mining and electricity generation as a result of the extended monsoon.The government's push to move away from carbon fuels has lead the share of renewables increasing in the total electricity generation, and hydro electricity generation registering double digit growth.

Climate change issues pose immediate challenge for the indian economy and companies

Climate change agenda if not pursued will reduce India's economic potential by 5.5% per year on average over the next 50 years as per a Deloitt study. If India does not move to low-emission fuels and reduce its dependence on fossil fuels, it could lose around $35 trillion across various sectors by 2070. The five sectors that could witness an annual loss in the value-added to GDP of more than $1.5 trillion per year are:

- Services sector(government and private)
- Retail and tourism sector
- Manufacturing industry
- Construction sector
- Conventional energy industry

Currently, these sectors together account for more than 80% of India's GDP. The number of working hours lost in India due to extreme heat will increase approximately 15 per cent by 2030. It translates into a projected 2.5 per cent to 4.5 per cent, or $150 billion to $250bn, risk to the country's gross domestic product, according to a McKinsey report.

No company will remain immune to climate change and these are already feeling the impact though in varying degrees.Increased incidence of droughts and increasingly hot weather has reduced water availability, area under cultivation and consequently on agriculture production and prices.Companies using fossil fuel are concerned about the future effects of climate change on their operations and customers.

Companies have started taking action to cut emissions and prepare for the impacts of climate change.There is increasing thrust of the government and sector regulators to introduce regulations and incentives to reduce emissions, and optimal water resource management. Demands for managing climate risks now come more from all the other stakeholders like investors, consumers, supply chain partners, and employees. In fact Investors are the most powerful drivers . One of the largest asset manager backed climate change activists to join the Exxon Mobil board up set with its strategy for climate change and reluctance to invest in renewable energy projects.As per the Deloitte survey younger generations of consumers, especially millennials and Gen Z, are increasingly particular on consuming sustainable products, with 73% of these saying they are even willing to pay more for them.

Board of Directors has onerous responsibility to address climate change issues

The Companies Act 2013 requires the directors to act in good faith in the best interests of the company, its employees, the shareholders, the community and for the protection of the environment.The Act thus requires the directors to remain conscious of and concerned about the effects of company's operations on climate change and in the same manner identify and assess the risks emanating from climate change,evolve and implement strategies to address them.Under the schedule IV of the Act independent directors have a duty to keep themselves well informed about the company and the external environment in which it operates; Any act of the board which is in the financial interests of the company or its shareholders but is detrimental to the environment may be against the letter and spirit of the law and the directors may be held accountable jointly as well as individually.

In may 2021 the SEBI introduced a new ESG reporting structure by the name Business Responsibility and Sustainability Report (BRSR). This required top 1000 listed companies to provide an overview of the entity's material ESG risks and opportunities, approach to mitigate or adapt to the risks along with financial implications of the same.The requirement that the the board's annual report should deal with material changes affecting the financial position of the company includes the financial impact of climate change as a consequence of any physical risk, transition risk, or litigation risk that may have materialized during the period. The SEBI Regulations requires the companies to report on how their businesses are being conducted in a manner that is sustainable and safe and what efforts these are taking to protect and restore the environment.

Environment protection groups have increasingly become active against the companies transgressing environment.There have been cases of large projects shelved or halted mid way because of public interest litigations or intervention of National Green Tribunal or action Ministry of Environment,Forest,and Climate Change or by state government authorities .Directors apart from being liable for regulatory action by SEBI faces prosecution under environmental laws.They may also face shareholders action under section 241 or class action under section 245 of the Companies Act.

India's commitment progressively to net-zero by 2070 would necessitate the boards to take long term as well as short term perspective of implications of company's operations on the environment in as much as environment effects on company's operations. Climate change-related risk' includes 'physical risks' arising from acute, catastrophic and gradual impacts of climate change; 'transition risks' from the transition towards a net zero emissions economy; and 'litigation exposure' from the attribution of climate change to a company's activities or the failure to manage the impacts of climate change on the business.

As per a KPMG report 16 Indian companies including Infosys Ltd, Tata Consultancy Services(TCS), GAIL, Axis Bank, Kotak Mahindra Bank, State Bank of India, noted in 2018 threats to their business due to water scarcity and climate change. Twenty four (24) large private companies have signed a declaration on climate change, pledging to move towards 'carbon neutrality.According to the Annual Report by the Carbon Disclosure Project, investor-requested corporate disclosures for climate change grew by 17% compared to 2019.

What the boards need to do

1. **Assess their ability to deal with the issues**

   It has become imperative for the board to critically assess its ability to deal with climate change issues. If I does not , it is at risk of penal consequences under the environmental laws, corporate law and applicable regulatory regime. The board of the oil giant Shell was recently sued for 'failing to properly prepare' for the energy transition.The boards of most of the companies have not yet listed climate change on their agenda or have paid lip service to the emanating issues and challenges.Climate change has assumed priority and a sense of urgency that it should be made part of vision and mission of the company.

   At present there has generally been huge gap between the intent and a well grounded strategy or action plan. The boards need to make a beginning with assessment of its own ability to deal with climate change related issues at the board level.

   Towards this end the board should review the knowledge of its directors individually and collectively about climate change and identify gap between what it should know and what it actually know. The level knowledge should be assessed in its overall context and as it may affect the company.For a 360 degree assessment they may probably need assistance of an external expert.

2. **Bridge the gap**

   Having identified the knowledge and expertise gap the board need to work on alternatives to bridge the gap. The alternatives may include appointment of a board member with vision ,perspective and experience on climate change related issues and approaches or hiring an external expert to guide and advise the board, or,organising orientation or training programs for the board members ,or ,strengthen and depend on the head of the function responsible for climate change related matters coming before the board. At least one board member should be fully conversant of the relevant laws ,regulations and imperatives. He should also critically observe their compliance at the board level . This apart the independent auditors should be asked to vouch and report to the board on quality of disclosures and compliance with well accepted international standards for example TCFD till the convergence take place which is currently under development .

3. **Make climate change as important agenda for the board**

   Let climate change be a priority area and be integral to board agenda and board room discussions. Towards this end all the investment proposals should assess climate change implications, risks and mitigations looking beyond mere compliance with the environmental and related laws.The board should set net -zero deadline with scope 1, scope 2 and scope 3 targets and monitoring progress on that.This strategic initiative will help in making climate change an enterprise wide issue and integral to internal organisation,system and processes.The chairman of the board has an important role to play in driving agenda on climate change and in enabling meaningful intervention of the board and its members.

4. **Have a board committee to focus on climate change or sustainability**

   A separate committee of the board should consider implications, company's strategy , and approach towards effects of climate change on the company and its business

   Many companies have setup CSR or ESG Committees of the board with extended scope of reference to environmental issues. Their focus has however been on social, governance and environmental responsibilities and not on climate

   change implications,concerns and risks.A need for separate committee for climate change is felt particularly for high risk companies.

5. **Encourage and require the management to set climate change targets**

   The board should ensure that the management has targets for carbon-reduction and over the period look beyond Scope 1 and 2 to Scope 3, ie emissions which are not management 's direct control . For example emissions taking place through outsourced operations or product use.

6. **Create suitable organisation and make executives accountable**
   Create an enterprise wide organisation with a separate department for climate change to provide support to different operational units and product divisions. The board should clearly lay down climate change goals for CEO and see that it percolate to all levels of executives .These should be given due weightage in the employees performance evaluation and incentive structure . Similarly relevant climate change knowledge and experience requirements should appropriately be made part of job specifications for various positions.

7. **Carry out a comprehensive climate change risk assessment**
   Climate change risks- physical, transitional and legal- impinge up on a company's sustainability. The board should deliberate and ensure a comprehensive climate risk matrix relevant for the company and that it is made integral part of its enterprise -wide risk framework . This would mean changes in its existing risk management policy and organisation, and increased resource allocation for risk management function.

Climate change is creating and would further create risks and opportunities for companies in a number of ways. Investors, lenders ,regulators , governments and other stakeholders are now expecting a prior and commensurate response from the promoters and management in addressing climate change issues. The board has a critical role to guide and steer the strategic direction of the company they lead, towards this end.