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Submission to the ASX Corporate Governance Council – Corporate Governance Council Principles and Recommendations (fifth edition)

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1 May 2024

About the authors

Assoc. Prof Anita Foerster researches and teaches in corporate sustainability regulation, climate and environmental law at the Department of Business Law and Taxation, Monash Business School, where she also directs the Green Lab, a hub for applied, interdisciplinary research on climate and sustainability. Anita has considerable expertise in the area of corporate climate governance. Her research explores legal and regulatory drivers for corporate energy transition and charts corporate and investor responses to regulatory and market pressure to align with the international Paris Agreement.

Ms. Ella Vines is a post-doctoral research fellow at Monash Business School's Green Lab, researching regulatory and market mechanisms for net-zero, nature-positive companies. This follows on from her PhD research which considers whether the interaction between the Paris Agreement and other laws including corporations law catalyse the reduction of Australian coal extraction and consumption. Prior to commencing her PhD, she worked as a commercial lawyer in litigation and dispute resolution and business and not-for-profit structuring.

Summary

The *Corporate Governance Principles and Recommendations* (*Principles and Recommendations*) provide important guidance on reporting and risk disclosure obligations and associated market expectations. It is critical that this guidance reflects and responds to the fast-evolving understanding of material business risks for Australian companies.

Since the third and fourth editions were published in 2014 and 2019 respectively, there has been an increased focus from investor, regulator and other financial stakeholders on risks posed by climate change and the role of companies in the transition to net-zero emissions in line with the Paris Agreement. Greater attention is also being given to risks posed by biodiversity loss and to the need for companies to reduce their negative impacts on nature, highlighted by the adoption of the Kunming-Montreal Global Biodiversity Framework in 2022. A third area of intersecting business risk and impact, which is garnering increased stakeholder attention, and which requires appropriate reflection in Australian corporate governance frameworks, is the rights of First Nations peoples in line with the United Nations Declaration on the Rights of Indigenous Peoples and UN Guiding Principles on Business and Human Rights.

Our previous submissions to the Australian Treasury and Australian Accounting Standards Board ('AASB') on sustainability reporting standards[1] have noted missed opportunities to strengthen disclosure requirements in ways which would better support the alignment of private capital and resources to achieving the goals of the international Paris Agreement (and away from activities which worsen climate change). Ensuring disclosure reforms assist with Australia's transition to net-zero emissions by 2050 is a key guiding reform principle for the Australian government.[2] To this end, we have previously argued for a more explicit adoption of a *double materiality* approach in Australia's sustainability-related disclosure frameworks that requires entities to report on climate performance and impacts, as well as their exposure to climate-related financial risks. As explained further below (see comments on proposed recommendation 7.4), a double materiality approach would also support improved corporate risk and impact management practices in relation to biodiversity and First Nations rights.

We recognise that the policy parameters set by the Australian government,[3] and the ASX Corporate Governance Council's intention to prepare guidance that is consistent with these parameters, means that such reforms may not be implemented through the *Principles and Recommendations*, at least at this point in time.

Nonetheless, our submission identifies some important opportunities to strengthen the proposed fifth edition in ways which will enhance the contribution of the *Principles and Recommendations* to supporting listed entities to manage a broad range of sustainability risks and to address the adverse impacts of their business activities in line with global goals for climate change, biodiversity and First Nations rights.[4]

Our comments can be summarised as follows:

1. **Recommendation 3.3. - We support stronger and more explicit guidance in relation to stakeholder engagement. We suggest the *Principles and Recommendations* adopt a similar approach to stakeholder engagement to that taken in the *UK Corporate Governance Code* (2018).**

2. **Recommendation 4.2 - We support tighter disclosure requirements in relation to auditing the full range of reports relied on by investors (including sustainability reports).**

3. **Recommendation 7.4 - We suggest amendments to:**
    a. **specify that if a listed entity determines that there are no sustainability-related material risks and opportunities that could reasonably be expected to affect the entity's prospects, the entity shall disclose that fact and explain how it came to that conclusion (so as to better align with AASB Exposure Draft SR1);**
    b. **better align the framing of the sustainability concepts in the proposed fifth edition with the International Sustainability Standards Board (on which Australian sustainability reporting reforms are based);**
    c. **refer to disclosure of *sustainability impacts* and *performance* as well as risks, in line with a *double materiality* approach and in recognition of the relevance of this information for investors and other stakeholders; and**

[1] Anita Foerster, Mukesh Garg, Michal Spencer, *Submission to the Australian Government Treasury Consultation, Climate-related financial disclosure* (17February 2023); Anita Foerster, Mukesh Garg, Michael Spencer, *Submission to the Australian Government Treasury Consultation, Climate-related financial disclosure* (21 July 2023); Anita Foerster, Ella Vines, Mukesh Garg, and Bei Cui, *Submission to the Australian Sustainability Reporting Standards – Disclosure of Climate- related Financial Information Exposure Draft SR1* 29 February 2024).

[2] Australian Government Treasury, *Climate-related Financial Disclosure* (Consultation Paper, June 2023) 4, Reform Principle 1.

[3] Australian Government Treasury, *Mandatory climate-related financial disclosures* (Policy Position Statement, January 2024); Australian Government Treasury, *Climate-related financial disclosure* (Consultation paper, December 2022); Australian Government Treasury, *Sustainable Finance Strategy* (Consultation Paper, November 2023).

[4] See generally, Anita Foerster, Mayleah House, Ingrid Landau and Vivien Chen, *Net Zero, Nature Positive and Socially Responsible? Exploring Corporate Law Reform Opportunities in Australia* (Report Prepared for the Australian Conservation Foundation and Jubilee Australia Research Centre, November 2023).

d. **include examples related to biodiversity and human rights risks in addition to the cyber risk and climate change-related risks already listed.**

Recommendation 3.3 – stakeholder relationships

In line with the increased recognition of the importance of stakeholder engagement in ensuring company directors discharge their duty to act in the best interests of the company,[5] we argue for a stronger recommendation and more explicit guidance on stakeholder engagement than currently proposed. We suggest that recommendation 3.3 specify that the board of directors of a listed entity should:

- take steps to ensure they understand the views of the company's key stakeholders (beyond shareholders); and
- describe in the annual report (or mandatory sustainability report) how their interests have been considered in board discussions and decision-making.

We note similar provisions in the *UK Corporate Governance Code* (2018), which provide that the board should understand the views of the company's key stakeholders and describe in the annual report how these have been considered in board discussions and decision-making.[6] Further, the UK Code provides that where 20% or more of votes have been cast against the board's recommendation on a resolution, the company should explain what actions it intends to take to consult shareholders to understand the reasons behind the result. The board should then provide an update on the views of shareholders and actions taken no later than 6 months after the initial vote and a final summary in the annual report on what impact the feedback has had on the decisions the board has taken and any actions or resolutions now proposed.[7] Similar recommendations would be beneficial in Australian in light of increasing use of shareholder resolutions to draw attention to environmental and social risks and impacts.

Recommendation 4.2 – audit of reports

We support tighter disclosure requirements in relation to auditing the full range of reports relied on by investors (including sustainability reports) as expressed in draft recommendation 4.2. We have previously noted that assurance on the impact of climate risk on an entity's financial statements and asset values can be costly and requires specialist skills.[8] Accordingly, we consider it appropriate that large, listed entities that have the resources and processes in place to complete such reporting and audits take the lead on this issue prior to the likely extension of mandatory reporting and auditing to medium-sized entities.

Recommendation 7.4 – disclose material risks

We consider the proposed shift towards guiding companies to disclose material risks and risk management strategies, and away from generic risks disclosures and distinctions between financial and non-financial risks, to be appropriate given recent regulatory developments in Australia which recognise the financial materiality of sustainability risks and which will make sustainability reporting mandatory.[9] However, we also highlight several opportunities to further strengthen the draft recommendation.

[5] Brett Walker SC and Gerald Ng, *The content of directors' 'best interests' duty: Memorandum of advice* (22 Feb 2022).
[6] *UK Corporate Governance Code* (2018) 7, provision 5.
[7] Ibid, provision 4.
[8] Foerster, Vines, Garg, and Cui (n 1) 9.
[9] Treasury Laws Amendment (Financial Market Infrastructure and Other Measures) Bill 2024 (Cth); AASB, Exposure Draft ED SR1 Australian Sustainability Reporting Standards – Disclosure of Climate-related Financial Information.

We suggest recommendation 7.4 be amended to specify that if a listed entity determines that there are no sustainability-related material risks and opportunities that could reasonably be expected to affect the entity's prospects, the entity shall disclose that fact and explain how it came to that conclusion. This would better align the *Principles and Recommendations* with the AASB Exposure Draft SR1,[10] and in turn with the ASX Corporate Governance Council's intention to better enable entities to respond to emerging regulatory requirements without creating parallel regulatory regimes.[11] Given the broad exposure of Australian companies to climate change and other sustainability risks, it is increasingly important that entities that determine they are not exposed, provide sufficient explanation for this determination. This information can be an important indicator of the preparedness and resilience of an entity, illustrating either that the entity has robust risk management arrangements in place, or indeed lacks sufficient understanding of their exposure and adequate attention to risk management.

Another amendment which would support regulatory consistency relates to the way the *Principles and Recommendations* frame the 'sustainability' of an organisation. Pursuant to the ISSB standard, on which the Australian sustainability reporting reforms are based, 'sustainability' is framed more comprehensively as follows:

> *Information about sustainability-related risks and opportunities is useful to primary users because an entity's ability to generate cash flows over the short, medium and long term is inextricably linked to the interactions between the entity and its stakeholders, society, the economy and the natural environment throughout the entity's value chain. Together, the entity and the resources and relationships throughout its value chain form an interdependent system in which the entity operates. The entity's dependencies on those resources and relationships and its impacts on those resources and relationships give rise to sustainability-related risks and opportunities for the entity.*[12]

We argue that the *Principles and Recommendations* should adopt a similar framing to the ISSB which explicitly recognises the interactions (risks, impacts and dependencies) of an entity with its stakeholders, society, the economy *and the natural environment*, throughout the value chain.

Finally, we have previously argued for a more explicit adoption of a *double materiality* approach in Australia's sustainability-related disclosure frameworks that requires entities to report on sustainability performance and impacts, as well as exposure to sustainability-related financial risks.[13] **It would be beneficial to recognise in the commentary to the *Principles and Recommendations* that reporting on a company's environmental and social *impacts and performance* (e.g., greenhouse gas emissions, impacts on biodiversity and human rights), as well as financially material risks to the entity, is increasingly important to a range of stakeholders, including institutional investors.** For institutional investors such as superannuation funds, which are long-term, diversified investors, financial returns depend on the overall performance of the economy, not only profits of an individual asset.[14] Diversified investors therefore have a financial imperative and implied duty to mitigate sustainability-related systemic risks through capital allocation and stewardship.[15] This includes seeking disclosure from investee companies about environmental and social impacts that threaten the stability of the economy and engaging with investee

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[10] AASB, Exposure Draft (n 9) [BC34]–[BC36].

[11] ASX Corporate Governance Council, *Principles and Recommendations 5th Edition Consultation Draft: Background paper and consultation questions* (February 2024) 4.

[12] ISSB General Sustainability-related Disclosures Standard (S1), provision 2. This is also reflected in the AASB Standards Exposure Draft (n 9) [B5].

[13] See above (n 1). See further Foerster, House, Landau and Chen (n 4) 18-20.

[14] Rick Alexander, Holly Ensign-Barstow, Lenore Palladino and Andrew Kassoy, *From Shareholder Primacy to Stakeholder Capitalism* (Report, 2020) 16.

[15] Principles for Responsible Investment, *A Legal Framework for Impact: Australia* (Policy Report, September 2022); Freshfield Bruckhaus Deringer, Principles for Responsible Investment, United Nations Environment Programme Finance Initiative, and the Generation Foundation, *A Legal Framework for Impact: Sustainability Impact in Investor Decision-Making* (Legal Report, July 2021); Frederick Alexander, *The Law in Anti-ESG Logic: Financial Interests of Companies like Meta don't Always Align with Those of its Shareholders* (Blog Post, 5 December 2022).

companies in relation to the management of these impacts (e.g., advocating for corporate emissions reduction targets in line with Paris Agreement goals).[16]

Given the increased investor and stakeholder focus on biodiversity risks and impacts[17] and the rights of First Nations peoples,[18] we also argue that the list of risk examples provided (cyber risk and climate change related risk) be expanded to also include emerging material risks associated with biodiversity and human rights (and in particular First Nations rights, participation and engagement).

In relation to biodiversity risks, it would be valuable to recommend that companies consider disclosing in line with the recommendations of the Taskforce on Nature-related Financial Disclosures,[19] given that these standards are likely to form the basis of future ISSB standards and those developed by the AASB as part of Australia's sustainable finance strategy reforms.[20]

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[16] See e.g., Climate Action 100+, *Net-Zero Benchmark*.

[17] See e.g., ACSI, 'Nature disclosure recommendations a welcome start to managing serious risks' (Media Release 19 Sept 2023), https://acsi.org.au/media-releases/nature-disclosure-recommendations-a-welcome-start-to-managing-serious-risks/

[18] See e.g., ACSI *Policy on Company Engagement with First Nations People* (2021).

[19] *Taskforce on Nature-related Financial Disclosures Recommendations* (September 2023).

[20] International Financial Reporting Standards Foundation, 'ISSB congratulates Task Force on Nature-related Financial Disclosures on finalised recommendations' (Media release, 19 September 2023); Taskforce on Nature-related Financial Disclosures, 'TNFD welcomes the ISSB's decision to commence work on nature-related issues' (Media release, 24 April 2024); International Financial Reporting Standards Foundation, *Request for Information IFRS, Sustainability Disclosure Standards: Consultation on Agenda Priorities* (May 2023) 7-9; International Financial Reporting Standards Foundation 'ISSB Consultation on Agenda Priorities, Current Stage' (Web page, accessed 1 May 2024) < https://www.ifrs.org/projects/work-plan/issb-consultation-on-agenda-priorities/#current-stage>.