

27 July 2018

ASX Corporate Governance Council
c/o ASX Limited
PO Box H224
Australia Square NSW 1215

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

Submission to consultation draft of the Corporate Governance Principles & Recommendations (4th edition)

Who we are

Australian Ethical Investment Limited was established in 1986 to manage the retirement and other savings of Australians in an environmentally and socially responsible way. Today we manage over \$2.8 billion in superannuation and managed funds for over 40,000 Australians in accordance with our [Australian Ethical Charter](#). The Charter guides us to avoid investments that harm people, animals and the environment and to seek out investments that support a sustainable future. Australian Ethical is publicly listed on the Australian Securities Exchange (ASX: AEF) and is one of the fastest growing wealth companies in Australia¹.

As a super fund we invest with long term interests and responsibilities across society and the economy. This perspective is important to consider alongside the voices of individual companies, industries and civil society groups which often focus on narrower business, social or environmental interests.

Our submission

Introduction

Thank you for the opportunity to comment on the ASX Corporate Governance Council's consultation draft of the fourth edition of its *Corporate Governance Principles & Recommendations (CGPR)*.

Australian Ethical largely supports the recommended changes to the CGPR, and in particular supports the proposed:

- commentary on how companies should approach corporate governance disclosures;
- changes to Recommendation 1.5 (diversity);
- new Recommendation 2.7 (ensuring that directors can participate in meetings in a language in which they are fluent)
- changes to Principle 3 and the associated commentary (culture of acting lawfully, ethically and in a socially responsible manner, and acknowledging the importance of a social licence);
- new Recommendation 3.1 (articulate and disclose core values);
- new Recommendation 3.3 (have and disclose a whistle blower policy);

¹ Our superannuation fund was the fastest organically growing fund in 2016 and 2017 (KPMG Super Insights Reports 2016 & 2017).

- new Recommendation 3.4 (have and disclose an anti-bribery policy)
- new Recommendation 4.4 (disclose the validation process used for corporate reports);
- new Recommendation 5.2 (provide ASX announcements to Board members)
- new Recommendation 5.3 (release investor and analyst briefings prior to the relevant meeting)
- amendments to the commentary on Recommendation 6.2 (investor relations program, especially the statement that ‘where significant comments or concerns are raised by investors, they should be conveyed to the entity’s board and relevant senior executives’);
- new Recommendation 6.4 (conduct all votes at shareholder meetings by way of a poll)
- amendments to the commentary on Recommendation 7.4 (acknowledging the importance of a social licence, suggesting that entities that believe they do not have any material exposure to environmental and social risks should consider carefully the basis for that belief and benchmark against their peers, and giving greater guidance on the disclosure of climate change risk);
- amendments to the commentary on Principle 8 (the additional statement that ‘an entity’s remuneration policy should not reward conduct that is contrary to the entity’s values’);
- amendments to the guidelines for executive remuneration in box 8.2 (the additional statement that targets for performance-based remuneration should be consistent with the company’s values, among other things).
- new Recommendation 8.4 (procedures around consultancy services provided by directors and senior executives and their related parties);

In our view these changes will guide companies to more effectively and responsibly govern themselves, including manage their social and environmental impacts and improve investor understanding of those impacts and their management. We already follow the recommended new principles 3.1, 3.3, 5.2, 5.3 and 6.4, and we intend to implement 2.7, 3.4, 4.4 and 8.4 to the extent we are not fully compliant already.

We also support the submissions of the Financial Services Council, Principles for Responsible Investment and Responsible Investment Association of Australasia (with Australian Ethical being a member and signatory to these organisations and principles).

One broad and important area where we perceive a significant gap in the CGPR (both in the current and proposed new version) is the absence of any explicit reference to animal welfare. In our view improved management and reporting on animal welfare issues is particularly important in the Australian context. Animal welfare including biodiversity concerns impact companies in the agriculture, food retail, health, cosmetic, fashion, entertainment, gambling, transport, construction, mining, logging, banking and insurance industries. Recent events in Australia and overseas demonstrate that poor animal welfare can drastically damage a company’s, and even an industry’s, social licence to operate and can impact consumer demand, profits and share prices. As a result, there is growing investor and other stakeholder interest in animal welfare issues. Accordingly the CGPR should be encouraging companies to report on animal welfare risks or metrics where relevant. In our view, only minor clarifications to the CGPR are necessary to do this.

Importance of companies managing animal welfare risks

The Australian public have become increasingly concerned about the way in which animals used for commercial purposes are managed and cared for. The 2016 Productivity Commission report on the Regulation of Australian Agriculture recognised that Australians place a value on animal welfare and that poor animal welfare can be considered a negative externality on society.²

Exposures of animal cruelty can also have sudden and significant impacts on businesses and entire industries. For example in 2013 the release of the documentary 'Blackfish' had an ongoing and significant impact on SeaWorld's visitor numbers, profits and share price in the United States.³ In Australia, the greyhound racing industry suffered a severe setback after a 2015 Four Corners program showed evidence of systemic live baiting practices. Greyhound racing was subsequently banned in the Australian Capital Territory and was very close to being banned in New South Wales. In Queensland the government inquiry led to the sacking of all race administrators and the state government scrapped construction of a proposed new greyhound racing track in Logan. The impact of this was felt by companies like Tabcorp, which had a significant drop in share price when the New South Wales government announced a ban on greyhound racing.⁴

The impact that evidence of animal cruelty can have on an industry has been evidenced most acutely in relation to the live export industry. In 2011, the live export industry lost its social licence almost overnight after footage emerged of Australian animals being subjected to extreme animal cruelty in Indonesian abattoirs. The Federal government immediately suspended the live export of cattle from Australia to Indonesia. This had flow on effects throughout the supply chain, impacting producers, livestock logistic providers and domestic transport companies as well as the exporters themselves.⁵ In 2013, the ASX-listed Australian Agricultural Company reported a \$46.5 million loss which it blamed in part on the 2011 suspension.⁶

The social licence of live export companies was again challenged after a 60 Minutes program in April this year showed extreme animal cruelty on live export ships. The viability of the live sheep export trade is now under threat on multiple fronts. The Labor party announced it would ban the live sheep export trade if elected to government and numerous Liberal party members have stated they support a ban. The Department of Agriculture has suspended Emanuel Exports' licence, effectively bringing the live sheep export trade to a temporary halt. And in the absence of an outright ban, there remains the prospect of regulatory changes and improved enforcement of regulation that could make the trade commercially unviable.

Animal welfare issues can also have a less acute but nevertheless significant impact on businesses and industries as public concern translates to changes in consumer demand. For example, in Australia public support for caged egg products has been dropping, and caged eggs now make up less than 50% of egg sales.⁷

² Productivity Commission report on the Regulation of Australian Agriculture (2016) p 204.

³ <http://time.com/3987998/seaworlds-profits-drop-84-after-blackfish-documentary/>

⁴ <https://www.businessinsider.com.au/tabcorp-shares-get-hit-as-greyhound-racing-is-banned-2016-7>

⁵ [https://www.weeklytimesnow.com.au/agribusiness/cattle/effects-of-australian-live-export-cattle-ban-to-indonesia-still-felt-by-beef-producers/news-story/86016c75dc8d4c3fdd0b071459b30fb1;](https://www.weeklytimesnow.com.au/agribusiness/cattle/effects-of-australian-live-export-cattle-ban-to-indonesia-still-felt-by-beef-producers/news-story/86016c75dc8d4c3fdd0b071459b30fb1)

⁶ <https://www.news.com.au/finance/business/live-export-ban-blamed-for-465m-loss/news-story/6b5f8ce31179f08582c27edc63783874>

⁷ <http://www.abc.net.au/news/rural/2017-01-05/caged-egg-market-trending-down-in-response-to-free-range/8164004>

There is also evidence of a growing trend for consumers in Western societies, and in Australia particularly, to adopt a vegetarian or vegan diet or reduce the amount of meat they eat.⁸ Food retailers are adapting to this change in consumer demand. For example in the last few months Woolworths has expanded its range of meat-free products and introduced plant-based protein in the meat aisle of its supermarkets,⁹ and Dominos has introduced a vegan cheese to its menu.¹⁰ It is possible that these changes in demand could impact the profitability of companies that are heavily dependent on animal agriculture or certain types of animal agriculture.

Growing importance of animal welfare issues to investors and other stakeholders

Animal welfare issues are increasingly on the radar of investors and other stakeholders (such as banks and insurance companies). This is for a number of reasons including:

- The impact animal welfare issues can have on a company's social licence to operate, as discussed above;
- Growing concern in the community regarding the treatment of animals. Recent research by the Responsible Investment Association Australasia found that when it comes to avoiding investments that do harm, Australians feel most strongly about animal cruelty, even above human rights violations;¹¹ and
- The link between animal welfare and other social and environmental issues, such as antibiotic resistance.

At Australian Ethical, we carefully examine the welfare of animals in all our investment decisions. Our concerns about the environmental, social and animal impacts in the agricultural sector mean we do not currently invest in animal agriculture at all. We also exclude cosmetics companies that test products on animals, as well as healthcare companies which use animals for medical testing unless they meet certain requirements.

A growing number of investors are more carefully considering animal welfare in their investment decisions. As of April 2018, there were 23 investors (including Australian Ethical) which are signatories to the BBFAW Global Investor Statement on Farm Animal Welfare and thereby commit to taking account of farm animal welfare in their analyses of food companies. Combined these companies represent £1.8 trillion in assets under management.¹² Increasingly investors are reporting on the way they take account of animal welfare in their investment and engagement activities.¹³

⁸ <https://www.adelaide.edu.au/global-food/research/healthy-societies/meat-consumption-trends/>;
<http://www.roymorgan.com/findings/vegetarianisms-slow-but-steady-rise-in-australia-201608151105>.

⁹ <https://www.woolworths.com.au/shop/browse/freezer/frozen-meals/vegan-meat-free-meals>;
<https://www.news.com.au/lifestyle/food/eat/funky-fields-launches-plantbased-minced-in-woolworths-supermarkets/news-story/a31d9afe57806253e2c243d5aa5419a5>

¹⁰ <https://newsroom.dominos.com.au/home/2018/1/17/meltdown-dominos-set-to-run-out-of-vegan-cheese>

¹¹ <https://responsibleinvestment.org/wp-content/uploads/2017/11/From-values-to-riches-Charting-consumer-attitudes-and-demand-for-responsible-investing-in-Australia-2017.pdf>

¹² <https://www.bbfa.com/investors/investor-statement/>

¹³ See e.g. <https://www.insightinvestment.com/globalassets/documents/responsible-investment/responsible-investment-reports/uk-aus-ri-report-2018.pdf> (see pages 38-9); and <https://www.unpri.org/download?ac=209>.

Banking and finance companies also consider animal welfare in their lending portfolios. For example, Bank of Queensland encourages its borrowers to adhere to the World Organisation for Animal Health standards for animal welfare.¹⁴ Westpac's statement on financing agribusiness provides:

We seek to develop relationships with agribusiness customers that do not: ... mistreat livestock and are in compliance with relevant jurisdictional animal welfare standards... We will not knowingly finance agribusiness customers that are not in compliance with these standards. Where a customer group also operates in other sectors, we will not knowingly provide finance, directly in support of its companies that are not compliant with this position statement.¹⁵

The recognition of animal welfare as an important factor in investment and financing decisions is reflected in guidance provided by industry bodies. For example, Principles for Responsible Investment (PRI) has recognised that animal welfare considerations form part of ESG factors as reflected in its 'Responsible Investment in Farmland' guidance.¹⁶ On the finance side, the International Finance Corporation have developed a 'Good Practice Note' for animal welfare in livestock operations in recognition of the fact that businesses that address or enhance animal welfare are likely to win or retain a competitive advantage in the global marketplace.¹⁷

Investor assessment tools are also being developed to assist investors assess companies by reference to animal welfare metrics. The Business Benchmark on Farm Animal Welfare has been specifically designed to support investors in their engagement with companies, and to help investors integrate farm animal welfare into their investment research and decision-making.¹⁸ Farm Animal Investment Risk and Return provides investors with research regarding the risks associated with intensive livestock farming, including animal welfare and biodiversity loss.¹⁹

¹⁴ <https://www.boq.com.au/Shareholder-centre/sustainability/approach-to-sustainable-lending>

¹⁵ https://www.westpac.com.au/docs/pdf/aw/sustainability/Agribusiness_Position_Statement.pdf

¹⁶ <https://www.unpri.org/download?ac=4001>

¹⁷ https://www.ifc.org/wps/wcm/connect/topics_ext_content/ifc_external_corporate_site/sustainability-at-ifc/policies-standards/policies-standards

¹⁸ <https://www.bbfaw.com/investors/>

¹⁹ <http://www.fairr.org/>

Recommended changes to CGPRs to include references to animal welfare issues

Any principles to guide responsible corporate behaviour will be radically incomplete if they fail to explicitly acknowledge the existence of the other sentient beings with which we share the planet.²⁰ Businesses can have a significant impact on people, the environment and animals and therefore should manage their impacts and risks in relation to all three spheres.

Concepts referenced in the proposed fourth edition of the CGPR, such as ‘acting responsibly towards the environment’, ‘good corporate citizenship’ and a ‘social licence to operate’ implicitly encapsulate animal welfare considerations. Our proposed changes to the CGPR, set out in the table below, simply seek to clarify this.

We have suggested including references to animal welfare considerations in relation to both ‘social’ and ‘environmental’ matters because in our view animal welfare considerations straddle both. For example, concerns about destruction of an endangered species’ habitat may sit comfortably within ‘environmental risk’, whereas farm animal welfare is more relevant to the ‘social’ limb (consistent with the Global Reporting Initiative Sustainability Reporting Guidelines and Food Processing Sector Supplement²¹ and with the Productivity Commission’s recognition of poor animal welfare as a negative externality on society).

Reference	Recommendations (by reference to proposed 4th edition)
Principle 3, Commentary	<p>Security holders understand this and expect boards and management to engage with these stakeholders and to be, and be seen to be, “good corporate citizens”. This may include, for example:</p> <p>...</p> <ul style="list-style-type: none"> • acting responsibly towards the environment and towards animals; and • only dealing with business partners who demonstrate similar lawful, ethical and socially responsible business practices.
Recommendation 7.4, Commentary	<p>As mentioned above in the commentary to principle 3, a listed entity’s “social licence to operate” is one of its most valuable assets. That licence can be lost or seriously damaged if the entity conducts its business in a way that is not responsible, having regard to human rights and the treatment of the environment and animals.</p>

²⁰ On animal sentience, see the Cambridge Declaration on Consciousness (2012): “The absence of a neocortex does not appear to preclude an organism from experiencing affective states. Convergent evidence indicates that non-human animals have the neuroanatomical, neurochemical, and neurophysiological substrates of conscious states along with the capacity to exhibit intentional behaviors. Consequently, the weight of evidence indicates that humans are not unique in possessing the neurological substrates that generate consciousness. Nonhuman animals, including all mammals and birds, and many other creatures, including octopuses, also possess these neurological substrates.”

<http://fcmconference.org/img/CambridgeDeclarationOnConsciousness.pdf>. Further, the very existence of animal cruelty prevention laws in Australia by implication recognises that animals have the capacity to suffer, and are therefore sentient.

²¹ <https://www.globalreporting.org/information/g4/sector-guidance/sector-guidance/food-processing/Pages/default.aspx>

Reference	Recommendations (by reference to proposed 4th edition)
Glossary	<p>environmental risks: the potential negative consequences to a listed entity arising from its impact or perceived impact on the natural environment including animals. It includes the risks associated with pollution, environmental degradation, adding to the carbon levels in the atmosphere, and threats to a region’s biodiversity or cultural heritage.</p> <p>social risks: the potential negative consequences to a listed entity arising from its impact or perceived impact on social groups (including employees, customers, suppliers and local communities) or from it being seen to operate outside accepted community standards (for example, with respect to the treatment of animals). It includes the risks that can lead to the loss of an entity’s “social licence to operate” mentioned in the commentary to principle 3 above</p>

We look forward to your response to our submission, and would be happy to discuss.

Yours sincerely



Phil Vernon
Managing Director

T 612 8276 6243 | M 0407 169 528 | E pvernon@australianethical.com.au