29 July 2018

Ms Mavis Tan
ASX Corporate Governance Council
c/o ASX Limited
PO Box H24
Australia Square NSW 1215

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

Dear Ms Tan

Submission on draft fourth edition of ASX Corporate Governance Council *Corporate Governance Principles & Recommendations.*

Environmental Justice Australia is a public interest legal practice with expertise in governance. We are grateful for the opportunity to comment on the proposed fourth edition of the *ASX Corporate Governance Principles & Recommendations*.

Amendments to the commentary to recommendations 2.2 and 2.6

1. We acknowledge that the current wording in both Recommendation 2.2 and 2.6 does make mention of sustainability and climate change issues as a component of emerging issues board members are increasingly expected to consider and address in their decision-making. However, **climate change is not an emerging issue.** Most, if not all, listed entities face climate change risks. Duties of directors in regard to climate risks have been explored at the highest level of the Australia bar and by regulators. The commentary to recommendations 2.2 and 2.6 downplays the level of climate competence *already* legally required of directors.

2. ASIC highlights that effective corporate governance is inextricably linked to the prudent and appropriate management of climate change issues. It is now 'conceivable that directors who fail to consider climate change risks now could be found liable for breaching their duty of care and diligence in the future.'[1] One legal basis for holding directors liable for failure to consider 'climate change risk' can be found in s 180(1) *Corporations Act 2001* (Cth), which imposes a 'duty of care and diligence' upon directors of a company. [2]

3. The head of the NSW Bar Association, Noel Hutley SC, with Sabastien Hartford Davis, has published an advice that confirms directors are required to consider 'climate change risks' to the extent that the risks intersect with the interests of the company and its stakeholders. We recommend the ASX CGC reads this advice carefully.

4. Recommendation 2.2 provides that the board skills matrix need not be a representation of the skills already possessed by existing board members. However, it

[1] Hutley SC and Hartford-David, Legal Opinion on Climate Change and Director's Duties, [3.5], page 3. Accessible via: https://cpd.org.au/wp-content/uploads/2016/10/Legal-Opinion-on-Climate-Change-and-Directors-Duties.pdf
[2] Ibid [3].

Environmental Justice Australia
ABN 74052124375
PO Box 12123
A'Beckett Street PO
Melbourne VIC 8006
L3, 60 Leicester St, Carlton
T (03) 8341 3100
F (03) 8341 3111
E admin@envirojustice.org.au
W www.envirojustice.org.au

is beyond doubt that each individual board member must already possess the skills to address sustainability and climate change issues where those issues potentially pose a significant risk. Programs and knowledge need to exist now. A statement of intention to equip its existing board members with, or recruit new board members who possess, the desired skills is not enough.

5. Climate change is not an emerging issue – it's an existing issue that has been within the public agenda for quite some time. It is widely understood that the policy space is dynamic. There is an ongoing need for directors to upskill or update their knowledge about the policy and regulatory landscape in relation to climate change. Many companies face transition risks due to policy, market and technological changes, boards must increasingly exhibit experience and skills in industrial and corporate transformation. Directors also need information and skills to understand the physical risks climate change poses to their business. We believe reference to these skills should be made in the updated commentary to recommendations 2.2 and 2.6.

6. To further clarify the current position of the law on the extent of the obligations of Australian company directors in relation to climate change risks, the ASX CGC needs to stipulate a clear legal standard that is carefully considered given there is a significant risk of guiding companies and directors in a manner which could lead them to breach their duties.

7. Today, climate risks are not just a social or environmental issues. The risks are widely recognized as financial risks, which pose foreseeable and material consequences for the market.[3] Three key recent developments debunk the traditional dichotomy between climate change risks and financial risks; a view that has been endorsed by APRA.

8. First, the application of director's duties under Australian corporate law to climate and sustainability risks, by Hutley SC, has highlighted the strong link between climate change risks and financial risks.

9. Second, the Garnaut Review found that Australia is particularly vulnerable to the physical risks of climate change given our terms of trade with developing countries less able to adapt to climate change. Such physical risks include damage to property, power outages, and disruption of trade. Australia is also currently in the midst of a transition to a low-carbon economy, and during this period, it is anticipated that indirect financial risks will arise from the associated changes in regulatory policy, technological innovation, and changing consumer preferences.[4] By establishing a global commitment to action on climate change, the Paris Climate Agreement 'brings the horizon forward' and makes the aforementioned transition risks more immediate and pertinent to address in the current context.

10. Third, the Financial Stability Board (**FSB**) Task Force on Climate-related Financial Disclosures (**TCFD**), endorsing the view of the G20 Finance Ministers and Central Bank Governors, has released recommendations to address the fact that a lack of climate risk disclosure was impeding investment, credit and underwriting decisions, subsequently leading to market distortion and inefficiencies.

11. We emphasise that the TCFD is borne out of a concern for stability in the global financial system. The difference between climate change and the GFC is that climate

---

[3] https://www.apra.gov.au/media-centre/speeches/australias-new-horizon-climate-change-challenges-and-prudential-risk
[4] Hutley SC and Hartford-Davis, p. 7-11.

change is foreseeable. The TCFD is trying to avoid the type of instability that resulted from the GFC. The TCFD states:[5]

> *Furthermore, because the transition to a lower-carbon economy requires significant and, in some cases, disruptive changes across economic sectors and industries in the near term, financial policymakers are interested in the implications for the global financial system, especially in terms of avoiding financial dislocations and sudden losses in asset values. Given such concerns and the potential impact on financial intermediaries and investors, the G20 Finance Ministers and Central Bank Governors asked the Financial Stability Board to review how the financial sector can take account of climate-related issues.*
>
> *As part of its review, the Financial Stability Board identified the need for better information to support informed investment, lending, and insurance underwriting decisions and improve understanding and analysis of climate-related risks and opportunities. Better information will also help investors engage with companies on the resilience of their strategies and capital spending, which should help promote a smooth rather than an abrupt transition to a lower-carbon economy.*

12. The disclosures sought by the TCFD may be considered material to the performance of a company and actionable under s 674 *Corporations Act 2001 (Cth)* if not disclosed within the requisite time.

13. As currently drafted, the Principles risk guiding firms and their directors to a standard such that the directors' consideration and disclosure of climate change risks might breach standards required by law. Thus, the ASX CGC risks guiding in a fashion that could expose directors to personal liability, and companies to financial liability.

Amendments to the commentary to principle 3

14. We believe the update to principle 3 is an important improvement. There is, however, much room for interpretation in the phrase 'a socially responsible manner.' The Commentary to principle 3 provides a list of non-exhaustive guidelines for what it deems to constitute acting in a "socially responsible manner", of which "acting responsibly towards the environment" is identified as a component. However, there is no explicit mention of environmental concerns of stakeholders in the three new proposed recommendations under Principle 3 - recommendation 3.1 (core values), 3.3 (whistleblowing policies) and 3.4 (anti-bribery and corruption policies).

15. We would like to see clarification in the commentary, confirming that action which undermines the climate goals instilled in the Paris Agreement is socially irresponsible. It is inconceivable that a company is asking in a socially responsible manner if it is contributing to a climate change scenario that is described as 'dangerous' by the United Nations Framework Convention on Climate Change.

Amendments to recommendation 7.4

16. Updating recommendation 7.4 provides the greatest opportunity for the ASX Corporate Governance Council to ensure robust climate risk disclosure amongst listed entities. As noted in the proposed update to the commentary, many listed entities are exposed

---

[5] Task Force on Climate-related Financial Disclosures, Final Recommendations, 15 June 2017, p iii: www.fsb-tcfd.org/publications/final-recommendations-report/

to climate change risks. As stated above, there would be very few if any listed entities that could rationally argue they face no material climate risk exposure. Accordingly, Recommendation 7.4 should explicitly recommend implementation of the TCFD recommendations, rather than including it as a suggestion in the commentary.

17. Mark Carney, Governor of the Bank of England, says the disclosure of climate change risks is crucial to the correct pricing of assets to ensure efficient capital allocation and financial stability in the market.[6] Mr Carney states:[7]

> *For investors to price financial risks and opportunities correctly, they need to weigh firms' strategies against plausible public policy developments, technological advances, and evolving physical risks.*

18. Whilst growing demand for climate-related disclosures has resulted in the development of numerous disclosure standards, this has also created significant variations in the approach adopted by listed entities towards disclosure of climate change risks.[8] Investors have claimed that inconsistencies in disclosure practices and non-comparable information hinder them from considering climate-related issues in their investment decision-making process.[9] This calls for standardised, TCFD-aligned disclosures across the board, which are mandatory for the sectors covered in the TCFD recommendations, consistent with the 'if not, why not' nature of Listing Rule 4.10.3. Widespread adoption of the TCFD recommendations will facilitate the integration of climate change risks as an inherent part of an organisation's risk management and strategic planning process.[10]

19. Therefore, Recommendation 7.4 should make mandatory the TCFD Recommendations on climate related risks for all sectors covered by specific recommendations in Annexure 1 to the TCFD.[11] These sectors are:

    (a) banks;

    (b) insurance companies;

    (c) asset owners;

    (d) asset managers;

    (e) energy groups;

    (f) transportation groups;

    (g) materials and building groups;

    (h) agriculture, food and forest product groups.

---

[6] Mark Carney, "Breaking the tragedy of the horizon—climate change and financial stability," (speech, Lloyd's, London,
September 29, 2015). http://www.bankofengland.co.uk/publications/Pages/speeches/2015/844.aspx
[7] https://www.bankofengland.co.uk/-/media/boe/files/speech/2016/resolving-the-climate-paradox.pdf?la=en&hash=CDFB1640F4635BEC9C08601FF616C842BB975CEC p12
[8] KPMG, "Adoption of Third Edition Corporate Governance Principles and Recommendations: Analysis of disclosures for financial years between 1 January 2015 and 31 December 2015" (2016).
[9] TCFD Recommendations, p. 2.
[10] TCFD Recommendations, p. 41.
[11] www.fsb-tcfd.org/wp-content/uploads/2017/12/FINAL-TCFD-Annex-Amended-121517.pdf

We thank you for the opportunity to make this submission.

Yours sincerely

David Barnden