

Ethical Partners' Submission on the ASX's draft fifth edition of the Corporate Governance Principle and Recommendations

ASX Corporate Governance Council
Via online portal

6 May 2024

Dear Council members,

Ethical Partners Funds Management (**Ethical Partners**) thanks the ASX Corporate Governance Council (the **Council**) for the opportunity to provide feedback on the proposed corporate governance principles and recommendations (**the Draft Principles**).

We are broadly supportive of the changes to the Draft Principles that recognise entities should build sustainable value, although we would welcome clearer direction that, in doing so, entities should respect human rights and operate within planetary boundaries. In short, our key recommendations are that the Council encourages:

- Entities to create sustainable value by operating within social and environmental boundaries (Recs 1.1, 3.1 and 3.3).
- Entities to set ESG and sustainability objectives as part of their strategic objectives (Rec 1.1)
- Boards of listed entities to have necessary ESG skills and experience, and be explicitly responsible for ESG governance (Recs 1.1 and 2.2)
- Boards to set clear, specific, and strategic ESG targets for executive remuneration and evaluate performance accordingly (Recs 1.6 and 8).
- Entities to take an intersectional approach to diversity metrics and create an inclusive culture, alongside setting targets for a gender balanced board (Recs 2.3 and 3.4)
- Entities have and disclose a specific human rights policy (Rec 3.2)
- Entities to take a double materiality approach to considering and addressing ESG risks, opportunities, impacts, and dependencies (Rec 7.4)
- Entities to disclose in line with the TNFD and IFRS S1 (Rec 7.4)

Our detailed feedback and recommendations are set out further below.

About Ethical Partners Funds Management

Ethical Partners Funds Management is a boutique Australian Fund Manager, managing over \$1.5 billion in ASX listed equities on behalf of large Australian super funds, schools, charities, foundations, and other investors who wish to have their money managed with a deeply integrated responsible investment approach.

Ethical Partners have a dual focus on performance and investing ethically. Our approach directly manages risk and identifies opportunities, provides the ability to invest in line with our clients' values, actively assesses the impact of our investments and engages and advocates for change. Further details about our investment approach and team can be found on our website [here](#).

About this Consultation

On 27 February 2024, the Council released a [consultation](#) on its draft of the fifth edition of the *Corporate Governance Principles and Recommendations*. The principles provide recommendations for listed entities to comply with or explain how the processes and structures for which they are governed.

If you have questions or seek further information on this submission, please contact:

Mayleah House

Head of Stewardship

mayleah.house@ethicalpartners.com.au

Detailed Comments

In providing feedback on the consultation draft, we have sought to both answer specific questions posed by the Council and provide broader feedback where of relevance and concern to Ethical Partners. Our feedback is structured according to each relevant principle and our recommendations are highlighted in bold.

Principle 1: Lay solid foundations for management and oversight

Recommendation 1.1

Ethical Partners welcomes the changes in the Draft Principle's commentary, which reflects that an entity's strategic objectives are to "build sustainable value." **However, we strongly suggest that the commentary be updated to reflect that:**

- **strategic objectives include ESG and sustainability objectives; and**
- **building sustainable value requires respecting human rights and operating within planetary boundaries; and**
- **the board's responsibilities under its charter should include oversight of the entity's ESG issues.**

In our view, building sustainable value requires acting within sustainability boundaries: taking advantage of the immediate benefits associated with implementing sustainability measures and pursuing ESG strategies that come with long-term benefits, even where there may be short-term costs.

As long-term, diversified investors, our performance is dependent on the performance of the economy broadly, which in turn depends on the stability and viability of environmental and social systems.¹ Our portfolio therefore bears the costs of sustainability impacts and harms caused or contributed to by individual companies.² Accordingly, it is in our interests as security holders and as the ultimate owner of various ASX-listed entities, for those entities to prioritise operating within sustainable boundaries over pursuing unfettered, short-term growth through activities that cause adverse environmental and social impacts.

While we acknowledge this understanding of security holders' interests may be interpreted from the current framing, we consider that the current language could be clearer and more explicit. In our experience engaging with Australian boards, investors' portfolio-wide and long-term sustainability interests are either broadly not well understood or often not prioritised by certain boards.

Separately, we also consider that the list of general board responsibilities in recommendation 1.1 is missing an essential element: oversight of the entity's ESG issues. Through our investment process, we assess how a company's board governs environmental and social issues. We consider effective board oversight on environmental and social issues as fundamental for good governance and a lack of such oversight flags to us potential governance risks. We therefore put forward these recommendations to raise the standards of governance across the ASX and ensure entities are acting within their shareholders' interests.

Recommendation 1.6

Ethical Partners agrees that performance of a listed entity's senior executives drives performance of the entity. Accordingly, in our company analysis, we assess whether executives are remunerated on clear ESG metrics and deliverables that are relevant to a company's sustainability targets and performance associated with their material risks, opportunities, impacts and dependencies.

¹ Principles for Responsible Investment (2022), [A Legal Framework for Impact: Australia](#); Federick Alexander (2020), [The Benefit Stance: Responsible Ownership in the Twenty-First Century](#).

² Federick Alexander (2020), [An Honourable Harvest: Is it Time for Universal Owners to Take Responsibility for Their Portfolios?](#)

We welcome the acknowledgement that performance extends to financial and non-financial performance although consider the language should be more explicit to reflect shareholder interests. As further discussed below, **we therefore recommend the commentary associated with recommendation 1.6 specifies that the board's process for evaluating performance should include evaluations based on clear ESG metrics and deliverables that are relevant to a company's sustainability targets and performance.**

Principle 2: Structure the board to be effective and add value

Recommendation 2.2

Ethical Partners strongly supports disclosures about current board skills, future skills a board is looking for and the process for assessing directors' relevant skills and experience in addition to disclosure of a skills board matrix. **While we welcome these additions, we strongly suggest that the associated commentary be strengthened to explicitly reflect sustainability matters as a relevant governance issue and a necessary board skillset.**

We consistently engage with our portfolio companies on board governance of ESG issues, including the need to disclose the ESG-related skills of the board. Demonstrating that the board has ESG-related skills, is seeking to recruit those skills in new director appointments or is taking actions to upskill directors on these matters is essential to providing us with confidence that the board is equipped to appropriately govern the company through the economic transition to net zero and its broader sustainability risks, opportunities, impacts and dependencies.

In our assessments, all companies have differing sustainability impacts (be it directly through their own operations or within their value chain) and are also exposed to varying ESG-related risks, including financial, physical, reputational or policy-related transition risks (for example, through increasing sustainability disclosure requirements, the likelihood of carbon price being introduced, as well as the flow on effects of mandatory human rights due diligence regimes). Often, however, these ESG-risk, opportunities, impacts, and dependencies are not adequately understood or disclosed by the entities. Accordingly, we consider it imperative that the Council recognise and explicitly communicate to ASX-listed boards that environmental and social matters are a relevant governance consideration that their boards must have appropriate expertise and experience to address.

Recommendation 2.3

Ethical Partners strongly supports the inclusion of a gender balanced board for the S&P/ASX300. As members of the HESTA 40:40 initiative, we have long engaged with our portfolio companies on board gender diversity. While we have seen and support progress in board diversity across the ASX, only having 35% of women holding directorships is insufficient to achieve gender equality. We believe the inclusion of having an specific objective to have a gender balanced board in these principles will be critical in levelling the playing field.

We also applaud measures to encourage broader diversity in recommendation 2.3(c). For the reasons discussed below, **we would recommend that the Council:**

- **more directly encourages entities to take an intersectional approach to diversity by amending recommendation 2.3(c) to say "the board of a listed should disclose any other relevant diversity characteristics"; and**
- **recommend disclosures of the relevant progress on how boards are creating a culture that avoids group think and fosters inclusive decision-making.**

At Ethical Partners, we recognise that the business case for diversity, equity and inclusion (DEI) extends beyond gender and that companies with both gender and ethnic and cultural diversity outperform peers.³ We also acknowledge that while there have been improvements in female workplace leadership, boards lack sufficient representation from First Nations peoples, culturally and linguistically diverse individuals⁴ as well as people with disabilities and those from the LGBTQI+ or migrant communities. We are therefore increasingly encouraging companies to consider deepening their approach to DEI beyond gender.

While we welcome the Council expanding its recommendation to broader diversity and clarifying comments that disclosures should refer to relevant (as opposed to general) diversity characteristics, we consider the language in recommendation 2.3(c) to be overly qualified. Specifically, the note that these characteristics should be disclosed “if [a board] is considering any other relevant diversity characteristics” is, in our view, unnecessary given that the recommendations are already based on a comply or explain basis. Therefore, entities are already afforded scope to not disclose such matters if they aren’t considering them, provided they can explain why such diversity characteristics are not relevant to their entity.

Further, we recognise diversity *without* inclusive decision-making and a culture that enables directors to voice potential dissenting opinions is arguably counterproductive.⁵ We therefore encourage the Council to take measures that incentivise boards to ensure they are not only considering director diversity metrics but also taking genuine action to create an inclusive environment where any challenging and potentially opposing views from directors are heard and meaningfully considered.

Principle 3: Instil a cultural of acting lawfully, ethically, and responsibly

Recommendation 3.1

Ethical Partners welcome the direction that listed entities should consider articulating its purpose. **We suggest that the Council goes further to articulate that a company’s purpose should be to “create sustainable value through balancing shareholder and other stakeholder interests within social and environmental boundaries,”⁶ among any other relevant considerations.**

Articulating a purpose that reflects the need to respect human rights and act within planetary boundaries is one crucial measure to overcoming the governance norm that we see (and which has been recognised by several academics) where broadly directors may have a narrow, short-term focus on profit maximisation⁷ in conflict with our interests as long-term shareholders for companies to both avoid adverse social and environmental impacts and instead positively contribute to sustainability outcomes.⁸

³ McKinsey & Company (2020), [Diversity Wins: How Inclusion Matters](#).

⁴ Helen Skouteris et al. ‘No One Can Actually See Us in Positions of Power: The Intersectionality between Gender and Culture for Women in Leadership’ (2023) 8(1) *BMJ Leader* 63.

⁵ Regnan (2021), [Beyond Diversity: Equity and Inclusion as an Overlooked Opportunity for Investors](#); Helen Skouteris et al. ‘No One Can Actually See Us in Positions of Power: The Intersectionality between Gender and Culture for Women in Leadership’ (2023) 8(1) *BMJ Leader* 63, 65.

⁶ Anita Foerster et al., ‘Net Zero, Nature Positive and Socially Responsible? Exploring Corporate Law Reform Opportunities in Australia’ (2023) *Monash Business School* (p.34); Beate Sjøfjell and Jukka Mähönen, ‘Upgrading the Nordic Corporate Governance Model for Sustainable Companies’ (2014) 11(2) *European Company Law* 58, 59.

⁷ Beate Sjøfjell et al., ‘Shareholder Primacy: The Main Barrier to Sustainable Companies’ in Beate Sjøfjell and Benjamin J. Richardson (eds), *Company Law and Sustainability: Legal Barriers and Opportunities* (Cambridge University Press, 2015); Jean J du Plessis, ‘Shareholder Primacy and Other Stakeholders Interests’ (2016) 34 *Companies and Securities Law Journal* 238, 238-239; Jean J du Plessis ‘2020 Vision: Current Reflections and Stakeholder Governance in a Post-Covid-19 World’ (2020) 37 *Companies and Securities Law Journal* 495, 496-497; Jessica Baker, ‘Australia is Burning: Aligning Corporate Social Responsibility and Community Expectations Following the Black Summer’ (2021) 36 *Australian Journal of Corporate Law* 113 ; Lynn Buckley, ‘The Foundations of Governance: Implications of Entity Theory for Directors’ Duties and Corporate Sustainability’ (2022) 26(1) *Journal of Management and Governance* 29;

⁸ Principles for Responsible Investment (2022), [A Legal Framework for Impact: Australia](#).

Recommendation 3.2

Ethical Partners supports the direction for entities to instil and continually reinforce a culture of acting lawfully, ethically, and responsibly. **We recommend that the Council also includes having and disclosing a specific human rights policy that commits the organisation to abiding by the United Nations Declaration of Human Rights (UNDHR) and UN Guiding Principles on Business and Human Rights (UNGPs).**

We firmly believe implementing and abiding by a clear human rights policy that applies to how a company engages with its employees, suppliers, and broader stakeholders within its value chain is essential for a healthy organisational culture. It is a key component in our assessment and consideration of potential companies for investment. Where a portfolio company does not have a human rights policy, we seek to engage with their executive management and board to encourage them to adopt one in order to mitigate associated risks.

The UNGPs encourages entities to have a policy commitment to respect human rights.⁹ Yet while setting and disclosing a human rights principle is a fundamental tenant of best practice corporate governance, it is a rudimentary and initial step only. Indeed, the UNGPs further encourages entities to have a human rights due diligence process to identify, prevent, mitigate and account for how they address impacts on human rights and remediation processes.¹⁰ ICGN Global Governance Principles notes that for boards to instil and demonstrate a culture of strong business ethics it should ensure its sufficient informed of how human rights issues presents as business risks or may compromise the company's own standards. It further directs boards to establish appropriate due diligence processes, strategies, disclosures, engagements and accountability and other measures to deal with human rights issues.¹¹

Despite these international standards, we believe the Australian corporate sector is lagging in best practice. At this stage, approximately 46% of the S&P/ASX 100 does not have a standalone human rights policy that is publicly available.¹² We estimate that this figure would increase exponentially across the broader ASX, where the percentage of companies *without* a human rights policy increases from approximately 33% in the top 50 companies in the S&P/ASX100 to 54% of the companies ranking between 51 and 100.

Accordingly, we strongly recommend the Council provide clear direction to entities to implement a human rights policy at first instance, as part of instilling an ethical culture to align with international best practice and encourage entities to meet shareholder expectations.

Recommendation 3.3

Respectfully, Ethical Partners believes that the reference to consideration of key stakeholder interests will be insufficient to alter director behaviour in a manner that aligns with our interests as long-term, diversified shareholders (as articulated in response to rec 1.1 and 3.1). Instead, **we urge recommendation 3.3 and its associated commentary to more strongly reflect that a listed entity should, in having regard to its impact and interaction with key stakeholders, respect human rights and operate within planetary boundaries. This should align with and reflect a company's purpose.**

We recognise that the current proposal reflects the latest legal opinion of how directors' best interest duty could be interpreted.¹³ It is our belief that companies that are informed by stakeholders and responsive to ESG issues in a manner that respects human rights and operates within planetary boundaries will perform better over the long term. It is our view that these companies will be able to both survive and thrive in a changing world as they will be more adaptable, responsibly managed, and resilient.

⁹ United Nations Human Rights (2011), [Guiding Principles on business and Human Rights](#) (principle 15(a)).

¹⁰ United Nations Human Rights (2011), [Guiding Principles on business and Human Rights](#) (principle 15(b)-(c)).

¹¹ International Corporate Governance Network (2023), [ICGN Global Governance Principles](#) (rec 4.7).

¹² This figure is based on our internal analysis of the ASX100 as at 24 April 2024.

¹³ Bret Walker QC and Gerald Ng (2022), [Memorandum of Opinion: The Content of Directors' "Best Interest" Duty](#).

We also recognise that the evidence is inconclusive on whether legislation and standards which direct companies to simply consider stakeholder interests is sufficient or does in fact encourage boards to create sustainable value aligned with our long-term interests as investors.¹⁴ Instead, we believe more explicit direction is required.

Alternatively, if such an approach is not adopted, we would recommend that recommendation 3.3 refer to key matters (including the environmental and social impacts of any decisions and operations on employees, the community, value chain, and the environment) that listed entities should consider in the best interest of the company instead of “stakeholders”. In this respect, we note that the framing of “*key stakeholder interests*” in the Draft Principles differs from the approach taken in other jurisdictions, specifically the UK where the relevant legislation instead refers to matters that companies must consider.¹⁵ We consider this framing, (particular reference to “*the likely consequences of any decision in the long-term*”, “*the impact of the company’s operations on the community and the environment*” and “*the desirability of the company maintaining a reputation for high standards of business conduct*”) to be clearer for directors and more appropriately aligned with shareholders’ interests.

Recommendation 3.4

In line with our comments in relation to recommendation 2.3, **we welcome and support the proposal to include disclosure around the effectiveness of an entity’s diversity and inclusion practices in recommendation 3.4(c)**. Such disclosure complements diversity metrics, providing a more complete view of an entity’s progression towards relevant targets. These leading disclosures will help inform our analysis and investment decisions.

Principle 7: Recognise and manage risk

Recommendation 7.4

Respectfully, Ethical Partners believes the definition of “material risk” in the Draft Principles and recommendations does not adequately encompass the full spectrum of material issues of concern to companies and to us as investors. **Accordingly, we recommend that the Council adopt a double materiality approach in defining “material risk” and/or state that a listed entity should disclose material ESG risks, opportunities, impacts, and dependencies.**

As aforementioned, it is in our interests as shareholders for companies to operate within sustainable boundaries as opposed to externalising their environmental and social impacts. We also believe that companies that do so will perform better across the long term and be rewarded in a transitioning economy. We therefore seek disclosures from entities not only on material ESG risks to their business, but also on their actual and potential impacts on environmental and social factors.

We acknowledge and firmly believe some of these negative ESG impacts can and will present as long-term risks to an entity’s prospects. Yet in our experience, the boards of many ASX-listed entities have not had the adequate foresight or understanding of emerging and long-term ESG risks and are more responsive when those issues present as short-term risks (e.g., potential carbon taxes) or requirements (e.g., mandatory climate disclosures) on their business. This is compounded where most Australian boards do not yet have adequate ESG or sustainability skills across the board or have individual directors with such experience.

¹⁴ David Collison et al, *Shareholder Primacy in UK Corporate Law: An Exploration of the Rationale and Evidence* (Report, 2011) 41-42.

¹⁵ *Companies*

Accordingly, greater direction must be provided to directors on the ESG factors that should be considered and disclosed. In our view, this encompasses ESG risks, opportunities, impacts, and dependencies using a double materiality approach as is being taken in the EU.¹⁶

Separately, we welcome comments that listed entities should consider emerging developments in sustainability standards. However, we believe the qualification that entities consider global standards “where no relevant standards as yet applies” to them, does not accurately represent the applicableness of voluntary standards, including the International Sustainability Standards Boards (ISSB) and the Task Force on Nature-Related Financial Disclosures (TNFD). **We therefore recommend that the Council provide firmer encouragement or direction for entities to report in line with the TNFD and the ISSB’s IFRS S1.**

Firstly, akin to climate change, nature degradation and biodiversity loss presents a systemic risk for socioeconomic and financial systems.¹⁷ Accordingly, investors are increasingly looking to align financial flows with companies restoring and conserving nature and actively steward companies to halt and reverse nature loss.¹⁸ We firmly believe that, given its systemic nature, all companies will have material impacts and dependencies on nature and biodiversity in their value chain and should report in line with the TNFD to attract capital and align with investor expectations. As early adopters of the TNFD, we also need and are seeking such disclosures from our portfolio companies as a matter of urgency to inform our disclosures.

Secondly, to inform our investment process, we seek disclosure of companies’ relevant sustainability risks, opportunities, impacts, and dependencies given our thesis that companies that operate in sustainability boundaries will perform better in the long-term. We also recognise that where international investors (specifically European financial institutions) are being required to report on the adverse sustainability impacts of their investment decisions,¹⁹ Australian companies seeking international capital will increasingly be expected to report general sustainability-related information. Accordingly, as a preliminary step, all entities should be considering whether they have any material sustainability risks and disclose such information according to IFRS S1.

It is therefore our position that the TNFD and IFRS S1 are currently applicable to ASX-listed companies despite neither currently being mandatory in Australia. We believe the Council should send a firmer signal to encourage TNFD and IFRS S1 disclosure in line with the approach the Council took to encourage Task Force on Climate-related Financial Disclosures in the 4th edition of the principles and recommendations.

Principle 8: Remunerate fairly and responsibly

Ethical Partners welcomes the changes in commentary to principle 8 to reflect that executive remuneration should align their interests with strategic objectives and the creation of long-term sustainable value for security holders (among other matters). **However, we encourage the Council to include an additional recommendation that a listed entity should link an appropriate portion of executive remuneration to a clear, specific, and strategic ESG target.**

In line with our feedback on recommendation 1.6, we believe it is imperative that senior executives are responsible for and drive an entity’s sustainability performance alongside financial performance. We therefore assess whether boards set specific ESG metrics and deliverables as a component of executives’ short-term incentives that are relevant to an entity’s substantial sustainability risks, opportunities, impacts and dependencies. We strongly encourage all boards to set ESG targets within executive remuneration and welcome this being reflected in the final principles and recommendations.

¹⁶ For more detail, see EFRAG (2023), [Draft EFRAG IG 1: Materiality Assessment](#).

¹⁷ NGFS (2022), *Central Banking and Supervision in the Biosphere: An Agenda for Action on Biodiversity Loss*,

¹⁸ For example, see 76 [members](#) of Finance for Biodiversity; See also PRI (2024), [Nature in Responsible Investment](#).

¹⁹ See for example, the EU’s Sustainability-related Disclosures in the Financial Services Sector Regulation.

Ethical Partners Funds Management sincerely thanks the ASX Corporate Governance Council for the opportunity to make a submission on the Draft Principles and welcomes any opportunity to discuss our feedback further.



Mayleah House
Head of Stewardship
Ethical Partners Funds Management