Climate Disclosure Standards Board

Submission by the Climate Disclosure Standards Board (CDSB) to the Consultation on the Review of the ASX Corporate Governance Council's Principles and Recommendations

03 July 2018

The Climate Disclosure Standards Board (CDSB) welcomes the opportunity to offer our written response to the Review of the ASX Corporate Governance Council's (the "Council") fourth edition of Corporate Governance Principles and Recommendations (the "*Principles and Recommendations*"). (see: https://www.asx.com.au/regulation/corporate-governance-council/review-and-submissions.htm)

CDSB is an international consortium of nine business and environmental NGOs. We are committed to advancing and aligning the global mainstream corporate reporting model to equate natural capital with financial capital. We do this by offering companies a framework for reporting environmental and climate information (the **CDSB Framework**) with the same rigour as financial information. In turn, this helps companies to provide investors with decision-useful environmental and climate information via the mainstream corporate report, enhancing the efficient allocation of capital. Regulators also benefit from compliance-ready materials. Recognising that information about natural capital and financial capital is equally essential for an understanding of corporate performance, our work builds the trust and transparency needed to foster resilient capital markets. Collectively, we aim to contribute to more sustainable economic, social and environmental systems.

This review of the *Principles and Recommendations* is urgently required in light of the vulnerabilities highlighted by the Senate Economics Reference Committee report of the Australian economy to climate-related risks. For example, around two thirds of companies listed on the ASX, operate in the energy, resources or financial services industries alone. This concentration has resulted in S&P Dow Jones ranking the ASX50 as the most exposed major stock exchange to stranded asset risks from the transition to a low carbon economy.[1] At the same time, this affords the Council an opportunity to support companies who are looking for guidance in relation to key developments in the non-financial reporting sphere, such as how to implement recommendations from the Task Force on Climate-related Financial Disclosures (the **TCFD**) and integrate these into their annual reports.

Please find our comments below and do not hesitate to contact us if we can be of further assistance.

Best regards,

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[1] S&P Dow Jones Indices (2017), The Carbon Scorecard

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Responses to specific questions

We have provided response to the Council based on the points highlighted for interested within the consultation document below:

- *whether stakeholders agree with the nine proposed new recommendations and, if not, why not;*

In a broad sense, we agree with the nine proposed recommendations. However, we believe that the commentary and recommendations associated with principle 3 could be significantly improved with the explicit inclusion of climate change and other environmental issues, as detailed below. In addition, we are certain that it would be of benefit to the ASX, investors and other stakeholders if the Council strengthened recommendation 4.4. We agree with the Council that to 'understand a listed entity's performance and prospects…the market needs the current and forward-looking information usually included in the annual directors' report' and, as such, CDSB believe that such information should come under the same assurance process to achieve equivalent high levels of quality and consistency as financial data and information. The Council should emphasise this need to equally high levels of assurance in recommendation 4.4.

We also note that the UK Financial Reporting Council published on 13 June 2018 a consultation draft of the Wates Corporate Governance Principles for Large Private Companies (see: https://www.frc.org.uk/news/june-2018/consultation-on-the-wates-corporate-governance-pri) that also included opportunities as well as risks within Principle 4. We noticed that the Principles and Recommendations are exclusively focused on governance of risks and we believe that opportunities should be governed in the same manner.

- *whether stakeholders agree with the changes proposed to the existing recommendations in the third edition and, if not, why not;*

We were pleased to see that the Council has directed companies towards considering climate (or carbon) risk and different considerations therein within the commentary to recommendation 7.4. Indeed, the amendments made to the commentary for recommendation 2.2 to better equip boards with the skills and knowledge necessary to understand and act on climate risk is necessary and welcome. However, CDSB believes that the *Principles and Recommendations* need to go further to ensure companies understand and act on the risks and opportunities that climate change poses to themselves and communities in Australia and elsewhere.

CDSB believe this would be best achieved by requiring Australia's listed companies to comply with the TCFD's four widely-adoptable disclosure recommendations through a specific reference to this within recommendation 7.4. The recommendations of the TCFD do not require businesses to reinvent the wheel, but to instead think afresh about their governance, strategy, risks, and metrics and targets in light of financial risks as a consequence of climate change. Mandating such disclosure more firmly would align the ASX with the findings of the Senate Economics Reference Committee's *Carbon risk* report (notably, ones that the Australian government agreed with) and with many of Australia's largest institutional investors[2]. In May 2018, 23 such investors, with assets under management surpassing $2 trillion, including Australian Super, HESTA and SuperVic, joined a global chorus of 288 investor voices demanding the G7 implement the recommendations of the TCFD[3].

Regulators across the world are taking note. In June this year, the UK Parliament's Environmental Audit Committee recommended to the government that they should require mandatory disclosure in line with the TCFD recommendations before 2022[4]. The Canadian Securities Administrators are further investigating new

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[2] Senate Economics Reference Committee (2017), Carbon risk: a burning issue
[3] The Investor Agenda (2018), Global Investor Statement to Governments on Climate Change
[4] Environmental Audit Select Committee (2018), Greening Finance: embedding sustainability in financial decision making

disclosure requirements to ensure listed companies follow the TCFD recommendations[5]. Improving recommendation 7.4, as suggested, then, represents an opportunity for the ASX to be align listed entities with other large markets globally.

- *specifically, whether stakeholders agree with the Council's proposal to include as part of recommendation 1.5 a requirement that entities in the S&P/ASX 300 set a measurable objective to have a minimum of 30% of directors of each gender on their boards by a specified date;*

This question is not within the remit of CDSB's expertise.

- *whether stakeholders agree with the annual timeframes proposed for board reviews in recommendation 1.6 and management reviews in recommendation 1.7;*

Yes, performing board reviews in line with the reporting period is sensible and correct.

- *whether stakeholders agree with Council's proposed changes to box 2.3, setting out the factors relevant to assessing director independence;*

This question is not within the remit of CDSB's expertise.

- *whether the proposed amendments to principle 3 and the accompanying commentary deal adequately with governance-related concerns related to an entity's values, culture and social licence to operate;*

Though we welcome the Council's additions to the *Principles and Recommendations* so as to ensure companies act in an ethical and socially responsible manner, we believe the scope provided in the commentary and recommendations are not thorough enough. We believe that any conception of a "social licence to operate" should include environmental sustainability and responsibility, especially regarding climate change. Climate change poses risks and threats to businesses and communities around the world presently and will increasingly do so in the future. The findings and recommendations of the TCFD, which should be included in the commentary, cement the connection between business, finance and climate change in terms of both risks and opportunities.

Including climate change and other environmental issues, e.g. resource depletion, biodiversity and water risk, within listed areas of consideration for the commentary of principle 3 would both reflect a truer, future-proof sense of a "social licence to operate" and align with the commentary of recommendation 7.4. The recommendation states that a 'listed entity should disclose whether it has any material exposure to environmental or social risks' before referring users, in the commentary, to 'the commentary to principle 3' and the applicability of climate-related risks to companies.

- *whether compliance with any of the new or amended recommendations might have any unforeseen consequences or give rise to undue compliance burdens for listed entities;*

No, we cannot foresee any negative consequences of the new and amended recommendations.

- *whether the level of guidance in the draft fourth edition is appropriate and whether stakeholders would like more guidance on any particular principles or recommendations; and*

In relation to the Council's commendable development of recommendation 7.4 to emphasise the importance of climate-related risks for Australian business and encouragement of following the TCFD recommendations, we believe that it would be highly beneficial for listed entities to be referred to the TCFD Knowledge Hub.

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[5] Canadian Securities Administrators (2018), Report on Climate change-related Disclosure Project

Developed by CDSB and the TCFD, The TCFD Knowledge Hub hosts a range of resources that can help companies identify, analyse and report climate-related financial information. The platform has been created to support the adoption of the TCFD recommendations and the development of high-quality, consistent and comparable climate-related financial disclosures.

- *whether there are any other gaps or deficiencies in the Principles and Recommendations that have not been addressed by the proposed changes in the consultation draft of the fourth edition.*

CDSB believe that once our proposed updates to the *Principles and Recommendations* are included, they will take Australia's listed companies forward in understanding and acting on climate-related risks and protecting investors. However, we believe the risks posed and opportunities offered by climate change require a more robust response from bodies such as the Council, especially so in light of directors' duties from the Corporations Act 2001[6]. CDSB encourages all countries and markets to act seriously on material climate-related risks, but Australia's current and future vulnerability means that swift action is especially necessary. As HSBC found earlier this year in a review of 67 countries climate risk exposure, Australia was the second most vulnerable developed market after Israel[7]. Indeed, this point was emphasised by the Senate Economics Reference Committee, who noted that Australia is 'particularly highly exposed to carbon risk.'[8] Allowing Australian business and investors to be exposed to such risks unnecessarily would be irresponsible on the part of regulatory bodies such as the Council. As such, we firmly believe that the *Principles and Recommendations* should require listed companies through an updated recommendation 7.4 to follow the disclosure recommendations of the TCFD.

If recommendation 7.4 and principle 3 and associated recommendations are updated as outlined above, the ASX's *Principles and Recommendations* will be a leading example of adapting corporate governance to better ensure a sustainable and resilient future for business, the market at large and wider society.
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[6] Commonwealth Climate and Law Initiative (2018), Directors' Liability and Climate Risk: Australia - Country Paper
[7] HSBC Global Research (2018), Fragile Planet: Scoring climate risk around the world
[8] Senate Economics Reference Committee (2017), Carbon risk: a burning issue