CHAPTER 02

Climate Change and Sustainability: New Standards for Sustainability Reporting and Disclosures

In *Davies Governance Insights 2018*,[8] we discussed the growing environmental, social and governance (ESG) movement and the trend toward increased reporting and disclosure of sustainability-related issues, including climate change and its related risk management by reporting issuers. In 2018 and 2019, investors and other stakeholders continued to press companies for greater transparency and accountability in managing their ESG risks and opportunities. In this chapter, we discuss the growing investor and regulatory expectations for more robust and transparent sustainability disclosure, as well as some of the most significant climate-related developments over the past year. We also review the disclosure standards applicable to climate-related issues, including the Canadian Securities Administrators' most recent guidance. In this context, we provide an overview of the leading climate disclosure frameworks and offer recommendations for boards and management of Canadian public companies to consider when tracking and reporting on sustainability initiatives.

Climate Change: Risks and Opportunities

Climate-related risks continued to grow in prominence over the past year. In October 2018, the United Nations Intergovernmental Panel on Climate Change (IPCC), a leading international authority on climate change, released a special report on the impacts of global warming of 1.5 degree Celsius above pre-industrial levels.[9] The IPCC was commissioned to explore the scientific feasibility of limiting the average global temperature increase to between 1.5 and 2 degrees Celsius in accordance with the 2015 Paris Agreement. The IPCC's report anticipates a progressive worsening of extreme weather events and other climate change impacts as global temperatures rise. The IPCC's findings are consistent with a new report released by Environment and Climate Change Canada detailing the current and projected impacts of climate change on Canada's environment.[10]

As the risks of climate change become better understood, governments and central banks are acknowledging it as a real source of financial risk. In May 2019, the Bank of Canada for the first time declared climate change a financial risk in its 2019 Financial System Review, bringing it in line with other central banks such as the Bank of England and the European Central Bank.[11] At the federal level, in June 2019, the Canadian government's expert panel on sustainable finance released its final report, which contains 15 recommendations to support the growth and development of sustainable finance in Canada.[12] It recommends the integration of climate risks into the supervision of federally regulated financial institutions. The report also includes recommendations designed to strengthen requirements for climate risk disclosure by Canadian public companies through a phased adoption of the disclosure framework of the Task Force on Climate-related Financial Disclosures (TCFD), discussed further below.[13]

Together with the federal government's recent implementation of its carbon pricing regime, discussed in our bulletin *Ontario Court of Appeal Rules That Federal Carbon Pricing Scheme Is Constitutional*,[14] governmental and financial sector responses to climate change have highlighted the pertinence of climate change risks – and related opportunities – for issuers. A recent analysis of the disclosures of over 6,900 international companies, including over 300 of the world's largest companies, published by the non-profit organization CDP (formerly the Carbon Disclosure Project) revealed that over half of these companies are identifying climate-related risks with the potential to have a substantive financial or strategic impact on their

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business.[15] Most companies report risks relating to potential policy and legal changes, and market shifts rather than physical risks.[16] The CDP found that approximately US$970 billion is associated with the risks reported by the world's largest companies, with approximately US$250 billion of this being linked to asset impairments or writeoffs.[17] At the same time, the opportunities associated with climate change are greater than the risks. Companies are identifying significant climate-related opportunities, including new products, resource efficiencies and alternative energy sources, representing potential financial impacts of over US$2.1 trillion. Companies are also reporting much lower costs to manage climate-related risks than their potential implications.[18] These findings suggest that companies that effectively identify climate-related risks and integrate these risks into their strategies early stand to capitalize on significant opportunities over the long term.

Growing Expectations for Sustainability Reporting and Responsible Investment

The year 2019 to date saw many issuers face continued pressure to increase transparency regarding their climate-related risks. As discussed further below, Climate Action 100+, a coalition of over 320 investors led by the California Public Employees' Retirement System (CalPERS), with more than US$33 trillion in assets under management, succeeded in pressuring major energy companies (including Royal Dutch Shell Plc and BP Plc) to improve their climate disclosures and align their strategies with the Paris Agreement.[19] In a similar initiative, as part of CDP's 2019 Non-Disclosure Campaign to drive further transparency regarding climate change, deforestation and water security, a group of 88 investors with almost US$10 trillion in assets is targeting over 700 global companies,

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including 34 Canadian public companies, for not sufficiently reporting their environmental data, and is pushing them to disclose this information through the CDP's disclosure platform.[20]

ESG-focused investing has also continued to gain traction. In addition to recommending the creation of incentives for climate-smart investment in the retail investment space, the final report of the Canadian federal government's expert panel on sustainable finance calls for the promotion of sustainable investment as "business as usual" within Canada's asset management community.[21] Canadian investors and investment firms are already integrating these principles into their investment processes. A notable example is the recent launch by RBC iShares, Canada's largest exchange-traded fund provider, of six new exchange-traded funds on the Toronto Stock Exchange (TSX) that are designed to focus exposure on issuers with positive ESG characteristics.[22]

Investor interest has manifested in a growing number of shareholder proposals focusing on sustainability issues. Climate change has been a top issue in the past two U.S. proxy seasons, with investors pushing not only for better reporting on climate change but also for the inclusion of environmental factors as performance measures tied to executive compensation. Shareholder proposals on environmental and social issues continue to outnumber those filed on governance issues, indicating that climate change and sustainability remain a major concern for investors.[23] At the same time, a record number of environmental and social proposals are being withdrawn, likely as a result of successful engagement efforts.[24] In Canada, where environmental and social-oriented shareholder proposals have been less common, a management-backed proposal at TransCanada Corporation seeking reporting on climate change risk passed with overwhelming support. These trends suggest, consistent with our recommendations throughout this report, that a cohesive engagement strategy may go far in addressing investor concerns.

In response to growing investor demands for ESG disclosure, proxy advisory firms have continued to focus on ESG factors in the 2019 proxy season. In its *2019 Proxy Paper Guidelines* for Canada, Glass Lewis & Co. (Glass Lewis) announced that in the case of issuers that have not properly managed or mitigated environmental and social risks, it may recommend that shareholders vote against members of the boards who are responsible for oversight of these risks.[25] In addition, Glass Lewis announced that it will integrate sustainability disclosure guidance developed by the Sustainability Accounting Standards Board (SASB) into its proxy voting products.[26] While the extent to which these standards will affect Glass Lewis's voting recommendations and influence investors remains to be seen, issuers should be prepared to respond to these market demands for increased transparency on sustainability issues.

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ENERGY INDUSTRY UNDER PRESSURE

Over the past year, investors have continued to exert pressure on companies in the energy industry to improve their disclosures around climate change and adopt emissions targets. In late 2018, New York Stock Exchange (NYSE)-listed Royal Dutch Shell Plc announced that it would establish short-term carbon-emission targets after coming under pressure from institutional investors.[27] In an industry first, Shell pledged to link executive pay to the carbon-reduction targets. Shell has now signed a joint statement with Climate Action 100+ and has set a target for 2021 of 2% to 3% lower than its 2016 net carbon footprint.[28]

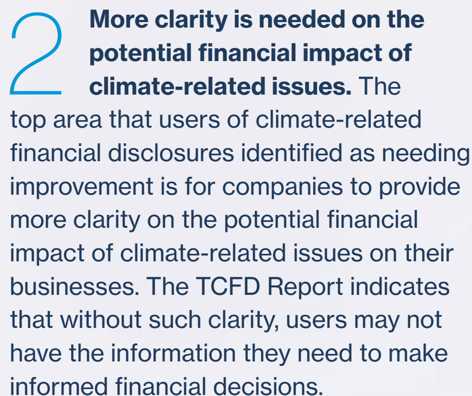
In early 2019, the board of directors of NYSE-listed BP Plc supported a proposal brought by Climate Action 100+ calling for disclosure on how the company's investments are compatible with the Paris Agreement and linking executive pay to reducing emissions.[29] The proposal, which was also backed by BP's management, obtained the support of almost all shareholders.[30] In a similar response to investor pressure, Glencore Plc, one of the largest global commodity producers listed on the London Stock Exchange, announced its plans to limit its annual coal production to align its business strategy with the goals of the Paris Agreement, after consultations with the Climate Action 100+ initiative.[31] Following in the steps of its industry peers in Europe, in April 2019 NYSE-listed Norwegian oil and gas company Equinor announced its intention to align its strategies with the goals of the Paris Agreement and link executive bonuses to climate targets.[32]

While European companies in the energy sector have demonstrated a willingness to respond to investor demands, investors have faced greater resistance in the United States. In April 2019, NYSE-listed Exxon Mobil Corporation, with the support of the U.S. Securities and Exchange Commission (SEC), blocked a shareholder proposal seeking to have the company adopt and disclose greenhouse gas (GHG) emissions targets in line with the Paris Agreement, despite support from major investors including the New York State Common Retirement Fund.[33] The SEC ruled that the non-binding proposal would "micromanage" Exxon by seeking to impose "specific methods for implementing complex policies" in place of managerial judgment.[34] Although the SEC did not support the attempt by NYSE-listed Chevron Corporation to block a similar proposal, a series of climate change–related proposals brought by shareholders of both Exxon and Chevron at their respective 2019 annual meetings failed to obtain shareholder approval. Nonetheless, the success of a similar climate change disclosure proposal at Exxon in 2018 demonstrates the potential for investor pressure to yield results in the U.S. energy sector, as discussed in *Davies Governance Insights 2018*.[35] See Chapter 7, Shareholder Proposals in the United States and Canada for further details concerning the U.S. and Canadian shareholder proposal regimes and recent developments.

Spotlight: Key Takeaways from the Second TCFD Status Report

In June 2019, the TCFD released its second status report (TCFD Report), which provides an overview of the climate-related financial disclosure practices of 1,100 companies in multiple sectors and regions over a three-year period.[36] In addition, the Task Force conducted a survey on companies' efforts to implement its recommendations for climate-related financial disclosures, as well as users' views on the usefulness of climate-related financial disclosures for decision-making. While some of the results of the disclosure review and survey are encouraging, the TCFD is concerned that not enough companies are disclosing "decision-useful" climate-related financial information. Below are some of the highlights from the TCFD Report.

1 **Disclosure of climate-related financial information has increased but remains insufficient.** Progress has been made to improve the availability and quality of climate-related financial information. The average number of recommended disclosures addressed by companies in their public reports has increased from 2.8 in 2016 to 3.6 in 2018, and the proportion of companies disclosing information that aligned with at least one of the TCFD's recommendations grew from 70% in 2016 to 78% in 2018. However, only about 25% of companies disclosed information aligned with more than five of the 11 recommended disclosures and only 4% of companies disclosed information aligned with at least 10 of the recommended disclosures.



2 More clarity is needed on the potential financial impact of climate-related issues. The top area that users of climate-related financial disclosures identified as needing improvement is for companies to provide more clarity on the potential financial impact of climate-related issues on their businesses. The TCFD Report indicates that without such clarity, users may not have the information they need to make informed financial decisions.

3 The majority of companies do not disclose the resilience of their strategies. As discussed further below, the TCFD advocates the use of scenario analysis to assess the resilience of an issuer's business strategy under different climate-related scenarios. Three out of five companies responding to the survey that viewed climate-related risk as material and used scenario analysis to assess the resilience of their strategies did not disclose information on that resilience. While the TCFD views this as an important gap in disclosure for companies with material climate-related risks, it is consistent with its understanding that companies are still in the early stages of adopting climate-related scenarios.

4 Mainstreaming climate-related issues requires the involvement of multiple functions. While sustainability and corporate responsibility functions are the primary drivers of TCFD implementation efforts, risk management, finance and executive management are increasingly involved as well. The TCFD advocates that the collaboration between multiple functions is critical to mainstreaming climate-related issues, with strong roles performed by the risk management and finance functions being especially important.

Climate-Related Disclosure and Sustainability Reporting: Trends and Disclosure Standards

As stakeholder expectations on climate disclosure have heightened, a number of organizations have advanced voluntary disclosure standards for climate risks. Current securities legislation in Canada already requires disclosure of certain material climate change–related risks in an issuer's regulatory filings, with further guidance provided in CSA Staff Notice 51-333 – *Environmental Reporting Guidance* and, most recently (as discussed below), CSA Staff Notice 51-358 – *Reporting of Climate Change-related Risks*. While securities laws do not prescribe a particular framework for disclosing those risks, many issuers are primarily doing so on a voluntary basis in accordance with one or more available disclosure standards. Canada's existing continuous disclosure regime requires issuers to disclose *all* material risks affecting their business and, where practicable, the financial impact of those risks, in their annual information forms (AIF) and management's discussion and analyses (MD&A) (and not solely in voluntary sustainability or corporate social responsibility (CSR) reports).

Additional prescribed climate disclosure may not be far away. For example, in its final report released in 2018, the federal government's expert panel on sustainable finance recommended modifications to the *Canada Business Corporations Act* to require all federally incorporated companies, not just public companies, to include climate-related disclosures in their annual reports. In addition, the International Institute for Sustainable Development has endorsed mandatory climate-related disclosure in Canada by 2021.[37] In the United States, institutional investors representing more than US$5 trillion in assets have also petitioned the SEC to require mandatory ESG disclosure by public companies.[38] In the near term, however, issuers still need to respond to stakeholder demands for greater transparency in climate disclosures by voluntarily disclosing key climate-related information.

And while the variety of available reporting standards has fuelled a trend toward greater climate-related reporting by many public issuers, it has also created confusion. In an effort to minimize the reporting burden on issuers, leading reporting frameworks and standards organizations, including the Global Reporting Initiative (GRI), TCFD, SASB, CDP and the International Integrated Reporting Council, recently announced the launch of a two-year project to align their guidance.[39] In the interim, issuers should focus on standards and disclosures that are appropriate to their industry, material to their stakeholders and relevant to their business plans and strategies. Issuers that are able to embrace available reporting standards to identify key climate-related risks and communicate these risks to investors are likely to adapt more easily to changes in guidance and growing investor demands for transparency.

CSA PROVIDES GUIDANCE ON MANDATORY REPORTING OF CLIMATE-RELATED RISKS

In August 2019, the Canadian Securities Administrators (CSA) published CSA Staff Notice 51-358 – *Reporting of Climate Change-related Risks* (CSA 2019 Notice), which provides guidance for reporting issuers to develop more effective disclosure of material risks, opportunities, financial impacts and governance processes relating

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to climate change. The CSA 2019 Notice does not create any new legal requirements; rather, it reinforces and expands upon guidance previously provided in the 2010 CSA Staff Notice 51-333 – *Environmental Reporting Guidance* (CSA 2010 Notice).

As discussed in *Davies Governance Insights 2018*,[40] the CSA's 2018 review of the mandatory and voluntary climate-related disclosure of 78 issuers on the Composite Index revealed that just under half of these issuers provided boilerplate disclosure or no disclosure at all.[41] The CSA also found a broad consensus among investors and other stakeholders that climate disclosure was largely deficient or incomplete. The ongoing release of generic, boilerplate disclosure by many reporting issuers led the CSA to issue the CSA 2019 Notice to elaborate on its previous guidance. The notice focuses primarily on issuers' disclosure obligations in their MD&A and AIF, and is intended to assist issuers in identifying material climate-related risks and improving their related disclosure. Below are some key takeaways from the CSA 2019 Notice:

1. Consider categories of climate-related risks and opportunities. The CSA 2019 Notice provides useful guidance concerning the categories of climate-related risks and potential opportunities that issuers should consider over the short, medium and long terms when disclosing climate-related information, as shown in Table 2-1. It also includes examples of risks that fit within these categories and the potential operational and financial impacts that could be relevant for disclosure, as well as questions for boards and management to consider in assessing the materiality of these risks. The CSA 2010 Notice also includes examples of entity-specific disclosure that issuers may find helpful.

TABLE 2-1:
Climate Change–Related Risks and Opportunities

Physical Risks	Transition Risks	Opportunities
– **Acute:** event-driven (e.g., increased severity of extreme weather events) – **Chronic:** longer-term shifts in climate patterns (e.g., sustained higher temperatures)	– **Reputational:** perceptions relating to how issuers contribute to or hinder a low-carbon economy – **Market:** shifts in supply and demand – **Regulatory:** increased regulation – **Policy:** actions that constrain or contribute to adaptation to climate change – **Legal:** legal actions and liabilities – **Technology:** new technology that displaces or disrupts old systems	– Resource efficiency and cost savings – Enhancement of existing processes or adoption of low-emission energy sources – Development of new products and services – Access to new markets – Building resilience along the supply chain

2. Conduct materiality assessments. The CSA 2019 Notice reminds issuers that for purposes of the MD&A and AIF, information is likely material if a reasonable investor's decision whether to buy, sell or hold securities would likely be influenced or changed if the information in question was omitted or misstated. Given that climate-related risks and their potential impacts are mainstream business issues, boards and management should take appropriate steps to understand, assess and disclose the materiality of climate-related risks to their businesses. For example, management should assess the current and future financial impacts of material climate-related risks on the issuers' assets, liabilities, revenues, expenses and cash flows over different time horizons. Issuers are also encouraged to draw upon voluntary disclosure frameworks to assist in making materiality assessments. Together, the CSA 2010 Notice and the CSA 2019 Notice set out a host of non-exhaustive guiding principles to assist issuers in making contextualized, entity-specific materiality assessments, having regard to a broad spectrum of climate-related risks over different time periods and taking into account both quantitative and qualitative factors.

3. Establish board and management expertise. Boards and management are advised to assess their relative expertise with respect to sector-specific climate-related risks to enable them to make informed decisions about risk management and disclosure.

4. Provide meaningful entity-specific disclosure. Boards and management should avoid vague or boilerplate disclosure. The CSA recommends that disclosure be relevant, clear, understandable and entity-specific to assist investors in understanding how issuers' businesses are specifically affected by all material risks resulting from climate change. Risk disclosure should also provide context for investors about how boards and management assess climate-related risks.

5. Create board oversight of climate-related issues. Boards should consider whether the methodology used by management to capture the nature of climate-related risks and assess their materiality is appropriate and effective. They should also consider whether oversight and management of climate-related risks and opportunities are integrated into issuers' strategic plans. Furthermore, boards should assess the effectiveness of issuers' climate-related disclosure controls and procedures to ensure the principal risks are being identified and appropriately managed.

6. Build climate-related risks into business processes and management practices. The CSA 2019 Notice encourages management to consider which business divisions or units are responsible for identifying, disclosing and managing material climate-related risks; their reporting lines to senior management; and the extent to which these responsibilities are integrated with mainstream business processes and decision-making. Management should also consider whether it has implemented effective systems, procedures and controls to gather reliable and timely climate-related information for purposes of materiality assessments, management decision-making and disclosure to investors, regulators and other stakeholders.

7. Prepare climate disclosure with the same rigour as regulatory filings. If issuers provide voluntary climate-related disclosure in accordance with one or more available voluntary disclosure standards, they may need to consider certain additional requirements and factors. The CSA 2019 Notice states that voluntary disclosure should be prepared with the same rigour as the issuer's regulatory filings and should not contain misrepresentations or obscure material information; all material information must be included in continuous disclosure (CD) documents (and not housed exclusively in voluntarily prepared sustainability, CSR and similar non-CD documents). If issuers disclose any forward-looking information relating to climate change, that disclosure must also comply with securities law requirements.

For further details about the CSA 2019 Notice and its impact on issuers, see our August 2019 bulletin, *Canadian Securities Regulators Provide Guidance on Climate Disclosure*.[42]

Detangling the Major Climate Disclosure Frameworks

The Global Reporting Initiative

The GRI is an international organization that has developed the GRI Sustainability Reporting Standards (GRI Standards), the first adopted global standards for sustainability reporting. As discussed in *Davies Governance Insights 2018*,[43] the GRI Standards are the most frequently used voluntary disclosure framework, particularly among major global companies. According to a recent Ceres analysis of the 476 largest companies of the Forbes Global 2000 (Ceres Report), 70% of major global companies use the GRI Standards in their disclosure, making the use of the GRI Standards the expectation rather than the exception.[44] The GRI Standards are designed to provide sustainability information to a wide range of stakeholders, including investors.[45] Accordingly, the GRI Standards are structured as an interrelated set of reporting standards on various economic, environmental and social topics, which are typically used to develop sustainability or CSR reports.

FIGURE 2-1: TCFD Recommendations and Disclosures

Source: Task Force on Climate-related Financial Disclosures[46]

Task Force on Climate-related Financial Disclosures

The TCFD was created by the Financial Stability Board in 2015 to develop recommendations for the disclosure of climate change–related risks and opportunities to investors, lenders and insurance underwriters. The TCFD's recommendations encourage disclosure of material information within four key categories: governance, strategy, risk management, and metrics and targets.[47] The TCFD framework also advocates the use of scenario analysis to assess the resilience of an issuer's business strategy under different climate-related scenarios. While the disclosures recommended in relation to strategy and metrics and targets require an assessment of materiality to be determined in a manner consistent with other risks in a company's regulatory filings, the TCFD recommends that information in respect of governance and risk management processes be disclosed irrespective of its materiality, as shown in Figure 2-1.

As of June 2019, nearly 800 companies and organizations with a combined capitalization of nearly US$9.3 trillion have expressed their support for the TCFD framework, an increase of more than 50% over the total identified in September 2018.[48] The percentage of public companies disclosing information aligned with at least one of the TCFD's recommendations has also grown steadily – from 70% in 2016 to 78% in 2018.

In line with the recommendations of the Canadian government's expert panel on sustainable finance in its final report, the federal government also announced in its 2019 budget its support for the TCFD disclosure standards and a phased approach to their adoption by major Canadian companies.[49] Although support for the TCFD framework is growing, disclosure continues to face challenges. According to the TCFD's second status report, companies are finding the disclosure of scenario analysis assumptions difficult.[50] The final report of the federal government's expert panel on sustainable finance encourages issuers to view scenario analysis as a tool to examine the exposure and vulnerability of long-term business strategy to various climate change pathways, rather than focusing on the specifics of the scenarios themselves.[51]

Sustainability Accounting Standards Board

The SASB is an independent, private sector organization focused on encouraging disclosure of sector-specific, material sustainability information that meets investor needs. In November 2018, the SASB released a complete set of final disclosure standards for 77 industries across 11 sectors, which identify a baseline set of financially material sustainability topics and their associated disclosure metrics for a typical company in each industry.[52] The SASB framework encourages the disclosure of only those climate change–related impacts that are reasonably likely to affect the financial

The SASB framework encourages the disclosure of only those climate change–related impacts that are reasonably likely to affect the financial performance or operating condition of a company and to affect shareholder value.

performance or operating condition of a company and to affect shareholder value. This standard is similar, although not identical, to the standard imposed on reporting issuers by Canadian securities laws.

According to *The State of Disclosure* report issued by SASB in 2017, which analyzed the financial filings of the top 10 U.S. companies in each of the industries, 73% of companies reported on at least three-quarters of the sustainability topics included in their industry standard, and 42% provided disclosure on every SASB topic.[53] With the recent announcement by Glass Lewis that it will integrate the SASB's standards into its proxy voting products, and the support of major asset managers such as BlackRock, Inc. for the framework, the SASB is likely to influence the discussion on climate change reporting in the near term.

CDP

CDP is a non-profit organization that has developed reporting questionnaires for the disclosure of information on climate change–related risks, water, forests and supply chains to investors and consumers. According to the Ceres Report, more than 86% of major global companies assessed disclosed using the CDP framework.[54] In 2018, the CDP updated its disclosure platform to align with the recommendations of the TCFD, meaning that in 2018, nearly 7,000 companies prepared TCFD-aligned disclosure through CDP.[55]

International Integrated Reporting Council

The IIRC is an international non-profit organization that has developed a principles-based framework for the reporting of concise, strategic and future-oriented information to a wide range of stakeholders (IIRC Framework).[56] The IIRC Framework encourages issuers to draw on information prepared in other reports, including financial statements and sustainability reports, to explain the full range of factors that materially affect the issuer's ability to create value over time. As a principles-based framework, the IIRC Framework does not prescribe specific key performance indicators but focuses on the disclosure of information relating to a company's governance structure, approach to risk management and other processes that may affect value creation. Approximately 1,600 companies in more than 65 countries are using the IIRC Framework to guide their reporting.[57]

Our Take: Focus on Meaningful (and Material) Disclosure and Engagement

Regulators, investors and other organizations in Canada and globally are increasingly calling on issuers to build sustainability-related factors and considerations into their strategic plans and to provide financially relevant and reliable ESG disclosures. In light of these shifting market expectations, boards of directors and management should ensure they have robust programs in place to identify, understand and mitigate sustainability-related risks relevant to their companies' financial performance and strategies and should seek to strengthen the quality and clarity of their ESG disclosures, including focusing on providing more relevant and entity- and sector-specific disclosures. The following recommended practices can assist issuers in managing these expectations:

1 Focus on substance over volume

Issuers should focus on disclosure that is meaningful to stakeholders and relevant to long-term business plans. In accordance with best practices for disclosure, issuers should ensure that disclosure is accurate, consistent over time and reliable so as to be decision-useful to investors and other stakeholders. Issuers can draw upon available disclosure standards to select and report on the measures that are most material to their business. The array of available disclosure standards can assist issuers in tailoring their disclosures for specific audiences. In all cases, focus on what is material and ensure all material information is contained in issuers' AIF and MD&A, as required, and not solely in voluntary filings or communications.

2 Improve engagement

Issuers should view engagement as an opportunity to identify the sustainability issues that are most material to their investors and other key stakeholders. Transparency through engagement can also be an effective tool for managing stakeholder expectations for disclosure and demonstrating commitment to sustainability issues. Issuers that lag behind their peers in sustainability engagement are more likely to face scrutiny about their disclosure practices and compensation structures as demands for transparency increase.

3 Incorporate sustainability into governance practices

Issuers should ensure that their governance systems align with their sustainability goals. Investors and other stakeholders are paying attention not only to the effect of ESG-related risks on companies but also to the way companies and their boards are addressing these risks in their strategies and decision-making. Issuers should seek to strengthen their governance systems, including board oversight of ESG issues and risk management processes, and should disclose the impacts of these governance systems on the management of ESG-related risks.

4 Consider using sustainability metrics in incentive plans

Boards should consider whether to build key sustainability performance measures into executive compensation incentive plans, particularly where climate-related or other sustainability factors are material to the issuer's strategy, financial condition, enterprise risk management and/or long-term profitability. Incorporating sustainability metrics into incentive plans can help to concretize targets and align management with sustainable practices and produce better outcomes.

5 Implement effective oversight structures and processes

To maintain oversight of climate-related issues, boards should determine how to most effectively build climate change into board and committee structures. An effective oversight structure is critical to ensuring the proper assessment of climate-related risks and opportunities, appropriate strategic decision-making and the establishment and tracking of climate-related metrics and targets. Boards should ensure that oversight structures and mechanisms are established and functioning, and that those structures have a clear mandate and purpose. It is worth considering whether the risk committee should have primary oversight responsibility for climate-related risk and opportunity assessment, including scenario analyses.

Notes

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