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Enhancing governance and culture to support the net zero transition

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Firms will need to overcome key governance and culture challenges to succeed in the net zero transition

- Many firms have made commitments to reach net zero greenhouse gas (GHG) emissions amid growing stakeholder expectations that they develop, disclose and execute credible transition plans. A key factor in whether a firm succeeds or fails on its transition plan will be its governance and culture.
- This report looks at four governance and culture challenges related to the transition and some good practices and questions for the Board to help address them. Unsurprisingly, there is no silver bullet. Boards will need to undertake and oversee a combination of actions to address the challenges.
- To inform our work, we conducted a survey of the disclosures of FTSE 100 financial services companies aligned to the Task Force on Climate-related Financial Disclosures (TCFD), as governance of climate risks and opportunities is one of the key pillars of TCFD disclosures.

Key challenges

1. Who is responsible?

- Firms will need to identify an executive with overall accountability for the design and execution of the transition plan.
- Firms will need to allocate responsibilities across the three lines of defence.
- Board, Board Committee and Executive Committee mandates, roles, terms of references and reporting packs should be updated to reflect responsibilities and enable oversight of transition plan progress.

2. Aligning priorities

- Some individuals within the business are likely to be resistant to the transition plan.
- Boards and CEOs must drive buy-in across the firm, backed up by aligned remuneration and incentives, where emissions are considered a key part of decision-making. They should also identify and emphasise opportunities the business should focus on.
- While the governance structure will vary by firm, it should be effective in cascading the transition strategy horizontally and vertically.

3. Making it real

- If staff do not understand the transition plan or decisions on business with large emitting clients are happening unchallenged, then the change is not real.
- Firms may need to transform their culture, drawing on previous experiences of large-scale culture programmes.
- Every employee needs to understand that every action they take to reduce emissions helps.
- Firms must identify training needs and experience gaps and put a plan in place to address them.

4. Group versus subsidiary

- Group and subsidiaries, as well as individual divisions, may be moving at varying speeds or in varying directions on their transition plans.
- Where a subsidiary is reliant on group shared services, strong engagement will be required so that the shared service centre understands subsidiary requirements.
- Communication will be important, and group and subsidiary can leverage existing channels and processes to reconcile their differences. Subsidiary Boards should be involved in disclosures of external commitments.

Executive summary

Key findings from the survey of TCFD disclosures of FTSE 100 financial services companies*

Climate risk

- At the executive level, the Chief Risk Officer (CRO) was most commonly cited as the individual responsible for overseeing climate risk management.
- Excluding where it was not disclosed or not clear, 70% had the CRO or the Chief Risk and Compliance Officer (CR&CO) solely responsible or jointly responsible with another role.
- Consideration of climate risk was typically integrated into broader Risk Committees.

Transition plan

- The individual(s) responsible for overseeing delivery of the climate ambition or transition to net zero at the executive level, below the CEO, was typically not disclosed or not clear (this disclosure is not a TCFD expectation).
- Where disclosed (three firms), the individuals had specific sustainability or climate roles (e.g. Chief Sustainability Officer).

Climate/Sustainability Committees

- According to TCFD disclosures, at the Board level, 11% of firms disclosed that they had a standalone Sustainability Committee, whereas at the executive level, most firms (83%) disclosed that they had a standalone ESG/sustainability Committee and/or Climate/Environment Committee.
- It was most common for Executive Committees to cover broader ESG/sustainability matters, rather than solely climate/environment.

Remuneration

- Two thirds of firms disclosed that they included climate or sustainability considerations in the executive scorecard, with some firms also starting to look at the executive long-term incentive plan (LTIP) (50%) and wider staff incentives (22%).

Training

- Most firms (78%) disclosed that they had provided training in relation to climate and sustainability to the Board and 56% disclosed that they had also provided training more broadly across the firm, typically to specific teams (e.g., risk or relationship managers) or staff-wide.

*We reviewed the TCFD disclosures of 18 financial services firms in the FTSE 100. These were: 3i Group Plc; Admiral Group Plc; Aviva plc; Barclays plc; Experian Plc; Hargreaves Lansdown plc; HSBC Holdings plc; Intermediate Capital Group plc; Legal & General Group; Lloyds Banking Group plc; the London Stock Exchange Group; M&G plc; NatWest Group; Phoenix Group Holdings plc; Prudential plc; Schroders plc; Standard Chartered plc; and St James's Place plc. The TCFD disclosures were contained in either the Annual Report, Climate/ESG/Sustainability reports, or standalone TCFD reports. The reports were published in 2022, reflecting on 2021.

Governance and culture challenges and good practices

1. Who is responsible?

Individuals must have the stature and resources to carry out new responsibilities

- The transition will mean the transformation of the firm across strategy, products and services, risk management, and operations. While net zero commitments may have initially emerged from corporate responsibility or strategy teams, multiple individuals and Committees are likely to have responsibilities in relation to the transition plan's design and execution, with ever increasing responsibilities across the three lines of defence, for Finance, and for more traditional corporate governance roles, including Executive Committees and the Audit Committee.
- Whereas firms have typically assigned responsibility for climate risk to the CRO, they may find it difficult to identify which individual/s (below CEO) and Committee/s should have responsibility for the design and execution of the transition plan.

Good practices

Oversight

- Board, Board Committee and Executive Committee mandates, roles, terms of references and reporting packs should be updated to reflect responsibilities and enable oversight of progress in relation to the transition plan, with Committee terms of references published.
- Where multiple Committees look at climate, it should be clear whether the Board looks across Committees to ensure consistency and see the whole picture, so that there is sufficient transparency and awareness of what is reported and where.

Execution

- Firms will need to identify an executive with overall accountability for the design and execution of the transition plan.
- As a major change programme, accountable Senior Management Functions will likely be required for each in-scope regulated entity. The delegated authority framework should be updated and communicated.
- The individual/s will need to have sufficient authority to deploy significant resources and set operational objectives. They need a broad skillset and the power to change incentives and influence decision-making.

Wider staff responsibilities

- To operationalise the plan, allocate responsibilities to all individuals and teams involved in the design and delivery of the transition plan, as well as across the three lines of defence. New responsibilities may emerge and need to be allocated as the transition plan is embedded. If a target is missed, it needs to be clear which individual is responsible.
- As part of transition plan design, identify critical decisions and who needs to be involved in sign-off. Firms should consider whether to update delegated authorities or "RACI" decision-making matrices.
- Ensure that responsibilities are updated in writing and are not just considered "side of desk".

Flexible and durable

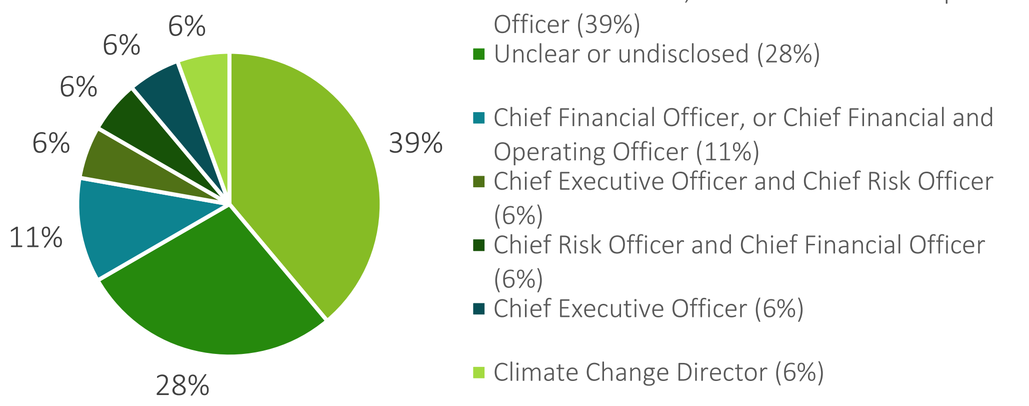
- Governance must support the consideration of new data which might affect metrics and targets, as well as the emergence of new issues, and be sufficiently flexible to support how plans may need to change as a result.
- The transition strategy and plan should survive turnover at the Board and executive level.

Survey of TCFD disclosures of FTSE 100 financial services firms
Climate risk and transition plan execution

Climate risk: At the executive level, the CRO was most commonly cited as the individual responsible for climate risk.

- Under TCFD guidance, companies are expected to disclose the Board's oversight of, and management's role in assessing and managing, climate-related risks and opportunities.
- At the executive level, the CRO was most commonly cited as the individual responsible for overseeing climate risk management.
- Excluding where it was not disclosed or not clear, 70% of firms had the CRO or the CR&CO solely responsible or jointly responsible with another role.

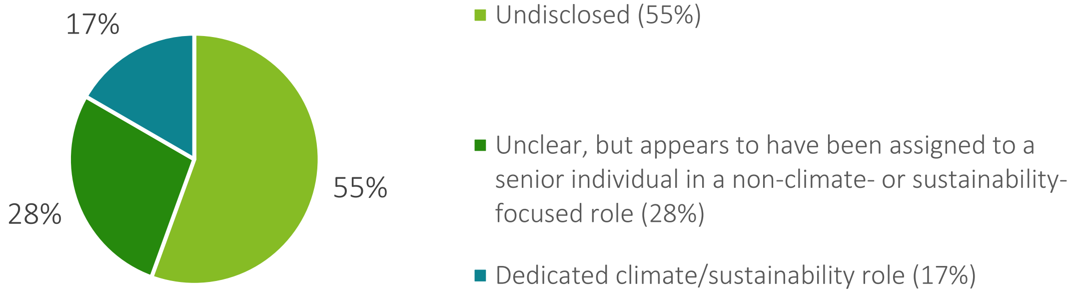
Who is responsible for overseeing the management of climate risk at an executive level?*



Transition plan: The individual(s) responsible for overseeing the net zero transition at the executive level, below CEO, was typically not disclosed or not clear.

- The individual(s) responsible for overseeing delivery of the climate ambition or transition to net zero at the executive level, below CEO, was typically not disclosed (55%) or was not entirely clear (28%); this disclosure is not an expectation in TCFD guidance.
- Where disclosed (three firms), the individuals had specific sustainability or climate roles (e.g. Chief Sustainability Officer).
- Out of the five firms where it appeared to be an individual, but was not entirely clear, the roles were more mixed and typically were not specific sustainability or climate roles e.g. operations, people, and strategy.

Who has responsibility for overseeing the climate ambition or transition to net zero (at executive level, below CEO)?



*Responsibility might be at Group level, entity level, or at both Group level and entity level.
N.B. Chart % values may not add to 100% due to rounding.

2. Aligning priorities

The Board must drive buy-in across the firm, backed-up by the right incentives

- Transitioning to net zero will require a shift to a fundamentally different and more sustainable economy. This will mean difficult decisions and significant changes across lending, investment and/or underwriting, particularly for more carbon intensive sectors. Not all clients will have the same climate ambitions and may be unwilling to have changes made to their products and services.
- This is likely to lead to at least some individuals within the business not buying-in to the transition plan. They may also have concerns about whether actions are in the best interests of their customers, or they might be reluctant to restrict their activities or say no to certain clients or opportunities.

Good practices

Purpose

- There should be a clear sense of purpose and alignment between the transition plan, climate strategy, business strategy, risk appetite, risk management, culture, and values.
- To galvanise action, the Board should set and communicate the decarbonisation agenda, based on management information (MI) from the business.
- Boards and CEOs need to drive discussion on the tough decisions that need to be made, as well as identify and emphasise the opportunities the business should focus on.

"Tone from the top"

- The CEO should drive the desired culture and behaviours.
- There must be consistent messaging that the transition plan is a key priority, and when other business priorities emerge they can still be framed taking emissions reduction into account (e.g., cost-cutting can help to reduce emissions).
- Multiple functions within the firm will have varying responsibilities in relation to the delivery of the transition plan. Therefore, a "centre of gravity" needs to develop around a key individual or idea to build momentum.

Governance structures

- While the governance structure will vary, it should be effective in cascading the transition strategy horizontally and vertically.
- It should enable coordination with other Committees or programmes, such as on the consumer duty and client engagement, and help identify conflicts of interest.
- Reporting lines (e.g., to monitor and report on transition plan progress) and the ability to make recommendations should be clear and specified, so that Committees provide a robust commercial framework for decision-making and do not become "talking shops".
- From end 2021, supervisors have expected banks and insurers' Boards to set climate-related financial risk appetite, which should be used in decision-making.

Remuneration and incentives

- Update performance criteria, role descriptions and remuneration throughout the organisation to align with the transition plan.
- Where executives and staff have specific responsibilities under the transition plan, link remuneration to those responsibilities. Collect the necessary MI to demonstrate individual contributions.
- Ensure emissions are considered alongside other key criteria (e.g., P&L, risk) when making investment, lending, or underwriting decisions, with clear targets and consequences.

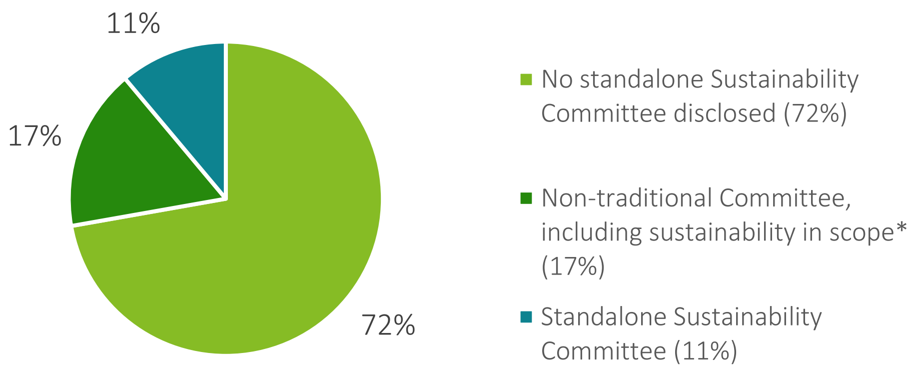
Survey of TCFD disclosures of FTSE 100 financial services firms

Climate and ESG Committees

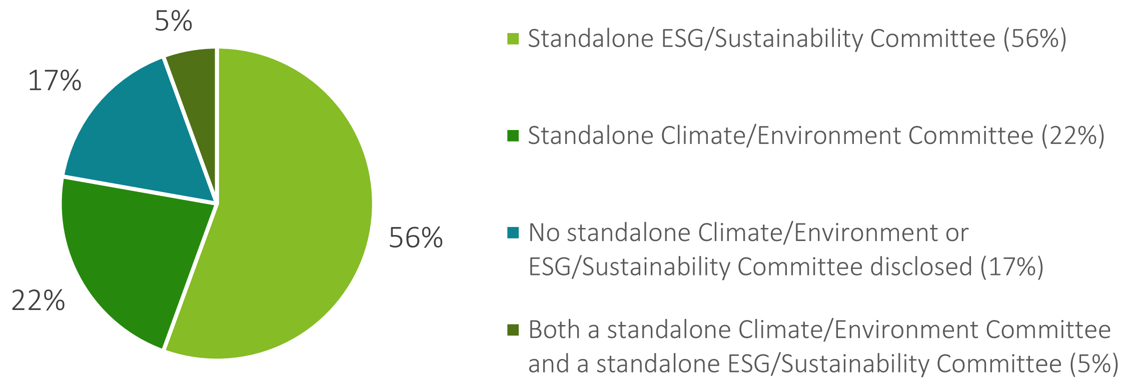
Climate/Sustainability Committees: According to TCFD disclosures, at the Board level, 11% of firms disclosed that they had a standalone Sustainability Committee, whereas at the executive level, most firms (83%) disclosed that they had a standalone ESG/sustainability Committee(s) and/or climate/environment Committee(s).

- At the Board level, 11% of firms disclosed that they had a standalone Sustainability Committee, while 17% of firms disclosed that they had a non-traditional Board Committee which included sustainability in its scope. By non-traditional, we are referring to a Committee other than e.g., the Audit Committee, Nominations Committee, Remuneration Committee, or Risk Committee.
- At the executive level, most firms (83%) disclosed that they had a standalone ESG/Sustainability Committee and/or Climate/Environment Committee. It was most common for Executive Committees to cover broader ESG/sustainability matters, rather than solely climate/environment.
- The responsibilities of the executive Committees were typically in relation to ESG strategy and meeting commitments and targets. However, there were also Executive Committees dedicated to integrating climate considerations into e.g. disclosures; risk; and reducing emissions across the firm's own operations (as opposed to financed emissions).

At the Board level, is there a standalone Sustainability Committee?



At the executive level**, is there a standalone Climate/Environment and/or ESG/Sustainability Committee?



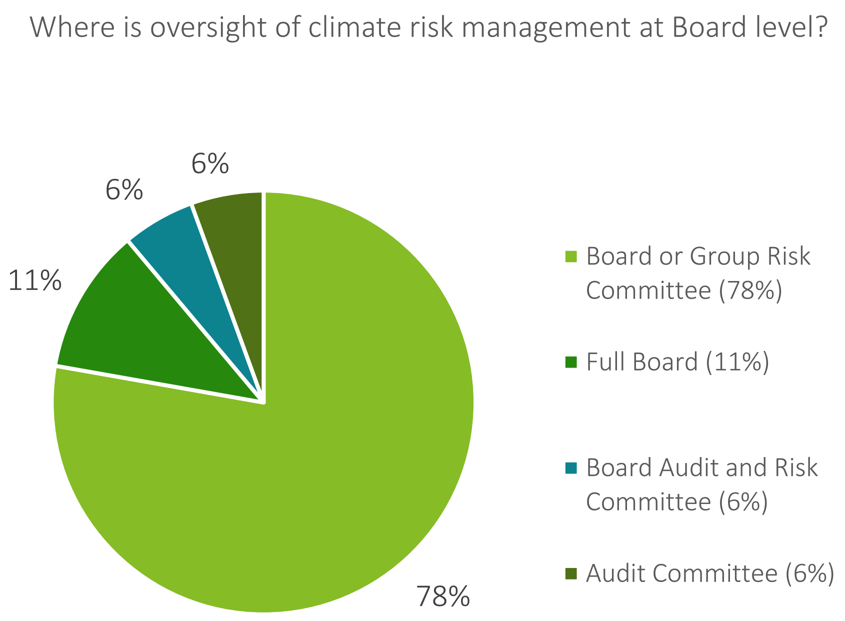
* These Committees were: Responsible Business Committee; Customer, Conduct and Reputation Committee; and Culture and Sustainability Committee.

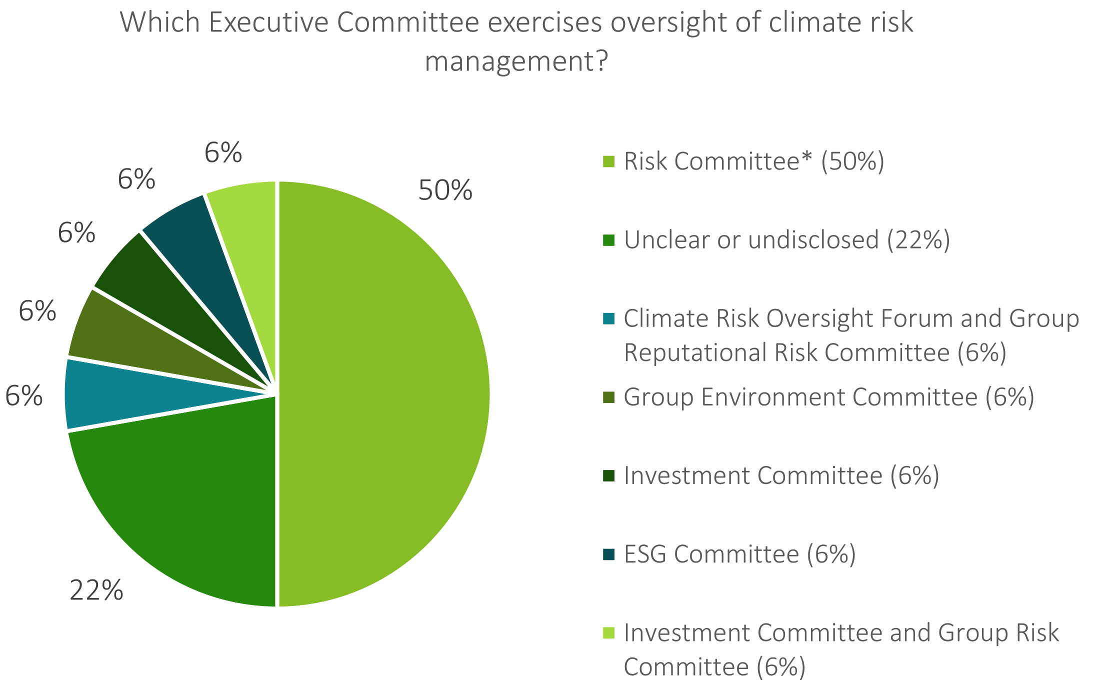
** The disclosures did not typically specify whether a non-Board Committee was an Executive Committee and so we made assessments based on the membership and/or organisation chart.

Survey of TCFD disclosures of FTSE 100 financial services firms
Committee oversight of climate risk

Committee oversight of climate risk: typically integrated into broader Risk Committees.

- At the Board level, 83% of companies had the Board or Group Risk Committee, or the Board Audit and Risk Committee, providing oversight of climate risk.
- At the executive level, 61% of companies disclosed that they had a Risk Committee and/or Investment Committee providing oversight of climate risk, with the remaining firms having a specialist ESG or Environment Committee, or not disclosing or making clear this information.



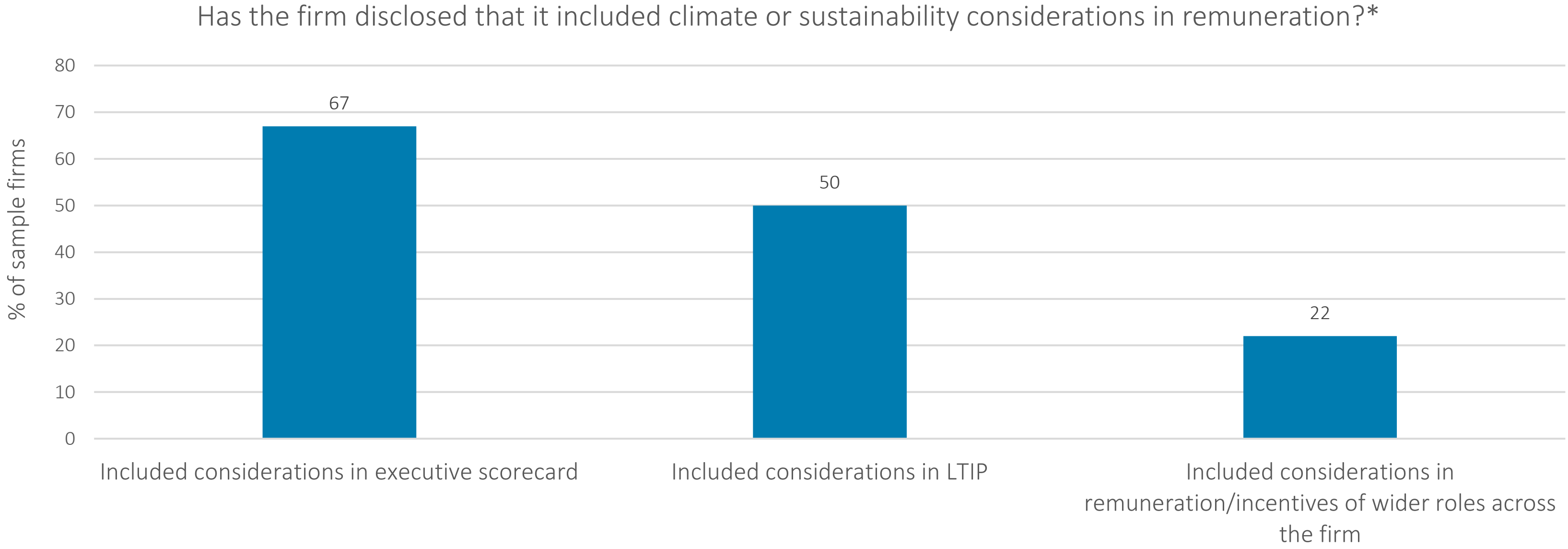


* May be called the Group Risk Committee, Executive Risk Committee, Group Risk Executive, or Executive Risk Management Committee.
N.B. Chart % values do not add to 100% due to rounding.

Survey of TCFD disclosures of FTSE 100 financial services firms
Remuneration

Remuneration: Most firms included climate or sustainability considerations in the executive scorecard.

- Under TCFD guidance, where climate-related issues are material, organisations are encouraged to disclose whether and how related performance metrics are incorporated into remuneration policies.
- Two-thirds of firms disclosed that they included climate or sustainability considerations in the executive scorecard, with some firms also starting to look at executive long-term incentive plan (LTIP) (50%) and wider staff incentives (22%).
- While this progress is positive, Executive Committees should consider the extent to which they have the information needed to assess performance objectively.



*We only reviewed TCFD disclosures and did not look at other disclosures e.g. remuneration reports.

3. Making it real

A culture transformation may need to take place

- Executing the transition plan will affect nearly every role within the firm. If staff do not understand the transition plan and how it will affect their role, and are not seeing day-to-day changes, then change is not happening.
- Even where some changes are taking place e.g., to lending, investment or underwriting decisions, there is a danger that a “tick box” mentality develops. If the biggest deals or investments with the largest emitting clients are still taking place without challenge or discussion, then the change is not real.

Good practices

Urgency and importance

- The focus should not just be on disclosures or regulatory compliance, but on reducing emissions.
- Every employee needs to understand that every action they take to reduce emissions helps and that they are required to demonstrate success with these actions.
- Milestones should be developed and tracked and staff should have actions and deadlines, so that reducing emissions is seen as something that needs to happen right now, rather than in the future.
- At the Board and executive level, targets need to be shorter than tenure.

Culture transformation

- Firms should draw on previous experiences of large scale culture transformation (e.g., conduct risk), and consider lessons from the past (e.g., in relation to misselling).
- They should ensure the “tone from above” supports the transition strategy, changing the perception of “desired attitudes” (e.g., through consistent messaging and positive user stories).
- They should test how well the transition strategy has been cascaded across the firm and whether change is happening (e.g., through bottom-up feedback from staff surveys, culture focus groups, and culture-related indicators and data).

Training and expertise

- Ensure the Board has adequate climate expertise and consider conducting a Board effectiveness review to identify skills gaps.
- Identify training needs and experience gaps across the firm and put a plan in in place to address them (e.g., relationship managers, product specialists, and compliance, risk and finance professionals). Staff may need to understand e.g., sector decarbonisation pathways and the firm’s approach to transition finance.
- Practical examples of climate strategy impact on e.g., products and services and day-to-day roles are helpful.

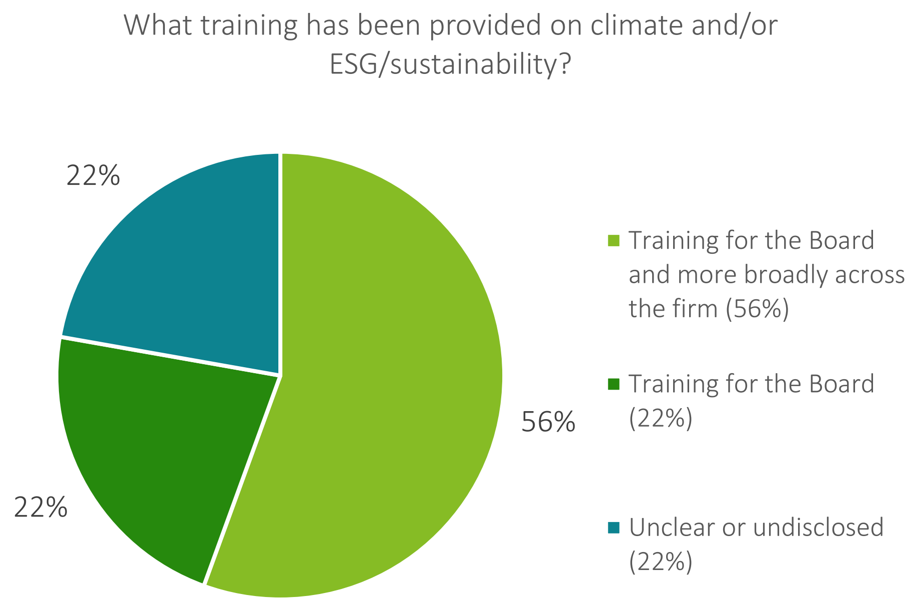
Challenge and MI

- Encourage diversity of opinion and staff to speak up without fear of repercussion (e.g., to identify greenwashing, misconduct, and weaknesses in the transition strategy and plan). Firms should consider opening up escalation channels and hotlines for staff to offer their feedback (e.g., through town hall meetings and/or anonymous feedback sessions).
- The Board and senior management should receive regular updates on progress against the transition plan, including plan assumptions and uncertainties.

Survey of TCFD disclosures of FTSE 100 financial services firms
Training

Training: Most firms (78%) disclosed that they have introduced training in relation to climate and sustainability.

- Most firms (78%) disclosed that they had provided training in relation to climate and sustainability to the Board and 56% disclosed that they had also provided training more broadly across the firm, typically to specific teams (e.g. risk or relationship managers) or staff-wide.
- Four of the firms (22%) disclosed that they had rolled out mandatory training, at least to certain groups of staff, in relation to climate and sustainability.



4. Group versus subsidiary

Leverage existing channels and processes to reconcile Group and subsidiary differences

- Different countries have different levels of decarbonisation ambition and some countries will find it much more difficult to achieve a just transition. Group and subsidiaries will have different priorities and their stakeholders and clients will have different climate ambitions.
- Consequently, group and subsidiaries may not track the same temperature goals and, even within the same jurisdiction, may have different transition strategies and priorities. This will be challenging for individual subsidiaries within the same group, where they are moving at varying speeds or in varying directions. Complex groups will also need to navigate divisional governance alongside entity and group governance given that divisions may face different challenges as part of the transition.
- There may also be considerations where the subsidiary is reliant on group shared services, for example, because supply chain decarbonisation may be run from Group.

Good practices

Internal communication

- Group and subsidiary will need to work together to understand and debate the different regulatory landscapes, national climate strategies and client and investor expectations in which they both operate.
- The Group should not force through change in the subsidiary, but understand the practical challenges the subsidiary may face.
- Where the Group is behind, the subsidiary can lead, providing clear reasons for its actions (e.g. regulatory and stakeholder expectations, or business opportunities).

Governance and processes

- Integrating as much dialogue as possible into the well-trodden business planning and risk appetite-setting processes between Group and subsidiaries will be helpful.
- Firms may want to consider a conference of Group and subsidiary chairs, or of chairs and NEDs.

Disclosures

- External commitments need to go through robust governance prior to being announced including involvement of subsidiary boards and governance arrangements.
- Link work underway on the transition plan to Consumer Duty Programmes. Some of the practical approaches to client engagement and client disclosure are currently being reviewed and updated and now is a helpful time to ensure alignment and leverage approaches.

Shared services

- Where a subsidiary is reliant on group shared services to deliver its transition plan, strong engagement will be required to ensure that the shared service centre understands the need for data and reporting, operational changes, new investment management approaches etc as a result of the transition.
- Intra-group service level agreements will need to be updated.

Conclusion

Conclusion

Firms must enhance their governance and culture to deliver on their transition plan

- If firms are to meet their net zero commitments and develop, disclose and execute credible transition plans, they will need to enhance their governance and culture through a combination of actions.
- They should focus on:
  1. ***Who is responsible?*** Assign an individual/s below CEO responsible for the design and execution of the transition plan and allocate responsibilities to all involved individuals and across the three lines of defence. Board and/or Committee mandates, roles and terms of references should be updated.
  2. ***Aligning priorities.*** Boards and CEOs must drive buy-in across the firm, backed up by aligned remuneration and incentives. Governance structures should be effective in cascading the transition strategy horizontally and vertically.
  3. ***Making it real.*** Transform the culture across the firm, so that every employee understands their role in the transition and that every action they take to reduce emissions helps.
  4. ***Group versus subsidiary.*** Leverage existing channels and processes to reconcile differences between Group and subsidiaries and ensure strong internal communication and debate.
- With the findings of the Intergovernmental Panel on Climate Change that we have a "brief and rapidly closing window to secure a liveable future", firms have no time to delay.

Questions for the Board:

? *Do we have a clear understanding of our climate commitments and are we receiving sufficient information to allow us to judge whether we are doing enough to meet them?*

? *How have our climate commitments and transition strategy influenced major decisions? E.g. have we turned down a client or business?*

? *Do we know what our actions are this month/quarter in relation to meeting our climate commitments and are there clear deadlines?*

? *If we asked our staff what their priorities are this week, would any of them say designing or executing the transition plan?*

? *How confident are we in being able to measure and report on the impact and outcomes of our strategic climate initiatives?*