Climate change

Keynote address by John Price, Commissioner, Australian Securities and Investments Commission, Centre for Policy Development: Financing a Sustainable Economy, Sydney, Australia, 18 June 2018

CHECK AGAINST DELIVERY

Introduction

Good evening. I am very pleased to be here tonight speaking at this forum and I thank the Centre for Policy Development for providing the platform and opportunity for me to share ASIC's views on this increasingly topical issue of climate risk.

While preparing my comments for this evening's address, I reflected on some remarks I recently delivered to the Audit and Risk Committee Forum in Melbourne just last month and, in particular, the 2018 Deloitte Global Human Capital Trends Report which I referenced in my comments there.

In that report Deloitte made the following observation based on a global survey of 11,000 business and HR leaders as well as interviews with executives from leading organisations:

> *'…we* [being Deloitte] *believe that a fundamental change is underway. Organizations are no longer assessed based only on traditional metrics such as financial performance, or even the quality of their products or services. Rather, organizations today are* **increasingly judged** *on the basis of their relationships with their workers, their customers, and their communities, as well as their impact on society at large—transforming them from business enterprises into social enterprises*.[1]'

While the primary focus of Deloitte's report was human capital, its conclusion is instructive and resonates with the subject matter of my address tonight. We continue to see both internationally and in our own market an increasing focus on company matters that sit outside of traditional evaluative metrics and in particular, those matters concerning the environment, sustainability and/or governance.

The evidence for that is very clear. For starters, you are all here this evening to hear about and discuss, amongst other things, climate risk and attendant disclosures. Moreover our own general work in the corporate governance area has highlighted the increasing market focus on ESG issues, from shareholder resolutions put forward at general meetings to the continuing emergence of investors with a specific ESG related investment focus, mandate or benchmarks.

I'll come back to this broad theme towards to end of my remarks this evening but I thought it useful to touch on it at the outset because it does speak very clearly to the changing environment that companies are operating in and the evolving context within which directors need to consider important governance related issues, including the risks and opportunities of climate change.

Key priorities on climate risk

So with that in mind, I'd like to move on to climate risk specifically. Perhaps it would be helpful at the outset for me to identify at a high-level ASIC's key priorities in this area before spending some time unpacking each a little further:

- Firstly, we are focussed on encouraging strong and effective **corporate governance**. We consider that the prudent and appropriate management of issues such as climate change (be it climate risk or opportunity) begins with the core fundamentals of corporate governance - **integrity, transparency, accountability and acting for a proper purpose**. This must be led by directors and senior management; and
- Secondly,we are focussed on **disclosure.** Where the law requires disclosure of climate risk, we are strongly focussed on ensuring that the law is complied with in a way that is useful and relevant to the market.

Corporate governance

In terms of governance, we know from our regulatory experience that companies that have a strong culture and effective corporate governance practices are better equipped to develop and implement effective strategies to manage risks and opportunities. This applies to climate risk just as it does to other risks such as compliance risks, cyber security or digital disruption.

We at ASIC have stressed this point time and time again. This starts with directors who are very important gatekeepers in our financial system. Good corporate governance should be part of a director's mindset when discharging her or his functions and is intrinsically linked with a strong corporate culture more generally.

As the end of financial year approaches, we again take this opportunity to encourage directors to take a proactive approach to strategy and risk management. Directors need to understand and continually reassess existing and emerging risks that may be applicable to their business and ask the relevant questions of management. This should extend to both short-term and long-term risks and opportunities.

Indeed, directors would do well to carefully consider the memorandum of opinion by Noel Hutley QC and Sebastian Hartford-Davis on climate change and directors duties which was commissioned some time ago by the host of this evening's event.[2] As many of you would no doubt be aware, the authors of that opinion observed amongst other things that it is '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.'

While matters such as this will, in the end, be determined by a court, we think the Hutley opinion is relatively unremarkable. We say that in the sense that, in our view, the opinion appears legally sound and is reflective of our understanding of the position under the prevailing case law in Australia in so far as directors' duties are concerned.

Of course the question of whether or not an entity is ultimately materially exposed to climate risk must be determined having regard to the particular circumstances applying in each entity's case. However the Hutley opinion highlights and reinforces the need for directors to adopt a **probative** and **proactive** approach in assembling the information reasonably required to inform their decision making in this area.

Depending on the circumstances, it may be difficult for directors who have not even considered the issue to later seek to invoke the business judgement rule.

Disclosure

Moving on to disclosure now, and as I mentioned earlier, we are strongly focussed on ensuring that, where the law requires it, companies disclose material climate change risks.

In ASIC Report 567 published earlier this year we highlighted some key areas including:

- Firstly, our policy in Regulatory Guide 247 which sets out our view that the law requires an Operating and Financial Review for a listed entity to include a discussion of environmental and other sustainability risks (including climate risk) where those risks could affect the entity's achievement of its financial performance or outcomes disclosed.
- Secondly, for companies seeking to raise funds under a prospectus, the law requires the disclosure of all information that investors and their professional advisers would reasonably require to make an informed assessment of the prospects of the company.
- In some cases, climate change risk and opportunity will be material to a company's prospects and must be disclosed in a prospectus in a clear, concise and effective way to ensure investors are able to make a fully

informed investment decision.
- Our policy in Regulatory Guide 228 sets out further detail and explicitly addresses the disclosure of environmental and regulatory risks in a prospectus.

Of course, in addition to these, the law may require climate risk to be disclosed in other contexts such as by way of continuous disclosure announcement or elsewhere and we have a range of guidance to assist our regulated populations in complying with their statutory obligations.

It is worthwhile noting though, that it is not just strict legal requirements that should be front of mind. Companies should also carefully consider the general information needs of investors.

The voluntary framework developed by the TCFD may help companies and advisors in considering how to disclose climate change related risks and opportunities and what type of information to disclose, both when there is an obligation under law and in circumstances where a company voluntarily discloses additional information, for example in a sustainability report.

Indeed, as many of you here tonight would be aware, a number of listed Australian companies have already announced an intention to report, or commence reporting over time, under the TCFD framework. We are closely monitoring developments in this regard and we have been and intend to continue engaging with key stakeholders on this issue and adopt a consultative approach as market practice develops over time.

ASIC has heard feedback from some stakeholders who are concerned about the implications of the TCFD Recommendations for director liability for forward looking statements. We have heard that this concern may be a reason that some boards are reluctant to fully adopt TCFD reporting to the market, particularly in relation to the scenario analysis component.

These concerns are understandable given the uncertainties surrounding future climate risk impacts. The TCFD did not go so far as setting a standard approach, and the existing tools and resources for judging impacts on climate risks are still evolving.

However, notwithstanding these issues, as a general proposition we do not consider that the law or our policy would impede an entity from undertaking scenario analysis. Likewise, we do not think that director liability should be a major impediment to reporting under TCFD Recommendations provided that the modelling adopts reasonable assumptions and inputs and discloses them in full. This can be achieved by making sure the disclosure is the product of a robust assessment of the best evidence available at the time.

More generally, we encourage companies and directors to carefully consider the TCFD's report, not just in the disclosure context, but as a key resource to assist in understanding, identifying and managing climate risk and opportunity.

Other ASIC work in this area

In addition to our core priorities, we are also considering climate change and climate risk in a number of other contexts which I will highlight very briefly:

- We have commenced a review of our relevant regulatory guidance to ensure that it continues to provide appropriate principles and high-level guidance that stakeholders can apply in meeting their disclosure obligations under the Corporations Act insofar as climate risk is concerned. The government's response to the senate economics references committee report on carbon risk encouraged ASIC to do just this and we are hoping to finalise our review and respond to the government before the year is out.
- Through IOSCO, we continue to participate in discussions with our international peers about reporting of environmental and sustainability risks and more broadly, we are monitoring international developments such as the recent release of the European Commission's Action Plan on Financing Sustainable Growth.
- We are continuing our focus on impairment testing and asset values in our upcoming review of 30 June 2018 financial reports. As we have noted elsewhere, in some cases climate change may affect asset values.
- We are also undertaking a review of climate change-related disclosures across the ASX 300 to better understand current market practices. Our current intention is to publish our findings later this year, and

- More broadly, a climate risk working group has been established under the auspices of the Council of Financial Regulators and we are participating along with our colleagues at APRA, the RBA and Treasury to help ensure there is a coordinated response to climate risk and its impact on our financial system and markets.

Social licence to operate

Before closing this evening, I'd like to return to the bigger picture and in particular a theme that I have spoken about before and loosely touched on earlier this evening. This is a company's social licence to operate.

In a discussion paper on shareholder primacy released back in 2014[3], the Governance Institute of Australia observed that:

> *'In the twenty-first century, the relationship between business and society is considered an implicit social contract…*
>
> *…For reasons of ethics and enlightened self-interest, those companies alert to the long-term impact of social issues and in a constant dialogue with their stakeholders have a competitive advantage.*
>
> *Shifts in social issues that ultimately feed into the fundamental drivers of corporate performance generate value creation opportunities. Focusing on a 'business is business' approach can lead managers to emphasise short-term company performance, while neglecting longer-term opportunities and issues.*
>
> *There is, therefore, considerable incentive for a company to conduct its business in a socially responsible manner.'*

Deloitte's more recent observation to which I referred earlier builds on this and speaks of a "fundamental change" in the way companies are evaluated.

For some company stakeholders, the social and environmental impact of corporate activity is an increasingly acute criterion considered in deciding which company to invest in or transact with. A salient question for boards and directors to ask now is therefore:

> *'how do we identify the risks and opportunities presented by this new environment and respond in a manner that is both consistent with the social contract under which we operate and nurturing of long-term business success?'*

For our part, we will continue to encourage boards and directors to ask these questions of themselves and shine the light on their own culture and corporate governance practices, two drivers which we believe are critical in answering them.

Thank you.

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[1] 2018 Deloitte Global Human Capital Trends, page 2.

[2] Noel Hutley, SC and Sesbastian Hartford-Davis, Climate Change and Directors' Duties, Memorandum of Opinion, 7 October 2016

[3] Governance Institute of Australia, Shareholder Primacy: Is there a need for change? Page 23

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