Climate & Corporate Governance Public Seminar

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Corporate Climate Governance

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International Climate & Sustainability Governance Measures

- Climate & Sustainability Reporting Mandates
  - Task Force on Climate-Related Financial Disclosure (climate) →
  - International Sustainability Standards Board (ISSB) (climate & sustainability)
- EU Corporate Sustainability Reporting Directive (CSRD) (2022)/ESRS (2023)
- EU Corporate Sustainability Due Diligence Directive (CS3D)
- OECD Corporate Governance Principles (2023)

What is the impact of climate & sustainability disclosure regulation on how we define and measure ‘good’ corporate governance?

Defining Corporate Governance

"Corporate governance involves a set of relationships between a company's management, board, shareholders and stakeholders. Corporate governance also provides the structure through which the company is directed and its objectives are set, and the means of attaining those objectives and monitoring performance are determined."

~ G20/OECD Principles of Corporate Governance (2023)

‘Good’ Corporate Governance Indicators

Internal Governance

– board characteristics (diversity, size, independence)

– strong shareholder rights (action by written consent; power to call meetings; director nomination/appointment/removal power)

– executive compensation incentives

External Governance

– shareholder activism & engagement

– transparency (disclosure)

– market for corporate control

– private litigation & public enforcement

– creditor monitoring

Measuring Good Governance – low agency costs, strong shareholder rights, minority shareholder protection, high financial performance

- Corporate Governance Indices – Gompers et al ‘G-Index’ (2009) ;Black et al 2017.

Good Governance & Sustainability?

- Board capacity/expertise on sustainability contributes to board efficiency (Aguilera et al JOM 2021)
- Bidirectionality of internal 'good governance' measures and sustainability (or CSR) (Ludwig & Sassen 2022)
- Board independence & diversity promote sustainability (or CSR) (Velte 2022)

But Drawbacks of Stakeholder-Oriented Decision Rules (& Fiduciary Duties)?

- Stakeholderisms' Revival in (Western) Corporate Purpose Debates

enlightened shareholder value | new corporate governance | responsible capitalism | sustainable corporate governance | shareholder welfare | enlightened value maximization

The Two Masters Problem (Easterbrook & Fischel (1991); Bebchuk & Tallarita (2020); Miller (2022)

- Higher agency costs to shareholders – Multiple 'masters' shields management from scrutiny
- Inefficient (in contrast to shareholder wealth maximization) → no benefits to stakeholders
  - No fair way to make 'tradeoffs' among stakeholders
  - Ambiguous decision rule for management
  - Impracticable
- Value-reducing

Lucian A Bebchuk & Roberto Tallarita, 'The Illusory Promise of Stakeholder Governance.' (2020) 106 *Cornell LR* 91

Robert Miller, 'How Would Directors Make Business Decisions Under a Stakeholder Model?' 77 *Business Lawyer* 773 (Summer 2022)

And the debate continues:

Colin Mayer, 'Shareholderism versus Stakeholderism – A Misconceived Contradiction. A Comment on "The Illusory Promise of Stakeholder Governance" by Lucian Bebchuk and Roberto Tallarita' (2022) 107 *Cornell LR* 1859

Holger Spamann & Jacob Fisher, 'Corporate Purpose: Theoretical & Empirical Foundations/Confusions,' ECGI Working Paper (2022)

Dirk Schoenmaker, Willem Schramade & Japp W Winter, Corporate Governance Beyond the Shareholder and Stakeholder Model, working paper (2022) (developing an integrated measure for corporate value)

Task Force on Climate-Related Financial Disclosure (TCFD) Framework

TASK FORCE ON CLIMATE-RELATED FINANCIAL DISCLOSURES

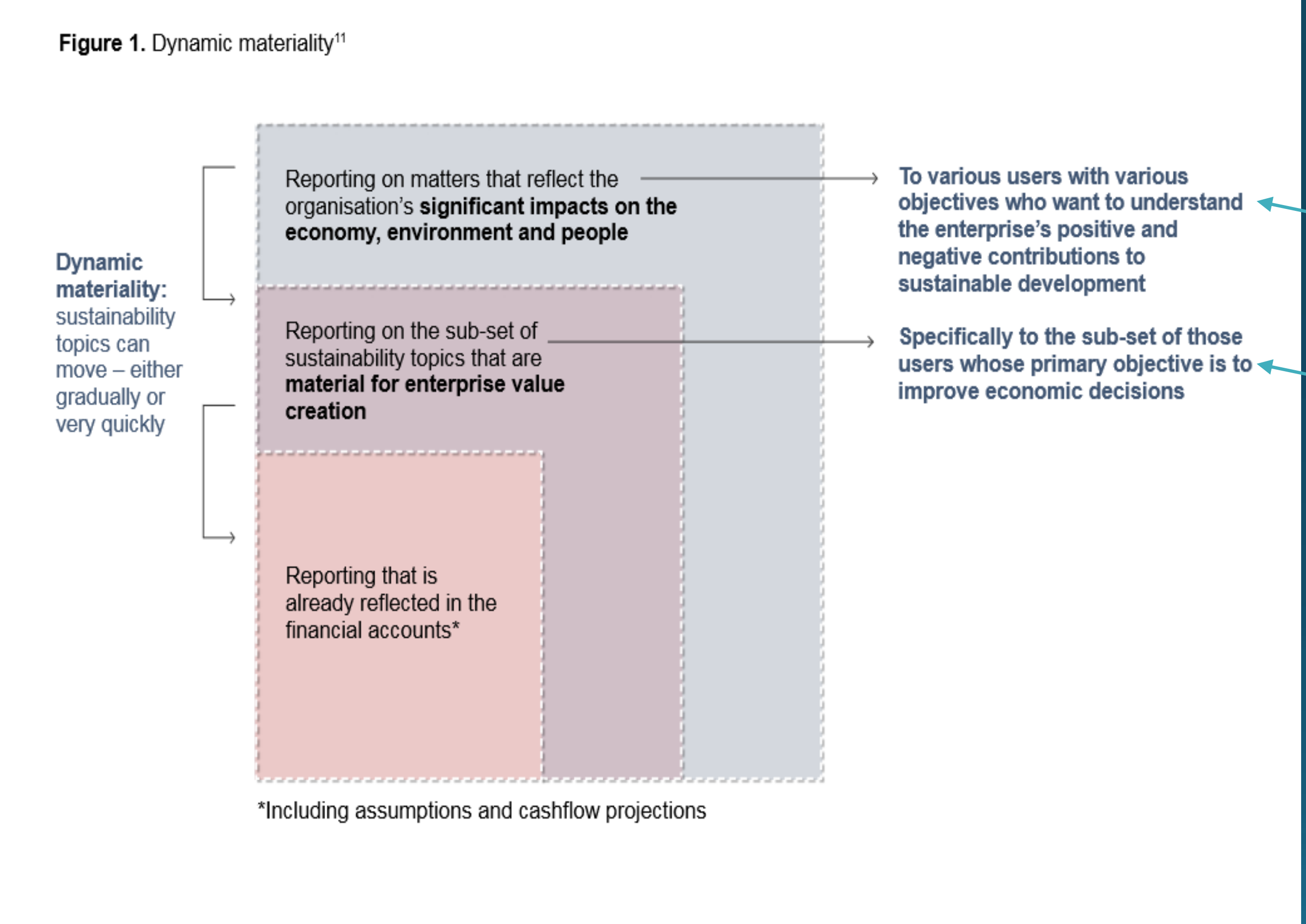
Figure 8. The Recommendations of the Task Force on Climate-related Financial Disclosures

Governance	Strategy	Risk Management	Metrics and Targets
Disclose the organization's governance around climate-related risks and opportunities.	Disclose the actual and potential impacts of climate-related risks and opportunities on the organization's businesses, strategy, and financial planning where such information is material.	Disclose how the organization identifies, assesses, and manages climate-related risks.	Disclose the metrics and targets used to assess and manage relevant climate-related risks and opportunities where such information is material.
Recommended Disclosures	**Recommended Disclosures**	**Recommended Disclosures**	**Recommended Disclosures**
a) Describe the board's oversight of climate-related risks and opportunities.	a) Describe the climate-related risks and opportunities the organization has identified over the short, medium, and long term.	a) Describe the organization's processes for identifying and assessing climate-related risks.	a) Disclose the metrics used by the organization to assess climate-related risks and opportunities in line with its strategy and risk management process.
b) Describe management's role in assessing and managing climate-related risks and opportunities.	b) Describe the impact of climate-related risks and opportunities on the organization's businesses, strategy, and financial planning.	b) Describe the organization's processes for managing climate-related risks.	b) Disclose Scope 1, Scope 2, and, if appropriate, Scope 3 greenhouse gas (GHG) emissions, and the related risks.
	c) Describe the resilience of the organization's strategy, taking into consideration different climate-related scenarios, including a 2°C or lower scenario.	c) Describe how processes for identifying, assessing, and managing climate-related risks are integrated into the organization's overall risk management.	c) Describe the targets used by the organization to manage climate-related risks and opportunities and performance against targets.

Defining Corporate Climate Governance

Source	Definition of Governance
TCFD (2017)	"The organization's governance around climate-related risks and opportunities."
CSRD – ESRS1 (2023)	"The governance processes, controls and procedures the entity uses to monitor and manage sustainability-related risks and opportunities."

'Thin' Corporate Climate Governance



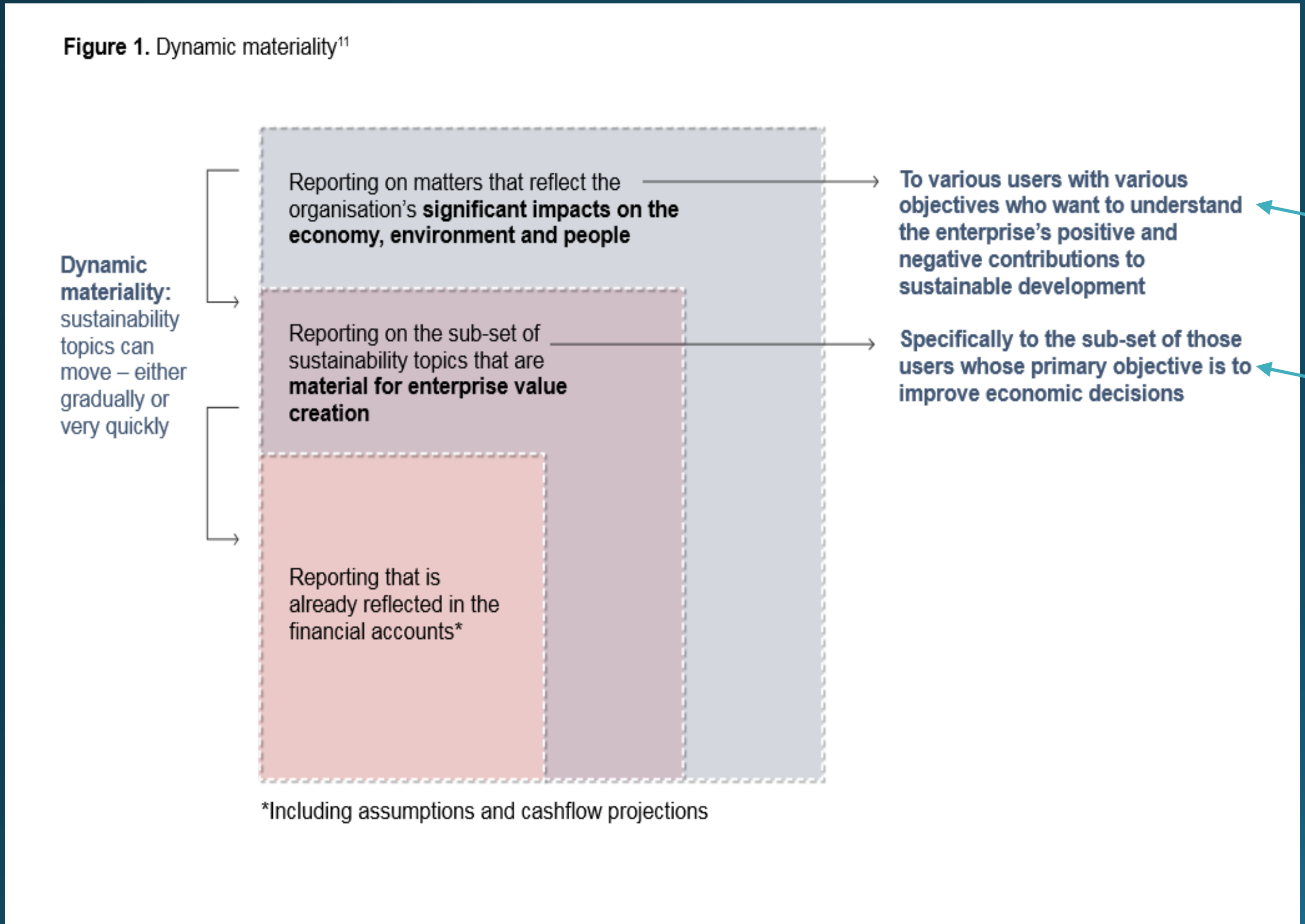
Double materiality

Single materiality

ESG Factors within Scope of 'Thin' Corporate Climate Governance

Source: ISSB Alliance Statement of Intent – Corporate Reporting (Sept 2020).

'Thick' Corporate Climate Governance



Double materiality

Single materiality

ESG Factors within Scope of 'Thick' Corporate Climate Governance

Source: ISSB Alliance Statement of Intent – Corporate Reporting (Sept 2020).

‘Thin’ & ‘Thick’ Corporate Climate Governance

<u>Thin Conception</u>

- Climate/ESG risk disclosure
- Climate/ESG risk integration into ERM function, internal financial controls
- GHG emissions monitoring

<u>Thick Conception</u>

- Climate/ESG risk disclosure
- Climate/ESG risk integration into ERM function, internal financial controls
- GHG emissions monitoring
- Climate/sustainability impact monitoring
- Strategy/Goals:

- Climate/sustainability impact mitigation
- Consumption reduction
- Corporate resilience

Corporate Governance Dimensions	Conventional Corporate Governance (Shareholder Primacy View)	Corporate Climate Governance
Corporate Purpose	Long-term shareholder value Long-term firm value **Shareholder wealth maximization** Enlightened shareholder value (Keay 2013)	Long-term shareholder value Long-term firm value Enlightened shareholder value Shareholder welfare maximization (Hart & Zingales 2022) **Long-term firm value optimization (resource bounded)**
Principal-Agent Costs Addressed	Shareholder-management conflict Majority-minority shareholder conflict	Shareholder-management conflict Majority-minority shareholder conflict **Shareholder-stakeholder conflict**
Risk Oversight & Risk Management	**Board discretion*** Stakeholder-informed **Goal: incentivize managerial risk-taking** (ie shareholder alignment) *subject to shareholder direction	**Climate-bounded board discretion*** Stakeholder-integrated **Goal: incentivize managerial risk management and mitigation** *subject to shareholder direction
Board Strategy	Climate/sustainability/resilience-**neutral/blind**	Climate/sustainability/resilience -**focused**
Profit-Sacrificing to Reduce Climate & Sustainability Impacts	**Permitted only if value-enhancing or otherwise in the interests of shareholders**	**May be required to *preserve* assets**

What's New?

'Thin' Corporate Climate Governance is More Revolutionary Than We Think.

'Thin' (single-materiality) forms of corporate climate* governance requires stakeholder-integrated decision-making and a climate-first corporate strategy.

'Thick' Corporate Climate Governance is Less Revolutionary (Anarchy?) Than We Think.

'Thick' (double-materiality) corporate climate* governance prioritizes climate and *certain* other material ESG risks with external enforcement mechanisms, transparent quantitative and qualitative measures, and independent assurance. It therefore deals with the 'Two Masters Problem' -- the central criticism of stakeholder-oriented corporate governance rules, and related agency cost and efficiency concerns.

*or sustainability

A transformation of corporate governance perhaps? . . . .

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