
The rise of sustainability oversight committees as part of modern board governance and oversight: Practical considerations

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Abstract Given the constantly evolving landscape, the intersection between corporate governance and sustainability has become a key topic for board members, shareholders and regulators who are seeking to ensure that companies remain competitive as well as relevant. This paper outlines how boards can become more effective in formulating strategic responses to the sustainability agenda through the creation of a specific sustainability committee, which is distinct from the risk and audit committees. It presents arguments for the creation of such a capacity, illustrating them with specific examples (such as materiality assessments). Focus is placed on the interactions with other key governance bodies (the risk, audit and remuneration committees) when such a governance body is being created, and it is suggested that solely applying a risk or audit lens is not sufficient and may create additional gaps in oversight. Finally, the paper discusses how a sustainability committee can become a 'learning' governance body, accelerating a sound understanding of how sustainability considerations can affect the strategy, opportunities and risks facing the company at different levels.

Keywords: *sustainability governance, sustainability oversight, corporate governance, climate agenda, sustainability strategy, ownership, sustainability education, board oversight*

INTRODUCTION

The intersection of the financial industry and sustainability has never been more prominent than in recent years. There is now a constantly evolving landscape — marked by regulatory changes, evolving scientific insights, technology advancements, business opportunities and emerging risks — which is shaping the operations of financial institutions and the ways in which they serve their public, corporate

and private clients. Sustainability has thus become increasingly crucial for banks (as intermediaries) and corporates in order to remain competitive and relevant in today's world. As with digital transformation, taking sustainability seriously requires institutions not only to transform their risk practices and disclosures, but also to review every business division in detail. As such, it should not be looked on as just a compliance risk exercise, since

the resulting business opportunities should also be taken into consideration.

Today, sustainability should be integral to the development of a company's corporate strategy. The governance of sustainability — including climate-related risks as well as business opportunities — can be complex, since sustainability and climate issues span the value chains of the entire organisation, touching everything that it does. From a board governance perspective, the topic is so wide that it risks 'popping up' on almost every existing subcommittee of the main board. Consequently, certain (complex) institutions and corporates have decided to create separate board governance bodies focusing exclusively on sustainability.

In this paper, concrete advice and other suggestions are offered in relation to the potential organisation of such a governance structure. In particular, it is argued that the creation of a cross-business and cross-functional governance structure for sustainability and climate-related issues, spanning the multiple layers of an organisation, should be considered. The practical aspects, topics for discussion and pros and cons of such an approach will be presented, with the suggested framework seeking to simplify the complex.

A dedicated sustainability oversight committee reporting directly to the main (supervisory) board,¹ at least in this phase of the sustainability journey, could assist organisations materially when they are implementing practices to improve their sustainability. The author recognises that such a one-size-fits-all solution may not be applicable to all companies in scope, but nonetheless urges the reader to consider the benefits that such a dedicated committee may create for their company's footprint. In this paper, practical insights will be shared about why such an approach to managing sustainability may not only be beneficial to an institution, but also, at the same time, strengthen the governance surrounding materiality assessments and disclosures, among others. Such a dedicated committee may also strengthen the company's expertise through issues relating to challenge and verification.

The practical insights being presented have mostly been drawn from the financial sector, but they are equally applicable to companies in other sectors, given the complexities of their value chains.

Ultimately, the objective is to develop a governance structure that, through increased ownership and transparency, can provide the basis for boards having greater analytical capacity in terms of overseeing as well as anticipating issues relating to the sustainability and climate agenda.

BACKGROUND

The key governance challenges facing a company board involve identifying the appropriate body or bodies to discuss sustainability issues and formulating a proper strategic approach. From their inception, the regulatory frameworks that are applicable to banks (eg the Basel Committee, the European Central Bank (ECB) and the Prudential Regulation Authority [PRA]/Financial Conduct Authority [FCA]) foresaw the governance bodies having a very clear and distinct role in relation to climate-related risks.

Broadly speaking, the frameworks all requested the banking boards to assign climate-related responsibilities to committees and their members and to exercise the effective oversight of climate-related financial risks, generally stipulating that the board and senior management should identify responsibilities for climate-related risk management throughout the organisational structure. The World Economic Forum² was early in publishing eight principles to guide the boards of companies along their sustainability journeys. Similarly, the Task Force on Climate-Related Financial Disclosures (TCFD) has recommended that companies should describe their board oversight of climate-related risks and opportunities as part of their disclosures. The main idea guiding this recommendation is that such information supports evaluations by different stakeholders of whether climate-related issues are receiving appropriate board and management attention with the company. Obviously, this proper demand³ can also be found in the Corporate Sustainability Reporting Directive at the European level, where it is subject to a materiality assessment. These principles, directives and guidance documents, however, do not specify how such demands should be practically implemented across the existing governance bodies.

The traditional board governance of financial institutions comprises four key committees at

non-executive (supervisory) board level: (1) an audit committee; (2) a risk committee; (3) a nomination committee; and (4) a remuneration committee. The necessary committee structure depends on the specific nature of the company and the legal requirements. A board or delegated committee does well when it identifies ‘blind spots’ and serves as a sounding board to executive management. The classic obstacles facing boards in realising such oversight duties are mainly: (1) gaps in information, knowledge or expertise; (2) competing priorities and team dynamics; and (3) time pressures. Given the vastness of the sustainability agenda, it is not surprising that banking and corporate boards have been struggling to cover this end-to-end agenda with their existing governance bodies. Indeed, even when boards have made true commitments to sustainability and climate governance, they continue to face further hurdles when moving towards implementation.

A Boston Consulting Group (BCG) and INSEAD survey⁴ clearly demonstrated this challenge, revealing that 91 per cent of directors think that their boards should devote more time to the strategic sustainability agenda, even though more than 53 per cent of those same directors said that their boards were not doing so effectively. A special workshop by the TCFD dedicated to governance⁵ found that despite the previously mentioned recommendation to disclose board oversight of climate-related risks and opportunities, companies had remained very reluctant to do so, with this area having the lowest levels of disclosure.

So, the key question now becomes: how can boards develop effective capacity for the sustainability agenda and address such governance hurdles? Let us first explore the available options for establishing effective governance.

Leveraging existing governance bodies has limitations for the sustainability agenda

In many financial institutions, (supervisory) board risk and audit committees have frequently been requested to oversee the sustainability agenda. Some risk and audit chairs have been concerned about having to assume such a broad range of sustainability responsibilities, given existing committee workloads,

a lack of knowledge and expertise and valid observations that they can only contribute to a ‘risk and disclosure’ conversation, rather than being able to consider the full strategic impacts on the institution.

A general fear exists that when the responsibility is assigned to a risk or audit committee, a specific lens will be assigned for sustainability and the related business opportunities will be missed. To avoid such misinterpretations, the risk and audit committees could be completely effective within their own scopes (silos), but they would not be able to provide the necessary holistic thinking to address a company-wide sustainability agenda. That is, looking only through a risk or audit lens is simply not sufficient — or, to be more provocative: climate risk reporting does not create a climate strategy. It also risks positioning the agenda as merely a second or third line of defence, which it is clearly not. With corporates, for example, in the energy and construction sectors especially, the topic of climate risk has often been assigned to existing board committees, such as the health, environment and safety committee, while the disclosure of the sustainability regime has been owned by the audit committee and the issuing of the green bonds has been the responsibility of the finance committee. Consequently, it has been challenging for boards to address the overall agenda as well as the deliverables by means of these existing committees, given the vastness of the sustainability agenda and the fact that the potential connections between the various areas of oversight may be lost.

Towards a dedicated sustainability oversight committee?

The TCFD report that was published in February 2022 contained seven interesting case studies on board sustainability oversight across a range of industries, including the financial and corporate sectors. All of these companies had either added a specific governance body to deal with their sustainability agenda or materially enlarged an existing committee at the board and at executive levels — the latter being more dominant in the corporate sector, surprisingly. These companies have clearly identified the creation of such a dedicated committee as being a major accelerator for their sustainability journeys. However, the BCG and

INSEAD study⁶ from March 2022 found that only 20 per cent of companies have endeavoured to create a dedicated sustainability committee at the board level.

Before describing the scope of such a dedicated committee, it is important to note that its creation should be considered as a delegated act of the main board, meaning that it should under no circumstances be seen as the main board abdicating accountability for this agenda. Secondly, once a company board decides to create such a dedicated committee at the non-executive level, it is recommended that a similar committee be created at the executive level, with a focus on operations, among other things. Over time, the board sustainability committee and the executive sustainability committee can evolve together, creating the necessary means of escalation when required. By doing this, a company's overall governance would be further enhanced through dedicated oversight at different levels of the organisation.

The various constraints/obstacles facing boards — such as expertise and time commitments — have previously been mentioned. A dedicated sustainability committee would support the main (supervisory) board and executive management by overseeing the sustainability agenda, as delivered by executive management, in a coordinated and focused way across all functions. Most importantly, this would allow the necessary opportunities for key dialogues to occur. The creation of such a committee would also be a significant indicator of the importance and impact of the topic on your organisation for your existing and future talent.

Presuming that a company board has decided to create such a dedicated committee, let us now consider the potential scope and duties of such a committee.

SCOPE AND DUTIES OF A DEDICATED SUSTAINABILITY OVERSIGHT COMMITTEE

Like any other subcommittee of the (supervisory) board, the committee should have a dedicated charter or terms of reference. Such a committee should also have a forward-looking agenda that is annually planned. The frequency of its meetings

should match those of the other committees of the board (at least quarterly, ideally). Overall, it is noticeable that the financial institutions and corporates that have decided to create such a dedicated committee have been actively publishing their terms of reference. Practitioners should closely review these when drafting their own charters or terms of reference, since this provides a magnificent learning opportunity.

A sustainability oversight committee as a dedicated committee of the board should oversee the following key elements:

- (1) The sustainability strategy (including the materiality assessment) and targets. The sustainability oversight committee determines the priority issues that need to be focused on as part of the sustainability strategy, including the short, medium and long-term goals. These may be disclosed to the public, with the agreement of the main board or supervisory board, underlining their subcommittee origins. On a related note, it is impossible for a sustainability committee to provide proper oversight if it fails to define and understand (double) materiality, including the very wide range of sustainability matters. Such a materiality assessment should mainly comprise (1) a financial lens and (2) an impact lens. From the financial perspective, this would not be fundamentally different to how a risk committee traditionally manages the material risks to a business — rather, the nuance would come with the following consideration of the potential impacts. Business functions, as well as risk management, should offer opinions on the material impacts on the business and value chains (eg procurement in relation to suppliers). Such impact assessments can only be fully achieved by the relevant experts or owners who comprehensively understand the potential impacts on the organisation and its value chain. As such, it would be better for this part of the assessment to be performed by a sustainability committee rather than a risk committee. As part of the (double) materiality assessment, the committee would be informed of stakeholders and their participation in the company's sustainability strategy, policies and practices.

- (2) The provision of independent expertise and a critical external view across a range of sustainability topics at both the national and international levels.
- (3) Offering advice on sustainability policies and programmes that are potentially subject to public issues and risks that may impact the company and its stakeholders. If the sustainability department is under the risk committee, it should be able to challenge such policies and prevent any conflicts, but if there is a distinct sustainability committee, then it would be able to identify and own such policies itself. Indeed, a dedicated sustainability committee would own the commitments and programmes relating to net zero, emissions and diversity and inclusion targets, whereas a risk committee would be limited to focusing on the regulatory commitments relating to sustainability (eg the climate and environmental risks identified by the ECB or PRA).
- (4) Offer advice on the evolution of the company's sustainability governance. In this respect, the performance of the committee would be evaluated by the main board.

Furthermore, a dedicated sustainability committee should also oversee the key sustainability metrics (eg the collection and analysis of greenhouse gas emissions) and the relevant climate and transition scenarios, as well as monitor the organisation's overall progress in realising its sustainability goals. This would support the general transition to a low-carbon or net zero economy, while also developing, improving and overseeing the company's specific sustainability targets. Environmental or socially related targets could also be linked with remuneration, provided that the true long-term impacts are considered in management's individual and collective goals. A sustainability committee, with its obvious responsibility for an organisation's sustainability strategy, could thus coordinate the inputs and provide the required details for final endorsement from the remuneration committee. A remuneration committee may not fully appreciate the complexity of the technical requirements in setting such targets, but the sustainability committee could do so with appropriate justifications and evidence, although ongoing care will need to be taken to ensure that this role remains sufficiently

independent (eg ensuring that the scorecards are not being designed by the head of sustainability).

Finally, such a dedicated committee would oversee and discuss the related disclosures, including the required data and the accompanying reporting infrastructure, although the role of the auditor should also be considered in relation to such sustainability disclosures. The committee should submit the disclosure work to the main board or supervisory board for approval at least once per year, as determined by the applicable annual disclosure regime. Important additional roles to be included in such a charter or terms of reference would include reviewing the company's environmental, social and governance ratings and advising the remuneration committee on sustainability-related key performance indicators to be included in long-term remuneration evaluations.⁷

SUGGESTED MEMBERSHIP OF A DEDICATED SUSTAINABILITY OVERSIGHT COMMITTEE

Similar to the other key committees of the board (such as risk and audit), the chair would be a non-executive independent director. Given the vastness of the area, the knowledge and expertise of the sustainability committee members should be matched by the committee's scope of responsibilities, as established in the charter or terms of reference. Cross-functional participation is the key to success. It also needs to be recognised that industry, overall, lacks board members with the required knowledge, given the constant evolution of this area in terms of risks and opportunities. This gap in understanding and expertise — so-called 'climate competency' — is often quoted as a material hurdle by boards. As such, ongoing commitments and investments in education would be key to committee members keeping up with new developments in the area. Indeed, external education is available to such members through various organisations. Among others, the Chartered Banker Institute launched in early 2018 a certificate in green and sustainable finance to help individuals develop their knowledge and ability in applying the key principles and core practices of green and sustainable finance. Their 'INTEGRITY'⁸ principles also assist practitioners in

incorporating sustainability concerns into their everyday decision making. To continue closing this competency gap, board directors across industries should also explore the sustainability trainings offered by the national director associations, climate governance initiatives (like Chapter Zero) and the sustainability executive education offered by the main business schools.

From experience, a broad range of disciplines and backgrounds are tremendously valuable for sustainability oversight committees. Business product thinking, disclosure, regulatory and audit skillsets, in addition to sustainability and climate and environmental risk skillsets, are all value-adding competencies. Clearly, the members of the committee will have different and complementary skills, but the richness of the resulting dialogue and the ongoing oversight would help the company and its stakeholders on their sustainability journeys. In this respect, the sustainability committee would also thus become a ‘learning’ governance body, thanks to the widespread interactions and dialogue that would occur when dealing with the matters facing the committee, rather than having to rely on only one or two members with specialised sustainability knowledge. By reviewing and reading the papers of the sustainability committee, engaging in discussions at the committee, listening to expert external speakers and receiving specific committee trainings, the non-technical members will have significant technical upskilling opportunities. Essentially, this would be a form of learning about sustainability by ‘osmosis’, which would accelerate the ‘tone from the top’ relating to sustainability. If it is properly executed, it will drive a cascade of learning requirements through the organisation, from the very top level to front-line roles, helping all members of the company to gain a sound understanding of how sustainability considerations affect its strategy, opportunities and risks.

Such a dedicated committee should therefore be supported by dedicated resources from different departments, which will further enhance the intracompany collaboration that is needed to be successful in this area — and may even also accelerate innovation.

Besides the obvious time dedications and focuses of such committees, the companies that have made

the effort to create such a committee are finding that other benefits are emerging. Most institutions indicate that a cross-functional sustainability committee has materially deepened their knowledge, given the different perspectives that are brought to the table.

Finally, the chair of this dedicated sustainability committee would report back to the board in a structured way on the conclusions that are reached at meetings: one key deliverable is clearly the strategy for sustainability, which would ultimately be approved by the main board and embedded within or connected with the main business strategy of the company.

CONCLUSION

The establishment of a dedicated sustainability oversight committee can help a company, its directors and its stakeholders make necessary changes to the governance of the sustainability and climate change agenda, including discovery of the relevant risks and business opportunities. While this may not be a one-size-fits-all solution for all companies, the current benefits of such a dedicated committee are material. This approach would ensure the strategic integration of the sustainability and climate agenda, not only focusing necessary attention on the risks, but also, importantly, on the business opportunities. Continuing to work only with the existing governance bodies, without introducing such an additional committee, may result in additional gaps in oversight as well as unnecessary exposures.

Notes and references

- 1 The terms ‘board’ and ‘supervisory board’ have been used interchangeably, since not all jurisdictions have two-tier board structures. This paper focuses on the most senior governance body, which often features independent non-executive directors as members or participants — namely, the body of elected or appointed members who jointly oversee the activities of an organisation or company.
- 2 World Economic Forum (January 2019), ‘How to Set Up Effective Climate Governance on

- Corporate Boards: Guiding Principles and Questions', available at https://www3.weforum.org/docs/WEF_Creating_effective_climate_governance_on_corporate_boards.pdf (accessed 10th January, 2024).
- 3 The Corporate Sustainability Reporting Directive was responsible for Article 29b being inserted into the European Accounting Directive. In Article 2c.1, the directive requests companies to disclose the roles of the undertaking's administrative, management and supervisory bodies in relation to sustainability matters and their composition, as well as their expertise and skills in terms of fulfilling such roles or the access that such bodies have to the necessary skills and expertise.
 - 4 BCG and INSEAD (March 2022), 'Directors Can Up Their Game on Environmental, Social, and Governance Issues', available at <https://www.insead.edu/sites/default/files/assets/dept/centres/icgc/docs/directors-can-up-their-game-on-environmental-social-and-governance-issues-march2022.pdf?nop> (accessed 10th January, 2024).
 - 5 Task Force on Climate-Related Financial Disclosures (February 2022), 'TCFD Workshop: Session 2 — Governance', available at <https://assets.bbhub.io/company/sites/60/2022/02/TCFD-Governance-Workshop.pdf> (accessed 10th January, 2024).
 - 6 BCG and INSEAD, ref 4 above.
 - 7 One of the eight guiding principles highlighted by the World Economic Forum involves making a clear link between the sustainability strategy and remuneration. Various opinions exist on the advantages and disadvantages of such interlinkage.
 - 8 INTEGRITY: Integrate; Nurture and nourish; Target transparency; Engage with established principles and guidance; Give professional advice and guidance; take Responsibility; Inspire; Think long-term; You. The Chartered Banker Institute (10th January, 2023), 'Responsible Banking and Sustainable Finance with the INTEGRITY Principles', available at https://www.charteredbanker.com/resource_listing/knowledge-hub-listing/responsible-banking-and-sustainable-finance-with-the-integrity-principles.html (accessed 10th January, 2024).

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