NSW EDO
DEFENDING THE ENVIRONMENT
ADVANCING THE LAW

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Mr Alex Cameron AO
Chair, ASX Corporate Governance Council
Exchange Centre
20 Bridge Street
Sydney NSW 2000

By email: mavis.tan@asx.com.au

Dear Mr Cameron,

Australian Securities Exchange (ASX) Governance Council consultation draft on Corporate Governance Principles and Recommendations (3rd Edition)

As a community legal centre specialising in public interest environmental law, EDO NSW welcomes the opportunity to comment on the draft *Corporate Governance Principles and Recommendations (3rd Edition)* (**Governance Principles**) of the ASX Governance Council (**the Council**). Overall, we strongly support the explicit references to environmental and social risks under Principle 7 (risk management),[1] although we have some suggestions on how this recommendation could be clarified and strengthened. In particular:

- Reference to the *ESG Reporting Guide for Australian Companies* should be included in the Council's recommendation, rather than the subsidiary commentary;
- Reporting requirements on environmental and social sustainability risks should be more explicit and detailed, including guidance on risk types, impacts and indicators;
- Commentary should also refer to the benefits of environmental and social reporting;
- Commentary could also refer to principles of Ecologically Sustainable Development;
- Website information should support, not replace, disclosures in annual reports;
- Future progress needed on integrated sustainability reporting.

EDO NSW supports corporate governance actions that contribute to environmental protection and ecologically sustainable development (**ESD**).[2] We also recognise that improved environmental protection, and arresting environmental decline, requires proactive action and leadership across all sectors of society, including the business community.

The reporting requirements on listed entities through the ASX Governance Principles are an important means of achieving a more transparent and consistent approach to environmental and social impacts of corporations' activities. The Governmance Principles provide a more

[1] ASX Corporate Governance Principle 7 is as follows: '*Recognise and manage risk* - A listed entity should establish a sound risk management framework and periodically review the effectiveness of that framework.' Under Principle 7, a proposed new Recommendation 7.4 states that 'A listed entity should disclose whether and if so how it has regard to economic, environmental and social sustainability risks'.

[2] For two decades, Australian governments have recognised ESD through the *National Strategy for Ecologically Sustainable Development* as: 'using, conserving and enhancing the community's resources so that ecological processes, on which life depends, are maintained, and the total quality of life, now and in the future, can be increased'. See http://www.environment.gov.au/node/13029.

level playing field and greater consistency in the information that companies provide to investors and other stakeholders.[3]

As the Council's consultation papers recognise, corporate activities can have significant impacts on the environment and communities. This includes through the extraction, use and depletion of natural resources, impacts on biodiversity, land use practices and livelihoods, and pollution and waste impacts – from the local to global scale. Historically, many environmental impacts have been externalised rather than factored into the cost of production, consumption and waste disposal. For example, financial research firm, Trucost, recently estimated the *annual environmental costs* from global economic activity at about $6.6 trillion, or 11% of global GDP in 2008.[4]

In the 21st century there is a growing realisation that this approach is not sustainable in the long-term. Environmental economist, Pavan Sukhdev observes:[5]

> *…there seems to be an increasing understanding among the major stakeholders of a corporation – investors, managers and consumers – that corporations' externalities can both cause significant impact on society and can leave the corporation exposed to resource scarcity and regulatory risk. An accounting framework that takes into account these risk exposures and makes explicit the magnitude of these externalities is the obvious and necessary next step in the evolution of financial accounting. These frameworks are already developed at a rapid pace by forward-thinking corporations … and by institutions such as the Global Reporting Initiative.*

Other examples of the growing momentum to examine and disclose environmental externalities include UNEP's *The Economics of Ecosystems and Biodiversity*;[6] the actuarial profession's consideration of the risks of 'resource constraints' to traditional investment strategies in a 'finite world';[7] the US National Research Council and CSIRO support for improved accounting for 'ecosystem services' in the wake of the Deepwater Horizon catastrophe;[8] and governments in the UK and Australia exploring 'natural capital' valuation and national environmental accounts.[9]

As the Australian Government (2011) acknowledges, it is not only environmental *costs* that are often invisible to the market, but also environmental *benefits*:[10]

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[3] We note that the principles require entities to report on compliance with the Council's recommendations, or report on why they are unable to comply ('if not, why not' approach – see ASX Listing Rule 4.10.3).

[4] See Trucost, 2010, 'Universal ownership: Why Environmental Externalities Matters to Institutional Investors', cited in Sukhdev, P., *Corporation 2020* (2012), 5 and 101.

[5] Sukhdev, *Corporation 2020* (2012), 102.

[6] See Bishop et al, *TEEB - The Economics of Ecosystems and Biodiversity Report for Business - Executive Summary* (2010), United Nations Environment Program (UNEP), available at www.teebweb.org.

[7] Jones, A., Allen, I., Silver, N., Cameron, C., Howarth, C. and Caldecott, B., *Resource constraints: sharing a finite world: Implications of Limits to Growth for the Actuarial Profession*, Institute and Faculty of Actuaries, Anglia Ruskin University, Cambridge and Chelmsford, January 2013.

[8] National Research Council of the National Academies of Science (USA), 'An Ecosystem Services Approach to Assessing the Impacts of the Deepwater Horizon Oil Spill in the Gulf of Mexico', National Academies Press, Washington DC, 2013; and Lee, K. (2013), 'Buried treasure: finding safer ways to tap into oil and gas from our oceans', *The Conversation*, 1 October 2013, available at: http://theconversation.com/buried-treasure-finding-safer-ways-to-tap-into-oil-and-gas-from-our-oceans-18736.

[9] UK Department for Environment, Food & Rural Affairs, *UK National Ecosystem Assessment* (June 2011), available at: http://uknea.unep-wcmc.org; and Australian Bureau of Statistics, *4655.0.55.002 - Information Paper: Towards the Australian Environmental-Economic Accounts*, Canberra, March 2013.

[10] Australian Government, *Response to the Independent Review of the Environment Protection and Biodiversity Conservation Act 1999* (2011), 3.

> *[The] United Nations Environment Program… notes that ecosystems deliver essential services worth between US$21 trillion and US$72 trillion a year, which is comparable with the 2008 World Gross National Income of US$58 trillion. At the same time, recent international findings continue to confirm that global biodiversity is in significant and ongoing decline.*
> *To tackle the challenge of biodiversity decline we must change how we manage the natural environment. This shift is important if we are to maintain healthy and resilient life-supporting ecosystem functions and biodiversity, particularly in the face of the impacts of climate change on natural ecosystems.*

Consistent with these comments, EDO NSW strongly supports the integration of environmental and social factors into corporate decision-making; and increased transparency through the inclusion of environmental and social risk performance in corporate reporting (both mandatory and advisory). Below we make some additional specific comments on the Council's 3rd Edition Governance Principles and associated changes to ASX listing rules and guidance.

Support accurate reporting on processes to deal with environmental and social risks

As noted, EDO NSW strongly supports the addition of Recommendation 7.4 in the ASX Governmance Principles: 'A listed entity should disclose whether and if so how, it has regard to economic, environmental and social sustainability risks'. Introducing an explicit disclosure requirement for the way an entity identifies, assesses, monitors and mitigates environmental and social risks of an entity's activities is a welcome improvement (although we are less certain of the intention and meaning of 'economic risks' in this context).

In addition, to achieve the most effective outcomes from the finalised 3rd Edition, EDO NSW submits that the Governance Principles should go further in their recommendations and guidance on how companies address and report on environmental/social risks and impacts.

Reference to the *ESG Reporting Guide for Australian Companies* should be included in the recommendation rather than commentary, to reflect contemporary governance standards

The draft Commentary to recommendation 7.4 refers, at footnote 30, to the *ESG Reporting Guide for Australian Companies*[11] (**ESG Guide**) for environmental, social and governance disclosures. This reference should be moved to the end of Recommendation 7.4 itself as a more effective reporting 'trigger'. The ESG Guide provides an authoritative, market-tested guide for types of risks, impacts, indicators and metrics that companies should, *at a minimum*, provide information on – and measure performance against.[12] If these risks and indicators are not relevant, reporting entities should explain 'if not, why not'.[13]

In line with the Council's logic in other areas of its consultation paper, we submit that the environmental matters in the ESG Guide should no longer be regarded as guidance, but rather contemporary governance standards that, if not followed, warrant an explanation as to why they are not being followed. The ACSI and FSC envisaged that 'companies should realistically be able to adopt this reporting Guide for their 2011/12 annual reporting.'[14] By the time the final 3rd edition comes into effect in mid-2014, the ESG Guide will have been available for three years. Another comprehensive review of the ASX Governance Principles may not occur for a further five years more.

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[11] Australian Council of Superannuation Investors and the Financial Services Council, June 2011.

[12] The ESG Guide (at 13-17) refers to 4 types of environmental risks and impacts – climate change contributions (direct and indirect) and adaptation risks; environmental management systems and compliance; efficiency of waste, water and energy; and other environmental issues (e.g. biodiviersity, toxics etc).

[13] As suggested in the ESG Guide (2011), 7.

[14] ESG Guide (2011), 7.

We note the Council's comments on why recommendation 7.4 is not more prescriptive.[15] However, noting the considerable overseas and Australian progress on 'integrated reporting' and identifying externalities, we submit that more concrete reporting recommendations will assist compliance, create a more level playing field, and support consistent performance.

Referring to the ESG Guide in Recommendation 7.4 would balance flexibility with clarity and effectiveness, and reflect investor and stakeholder expectations. Specific reference to ESG Guide indicators would also aid listed entities to disclose 'benchmarks' for performance measurement (noted in the commentary); and fulfil the new requirement in Principle 7 for listed entities to 'periodically review the effectiveness' of their risk management frameworks (which we support).

Reporting requirements on environmental and social sustainability risks should be more explicit and detailed, including guidance on risk types, impacts and indicators

The commentary to Recommendation 7.4 acknowledges the importance of sustainable activities to avoid long term impacts on local communities, broader society and the environment (draft Governance Principles, p 28). This commentary would benefit from further examples of appropriate compliance in disclosing whether, and how, an entity 'has regard' to economic, environmental and social sustainability risks. This could be similar to the suggestions and information boxes provided for Recommendations 1.5, 2.1, 3.1 and 8.2.

Commentary should also refer to the *benefits* of environmental and social reporting

The commentary on recommendation 7.4 informs entities of Australian and overseas initiatives that have emerged in response to demand for greater environmental, social and governance (**ESG**) reporting. In addition to this important guidance, the commentary could provide more information on the benefits of ESG reporting, to encourage entities to embed a more comprehensive approach to environmental risk management and reporting.

A greater focus on environmental risk management and reporting requirements can have a range of co-benefits for the community, environment, investors and companies. For example, the benefits for companies include:

- understanding strengths, weaknesses and true costs and benefits of their operations;
- ability to minimise and respond to environmental and social risks in an informed way;
- preparedness and resilience against operational failures (spills, leaks, contamination, other pollution) and environmental emergencies (floods, drought, climate change);
- avoiding reputational damage from environmental incidents or loss of social licence;
- reduced exposure to risks of regulation of environmentally damaging activities; and
- new business opportunities as a result of identified cost-savings, efficiencies and other competitive advantages.

Commentary could also refer to principles of Ecologically Sustainable Development

The commentary on recommendation 7.4 could also usefully refer to the principles of ESD, which underpin various Australian planning and environmental laws and decision-making.[16] ESD provides a framework to redress common imbalances in information and procedures,

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[15] See Council consultation paper (August 2013), para 88: 'Notwithstanding these developments internationally [and the joint publication by ACSI and the FSC of *ESG Reporting Guide for Australian Companies* (June 2011)], the Council considers that it would be premature to expect listed entities in Australia to adopt integrated reporting until the international framework for such reporting is much better developed than it currently is.'

[16] See, for example, *Environment Protection and Biodiversity Conservation Act 1999* (Cth), ss 3-3A. See also Protection of the Environment Administration Act 1991 (NSW), s 6; *Sustainable Planning Act 2009* (Qld), ss 3-8.

by requiring that 'decision making processes should effectively integrate both long and short-term economic, environmental, social and equity considerations.'[17] ESD principles include:

- adopting a precautionary approach when dealing with serious environmental risks and scientific uncertainty;
- conservation of biodiversity and ecological integrity as fundamental considerations in decision-making;
- considering intergenerational and intragenerational equity; and
- promoting improved valuation, pricing and incentive mechanisms (including the 'polluter pays' principle).

Website information should support, not replace, disclosures in annual reports

The Council seeks feedback on its proposal to allow listed entities to make their corporate governance disclosures on their website rather than in their annual report.[18] Although we support the increased use of an entity's website for information regarding its corporate governance and environmental risks, we submit that this should be framed *in addition to*, not as a substitute for, disclosures in annual reports. Websites have the benefit of convenience and accessibility, but these same features allow for frequent changes to information. On the other hand, an annual report can provide an authoritative snapshot that can be compared year on year by investors and stakeholders. Also, as the Council suggests, the annual report should provide website links to more detailed or updated information.

In relation to another issue of transparent access, we support the introduction of Appendix 4G to the ASX Listing Rules, which will provide information in one document about a listed entity's corporate governance disclosures and where those disclosures are located.

Future progress needed on integrated sustainability reporting

The Council's consultation paper (para 88) indicates a number of issues that it believes should be progressed to provide for a more mature international framework of 'integrated reporting' for environmental and other sustainability. Having identified these issues, we would welcome the Council's further involvement in progressing this important work.

In the meantime, we submit that recommendation 7.4 of the ASX Governance Principles should be clarified and strengthened as outlined in this submission, so that all stakeholders can benefit from more transparent, environmentally-sound strategies for investment and development.

We hope this submission assists the Council in finalising the ASX *Corporate Governance Principles and Recommendations (3rd edition)*. For further information please contact me on 02 9262 6989.

Yours sincerely,
EDO NSW

Mr Nari Sahukar
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[17] *National Strategy for Ecologically Sustainable Development*, agreed by Council of Australian Governments, 1992. See also footnote 2 above.
[18] See Council consultation paper (August 2013), para 13.