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Climate Change: A Board Level Consideration

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In this update we consider the duties of Guernsey directors in relation to climate change as part of Guernsey Green Finance's Sustainable Finance Week 2021.

The climate crisis

The Intergovernmental Panel on Climate Change (**IPCC**), a UN body comprising 195 member countries and a global group of hundreds of leading scientific experts, states that '*warming of the climate system is unequivocal*'[1] based on scientific evidence and that they are now '*95 percent certain that humans are the main cause of current global warming*'[2].

Practices such as deforestation, fossil fuels and intensive agriculture are not sustainable at current levels. The UN notes, for example, that '*should the global population reach 9.6 billion by 2050, the equivalent of almost three planets could be required to provide the natural resources needed to sustain current lifestyles*'[3]. Such practices are also harmful to the planet. The world's average surface temperature has risen by approximately 1°C since pre-industrial levels and the increase will surpass 1.5°C between 2030 and 2052 unless action is taken to reduce greenhouse gas emissions by 2030[4]. With its goal to limit global warming to a threshold of 1.5°C (or at least well below 2°C), the Paris Agreement came into force on 4 November 2016 and was adopted by 196 parties. The difference between 1.5°C and 2°C seems slight, but the IPCC reports that this half a degree increase alone would see the number of people exposed to climate-related risk increase by several hundred million by 2050[5].

Why push climate change to the top of the list?

The World Health Organisation has long warned of the dangers in the increase of global health crises brought about by climate change[6], raising the concern that, unless significant climate change related goals are met, COVID-19 is unlikely to be the last such pandemic. Further, the economic down turn and lockdown measures brought about by COVID-19 have only served to reinforce boards' awareness of the impact such global events have on their companies' business.

Board considerations relating to climate risk

Whilst Guernsey has shown leadership and reinforced its reputation for innovation with its range of green financial services products, it has not yet introduced mandatory reporting standards, sensibly waiting to see

[1] https://www.ipcc.ch/site/assets/uploads/2018/02/AR5_SYR_FINAL_SPM.pdf
[2] https://www.ipcc.ch/site/assets/uploads/2018/02/SYR_AR5_FINAL_full.pdf
[3] https://www.un.org/sustainabledevelopment/sustainable-consumption-production/
[4] https://www.ipcc.ch/site/assets/uploads/sites/2/2019/06/SR15_Full_Report_High_Res.pdf
[5] https://www.ipcc.ch/site/assets/uploads/sites/2/2019/06/SR15_Full_Report_High_Res.pdf
[6] https://www.who.int/health-topics/climate-change

where international consensus will land. This does not mean, however, that directors of Guernsey companies can ignore climate risk issues. Here are some reasons why:

Duties & responsibilities

Directors of a Guernsey company owe fiduciary duties to that company, to act in what they honestly consider to be the best interests of the company. This duty includes that of exercising independent judgement, overseeing the company and keeping oneself sufficiently informed to make decisions.

In addition, directors owe a duty of skill and care to their company, the standard of care being that of a reasonable person having the director's own knowledge, skill and experience, and that which may be reasonably expected of someone with the director's function. Factors which may be used to evaluate the level of diligence and skill reasonably expected of a director include the role of the director in the governance and management structure of the company, the skill which the director has held themselves out as having and the size and nature of the business. Whilst a Guernsey court will not lay down any particular steps that a director must take to discharge their duty, case law provides a general standard against which the court will examine the facts and circumstances for evidence of whether appropriate care, diligence and skill was exercised. Accordingly, a director may be in breach of their duty, irrespective of whether the director honestly believes that they acted with proper skill and diligence.

Whether and how climate change is material to a particular company and over what period is entirely fact sensitive. A board of a fund whose property portfolio is exposed to flooding from rising sea levels would be abdicating its duties if it did not consider, or chose to ignore, the impact of climate change. Businesses in other sectors may be almost entirely unaffected.

However, we would expect all boards to consider their climate competence in light of the business being undertaken and, where appropriate, whether they have been sufficiently briefed on climate related risks to enable them to discharge their duties, their oversight of the business, its governance and risk management framework.

Disclosures

Whilst Guernsey as a jurisdiction has not introduced mandatory climate change reporting, Guernsey companies may be caught by international measures. By way of example, the EU's regulation on sustainability related disclosures in the financial services sector (**SFDR**), the Level 1 text of which came into force earlier this year, requires pre-contractual and periodic disclosures at an entity and product level, with Guernsey AIFMs who are actively marketing within the EEA seemingly caught[7].

Insufficient or misleading disclosures could lead to regulatory investigation, reprimand, fines and investor action for mis-selling, in addition to reputational damage.

Code of Corporate Governance

Finally, it is worth noting that the Guernsey Financial Services Commission (the **Commission**) is consulting on proposals to amend the Finance Sector's Code of Corporate Governance (the **Code**) to take specific account of climate change considerations. The Code applies to all companies which hold a licence from the Commission under Guernsey's regulatory laws or which are registered or authorised as collective investment schemes. The Commission is proposing to introduce a new requirement in the Code, effective from 1 October 2021, that boards consider the impact of climate change on the firm's business strategy and risk profile and, where appropriate, make timely climate change related disclosures.

However, what is most noteworthy about the consultation is not the proposal itself, but the language used in the explanatory statement. The Commission is unequivocal that boards must consider their business strategy and risks in relation to climate change, adapt to climate change and keep abreast of international developments, including disclosure.

Conclusion

The planet must learn to adapt to climate change. Boards will need to do so too.

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[7] https://www.mourant.com/news-and-views/updates/updates-2021/grey-areas-among-the-green--the-impact-of-the-eu-s-sustainability-disclosure-measures-on-channel-islands-firms.aspx

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